Long term investment and the role of guarantees in social housing finance

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Objectives

<table>
<thead>
<tr>
<th>Growing reliance on private finance in difficult markets</th>
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<tbody>
<tr>
<td>Emerging use of government guarantees to improve conditions</td>
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<td>Various illustrations inform best practice</td>
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<td>‘Reactions’ by EU Parliament and Housing Ministers</td>
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Private investment in social housing

- Now a strong feature of many European systems
- Approaches have different components – instruments, intermediaries, investors
- Different government measures - co-financing, regulation, tax incentives, guarantees
- Diverse outcomes before and after the crisis – volume, cost, organisational, policy
- Lessons to be learnt from this
Private finance is underpinned by many public measures

For developers of housing and their tenants
   → Land supply and planning policy, prioritising affordable available housing
   → Grants from public sector for supply, to provide equity, collateral
   → Low interest (subordinated) loans from public sector
   → Tax exemptions for operating non-profit business model and below market rents
   → Revenue assistance (RA) to ensure rents affordable to lower income households
   → Direct provision of RA to landlords to secure revenue (as in UK)
   → Adequate regulation standards of financial reporting amongst providers
   → Solidarity funds to support sector (as in NL)

For financial markets:
   → Regulating fund management and creating semi-protected circuits
   → Facilitating special purpose financial intermediation for housing promotion
   → Publicly owned FI with off market, off budget closed circuits of savings and loans

For investors and governments:
   → Tax incentives
   → Guarantees
   → Suborinated public loans
What are guarantees?

- Guarantees influence the credit allocation of lenders by giving comfort to investors.
- This comfort comes in the form of a third party (e.g. a government agency) legal promise of performance to a beneficiary (investor).
- Performance is typically defined as the payment of an agreed interest (coupon rate) or principle within a particular time frame.
- In the event that the borrower fails to perform as agreed, the guarantor may be called on to make these payments.
Why governments use guarantees

1. Address market failure causing undersupply in segments of housing market
2. In the context of shrinking government budgets and increased reliance on private investment, need to increase investor comfort and familiarity with new assets
3. Bolster credibility of investment to reduce cost, increase leverage and broaden access to finance
4. Speed up provision of necessary infrastructure at minimal government cost
5. Improve terms, amidst tighter borrowing conditions limiting long term debt, thereby maximising benefit of any government subsidy
<table>
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<tr>
<th>Guarantees – arguments for and against</th>
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<tbody>
<tr>
<td><strong>For – A ‘virtuous circle’</strong></td>
</tr>
<tr>
<td>✓ Broadens access to mortgage credit to important but neglected segments of the housing market</td>
</tr>
<tr>
<td>✓ Stabilizes housing markets, act counter cyclically by promoting mortgage bond liquidity and ameliorate negative effects of credit down turns on housing markets</td>
</tr>
<tr>
<td>✓ Protects investors from loss when lending criteria is broadened to encompass borrowers otherwise excluded do lack of asset policy or low yield</td>
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<tr>
<td>✓ Reduces the cost and improves the terms of mortgage loans to regulated non-profit providers supplying lower rent dwellings accessible to lower income households</td>
</tr>
<tr>
<td>✓ Supports social and economic policies of governments for (environmentally) sustainable investment in infrastructure such as social housing</td>
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New AHURI research


- Key input - Dr Gurtner, EGW and Mr Williamson, THFC
## Selected guarantee schemes

<table>
<thead>
<tr>
<th>Guarantee Scheme</th>
<th>Intermediary</th>
<th>Targeting</th>
<th>Fin. Impact</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dutch Guarantee Fund Social Housing (WSW) backed by the sector, a fund and central and local Dutch governments (1983)</td>
<td>Independent foundation</td>
<td>Yes</td>
<td>1-1.5% below going market rates for similar mortgages</td>
<td>0%</td>
</tr>
<tr>
<td>Swiss Bond Issuing Co-operative for Limited Profit Housing (EGW) backed by the Swiss Federal Government (1991)</td>
<td>Co-operative</td>
<td>Yes</td>
<td>Small margin above government borrowing costs</td>
<td>0% since 2003</td>
</tr>
<tr>
<td>UK Affordable and Private Rented Housing Guarantee Schemes, backed by UK government (NEW in development mid 2013)</td>
<td>Non-profit corporation</td>
<td>Yes</td>
<td>Aims to provide 30 year finance at small margin above government borrowing costs</td>
<td>0% based on lengthy THFC experience, guarantee introduced 2013</td>
</tr>
<tr>
<td>French Mutual Fund for Guarantees of Social Housing (CGLLS), backed by the French government (2001)</td>
<td>Publicly owned corporation</td>
<td>Yes</td>
<td>Market only exists with guarantee</td>
<td>0% since 2008, has been higher 0.04%</td>
</tr>
<tr>
<td>Irish Housing Finance Agency backed by the Irish government (1982 LAs/2012 VHBs)</td>
<td>Publicly owned company</td>
<td>Yes</td>
<td>Very limited market without guarantee</td>
<td>0% for LAH, new for VHBs</td>
</tr>
<tr>
<td>Scottish government’s National Housing Trust, backed by the Scottish government (2010)</td>
<td>Publicly owned Trust</td>
<td>Yes</td>
<td>NA</td>
<td>0% new</td>
</tr>
<tr>
<td>US Risk Sharing Scheme between Housing Finance Authorities and HUD, backed by Federal Housing Administration insurance (1992 pilot/2001 permanent)</td>
<td>Publicly owned corporations</td>
<td>Yes</td>
<td>Diverse</td>
<td>NA</td>
</tr>
</tbody>
</table>
Dutch WSW

Investors
Public and Private sector banks

Housing
Corporations

1st layer security

WSW Guarantee Fund

2nd layer security

Backstop Guarantee Central & Local government

3rd layer security

CFV Solidarity Fund

Loans Bonds

Certificate

50% CG 50% LG

Australian Housing and Urban Research Institute
**Swiss Bond Issuing Cooperative**

- **Investors**
  - Pension and Insurance funds
  - Capital
- **Bonds**
  - EGW / CCL Bond Issuing Cooperative
  - Loans
- **Interest / Principal**
- **Non-profit housing associations and co-operatives**
- **Guarantee**
  - Swiss Federal Government
- **3rd layer security**
- **1st layer security**
- **2nd layer security**
French CGLLS

Investor (Livret A) Caisse des Depôts et Consignations CDC

Loans
Interest / Principal

Social housing companies

1st layer security

Guarantee
Fee

Caisse de Garantie du Logement Locatif Social CGLLS

2nd layer security

Mission d’Inspection Intermunicipale

Loans

Financial control and Inspection
Irish HFA

IMF Banks

Loans

Interest / Principal

Housing Finance Agency

2nd layer security

Guarantee

Fee

Voluntary Housing Bodies

1st layer security

Irish Government Minister of Finance

3rd layer of security
UK Guarantee for private and affordable rental housing (potentially with EIB loans)

1st layer security

Private developers and RSLs

2nd layer security

The Housing Finance Corporation THFC

Bonds

Guarantee

Fee

Capital

Banks and Institutional investors

3rd layer of security

UK Government
Scotland’s National Housing Trust

Public Works Loans Board 65-70% loan

Loan

Local Authority

Loan 65-70%

Scottish Futures Trust

Funding 30-35%

Special Purpose LLP

Private developers and RSLs

Management and maintenance

Scottish Government

Secures only LG loan

Guarantee
US HUD-HFA risk sharing scheme

Local Office Housing and Urban Development (HUD)

50% 2nd layer security

Repayments

Loans

Providers of Affordable Housing

1st layer security

Repayments

Loans

Qualified State and Local Government Housing Finance Agencies

50% 2nd layer security

Risk Sharing Agreement

Housing Finance Administration

Guarantee

Investors
Banks
Institutional Investors

Bonds

Coupons
<table>
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<tr>
<th>Principles</th>
<th>What does this mean in practice?</th>
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<tbody>
<tr>
<td>Boundaries</td>
<td>✓ Agreed principles, defined characteristics of eligible projects for guarantee, overall and project related borrowing volume cap (and hence contingent liability for government), competitive allocation process for certificates, long term policy commitment to co-financing and revenue arrangements</td>
</tr>
<tr>
<td>Lowering risk</td>
<td>✓ Expert management and regular professional reports, appropriate regulation and enforceable compliance, sufficient equity and revenue base, back stop role of government</td>
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<tr>
<td>Transparency and commitment</td>
<td>✓ Professional audit and accounting, commitment to a sustainable business model (equity and revenue), appropriate joint marketing strategy by stakeholders involved</td>
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<tr>
<td>Expert intermediary</td>
<td>✓ Vetting and herding CHO investment needs, independent and expert, able to assess proposals, their risks and enforce compliance amongst borrowers</td>
</tr>
<tr>
<td>Scale and frequency</td>
<td>✓ Pool multiple smaller borrowing demands to achieve efficient scale, regular bond issues to sustain market interest, offer a pipeline of tradable investment opportunities</td>
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<tr>
<td>Adequate structure</td>
<td>✓ Clear and agreed structure including compliance process, lines of defence against default, expert resources to assess risk and build up reserves and agreed loss sharing arrangements.</td>
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The sustainable financing of housing

- **Growing interest** in mechanisms to achieve long term financing across the UNECE region.
  - Green Paper on Long Term Financing of the European Economy, March 2013
  - EU Housing Ministers Meeting December 2013

- **Rejection of marginalisation** of social housing
  - European Social Charter (Article 31)
  - Resolution of the European Parliament on social housing 2012/2293(INI) - 11/06/2013

- **Gaps** in knowledge and expertise

- Exchange and (re) **build capacity** in this area
Moving forward

- Focus on the established and excellent track record of different types of intermediaries and guarantee schemes serving social housing in the UK, the Netherlands, Austria, Switzerland and France.

- Zero default rate, very low risk, low fees and commissions, lower interest rates, longer terms.

- Potential for closer collaboration between intermediaries.

- Build positive relations with appropriate financial institutions – managed funds, industry pension funds (certain portfolios and payment strategies), EIB.

- Learn from and promote good practice in this field.
Further information

Search online for research reports
www.ahuri.edu.au

- International financial mechanisms
  http://www.ahuri.edu.au/publications/download/ahuri_30440_rp
- Social Housing Guarantee Research
- Housing Supply

Or make direct contact with researchers
Julie.lawson@rmit.edu.au

Thank you