FUNDING FOR SOCIAL AND AFFORDABLE HOUSING: THE POTENTIAL USE OF 'PRUDENTIAL BORROWING' BY THE NORTHERN IRELAND HOUSING EXECUTIVE

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INTRODUCTION

1. On the 15 January 2009 the Committee received a briefing from the Minister for Social Development on the outcome of the December Monitoring Round and the future of the Housing Programme. One of the issues raised by the Minister during the briefing was the capacity for local authorities in England and Wales to access loans for capital programmes through the 'prudential borrowing powers' set out in the Local Government Act 2003. These powers permit councils to access private finance without the consent of central government, providing they remain within their own affordable borrowing limits.

2. The Minister highlighted that under current Treasury rules, the Northern Ireland Housing Executive, as a Non-Departmental Public Body (NDPB), does not have freedom to access additional finance in such a way. The Department has indicated that it had entered into discussions with the Department of Finance and Personnel in order to explore the potential for devising a means of alleviating such rules with regard to the Northern Ireland Housing Executive.

3. To assist the Committee in its deliberations on private finance and social and affordable housing this paper provides an overview of:

    - local authority 'prudential borrowing' powers in Great Britain;
    - housing associations and the private financial market; and
    - a brief overview of some of the potential advantages, disadvantages and barriers to borrowing from the private financial market.

AN OVERVIEW OF 'PRUDENTIAL BORROWING' IN GREAT BRITAIN

4. The Local Government Act 2003[1] introduced new financial freedoms and flexibilities for local authorities in England and Wales. The Act provides local authorities with the power to borrow money to invest in capital works and assets providing the cost of borrowing is affordable and in compliance with principles set

[1] Local Government Act 2003, www.opsi.gov.uk/acts/acts2003/ukpga_20030026_en_1

out in the CIPFR[2] endorsed '[Prudential Code for Capital Finance in Local Authorities]'[3].

5. Under the Act, local authorities are permitted to borrow from either private sector sources, such as commercial banks or bonds, or from the Public Works Loans Board (PWLB)[4]. The Local Government in Scotland Act 2003 introduced a similar prudential borrowing framework for local councils in Scotland. There is currently no prudential borrowing regime for councils in Northern Ireland.

6. The use of prudential borrowing by local authorities has increased steadily since its introduction. For local authorities in England and Wales, for example, prudential borrowing has increased from £987m (7% of total spend) in 2004/05 to £2768m (15.1% of total spend) in 2006/07. The number of local authorities using prudential borrowing also rose during this period from 189 local authorities in 2004/05 to 248 in 2006/07[5].

7. Many local authorities use the prudential borrowing framework to meet their obligations under the Decent Homes Standard. The London Borough of Harrow, for example, draws on prudential borrowing to support their decent homes investment programme which involves addressing a backlog of maintenance and repairs to their housing stock[6]. In Scotland, local authorities are being invited to apply for a share of £25m to help kick-start a new generation of council house building. In 2006/07 only six new council houses were completed in Scotland. The fund is aimed at encouraging councils to use their prudential borrowing capacity to build new homes and thus help address the shortage of social housing[7].

8. A similar message is being communicated by the Homes and Communities Agency (HCA) with its chief executive indicating that local authorities should use prudential borrowing to fund major social developments[8]. Portsmouth City Council, for example, has set up a company called 'Portsmouth Social Housing' to build around 400 social housing units. Up to 50% of the subsidy for this programme is funded by the HCA with the rest of the money made up from different 'pots' including prudential borrowing[9].

[2] The Chartered Institute of Public Finance and Accountancy (CIPFA).
[3] For further details of the Code and related Guidance see www.cipfa.org.uk/pt/prudential_framework.cfm
[4] The Public Works Loans Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. At present nearly all borrowers are local authorities requiring loans for capital purposes. Loans are drawn down from the National Loans Fund and interest rates are determined by the Treasury. For further information see the PWLB website www.dmo.gov.uk/index.aspx?page=PWLB/Introduction
[5] Local Government Association (2007) Funding innovation: local authority use of prudential borrowing, p1. www.lga.gov.uk/lga/aio/22386
[6] Ibid, p6.
[7] Scottish Government News Release. 'Cash for councils to building housing'. 25 November 2008. www.scotland.gov.uk/News/Releases/2008/11/25144019
[8] Public Servant news article, 'Start borrowing to build houses, councils are told'. 30 January 2009. www.publicservice.co.uk/feature_story.asp?id=11220
[9] Improvement and Development Agency (IDeA) article, 'Constructing through the credit crunch' www.idea.gov.uk/idk/core/page.do?pageId=9419118

HOUSING ASSOCIATIONS AND THE PRIVATE FINANCIAL MARKET

9. Housing Associations, unlike the Northern Ireland Housing Executive, have the flexibility to raise private finance (in conjunction with the Housing Association Grant) to fund developments. Typically two thirds of a development in Northern Ireland will be funded through the Housing Association Grant with the remaining costs met by the Housing Association through a mixture of private finance and its own financial reserves[10]. According to the Northern Ireland Federation of Housing Associations (NIFHA), Housing Associations here have levered £395m of private investment into social housing between 1991-2008 and a total of £47m of private investment was levered in 2007-08[11]. The debt position of housing associations in England and Wales is considerably greater given the size of the sector. According to the Tenant Services Authority (TSA) £5bn of the £5.3bn debt needed over the next 12 months is already in place. In total, the sector has facilities of £51.6 billion arranged and drawn debt of £37 billion[12].

10. One of the aims of the New Housing Agenda for Northern Ireland is to increase the levels of private sector finance in the housing sector to complement the resources already committed from public funds. Subsidies to Housing Associations have been reduced by 10%, requiring Housing Associations to contribute even greater levels of private finance.

11. Innovative ways are being sought to help housing associations in Northern Ireland access alternative lending sources. One recent example of this was the ability of Clanmil Housing Assocation to secure £15m from the European Investment Bank[13] to support the delivery of three new housing projects across Belfast. This was part of a wider £100m loan package secured by the Housing Finance Corporation[14] from the European Investment Bank (Clanmil being the only beneficiary in Northern Ireland). A Clanmil HA press article indicates that the Housing Finance Corporation will pass on the attractive lending rates to Clanmil making the loan considerably less costly than other forms of private finance currently on offer[15].

THE POTENTIAL ADVANTAGES, DISADVANTAGES AND BARRIERS TO BORROWING FROM THE PRIVATE FINANCIAL MARKET

12. Housing Associations have the ability to secure loans at very competitive rates because they are perceived to be a sound financial prospect. One particular advantage for the Northern Ireland Housing Executive is that its status as a Non-

[10] Northern Ireland Federation of Housing Associations. Perspectives in Social Housing Magazine. Spring 09, p14.
[11] Northern Ireland Federation of Housing Associations Press Release. 'Housing Help'. 23 December 2008. www.nifha.org/press-room/index.php/69/
[12] Tenant Services Authority. Quarterly Survey of Housing Associations, January 2009.
[13] The European Investment Bank was created by the Treaty of Rome in 1958 and is the long term lending bank of the European Union. For further information see www.eib.org/about/index.htm
[14] The Housing Finance Corporation is an independent, not-for-profit organisation that makes loans to Registered Social Landlords and which acts as a financial intermediary. For further information see www.thfcorp.com/
[15] Clanmil Housing Association Press Release. 'Clanmil secures £15m from European Investment Bank to deliver new housing projects across Belfast'. 14 January 2009. www.clanmil.org/latestnews.php

Department Public Body, has the potential to place it on a similar footing with regard to securing loans at competitive rates.

13. It is important to note that the global economic downturn has somewhat changed the relationship between some housing associations and private lending institutions. A recent inquiry into '[Housing and the Credit Crunch](www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/101/10102.htm)' by the House of Commons Communities and Local Government Committee revealed that:

    'as well as a reduction in the amount of lending, the terms on which banks will lend to housing associations have become more stringent. Housing associations have had little benefit from falling interest rates as loans to them are traditionally linked to the LIBOR inter-bank lending rate, which has fallen much slowly than the bank base rate"[16] [17].

14. The inquiry further highlighted that *'banks are not simply restricting the criteria for new lending, but are seeking to toughen up the terms of existing loans to housing associations'*. The Committee's report cites one example of such behaviour:

    'A housing association which had a group structure with three different organisations in its group decided […] that it wanted to collapse that governance structure so that there is one organisation with resident panels, a different model but saving about £300,000 a year and the £300,000 could be invested in better services, neighbourhood support services, new development, whatever. Their core lender said that if they did that, it would regard that as a significant event in the terms of the loan agreement and re-price the entire loan book at a cost to that organisation of £1.9 million a year. The impact of that is that nothing happened; there was no change. So £300,000 of efficiency savings are not being generated, a more rational governance structure has not been put in place and the bank has gained not a single penny piece from its behaviour'[18].

15. Access to commercial borrowing by the Housing Executive could potentially expose it to more volatile funding sources during economic downturn periods. However, it may be the case that the Housing Executive's ability to borrow from alternative sources may be a longer term aspiration which will outride the current economic downturn. Issues such as those outlined above may be less relevant in the coming years.

16. Perhaps the greatest immediate hurdle for the Northern Ireland Housing Executive in gaining access to commercial borrowing or a framework similar to the 'prudential borrowing' regime in Great Britain, is the amendment of Treasury rules. This has the potential, if it is indeed at all possible, to be a highly complex and time intensive process which could involve legislative changes and the formulation of a regulatory regime.

March 2009

[16] House of Commons (2009) Communities and Local Government Committee Third Report. Housing and the Credit Crunch, p27.
www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/101/10102.htm

[17] LIBOR refers to the London Inter-Bank Offer Rate and refers to the rate at which banks lend to each other.

[18] Ibid, p28.