Scottish Borders COUNCIL

Item 10

PROVIDING LOAN FACILITIES TO BORDERS BASED REGISTERED SOCIAL LANDLORDS

Joint Report by Chief Financial Officer & Director of Social Work

SCOTTISH BORDERS COUNCIL

7 FEBRUARY 2013

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to seek approval from Members to provide a loan facility to Berwickshire Housing Association (BHA), Eildon Housing Association (EHA) and Scottish Borders Housing Association (SBHA).**

1.2 The Council has agreed the principle of lending at its meeting of 15 December 2011 and the proposal outlined in this report is to provide the loan facility, to the 3 Registered Social Landlords (RSLs). The amount requested by the above 3 RSLs is £13.0 million. It is envisaged that this lending will assist the development of up to 163 additional affordable housing units which have been previously identified and prioritised via the Council's Strategic Housing Investment Plan (SHIP) processes.

1.3 The provision of these loan facilities is conditional on obtaining Scottish Government consent to borrow to lend and agreement of the terms and conditions with each RSL.

1.4 Appendix 1 contains a summary of the proposed outline terms and conditions that will be negotiated with the RSLs.

2 RECOMMENDATIONS

2.1 **It is recommended that subject to Scottish Government approval the Council:-**

(a) **Agrees to providing an secured loan facility of up to £5.0 million to BHA to assist affordable housing developments at Acredale Eyemouth and Todlaw Duns, in line with the Council's Strategic Housing Investment Plan (SHIP) 2012/15.**

(b) **Agrees to providing a secured loan facility of up to £5.0 million to EHA to assist affordable housing developments at Newcastleton, Stichill, Peebles, Lauder and Galashiels in line with the Council's SHIP 2012/15.**

(c) **Agrees to providing a secured loan facility of up to £3.0 million to SBHA to assist affordable housing developments at Stonefield and Deanfield, Hawick in line with the Council's SHIP 2012/15.**

(d) **Agrees that powers be delegated to the Chief Financial Officer and the Head of Legal and Democratic Services to finalise the associated financial and legal issues and proceed to provide the**

loan facilities to BHA, SBHA and EHA.

3 BACKGROUND

3.1 At its meeting on 15 December 2011 the Council agreed to the principle of providing a loan facility to Registered Social Landlords (RSLs) in the Borders to support the delivery of the Council's Strategic Housing Investment Programme (SHIP). It was agreed that Council Officers should engage with RSLs in terms of their specific requirements, explore the associated financial and legal issues, and report back to Council when that work was complete. Officers have also been in discussion with counterparts at City of Edinburgh Council who were awaiting the outcome of a request for consent of Scottish Ministers to on-lend to RSLs. It is understood that this consent has now been granted.

3.2 In addition, Annex D of the Council's Treasury Investment Strategy sets out permitted investments and included within this is the ability to lend to third parties, up to a cumulative maximum of £30m. The Strategy states that each loan requires Member approval and that each application is supported by the service rationale behind the loan and the likelihood of partial or full default. The full rationale behind on-lending in general was outlined in the Council paper of 15 December 2011 and this report outlines the detail of the proposed loan facilities.

3.3 The Council intends to finance these loan facilities via external borrowing from the Public Works Loans Board (PWLB). Normally, the Council only has authority to borrow in the medium to long term for capital expenditure purposes. In order to borrow to finance the proposed loan facilities the Council will be required to seek consent from the Scottish Government (SG) to treat these facilities as part of its Capital Financing Requirement.

3.4 The financial limits linked to the Capital Financing Requirement for the Council are part of the approved Prudential Indicators under the Treasury Management Strategy. The proposals for the loan facilities were initially incorporated into the 2012/13 Treasury Management Strategy approved in February 2012, and are included in the 2013/14 Treasury Management Strategy that will be presented to Council for approval on the 7 February 2013.

3.5 RSLs themselves cannot directly access funds from PWLB – although PWLB do have the power to lend direct, it is their policy not to do so because of the perceived risk. This risk relates to the fact that PWLB historically do not secure their loans due to the nature of their financing arrangements.

3.6 The constrained funding situation for RSLs in general is mainly driven by Scottish Government (SG) ending the previous Affordable Housing Investment Programme (AHIP) arrangements and introducing a new Innovation and Investment Fund, and subsequent Affordable Housing Supply Programme and associated arrangements. These are both predicated on the developing RSL having the financial capacity to be able to front fund all elements of the delivery of projects, with grant being provided upon completion. In addition new grant unit benchmarks have been introduced which are much lower than those previously available via previous AHIP arrangements.

3.7 Historically and generally speaking RSLs have been able to put favourable loan facilities in place through the normal financial market routes. However the significant change in the financial lending markets in the last few years has impacted on the RSLs ability to secure similar terms and conditions. When RSLs have approached their existing lenders awith respect to financing their SHIP related projects they have encountered significantly impaired terms. Specifically related to reduced loan duration, more stringent financial covenants being required and in some cases conditions being imposed on new lending which would force a wider renegotiation of the terms and conditions attached to previous borrowing. In response, RSLs are now seeking to secure access to new funds in ways which do not disturb existing loan agreements nor expose them to unnecessary re-financing risk due to the shorter term financing being offered on less advantageous terms.

3.8 The proposed lending will alleviate the problems currently faced by local RSLs by providing terms and conditions which are more manageable for the RSLs and facilitate delivery of the SHIP commitments.

4 PROPOSALS

4.1 Council officers have been in discussion for some time with staff from the local RSLs and proposals have now been received from BHA, EHA and SBHA. Waverley Housing has not brought forward any proposals which are in line with Council agreed SHIP priorities.

4.2 **BERWICKSHIRE HOUSING ASSOCIATION** has indicated that it would propose to use the proposed Council loan facility to assist projects at Acredale ph2 Eyemouth and Todlaw Duns. Together these projects would deliver an additional 55 new build housing units, and would require loan financing support of an estimated £5.0 million.

4.3 Subject to on-lending to the Association being agreed, it is proposed that Acredale ph2 Eyemouth will provide 32 homes for social rent. Todlaw ph3 Duns will provide 22 homes for social rent. The Association is proposing developing the latter project as one which will require no subsidy. However project viability is dependant on a number of financial variables with interest rates/re-financing risk being key factors.

4.4 Costs are being finalised and some of these homes may be leased to a subsidiary within the Association's group structure and let as affordable housing with mid market rents but the Todlaw project could not proceed without alternative funding being secured. The Acredale ph 2 project has grant allocated to assist it's delivery for anticipated completion by 31 March 2015.

4.5 **SCOTTISH BORDERS HOUSING ASSOCIATION** has indicated that it proposes to use Council loan facility to deliver 44 new build homes for social rent as one element of the Stonefield Estate regeneration in Hawick. It proposes to use the Council loan facility to support the 3 phases as follows:–

Ph1 10 homes £0.642million

Ph2 24 homes £1.086 million
Ph3 10 homes £0.510 million

4.6 Phase 1 has grant allocated to assist delivery by 31 March 2015. Phase 2 and 3 are pipeline projects within SHIP, and subject to grant and borrowing being secured, both could potentially complete by 31 March 2017.

4.7 The Association also proposes to use an estimated £0.260 million of Council loan facility to fund the redevelopment of 10 homes on the site of the former Deanfield sheltered housing in Hawick. This again could complete by 31 March 2017 subject to grant and borrowing being secured.

4.8 SBHA estimate that in total these projects would require Council loan facility support of £3.0 million. Although these SBHA projects are not dependant on the Council loan facility support, if this were not available, SBHA would need time to re-evaluate development commitments according to lending market conditions prevalent at that time and this may delay delivery of the projects.

4.8 **EILDON HOUSING ASSOCIATION** has indicated that it proposes to use Council loan facility to deliver 64 new build homes at the following locations:–

Newcastleton 8 homes £0.415 million

Stichill 8 homes £0.417 million

Dunwhinny Lodge Peebles 16 homes £1.481 million

Croft Road Lauder 12 homes £1.250 million

Easter Langlee Ph1 20 homes £1.690 million

4.9 These projects will provide 55 homes for social rent, plus 9 for mid market rent. Together these projects would require an estimated £5.316 million external market borrowing; however, the Association has indicated that it could reduce this as an Council loan facility requirement to £5.0 million. EHA is not dependant on Council loan facility to deliver the above projects, but the changing financial lending market means that utilising the facility would provide considerably less risk for the developments in terms of re-financing risk and increased certainty due to having the necessary funding in place with obvious advantages for project programming and delivery by 31 March 2015.

4.10 In summary the provision of a Council loan facility to these RSLs will enable the development of affordable housing, within SHIP agreed timeframes timescales that is not compromised by the impact of significantly more restrictive financing conditions. The inability to provide these facilities will have the potential to limit the scale and number of affordable housing projects.

4.11 If the Council supports the proposals for creating RSL loan facilities to support these projects then there will be a series of steps required to finalise arrangements, including:-

Legal:

(a) The powers under which the Council could assist by providing loan finance secured on the assets held by RSLs are detailed in the Housing (Scotland) Act 2001 (section 92) and require consent of Scottish Ministers. Informal discussions with Scottish Government have indicated that the Council will have to make an application for their consent to borrow to fund the loan facility and would be considered positively, as long as it were supported by a robust business case and justification for the non-use of traditional RSL borrowing sources.

(b) The form of standard security offered by the RSLs is anticipated to be in the form of property and / or land. The Chief Financial Officer has developed proposed terms and conditions to be used in conjunction with on-lending and these will need to be discussed and agreed individual arrangements with the RSLs. These are set out in Appendix 1. Some flexibility around the financial covenants and the margin proposed is requested to facilitate these negotiations.

(c) Financial: Terms and conditions for the on-lending (e.g. period of loan, rate of interest) plus an administrative/risk related margin (proposed to be a minimum of 0.5% but may be higher subject to the risk associated with the financial covenants) will need to be negotiated.

(d) Due diligence will require to be applied to individual RSL accounts to establish confidence in their ability to repay their respective loan

5 IMPLICATIONS

5.1 Financial

(a) The proposed outline terms and conditions are set out in Appendix 1.

(b) It is proposed that in the event that an RSL requires the Council to amend the financial covenants to a lower mutually agreed level, this will result in an increased risk and this will be compensated for by an increase in the margin applied to the PWLB rate.

(c) It is proposed that the Chief Financial Officer and the Head of Legal and Democratic Services are delegated authority to negotiate the finalised terms and conditions, and the ultimate loan facility agreement with the individual RSLs.

(d) The key constraint to delivery of the project will be the securing of the Scottish Ministerial consent to borrow to fund the loan facility.

(e) There should be no net revenue impact for the Council as the intention is to ensure that all related costs of the facility e.g. interest and PWLB arrangement fees will be covered by the payments from the RSL. It is also assumed that the consent from Scottish Ministers will allow the deferral of the statutory loan repayment charges to revenue until the repayment of capital from the RSL in accordance with the agreed repayment schedule.

(f) The indicative drawdown schedule for the loan facilities is as follows and will be included in the Treasury Strategy indicator estimates:

£m	***2013/14***	***2014/15***	***2015/16***	***2016/17***
BHA	5.0			
SBHA	0.642	1.086	0.510	0.260
EHA	5.0			
Total	**10.642**	**1.086**	**0.510**	**0.260**

There is no direct impact on the Council's ability to borrow to fund the capital programme or where 'Consent To Borrow' has already been approved by Scottish Government.

5.2 **Risk & Mitigations**

(a) Scottish Ministers may opt to refuse to consent to the proposed on-lending by the Council. This would compromise the Council's 'Ambitious for The Borders', and Single Outcome Agreement, both have a target of 100 affordable housing units to be delivered each year. The new Local Housing Strategy 2012-17 has an annual target of 103 affordable houses. Proposals in this report will contribute to meeting these targets.

(b) From the Council's perspective, the major risk is clearly associated with the loan arrangements and the risk of individual RSLs not repaying all or part of their loan.

Measures to mitigate the risk include:-

i. Standard security being taken over individual RSL assets to the value of the loan, with the Council having the sole interest in the assets
ii. Due diligence on individual RSL accounts by both the Council and independent third party
iii. Regular monitoring and dialogue with individual RSLs

5.3 **Equalities**

There are no equality issues directly related to this report.

5.4 **Acting Sustainably**

There are no direct economic, social or environmental issues with this report which would impact upon the Council's sustainability policy.

5.5 **Carbon Management**

There are no effects on carbon emissions associated with this report.

5.6 **Rural Proofing**

It is considered that this proposal will have a positive affect by assisting in increasing the supply of affordable housing in a number of Borders settlements. Duns and Lauder are classed as being in an "accessible rural" area as per Scottish Government's land classification methodology, whilst Stichill and Newcastleton are classed as being "remote rural".

5.7 **Changes to Scheme of Administration or Scheme of Delegation**

No changes to the Scheme of Administration or Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Head of Legal and Democratic Services, the Head of Audit and Risk and the Clerk to the Council have been consulted and comments are incorporated in the report.

6.2 The Council's Corporate Management Team considered this report on 5th December 2012.

Approved by

Chief Financial Officer **Signature ....**

Director of Social Work **Signature ....**

Author

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Background Papers: None
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PROPOSED DRAFT TERMS AND CONDITIONS LENDING TO R.S.L.S

Borrower	[NAME OF REGISTERED SOCIAL LANDLORD]
Lender	Scottish Borders Council ("SBC" or the "Council")
Facility	Fixed Term Secured Loan Facility with principal repayable in full at end of the individual loan tranche term
Facility Amount	Up to the maximum facility agreed by Scottish Borders Council.
Purpose	To facilitate the provision of [XX] additional affordable housing units in the Scottish Borders.
Facility Term	Total facility Term: 1 -15 years if Fixed Rate or 1 -10 years if Variable. However individual tranches of drawdown subject to: Fixed Rate Loan - Minimum term 1 year Maximum term 15 years Variable Rate Loan – Minimum term 1 year Maximum term 10 year *(Restriction on Variable term linked to PWLB terms)*
Drawdown	Single or multiple tranches. However there will be a fixed term for each tranche and each tranche would then have an individual interest rate based on the PWLB rate prevailing that this time. The Lender will require at least 5 working days notice prior to final drawdown of the loan or each individual loan tranche, and must keep the Lender updated on proposed changes to the agreed programme of drawdowns (see Conditions Precedent) as material changes in the profile will affect the Council's prudential indicators and restrict the on-lending capacity.

Interest Basis	**<u>Fixed Rate</u>** PWLB fixed rate for the appropriate term of the loan. This will be based on PWLB fixed rates as published at the time that the loan is requested for drawdown. (note this varies twice a day) This will be fixed at the rate agreed between PWLB and the Council when the loan is agreed between these two parties. Interest will be payable half yearly, with the first payment due on the anniversary of the loan (or individual tranche) drawdown. (need to specify this more clearly) **<u>Variable Rate</u>** PWLB variable rate appropriate to the interest payment profile – i.e. monthly, quarterly or half-yearly. The rates will be derived directly from the PWLB. Following drawdown the interest payment profile will be fixed and cannot be varied.
Margin	The Lender will add a margin, typically of 0.5% to the applicable PWLB interest rate. *(N.B. changes to negotiated covenants may result in increase margin to reflect increased risk)*
Security	Standard Security will be required for all sums due or becoming due. Valuations for the security will be on the basis of market valuation (subject to tenancies) Any changes to the security arrangements will be subject to agreement with the Lender.
Repayment	Maturity basis – i.e. principal repaid in full at end of facility term.
Prepayment / Indemnities	Prepayment will be subject to the same early re-payment conditions that PWLB will apply. In the event of early repayment the same amount cannot be re-borrowed under the facility. Both variable and fixed interest rate loans will have costs associated with repayment and information on these are available at www.dmo.gov.uk

Fees	
Arrangement Fee	Purely transfer of cost from PWLB to ensure cost neutral to Council Fixed Rate Loans - 35p for every £1,000/part of £1,000 Variable Rate Loans – 45p for every £1,000/part of £1,000
Non Utilisation Fee	Nil
Commitment Fee	Nil
Security Fee	An costs associated with registering any Standard Security will be born by the Borrower.
Monitoring Fee	Nil
Valuation Fee	Where the Lender already has Standard Security over existing properties these will be revalued and the Lender to select the valuer. A valuation will also be required on any additional Standard Security required to cover the value of the amount borrowed. Any costs associated with this valuation process will be the liability of the Borrower.
Legal Fee	The Lender and Borrower will be responsible for their own legal fees.
Financial Covenants	a) Gearing – up to 70% (need to define this for members) b) Interest Cover Ratio – Not less than 0.9 : 1 in any one financial year and a minimum of 1.1 : 1 in aggregate in any three year period (ditto) c) Asset Cover – a minimum cover ratio of 120% using MV-T (market value subject to tenancies) valuation basis; or 100% Cash Cover (ditto) (N.B. *Should these covenants be required to be negotiated then this will increase the premium over the PWLB rate charged to reflect increased risk)*
Information requirements	Quarterly management accounts to be provided within 45 days of each period end. Draft unaudited accounts to be provided within 90 days of the Borrower's year end. Audited accounts to be provided within 180 days of the Borrower's year end.

Events of Default	To be standard for this type of loan agreement and to include (i) any failure to make timely payment of any amount due under the loan agreement, (ii) the Borrower becoming insolvent, (iii) any failure to maintain the financial covenant, (iv) any representation being materially untrue when made or repeated and (v) anything which, in the Lender's reasonable opinion, constitutes a material adverse change in the Borrower's financial condition
Conditions Precedent	(i) Consent to Borrow to on lend to Borrower received from Scottish Government (ii) Compliance with Financial Covenants (iii) Security over assets to value of loan in place (iv) The Borrower provides the Lender with a proposed programme of loan tranche drawdowns (where there is more than one tranche) for the Lender to agree and annually (each October) agrees with the Lender of any amendments to this drawdown programme until all tranches have been lent.
Documentation	To be agreed between Borrower and Lender
Assignments/Transfers	Neither the Lender nor the Borrower may assign or transfer its rights under the loan agreement without first obtaining the prior written consent of the other party (not to be unreasonably withheld or delayed).
Jurisdiction	Scottish Law