NEWS

March 2024

STAND 908

LIVERPOOL HOUSING FINANCE CONFERENCE & EXHIBITION, 13 & 14 MARCH

We will be exhibiting on stand 908 at the Finance Conference in Liverpool in March. The stand is better situated than last year and a little larger to accommodate our new backdrop.

Adrian Jolliffe and Clive Eccleston will be there both days and Paul Hackett will be attending all day on Tuesday.

William Krafft from Nordkap our treasury management software partners will be travelling from Stockholm to join us both days.

We very much hope to see you there.

LONDON TREASURY MANAGEMENT CONFERENCE 10 OCTOBER 2024

Although it seems a long way off we have also committed to exhibit at the Treasury Management Conference in London on 10 October.

RENT STANDARD CONSULTATION

An Opinion

The current policy statement on rents for social housing refers to the principle established in 2017 for a long term rents deal. The Government committed to annual increases, on both social rent and affordable rent properties, of *up to CPI plus 1% from 2020, for a period of at least five years*. So at some point during 2024 we ought to expect an update for the next five.

We are also promised a decent homes standard consultation any time now. This will introduce the Minimum Energy Efficiency Standard.

Whilst it's possible to run two consultations in parallel, RPs would justifiably call foul if faced with a rent consultation before knowing the increased cost of DHS II. It's unlikely that the DHS II consultation will be concluded by the summer so a rent consultation followed by a policy announcement in September looks challenging.

PM Sunak has said that the general election will take place in the Autumn. If the Government were to call a snap election, then one or both consultations could be delayed. Government guidance says consultations should not be launched during election periods.

So what will happen if there was an early election? Firstly, any consultations in the pipeline would be kicked down the road for the incoming Government. Then, in the absence of government direction or consultation, we would argue that the starting point should be CPI+1%, simply a continuation of the "*at least five years*" policy.

With public sector finances under strain, and the Government looking for headroom to finance a giveaway budget, there has been press speculation that the Chancellor may make a wider policy decision to cap all government inflation assumptions to CPI +0.75%. That is speculative but it is probably safe to say that the strain on public finances will influence all decisions.

If a rent consultation went ahead, the outcome could be less favourable than last time. The original consultation considered affordability for tenants but on balance supported RP finances with CPI +1%; this time the Government could instead choose to lean towards tenant's interests.

Against this backdrop, 2Tix Ltd is advising clients to take a cautious approach and apply CPI+0% in their business plans for 2025 and beyond.

COVENANT BREACH:
We are expecting fewer breaches of covenant in 2024 than in 2023. Lenders were generally pragmatic and flexible in dealing with breaches but there is no common thread to how lenders respond other than a clear focus on 24 month cash flow forecasts.

RENT STANDARD: A consultation ought to take place in 2024. DHS II and the general election could mean that consultations are delayed. The hope is for a continuation of CPI +1% but we expect that the outcome will be influenced by the poor state of public sector finances.

We are advising clients to apply CPI+0% in their business plans.

NEW LOANS AND REFINANCING: There is more new loans and refinancing activity than in 2023. Margins have slipped due to the competitive environment and we have lowered our business plan guidance accordingly.

Financial covenant capacity is a major decider when choosing a new lender. Higher interest rates have reduced break costs and this has encouraged more prepayment of loans.

2TIX ASSIGNMENTS

We are very pleased that we have done our bit to help several RPs maintain their independence in a very difficult year.

Recovery from Breach of Covenant – lessons learnt

The Regulator's quarterly survey recorded 51 housing associations with a current covenant waiver. During 2023 we saw more breaches of financial covenant than ever before; almost without exception they were a breach of interest cover. The rent cap and high inflation on costs created a major test of resilience, particularly for borrowers with EBITDA-MRI (which includes capitalised expenditure and is common in social housing).

From our business planning work, there appears to be less potential for covenant breaches this year compared to last. The 7.7% rent increase followed by lower inflation has improved the outlook considerably.

Our experiences in 2023 were enlightening. Lenders understand that housing associations are inherently resilient so have been taking a pragmatic approach. The unusual combination of stresses in 2023 was the primary cause of covenant breach, but suboptimal forecasting and management accounting must carry some of the blame.

Lender's methods for managing borrowers in breach varied significantly. In most cases, the relationship team maintained continuity with little fuss. Invariably they sought additional reassurance and forecasts to show a path to recovery. We saw few instances of additional charges and no changes to margin. Once in breach, lenders rarely offer a complete waiver, preferring to reserve their right of action should the situation not be resolved.

In a few cases we have seen lenders switch loan management to their "recovery team", and cut out the relationship manager. These teams are inevitably generalist in recoveries, not specialist in social housing, and so we found ourselves acting as go-between, explaining the nuances of social housing (and on one occasion their own covenant arrangements).

We have seen lenders appoint an independent accounting firm to investigate on their behalf. Investigations carry hefty fees, take weeks or even months to complete, and in our opinion offer limited value for money. It would be better to spend that money on advice from a specialist.

We saw draft reports containing misconceptions and little in the way of solutions. In one instance a new financial covenant suite was proposed with a 12 month rolling test that was rehash of the existing, just using the same information and changing the calculations to reveal nothing new. The most interesting commonality was that a 24 month forecast, showing the borrowers commitment to recovery, is a core requirement for a borrower in breach and carries as much if not greater weight than the long term financial plan.

We believe it is essential for housing associations to have their financial forecasts independently checked to ensure accuracy and reliability. A thorough review of their business plan by 2TIX can help identify irregularities, potential risks and opportunities, allowing for proactive decision-making and strategic planning. In an ever-changing economic environment, it is crucial for housing associations to have a clear understanding of their financial position to maintain their resilience and sustainability.

New Loans Pipeline

Our new pipeline amounts to a lot more activity than we saw in 2023. In almost every case, refinancing of older loans appears to be part of the equation. Updating financial covenants is playing a major part with refinancing for lower margins also becoming more common. All of the pipeline assignments are at different stages so it does look like a busy first half of 2024 may well continue for the rest of the year.

Lenders are enthusiastic to lend on good propositions and margins have slipped in this competitive environment. A marginal lending proposition will still find it hard to borrow. Each time we go out for funding we are seeing six or more offers, even for a relatively small loan, which suggests that there may be potential for more margin falls. We have reduced our guidance for the margin on a new 10 year loan by 0.15%.

Lending policies never fail to surprise, but so far this year we have been advised “too competitive”, “too long”, “too small”, “too busy” and “unable to offer a fixed rate just now” as the justification given for not submitting heads of terms.

Financial covenant capacity is increasingly important when choosing a new lender. Gearing and asset cover remain almost universally standard across most lenders; but there is greater variation of interest cover. Lenders are more willing to tailor this covenant to the client’s needs (or to win the deal) and it means that the levels and definitions of the interest cover covenant can trump margin as the deciding factor.

Clients are generally reluctant to prepay loans where there is a break cost but we have seen in one case a borrower prepay an old fixed rate loan with a very large break cost to release security and simplify its portfolio. The increase of swap rates, to a fraction over 4%, has reduced break costs, making prepayment a lot more attractive than it has been for many years.

Business Planning

Last year we experienced a widespread drop in development ambitions, with housing providers curtailing and even completely scrapping anything other than committed development. We are now seeing some restoration of development plans and a greater commitment to property sales. Mainly these sales are properties which are either not part of the core portfolio or are considered to be no longer viable after calculating the expected investment in decarbonization required over the course of the next few years.

For one or two associations, sales have become essential to ensure that they can continue to meet their financial covenants over the long term. Individual valuable properties are capable of repaying a disproportionate amount of debt and this can rebalance a business plan in distress. Sales means that grant will need to be recycled, or worse repaid, and nobody wants that! We now see business plans with new properties specifically to recycle social housing grant. In one case we have seen an association engage with Homes England to recycle grant into properties that had previously been purchased without.

The care home sector is still under cost and occupancy pressure and we have seen one RP shut a care home to cut its losses. The reset of the Local Housing Allowance may help a little but recruitment is still problematic and care vacancies in some areas haven’t returned to pre-pandemic levels.

NORDKAP is the ultimate Treasury Management software solution for housing associations. It offers innovation, efficiency and value from the top provider in Sweden. Handle your loans, your interest rates and your properties in one platform. Simple to master, simple to operate, very secure. Nordkap is affordable treasury management software that simplifies your work. Contact us for a free demo and a free 45-day trial with no strings attached.