# THE Social Housing Funding PROPOSAL

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Irish**League** of **Credit**Unions

IRELAND

# A proposal for Irish credit unions to fund the provision of social housing

Prepared by
the Irish League of Credit Unions
October 2015

# Contents

# 1. Executive Summary

## 1.1. Introduction

1.1.1. The purpose of this paper is to present a proposal whereby the Irish credit union movement could create a dedicated funding vehicle to provide finance for social housing in line with Government Policy.

1.1.2. The proposal is aligned to Irish League of Credit Unions "*Six Strategic Steps*".

1.1.3. This paper was prepared with the use of an external consultancy firm, Moore Stephens Nathans. Moore Stephens Nathans is a large accounting and consultancy professional services firm with a niche expertise in advising credit unions, having acted for over 100 credit unions on a range of consultancy related projects over the past 5 years.

## 1.2. Key Findings and Conclusions

*The Commonality of Interests*

1.2.1. Social housing refers to the provision by the Irish Government of housing supports for those unable to provide for accommodation from within their own resources. It is a key social policy and it impacts a significant proportion of the population in a profound way. During the recession there were successive years of reduction in the social housing budget, which saw the Exchequer funding fall from over €1.7bn p.a. in 2008 to €597m p.a. in 2014. In November 2014, Alan Kelly TD, Minister for the Environment, Community and Local Government published the *Social Housing Strategy 2020* ("SHS"). Key themes in the strategy are as follows:

- The State adopts a central role in the direct provision of social housing through a resumption of building on "a significant scale".
- The funding of this programme will require the development of innovative funding mechanisms that do not increase the General Government Debt i.e. financial sustainability.

1.2.2. Credit unions are self-help co-operative financial organisations geared to attaining the economic and social goals of members and wider local communities. Credit unions have been part of the Irish financial services landscape since the 1960's when enabling legislation was passed. Irish credit unions, like other Irish financial institutions, are currently strategically challenged due to low lending demand. Loan to asset levels have fallen at movement wide level from 44% in 2010 to 27% in 2015. During this period, the movement has maintained its funding base, and as a result, has significant levels of member funds held in investment related products earning a low yield and put to an unproductive purpose. This also exposes significant levels of member funds to market risk as income yields are under increased margin pressure due to the prolonged low interest rate environment. Currently, the movement has circa €8.5bn held in investments.

1.2.3. Our proposition is broadly as follows: the ILCU movement credit unions would form a special purpose vehicle that would either:

1. Invest in a state owned "financial vehicle" which would on-lend to Approved Housing Bodies to fund the development of social housing.

2. Invest and on-lend directly to Approved Housing Bodies to fund the development of social housing.

1.2.4. The key benefit arising for the credit union movement from this proposition would be that it would enable the movement to put a significant portion of the members' funds of €8.5bn (currently held in short term investments) to a more productive and economically rewarding purpose, while at the same time, addressing a key social issue that deeply affects the communities which credit unions serve. This would represent an initiative that would be very closely aligned to the core values of the credit union movement; economic democracy, inclusiveness, human and social development, community focus etc.

1.2.5. The key benefit for the State of this proposition would be that this would enable the Government Strategy of "Off-Balance Sheet" sustainability to be fulfilled over short, medium and long term time-horizons. Credit unions could become the leading funder of the social housing strategy (via AHBs) and reduce the financial commitments of the State to the Social Housing Agenda, while, enabling the Government to retain complete control over Social Housing Policy. This would also have a wider economic impact. The initiation of Social Housing Projects would create employment, generate taxes and provide stimulus to the construction sector etc. The key benefit for the population as a whole is obvious; the creation of a sustainable supply of social housing opportunities for those in need.

*The Economic Impact to Irish Credit Unions*

1.2.6. This has been estimated as enabling a contribution of between €26m to €78m per annum to the credit union movement, dependent on penetration:

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| **Based on 75% Penetration of 35,000 Homes** | **€m** | **€** | **€** | **€** | **€** | **€** |
| Incremental Build Up of Funding Position | 520.6 | 1,041.3 | 1,561.9 | 2,082.5 | 2,603.1 | 3,123.8 |
| Assume Social Housing Funding Yield at 3.5% | 18.2 | 36.4 | 54.7 | 72.9 | 91.1 | 109.3 |
| Less Foregone Investment Yield at 1% | (5.2) | (10.4) | (15.6) | (20.8) | (26.0) | (31.2) |
| *Net Incremental Yield* | *13.0* | *26.0* | *39.0* | *52.1* | *65.1* | *78.1* |
| | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** |
| **Based on 50% Penetration of 35,000 Homes** | **€m** | **€** | **€** | **€** | **€** | **€** |
| Incremental Build Up of Funding Position | 347.1 | 694.2 | 1,041.3 | 1,388.3 | 1,735.4 | 2,082.5 |
| Assume Social Housing Funding Yield at 3.5% | 12.1 | 24.3 | 36.4 | 48.6 | 60.7 | 72.9 |
| Less Foregone Investment Yield at 1% | (3.5) | (6.9) | (10.4) | (13.9) | (17.4) | (20.8) |
| *Net Incremental Yield* | *8.7* | *17.4* | *26.0* | *34.7* | *43.4* | *52.1* |
| | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** |
| **Based on 25% Penetration of 35,000 Homes** | **€m** | **€** | **€** | **€** | **€** | **€** |
| Incremental Build Up of Funding Position | 173.5 | 347.1 | 520.6 | 694.2 | 867.7 | 1,041.3 |
| Assume Social Housing Funding Yield at 3.5% | 6.1 | 12.1 | 18.2 | 24.3 | 30.4 | 36.4 |
| Less Foregone Investment Yield at 1% | (1.7) | (3.5) | (5.2) | (6.9) | (8.7) | (10.4) |
| *Net Incremental Yield* | *4.3* | *8.7* | *13.0* | *17.4* | *21.7* | *26.0* |

*The Mechanism – Approved Housing Bodies*

1.2.7. Approved Housing Bodies ("AHBs) will play an increased role in the provision of social housing strategy over the coming years, in line with the national strategy to move to "off balance sheet" finance. The proposed mechanism developed in this paper sets out a structure by which the Irish credit union movement could fund AHBs to provide social housing.

1.2.8. AHBs provide and manage social rented housing. They are private, non for profit organisations formed for the purpose of relieving housing need.

1.2.9. There are approximately 520 Approved Housing Bodies in Ireland with a stock size of over 27,000 units. It is estimated that approximately 17% of the current stock is supplied by AHBs. Approximately 10% of AHBs provide 80% of the housing supply. Therefore, there are a small number of well-established and financially sound AHBs who provide the vast majority of the social housing needs.

1.2.10. The 2011 *National Housing Policy Statement* introduced a Voluntary Regulation Code, which was designed to provide a framework through which the standards and operating practices of AHBs may be more effectively regulated. In February 2014, the Minister for the Environment, Community and Local Government established an Interim Regulatory Committee under the Board of the Housing Agency. It is worthwhile to note that one of the primary stated regulatory objectives is to "facilitate investment". The regulatory focus with regard to the AHBs is to ensure that AHBs meet certain objectives in relation to *"governance, financial viability and performance management".*

*Risks to the Irish Credit Union Movement*

1.2.11. The nature of the risks that the proposal would present to credit unions' funds could be summarised into two core risk types, as follows:

- Counterparty Risk – risk that an AHB defaults and credit unions have to impair the investment in the Credit Union SPV as the AHB is unable to repay the SPV.
- Liquidity Risk – risk that credit union funds are unduly tied up for excessively long periods of time and the Credit Union SPV is unable to meet liquidity calls from credit unions.

1.2.12. It is important at the outset to note that credit unions are constantly exposed to counterparty risks. Every loan that a credit union grants and every investment that a credit union makes, exposes the credit union to risk; risk that the member defaults on a loan, or risk that a counterparty fails to redeem an investment. The fact that a social housing scheme presents counterparty risk should not of itself be a concern. What is relevant is the level of risk, the nature of risk, and the mitigants that can be put in place to manage the risk. The core principle in underwriting is that loans are underwritten based on a robust assessment of the ability of the borrower to repay the loan. In the context of social housing, the State (via DECLG and Local Authorities) is a party to the Payment and Availability Agreement and this is the key funding source by which the loans are repaid. It is standard that monies received from Local Authorities via Payment and Availability Agreement are paid directly to the lender. Therefore, the key mitigant in underwriting loans that are part of a social housing scheme is that the State is ultimately the counterparty to the loan repayments. In addition, the fact that over 80% of the housing needs are provided by a small pool of well established, financially sound, and regulated entities is a key aspect of reducing the risk profile of the proposition.

1.2.13. A social housing scheme would undoubtedly impact liquidity levels in the credit union movement. However, the *relativity* of liquidity is the key consideration in the context of credit unions at this stage of the economic cycle of recovery. Currently, the Irish credit union movement has reached historic highs in liquidity levels. The general legal and regulatory requirement for liquidity is 20% in credit unions (liquidity being defined as cash and investment less than three months to maturity as a percentage of unattached savings[1]). Currently, liquidity levels are at **34.5%**. Therefore, the Irish League of Credit Unions would view that a social housing scheme could redress a liquidity imbalance, rather than expose the movement to excessive liquidity risk, provided the scale of the scheme is measured, proportionate and regulated.

*The Proposed Structure*

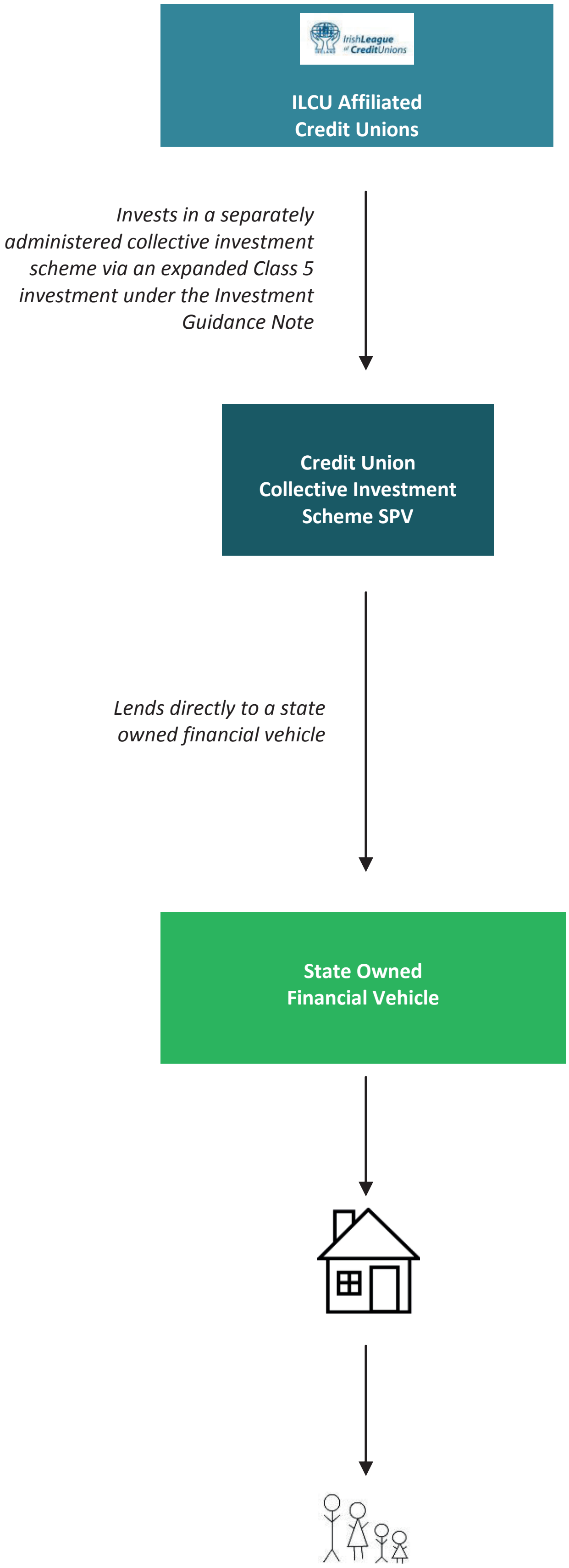
1.2.14. The proposed structure is set out overleaf. In order for a credit union social housing scheme to fit within the current regulatory framework, a change in regulatory guidance would be needed to expand the definition of collective investment schemes to include social housing projects. Class 5 Collective Investment Schemes would need to be expanded, along the following lines (see underline):

> *"Units or shares in open-ended retail collective investment schemes, including Approved Housing Body property schemes, but excluding all other property schemes, authorised by the Financial Regulator"*

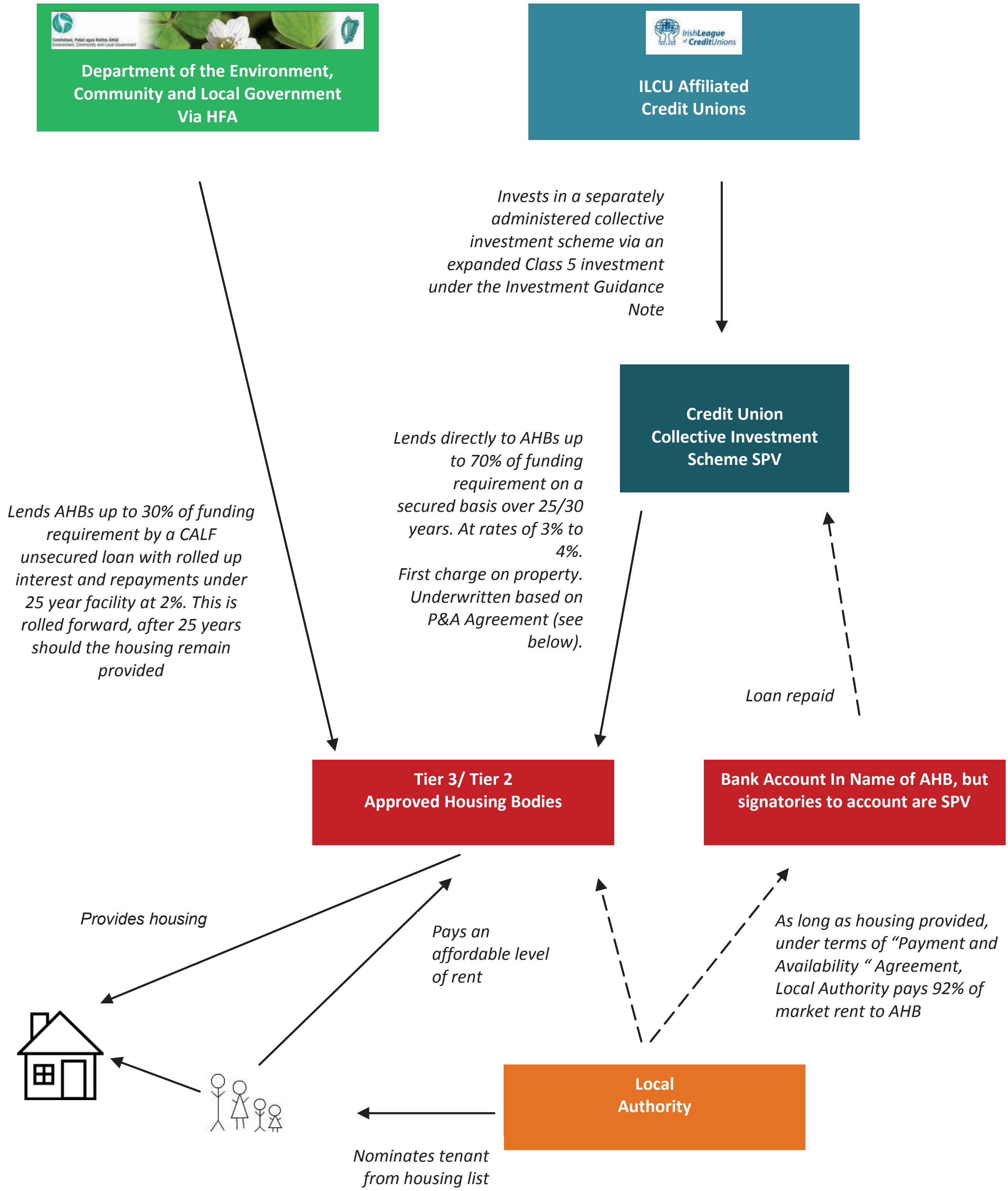
1.2.15. In making this decision, the key considerations of the Central Bank of Ireland are likely to be the impact that a social housing scheme would have on the safeguarding of member funds and the stability and well-being of credit unions in general. In this regard, it is likely that any regulatory analysis would centre on key risks, namely counterparty risk and liquidity risk. Therefore, points made on the low inherent level of counterparty and liquidity risks above, would be central to any analysis.

[1] There are new requirements for liquidity as part of the CP88 consultation process, but these generally relate to short term liquidity and should not alter the above analysis).

1.2.16. A direct investment model is illustrated below:



1.2.17. An indirect investment model is illustrated below:



# 2. Introduction to Social Housing

## 2.1. Introduction to Social Housing

2.1.1. Social housing refers to the provision by the Irish Government of housing supports for those unable to provide for accommodation from within their own resources. It is a key social policy and it impacts a significant proportion of the population in a profound way. It also has a high degree of interdependency with the property market, and, is closely linked to fiscal and regulatory policies i.e. the housing market is sensitive to social housing policies. The principal classes of citizens in need of social housing supports are as follows:

- Renting with Rent Supplement (approximately 50% of those who qualify for support)
- Renting without Rent Supplement (approximately 26% are currently renting in the private rented sector)
- Living with Parents (approximately 20%)
- The remaining proportion would relate to emergency accommodation for homeless people, people with disability, people living in overcrowded or unfit accommodation and people whose mortgages have been deemed to be unsustainable under the Mortgage Arrears Resolution Process.

2.1.2. Traditionally, the provision of social housing was done in three ways:

- *Local Authorities:* Local authorities are the largest single providers of socially rented housing in Ireland, controlling circa 147,000 dwellings.
- *Approved Housing Bodies:* ("AHBs"). Approximately 500 AHBs manage approximately 27,000 dwellings. AHBs can be limited companies, societies or trusts and they must have as their primary objective the relief of housing needs, poverty or hardship or the welfare of Travellers and the provision and management of housing. They cannot distribute surplus profits, bonus or dividends to members and their assets must be used to meet their primary objective.
- *Private Rental Sector:* The private sector provides accommodation supported by Rent Supplement for approximately 74,000 households.

2.1.3. During the recession there were successive years of reduction in the social housing budget, which saw the Exchequer funding fall from over €1.7bn p.a. in 2008 to €597m p.a. in 2014. During this time the mix of social housing supports changed, and there was a notable increase in support provided by the Private Rental Sector (due to low level of funds available for capital investment). The current constraints in the availability of rental properties in urban areas present challenges to the provision of adequate social housing to those in need.

## 2.2. Introduction to the Social Housing Strategy

2.2.1. In November 2014, Alan Kelly TD, Minister for the Environment, Community and Local Government published the *Social Housing Strategy 2020* ("SHS"). This SHS supports the realisation of a new vision: *"that to the greatest extent possible, every household in Ireland will have access to secure, good quality housing suited to their needs at an affordable price and in a sustainable community"*. It will:

- Provide 35,000 new social housing units, over a 6 year period, to meet the additional social housing supply requirements as determined by the Housing Agency
- Support up to 75,000 households through an enhanced private rental sector; and
- Reform social housing supports to create a more flexible and responsive system.

2.2.2. Key themes in the strategy are as follows:

- The State adopts a central role in the direct provision of social housing through a resumption of building on "a significant scale".
- The funding of this programme will require the development of innovative funding mechanisms that do not increase the General Government Debt i.e. financial sustainability.

2.2.3. The strategy contains three Pillars:

- Pillar 1: Provision of New Social Housing *Supply*
- Pillar 2: Providing Housing *Support* through the Private Rental Sector
- Pillar 3: *Reform* - creating more flexible and responsive social housing supports

2.2.4. Pillar 1 specifically deals with funding. Pillar I provides a framework for "off-balance sheet" delivery of social housing units. Off-balance sheet, in this context, means that the assets/ funds associated with Social Housing Policy are not included in the balance sheet of the Government. The strategy states that *"…the Government is committed to…… putting in place mechanisms which are capable of raising finance in a sustainable manner and which can be used to drive, plan and coordinate the provision of new social housing"*. Pillar 1 sets out three mechanisms to deliver off-balance sheet, one of which is a "financial vehicle". This is now briefly explained.

2.2.5. Under the SHS, a "financial vehicle" would be established by the State to facilitate the aggregation of private investment into a fund for subsequent lending as "project finance". The SHS states that AHBs in Ireland lack sufficient scale to access capital markets at competitive rates. The Government, as part of Budget 2015, announced that €400m of public investment will be available, including the proceeds from the sale of Bord Gáis energy business, to capitalise this new vehicle and provide for at least 2,000 housing units. This investment would then leverage private sector finance which will be raised from a variety of sources which could include "*the EIB, ISIF, Pension Funds, Credit Unions and other financial institutions, both domestic and international"*. This funding will then be lent on to qualifying AHBs, giving them access to long term finance. The SHS states that:

> *"this new source of funding will enable AHBs to better leverage their existing stock with the ultimate aim of delivering more housing from scarce exchequer resources. This funding solution will be part of an incentivised programme where AHBs will commit to deliver specific housing targets and AHBs that are the most active and capable of delivering new housing supply will receive a greater proportion of this funding"*

2.2.6. The SHS goes on to state that:

> *"This financial vehicle could also provide the foundation for a more developed Social Housing Body, in the medium-to-long term. The challenge would be to ensure greater freedom from day-to-day government control and direction but more significantly it would have to be capable of breaking even and having sufficient income to fund borrowing. This would require that rents charged would be aligned with the cost of provision and in practice; this will require both mixed tenure development and payments by local authorities to meet the short fall between costs and differential rents"*

2.2.7. The shift from public sector funding to private sector funding was concisely summarised by the European Investment Bank as follows[2]:

> *"The Irish social housing sector is in the early stages of transitioning from a fully public sector and grant funded model towards greater involvement of private sector financing. This shift away from 100% capital grants has been influenced both by the need to decrease public sector deficits as well as a wish to increase efficiencies and put Approved Housing Bodies (AHBs) at the centre of social housing delivery in the future. Public capital budgets have decreased significantly and new initiatives such as the Capital Advance Leasing Facility (CALF) and Payment and Availability Agreement (PAA) have been put in place to provide incentives to financial institutions to enter the social housing financing market. As a result, commercial financial institutions have now started lending to the sector, although its scale and terms is still very limited, with only a handful of loans disbursed to a just a few of the larger AHBs."*

[2] Final Report for the Department of Public Expenditure and Reform, 2014

Credit Union

# 3. Approved Housing Bodies

## 3.1. Introduction to Approved Housing Bodies (“AHBs”)

3.1.1. AHBs are defined as follows:

*Approved Housing Bodies (AHB) (include Housing Associations and Co-operatives) provide and manage social rented housing. They are private, non for profit organisations formed for the purpose of relieving housing need.*

3.1.2. Under Section 6 of the Housing (Miscellaneous Provisions) Act, 1992, bodies must obtain ‘approved status’ from the Department of Environment, Community and Local Government. A body seeking to obtain, and to retain, approved status must: -

- *have as primary objective the relief of housing need, or poverty or hardship or the welfare of Travellers, and the provision and management of housing,*
- *have in its memorandum of association or registered rules, provisions prohibiting the distribution of any surplus, profit, bonus or dividend to members and requiring that the assets of the body be applied solely towards its objects.*

## 3.2. Nature, Scale and Extent of AHBs

3.2.1. There are approximately 520 Approved Housing Bodies in Ireland with a stock size of over 27,000 units. It is estimated that approximately 17% of the current stock is supplied by AHBs.

3.2.2. AHBs provide housing in response to a range of different needs including families on low incomes, households with special needs, such as older persons, people with disabilities and homeless persons. AHBs work in partnership with Local Authorities. AHBs take nominations from the Local Authority's social housing waiting list to fill available accommodation provided by the AHB.

3.2.3. Based on research, the top 10 AHBs are as follows:

| AHB Name | Total Housing Stock |
|---|---:|
| Respond Voluntary Housing Agency | 5,200 |
| Cluid Housing Association | 5,000 |
| Túath Housing Association Ltd | 1,850 |
| National Association of Building Cooperatives | 1,800 |
| Focus Housing Association Ltd | 1,500 |
| The Iveagh Trust | 1,350 |
| Society of Saint Vincent de Paul | 1,000 |
| Circle Voluntary Housing Association Ltd | 550 |
| Oaklee Housing | 400 |
| Simon Communities Ireland | 400 |

## 3.3. Funding Mechanisms for AHBs

3.3.1. Traditionally the two principal funding mechanisms were, as set out in the DELG Capital Scheme:

- Capital Assistance Scheme
- Capital Loan and Subsidy Scheme

3.3.2. The capital assistance scheme worked by direct grant support. A grant was given to the local authority by the DELG. The local authority then granted a 30 year mortgage to the AHB and waived charges and repayments provided certain conditions were met.

3.3.3. The capital loan and subsidy scheme worked by the provision of a loan to the AHB by the local authority, and the provision of a subsidy to assist with the loan repayment. Key items to note are as follows:

- Loans were generally a 30 year annuity mortgage loan.
- Loans are made up to 100% of the cost.

3.3.4. The Capital Advance Leasing Facility ("CALF") was established by the DELG in 2011 to improve the financial viability of AHBs when seeking private finance from commercial sources. As such, the CALF facility works in combination with private funding sources. The CALF facility is an unsecured bullet loan (i.e. repayable only at maturity) and is typically set for a 25 year period with a simple fixed interest rate of 2% per annum. The loan is made from local authorities to Approved Housing Bodies and covers up to 30% of the funding required for purchasing, building or renovating social housing dwellings. The main purpose of the CALF facility is to provide AHBs with upfront capital to invest in new or existing stock. As it is considered as subordinated debt, it allows AHBs to acquire investment from external sources more easily.

3.3.5. Based on discussions with AHBs, it would appear that the CALF funding can be rolled over after 25 years, provided the housing need is still supplied. In this regard, it would suggest that CALF funding is unsecured perpetual debt, that can only become repayable should the housing scheme fail to provide the housing need to the Local Authority seeking a nomination.

3.3.6. Local Authorities may use CALF funds for any social housing expenditure they choose (i.e. refurbishing/upgrading existing stock, or acquiring new units) in accordance with the Housing Acts 1966-2009. By February 2014, €13.5 million had been provided by government for CALF payments since 2011 and it was expected that €10 million would be available during 2014.

3.3.7. This financing structure appears consistent with Clúid who state the following in their website:

> *Debt Funding*
> *Loans from financial institutions. Clúid funds part of the acquisition and construction of housing with loans from financial institutions.*
> *Loans from government. A long-term government loan (covering a maximum of 30% of the funding required) plays an important role in leveraging private finance. This loan is facilitated under the Capital Advance Leasing Facility.*
> *Government funding under the Capital Assistance Scheme facilitates housing people with particular needs. A small proportion of Clúids properties are purchased through the Capital Assistance Scheme which is a government grant for the provision of housing for older people, people with a disability, and those who have experienced homelessness.*

3.3.8. The Annual Report of Nabco discloses that it had total local authority debt of €151m in 2013. This was broken down as follows:

| Nature of Debt | 2013 | 2012 |
|---|---|---|
| Capital Loan and Subsidy Scheme financing | 148,863,915 | 157,292,686 |
| Capital Assistance Scheme financing | 358,027 | 1,287,475 |
| Capital Advance Agreement financing | 1,445,850 | 0 |
| | **150,667,792** | **158,580,161** |

3.3.9. Based on the above, the following should be noted:

- Capital loan and subsidy is the primary source of funds, but is reducing.
- Capital assistance/ grants plays a minor role
- CALF and bank loans are the new and growing source of finance

## 3.4. Regulation of AHBs

3.4.1. The 2011 *National Housing Policy Statement* introduced a Voluntary Regulation Code, which was designed to provide a framework through which the standards and operating practices of AHBs may be more effectively regulated. Although the code was by its own definition voluntary, it was intended to be a precursor to a statutory code of conduct for AHBs.

3.4.2. In February 2014, the Minister for Housing and Planning established an Interim Regulatory Committee under the Board of the Housing Agency. The regulatory objectives were set out as follows:

- *To provide assurance to tenants, Boards, Government and potential investors that*
- *the sector is stable and well-regulated.*
- *To safeguard tenants and public investment in the sector*
- *To improve and encourage good governance and financial health across the sector*
- *To provide a framework for AHBs to manage risk effectively and to focus on achieving best outcome for tenants*
- *To facilitate investment in social housing by growing confidence in the sector*
- *To contribute to the overall sustainability of the sector*

3.4.3. It is worthwhile to note that one of the primary stated regulatory objectives is to "facilitate investment".

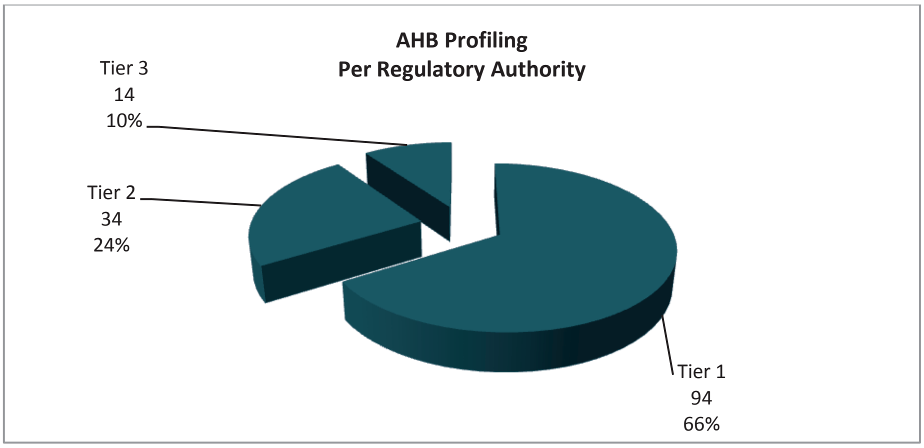
3.4.4. The regulatory focus with regard to the AHBs is to ensure that AHBs meet certain objectives in relation to *"governance, financial viability and performance management"*

3.4.5. The Government have committed to introducing statutory based regulation for AHBs by 2016.

3.4.6. The regulatory code has a stated principle of proportionality. In this regard, the regulatory framework for AHBs will be tiered as follows:

| Tier | Number of Units |
|---|---|
| Tier 1 | 0-50 |
| Tier 2 | 50 – 300 |
| Tier 3 | Over 300 |

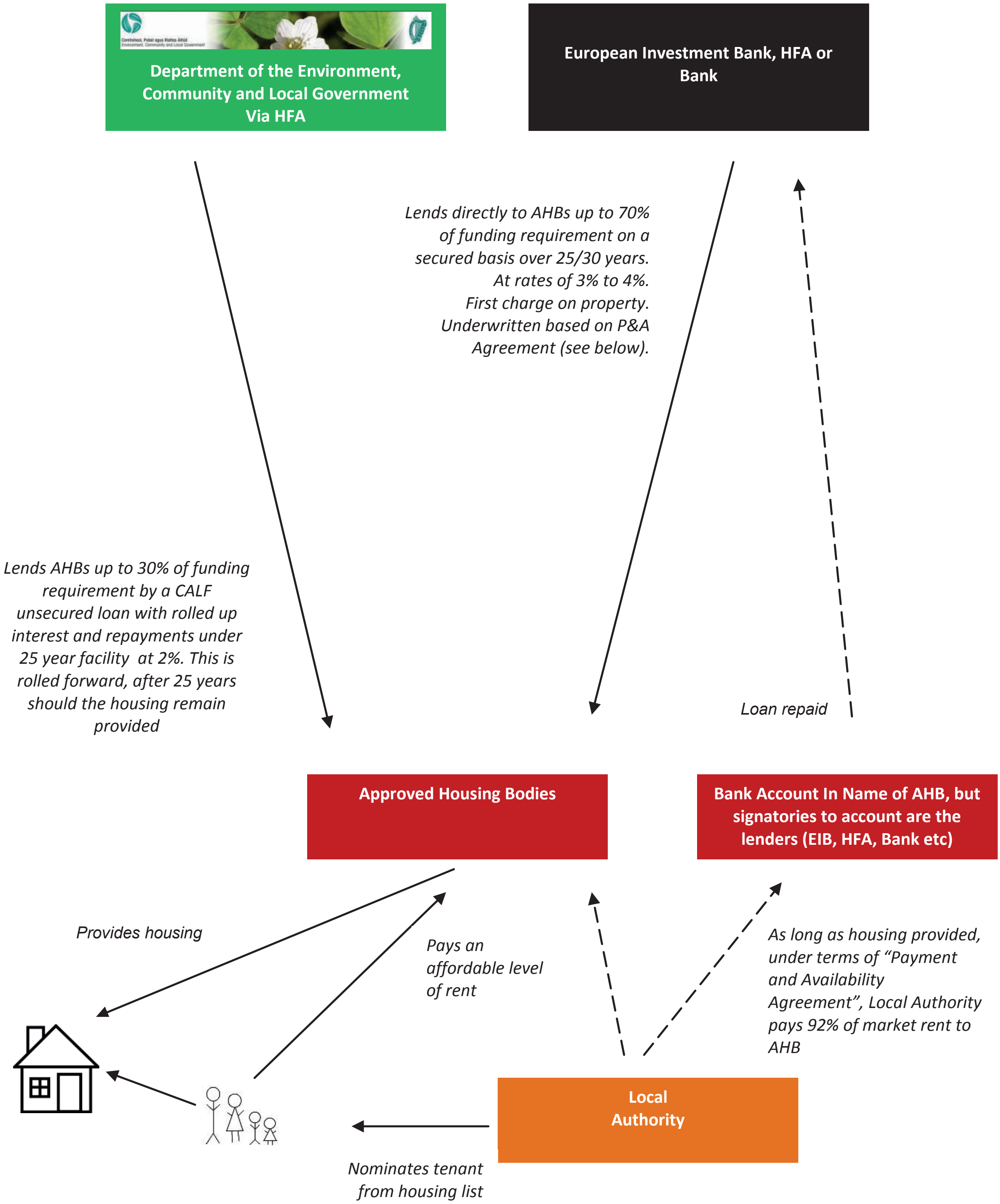
3.4.7. Based on the AHBs reviewed by the Regulatory Authority to date (comprising of a total of 142 of the population of 520), the mix in tiers is as follows:




3.4.8. Based on the AHBs reviewed by the Regulatory Authority to date, the Tier 3 AHBs (i.e. 10% of the population) provide roughly 80% of the housing supply. The Regulatory Authority has stated that 87% of the AHB housing stock is owned, with the remaining 13% leased or managed on behalf of a third party. The Regulatory Authority has stated that 84% of AHBs have been in existence for over 10 years. The Tier 3 AHBs have been in existence for an average of 22 years.

## 3.5. The AHB Business Model

3.5.1. The current business model is summarised below:



3.5.2. The business model can be therefore summarised as follows:

- The AHB secures a CALF loan up to 30% of the purchase/ development cost. This is unsecured with simple interest at 2% rolled up, over a 25 year period. At the end of the 25 year period, the loan can be rolled forward for another 25 years provided the housing need is met. In this regard, while the loan is technically repayable, as long as the housing need is provided, the loan is perpetual in nature. This gives the AHB an ability to gear up, or, leverage from a private funding source.
- Then the AHB will secure finance for the 70% needed to complete the purchase/ development. This will be on more commercial terms:
    - The loan will be 25/30 years.
    - A first charge is taken on the property
    - Interest will be charged, currently at rates between 3.5% and 4%.
    - The key feature of the credit risk management however, relates not to the first charge, but the "Payment and Availability Agreement". This is an agreement entered into by the AHB and the Local Authority whereby the Local Authority agrees to provide the AHB with 92% of the market rent. Generally, the *Payment and Availability Agreement* will equate to the loan repayment, and hence the loan repayment will be fully funded by the Payment and Availability Agreement. It is understood that the provider of finance will go as far as to be the named signatories on the bank account of the AHB i.e. the Payment and Availability Agreement funds are directly channelled to the finance provider. This is the key feature of the underwriting – the repayment capacity is almost guaranteed, provided the AHB can meet the nomination demands of the Local Authority. Less focus is placed on the first charge (even though the charge will be put in place).
    - The AHB will then charge an affordable rent to the tenant and it will look to ensure that this covers standard repairs and maintenance and operating costs. This may be on par, below, or above, the 8% remaining market rent not covered by the Payment and Availability Agreement.

## 3.6. Economic Analysis of Credit Needs of AHBs

3.6.1. The 2020 strategy provides that 35,000 homes will need to be built over the coming 6 years. Based on our discussions with representatives of the AHB movement, an average unit would cost circa €170,000. This, multiplied out, equates to a total funding requirement of € 6bn. Currently, AHBs provide only 17% of the housing need. However, mindful of the stated strategy to move away from public funding to private funding of AHBs, it is likely that this level of AHB penetration will increase significantly over the coming years. Below, a range of possible funding requirements based on a range of penetration levels is set out:

| | Housing Finance Need € bn | CALF Portion (30%) € bn | Private Funding (70%) € bn |
|---|---|---|---|
| At 100% penetration | 6.0 | 1.8 | 4.2 |
| At 75% penetration | 4.5 | 1.3 | 3.1 |
| At 50% penetration | 3.0 | 0.9 | 2.1 |
| At 25% penetration | 1.5 | 0.4 | 1.0 |

# 4. The Opportunity for Irish Credit Unions

## 4.1. Introduction to credit unions in context of the social housing

4.1.1. Credit unions are defined as follows:

> *"Self-help co-operative financial organisations geared to attaining the economic and social goals of members and wider local communities. Each credit union is governed by its members. The membership elects (from within that membership) unpaid volunteer officers and directors who establish the policies under which the credit union operates".*

4.1.2. Credit unions have been part of the Irish financial services landscape since the 1960's when enabling legislation was passed. Credit unions typically raise a funding base by accepting funds from its members through shares. Credit unions then lend to their members to assist them meet their social and economic goals. Loans are generally unsecured, small, and for a short term. At the end of the financial year, a credit union will calculate any surplus or deficit it has on its activities, and make a dividend as appropriate to its members.

4.1.3. The credit union movement is guided by a number of operating principles. These operating principles are founded in the philosophy of co-operation and its central values of equality, equity and mutual self-help. Operating principle number 10 states the following:

> *"Continuing the ideals and beliefs of co-operative pioneers, credit unions seek to bring about human and social development. Their vision of social justice extends both to the individual members and to the larger community in which they work and reside. The credit union ideal is to extend service to all who need and can use it. Every person is either a member or a potential member and appropriately part of the credit union sphere of interest and concern. Decisions should be taken with full regard for the interests of the broader community within which the credit union and its members reside"*

4.1.4. Irish credit unions, like other Irish financial institutions, are currently strategically challenged due to low lending demand. Loan to asset levels have fallen at movement wide level from 44% in 2010 to 27% in 2015. During this period, the movement has maintained its funding base, and as a result, has significant levels of member funds held in investment related products earning a low yield and put to an unproductive purpose. This also exposes significant levels of members' funds to market risk as income yields are under increased margin pressure due to the prolonged low interest rate environment. Currently, the movement has circa €8.5bn held in investments. There are approximately 370 Irish credit unions located throughout the State with a wide socio-economic and political reach.

## 4.2. The ILCU Proposition

4.2.1. Our proposition is broadly as follows: the ILCU movement credit unions would form a special purpose vehicle that would either:

- Invest in a state owned "financial vehicle" which would on-lend to Approved Housing Bodies to fund the development of social housing.
- Invest and on-lend directly to Approved Housing Bodies to fund the development of social housing.

4.2.2. The key benefit arising for the credit union movement from this proposition would be that it would enable the movement to put a significant portion of the members' funds of €8.5bn (currently held in short term investments) to a more productive and economically rewarding purpose, while at the same time, addressing a key social issue that deeply affects the communities which credit unions serve. This would represent an initiative that would be very closely aligned to the core values of the credit union movement; economic democracy, inclusiveness, human and social development, community focus etc.

4.2.3. The key benefit for the State of this proposition would be that this would enable the Government Strategy of "Off-Balance Sheet" sustainability to be fulfilled over short, medium and long term time-horizons. Credit unions could become *the* key funder of the social housing strategy (via AHBs) and reduce the financial commitments of the State to the Social Housing Agenda, while, enabling the Government to retain complete control over Social Housing Policy. This would also have a wider economic impact. The initiation of Social Housing Projects would create employment, generate taxes and provide stimulus to the construction sector etc.

4.2.4. The key benefit for the population as a whole is obvious; the creation of a sustainable supply of social housing opportunities for those in need.

## 4.3. Economic Impact

4.3.1. As stated above, the level of funding required by AHBs is difficult to anticipate. It is expected to be significantly in excess of the current requirement as the Governmental Strategy is to shift from public funding to private funding over the coming 6 years. But how much of the expected 35,000 housing stock will be provided by AHBs is not clear.

4.3.2. In Section 3, a range of penetration that the AHBs could expect was set out, ranging from 100% penetration to 25% penetration of the expected 35,000 housing stock. Below an economic impact analysis is completed setting out what incremental margin the Irish credit union movement could expect to earn through becoming the sole private credit provider to AHBs, based on two key assumptions:

- The credit union movement can expect to earn 1% on investments over the coming 6 years.
- The credit union movement can expect to earn 3.5% on funding provided to AHBs

| ***Based on 75% Penetration by AHBs of 35,000 Homes*** | **2016 €m** | **2017 €** | **2018 €** | **2019 €** | **2020 €** | **2021 €** |
|---|---|---|---|---|---|---|
| Incremental Build Up of Funding Position | 520.6 | 1,041.3 | 1,561.9 | 2,082.5 | 2,603.1 | 3,123.8 |
| Assume Social Housing Funding Yield at 3.5% | 18.2 | 36.4 | 54.7 | 72.9 | 91.1 | 109.3 |
| Less Foregone Investment Yield at 1% | (5.2) | (10.4) | (15.6) | (20.8) | (26.0) | (31.2) |
| *Net Incremental Yield* | *13.0* | *26.0* | *39.0* | *52.1* | *65.1* | *78.1* |

| ***Based on 50% Penetration by AHBs of 35,000 Homes*** | **2016 €m** | **2017 €** | **2018 €** | **2019 €** | **2020 €** | **2021 €** |
|---|---|---|---|---|---|---|
| Incremental Build Up of Funding Position | 347.1 | 694.2 | 1,041.3 | 1,388.3 | 1,735.4 | 2,082.5 |
| Assume Social Housing Funding Yield at 3.5% | 12.1 | 24.3 | 36.4 | 48.6 | 60.7 | 72.9 |
| Less Foregone Investment Yield at 1% | (3.5) | (6.9) | (10.4) | (13.9) | (17.4) | (20.8) |
| *Net Incremental Yield* | *8.7* | *17.4* | *26.0* | *34.7* | *43.4* | *52.1* |

| ***Based on 25% Penetration by AHBs of 35,000 Homes*** | **2016 €m** | **2017 €** | **2018 €** | **2019 €** | **2020 €** | **2021 €** |
|---|---|---|---|---|---|---|
| Incremental Build Up of Funding Position | 173.5 | 347.1 | 520.6 | 694.2 | 867.7 | 1,041.3 |
| Assume Social Housing Funding Yield at 3.5% | 6.1 | 12.1 | 18.2 | 24.3 | 30.4 | 36.4 |
| Less Foregone Investment Yield at 1% | (1.7) | (3.5) | (5.2) | (6.9) | (8.7) | (10.4) |
| *Net Incremental Yield* | *4.3* | *8.7* | *13.0* | *17.4* | *21.7* | *26.0* |

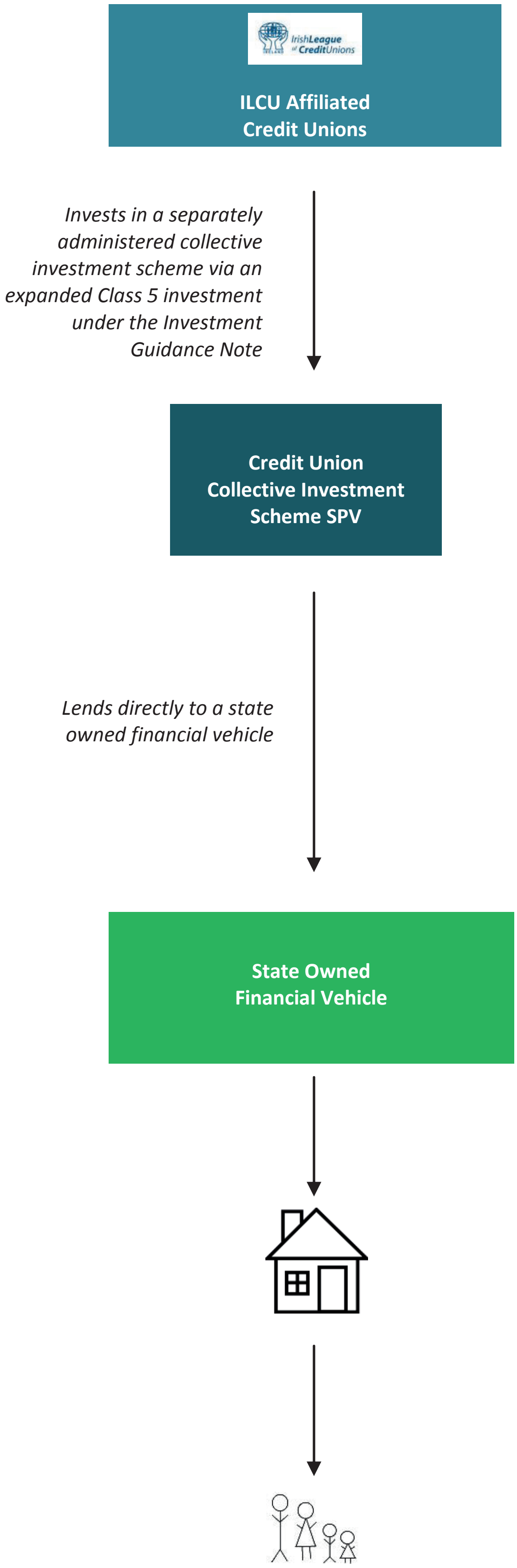
4.3.3. Based on this, at full maturity, the incremental yield would be likely to range from €26m per annum to €78m per annum based on an AHB range of 25% and 75% respectively.

4.3.4. While operating costs would need to be incurred to both invest in the structure, and operate the structure, this would be proportionate to the nature, scale and complexity of the structure and will be considered anon in this report.

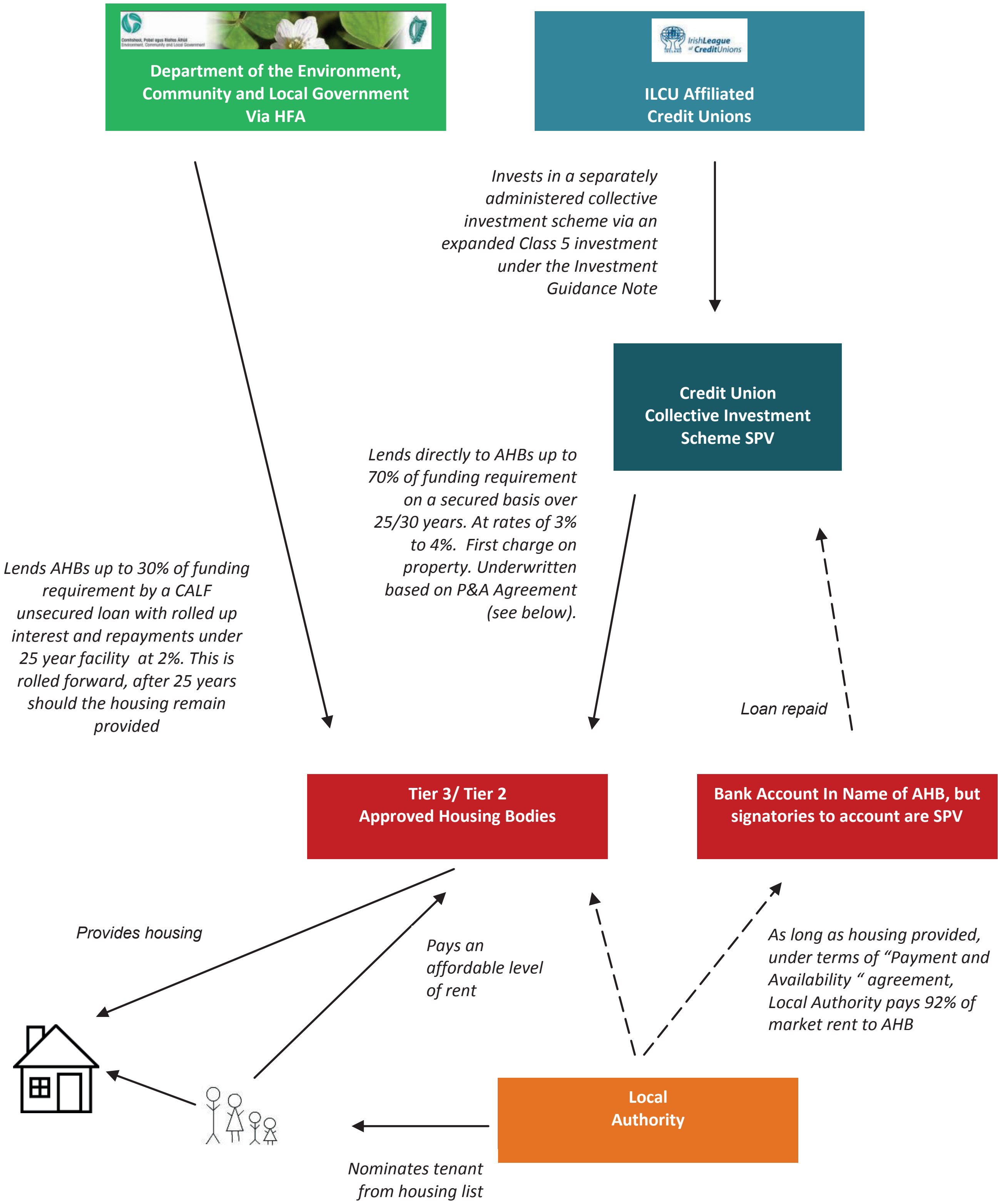
# 5. The Proposal

## 5.1. The Proposed Model

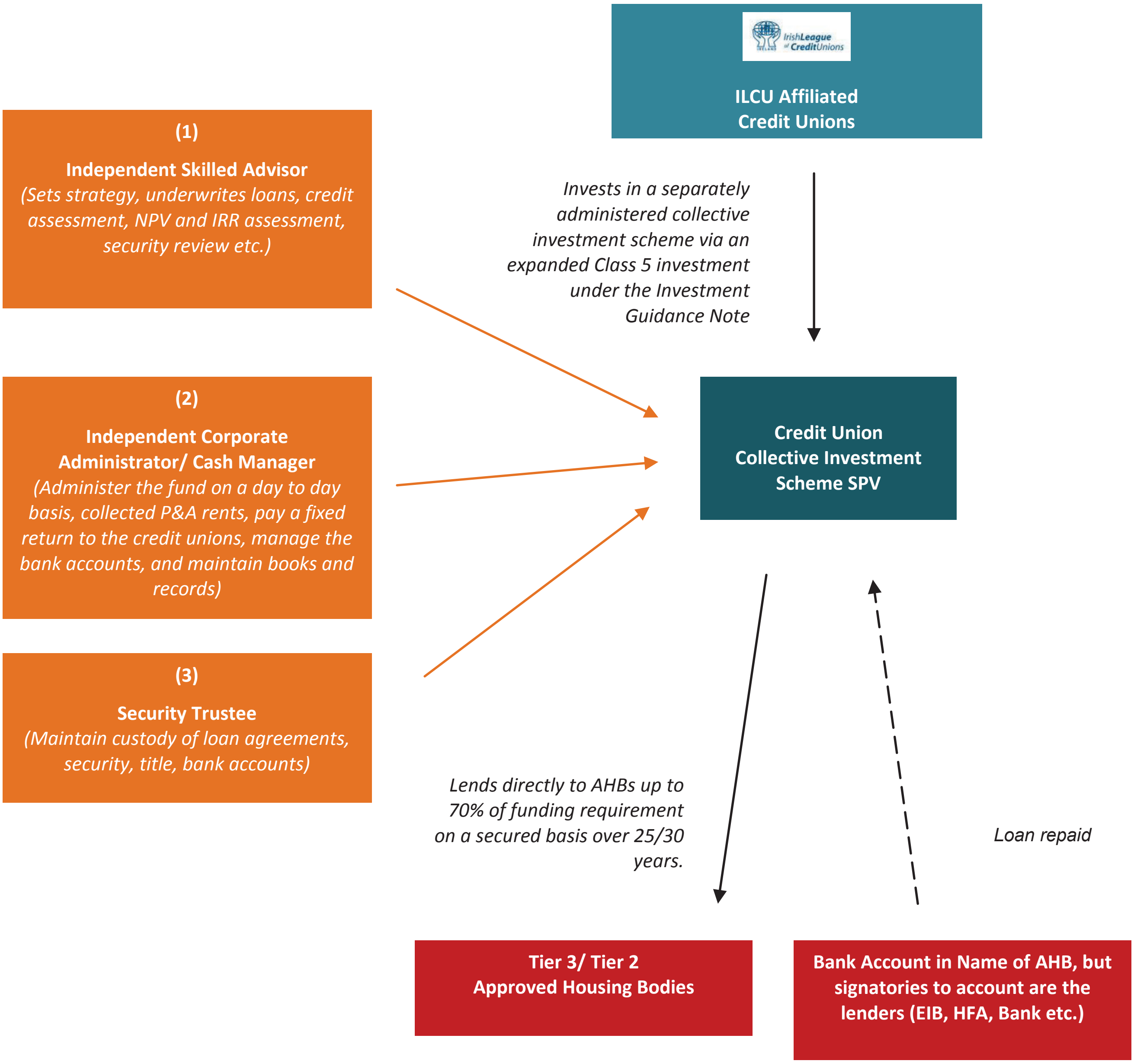
5.1.1. A direct investment model is illustrated below:



5.1.2. An indirect investment model is illustrated below. This proposed model would be to simply insert a credit union funding vehicle in place of the current finance providers (EIB, HFA, Banks) as follows to finance AHBs as set out below (initially to the Tier 3 and Tier 2 AHBs which are subject to a higher degree of regulation):



5.1.3. A "zoom in" of the ILCU funding vehicle is as follows showing the infrastructural supports that would be needed to operate the scheme (in the orange boxes), namely an advisor, an administrator, and a custodian.




5.1.4. With regard to the infrastructure required to support the Credit Union Collective Investment SPV (the orange boxes), the following should be noted:

- It is likely that the Administrator and the Trustee role could be outsourced to one service provider. Ireland is a global leader in the funds industry with a clear and practical regulatory framework, and, an unparalleled depth of professional expertise. It would be expected that the Administrator would perform the basic administration of the fund and issue monthly net asset value reports to the SPV.
- The role of advisor is a critical role in the structure. The fundamental role of the independent advisor would be to assess social housing projects and underwrite housing projects. In doing this, the advisor would have a robust risk management framework to identify, assess, measure, manage, and report on risks that the SPV fund would, or ought to be exposed to. Furthermore, the

advisor would have a strategy.  There are a number of options with regard to how the advisor could be established:

- The ILCU could independently appoint an appropriately fit and proper advisor.
- The ILCU could, in consultation with the Department of the Environment, appoint an appropriately fit and proper advisor.
- The Department of the Environment could, in consultation with the ILCU, form a state owned vehicle to act in an advisory capacity.
- The Department of the Environment could form a state owned vehicle to act in an advisory capacity.

# 6. Risk

## 6.1. Importance of Risk

6.1.1. If this model were to be a success, then somewhere between €1bn to €3bn of credit union members' funds could be invested in social housing funding. The paramount principle in the governance and regulation of credit unions is the safeguarding of members' funds. Therefore, a detailed understanding of the risks associated with the proposal is required to ensure that all steps have been taken to identify, measure, and assess risks that the proposal could reasonably be expected to present to members' funds.

6.1.2. The nature of the risks that the proposal would present to credit unions' funds could be summarised into two core risk types, as follows:

- Counterparty Risk – risk that an AHB defaults and credit unions have to impair the investment in the Credit Union SPV as the AHB is unable to repay the SPV.
- Liquidity Risk – risk that credit union funds are unduly tied up for excessively long periods of time and the Credit Union SPV is unable to meet liquidity calls from credit unions.

## 6.2. Overview of Counterparty Risk

6.2.1. It is important at the outset to note that credit unions are constantly exposed to counterparty risks. Every loan that a credit union grants and every investment that a credit union makes, exposes the credit union to risk; risk that the member defaults on a loan, or risk that a counterparty fails to redeem an investment. The fact that a social housing scheme presents counterparty risk should not of itself be a concern. What is relevant is the level of risk, the nature of risk, and the mitigants that can be put in place to manage the risk.

6.2.2. A social housing scheme involves secured lending. Over 90% of credit union loans are unsecured. Therefore, a social housing scheme loan which is secured would be less risky than a standard credit union loan which is unsecured.

6.2.3. The core principle in underwriting is that loans are underwritten based on a robust assessment of the ability of the borrower to repay the loan. In the context of social housing, the State (via DECLG and Local Authorities) is a party to the Payment and Availability Agreement and this is the key funding source by which the loans are repaid. It is standard that monies received from Local Authorities via Payment and Availability Agreement are paid directly to the lender. Therefore, the key mitigant in underwriting loans that are part of a social housing scheme is that the State is ultimately the counterparty to the loan repayments.

6.2.4. The Credit Union SPV would be supported by a specialised underwriting team with skills to underwrite this special class of loans. Based on our research, the underwriting of AHB loans has a sophisticated infrastructure and architecture. The *Irish Council for Social Housing* has prepared detailed loan assessment spreadsheets which are widely used. These tools employ sophisticated corporate finance techniques to analyse, assess and appraise social housing schemes:

- Net present values
- Internal rate of return

- Interest cover calculations
- Debt service ratios
- 30 Year projections of income, costs and balance sheets
- Sensitivity analyses
- Inflationary functionality

6.2.5. Therefore, through the specialisation of underwriting tools and underwriters, the quality of underwriting the underwriting capability of loans to fund social housing schemes should be robust.

6.2.6. The operational risk that the AHBs will be unable to provide housing facilities to satisfy their obligations under the Payment and Availability Agreement and hence jeopardise repayment capacity, must be accepted as a key risk. However, this risk is significantly mitigated by the current voluntary regulatory code, and the soon to be statutory regulatory code. The regulatory framework will result in a more robustly governed AHB sector with better governance, risk management and strategic planning processes. A regulatory objective is to encourage investment in AHBs. It is therefore reasonable to expect that the regulatory approach would be calibrated to safeguard inward investment in AHBs.

6.2.7. Operational risk would be further mitigated by limiting a social housing scheme to better regulated Tier 2 and Tier 3 AHBs. As stated earlier, 80% of the social housing provided by AHBs is provided by only 14 Bodies. The average age of these bodies is over 20 years. Therefore, the vast majority of the monies used as part of a social housing scheme would be invested in a limited pool of well established, large, mature and financially stable AHBs.

6.2.8. The risk that a collapse in market rents could lead to a mismatch between the Payment and Availability Agreements payments and the loan repayments must be considered. It is reasonable to assume that any collapse in rents would be likely to form part of wider economic dislocation, and that other type of loans exposed to the economy would be similarly distressed in this scenario. Therefore, one could argue that a collapse in market rents would leave the credit union sector no less exposed that it would be to other types of lending, in this scenario. It is also understood from research and discussion with AHBs, that in this eventuality, or in the event of any other unforeseen catastrophe, it is likely that State Intervention would occur; on the basis that social housing is a key social policy and a critical need for a significant proportion of the population.  If AHBs are the primary provider of social housing by 2020, this is not an unreasonable assumption.

6.2.9. With regard to other risks from unforeseen events, the level of capital in credit unions in relevant. The nature of capital was articulated by the Central Bank of Ireland in the context of credit unions as follows[3]:

> *"Adequate reserves are the foundation on which the financial stability of a credit union rests. Adequate reserves support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Credit unions need to maintain sufficient reserves to ensure continuity and to protect members' savings. Adequate reserves maintain savers' confidence. A strong overall reserves position enables credit unions to deal with future uncertainties and to act flexibly in adverse economic conditions. Lack of adequate reserves may threaten the financial soundness, stability and future of a credit union"*

[3] Regulatory Reserve Ratios for Credit Unions, 2009

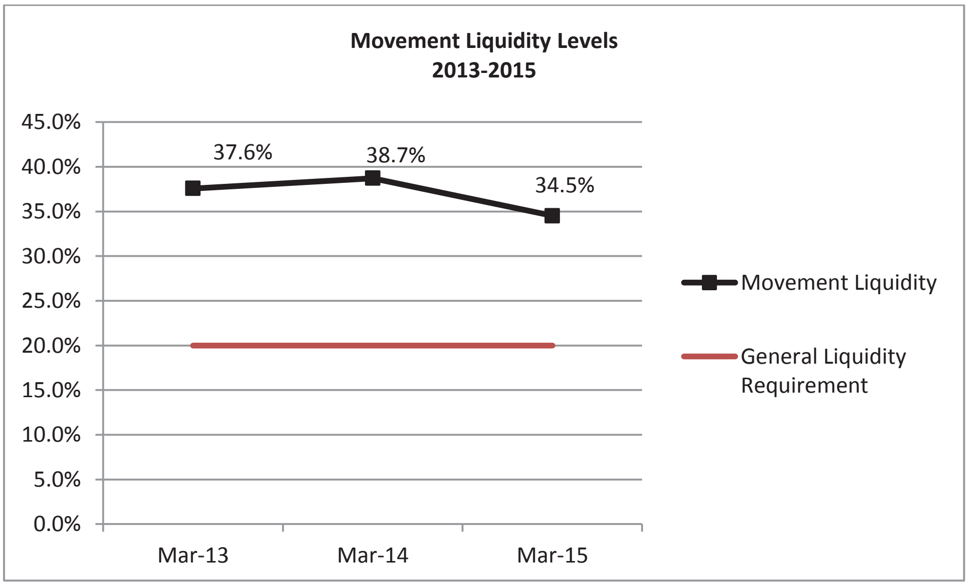
6.2.10. The average reserve ratio in credit unions is 16%, 6% above the required level of 10%. The fact that credit unions are so well capitalised is relevant in any assessment of risk that the sector may be exposed to.

## 6.3. Overview of Liquidity Risk

6.3.1. A social housing scheme would undoubtedly impact liquidity levels in the credit union movement. Loans to AHBs would typically be for 25 to 30 year terms. Credit unions are funded by demand savings. For this reason, the general legal and regulatory framework of credit unions limits the use of members' funds to short term loans and investments; there are restrictions under Section 35 of the Credit Union Act on the length of loans, and there are restrictions in the 2006 Investment Guidance Note on the duration of investments.

6.3.2. It is difficult to argue against the fact that a significant concentration of credit union funds in 30 year social housing projects could serve a mismatch in asset liability management strategy with the short term nature of the credit union funding base.

6.3.3. However, the *relativity* of liquidity is the key consideration in the context of credit unions at this stage of the economic cycle of recovery. Currently, the Irish credit union movement has reached historic highs in liquidity levels. The general legal and regulatory requirement for liquidity is 20% in credit unions (liquidity being defined as cash and investment less than three months to maturity as a percentage of unattached savings[4]). Currently, liquidity levels are at **34.5%**. While optimal liquidity is difficult to determine (as liquidity ultimately must meet member savings patterns which are inherently unpredictable and especially sensitive to complex factors), it is not unreasonable to state that liquidity levels are disproportionate in the context of the relatively stable savings base in the credit union movement over the past 3 years. This is illustrated below:




6.3.4. Therefore, the Irish League of Credit Unions would view that a social housing scheme could redress a liquidity imbalance, rather than expose the movement to excessive

[4] There are new requirements for liquidity as part of the CP88 consultation process, but these generally relate to short term liquidity and should not alter the above analysis).

liquidity risk, provided the scale of the scheme is measured, proportionate and regulated. Below an illustration of the relative impact on liquidity if the credit union movement invested in a social housing programme of €1bn, €2bn and €3bn based on liquidity levels at 30 June 2015 is set out. It was assumed that the movement would fund the investment in social housing from a mix of investments at short, medium and long term based on the current liquidity mix (clearly if the movement chose to fund the investment from investments that are not liquid in any event, liquidity would remain unchanged). It is noteworthy that in all instances the liquidity levels remain comfortably above the 20% minimum requirement.

| Investments by duration | Amount € | €1bn Social Housing Investment € | Revised Amount € |
|---|---|---|---|
| On Demand | 1,570,123,343 | (177,582,166) | 1,392,541,177 |
| 1 - 7 days | 198,171,717 | (22,413,375) | 175,758,342 |
| 7 - 31 days | 526,106,668 | (59,503,071) | 466,603,597 |
| 1 - 3 months | 948,492,038 | (107,275,184) | 841,216,854 |
| 3 - 12 months | 1,525,266,889 | (172,508,866) | 1,352,758,023 |
| 12 - 60 months | 4,073,511,806 | (460,717,339) | 3,612,794,467 |
| > 60 months | 530,713,181 | 1,000,000,000 | 1,530,713,181 |
| | **9,372,385,642** | - | **9,372,385,642** |
| | | | |
| Attached Shares | | | 9,396,690,408 |
| Original Liquidity | | | 34.51% |
| Revised Liquidity | | | 30.61% |
| Liquidity Reduction | | | 3.90% |

| Investments by duration | Amount € | €2bn Social Housing Investment € | Revised Amount € |
|---|---|---|---|
| On Demand | 1,570,123,343 | (355,164,331) | 1,214,959,012 |
| 1 - 7 days | 198,171,717 | (44,826,749) | 153,344,968 |
| 7 - 31 days | 526,106,668 | (119,006,143) | 407,100,525 |
| 1 - 3 months | 948,492,038 | (214,550,368) | 733,941,670 |
| 3 - 12 months | 1,525,266,889 | (345,017,732) | 1,180,249,157 |
| 12 - 60 months | 4,073,511,806 | (921,434,677) | 3,152,077,129 |
| > 60 months | 530,713,181 | 2,000,000,000 | 2,530,713,181 |
| | **9,372,385,642** | - | **9,372,385,642** |
| | | | |
| Attached Shares | | | 9,396,690,408 |
| Original Liquidity | | | 34.51% |
| Revised Liquidity | | | 26.70% |
| Liquidity Reduction | | | 7.81% |

| Investments by duration | Amount € | €3bn Social Housing Investment € | Revised Amount € |
|---|---|---|---|
| On Demand | 1,570,123,343 | (532,746,497) | 1,037,376,846 |
| 1 - 7 days | 198,171,717 | (67,240,124) | 130,931,593 |
| 7 - 31 days | 526,106,668 | (178,509,214) | 347,597,454 |
| 1 - 3 months | 948,492,038 | (321,825,551) | 626,666,487 |
| 3 - 12 months | 1,525,266,889 | (517,526,598) | 1,007,740,291 |
| 12 - 60 months | 4,073,511,806 | (1,382,152,016) | 2,691,359,790 |
| > 60 months | 530,713,181 | 3,000,000,000 | 3,530,713,181 |
| | **9,372,385,642** | - | **9,372,385,642** |
| | | | |
| Attached Shares | | | 9,396,690,408 |
| Original Liquidity | | | 34.51% |
| Revised Liquidity | | | 22.80% |
| Liquidity Reduction | | | 11.71% |

# 7. Expansion of Regulatory Investment Guidance Note

## 7.1. The 2006 Guidance Note for Investments

7.1.1. The types of investments that credit unions are authorised to invest in is set out by regulation. The Central Bank of Ireland issued a Guidance Note in 2006 which provided a framework for the investments that credit unions are authorised to invest in.

7.1.2. The list of authorised investments is as follows:

| Investment Framework |
|---|
| Class 1 Irish and EMU State Securities |
| Class 2 Accounts in Authorised Institutions |
| Class 3 Bank Bonds |
| Class 4 Investment In Equities |
| Class 5 Collective Investment Schemes |

7.1.3. Collective Investment Schemes are defined as follows :

> *"Units or shares in open-ended retail collective investment schemes, other than property schemes, authorised by the Financial Regulator"*

## 7.2. Necessary Expansion to the 2006 Guidance Note for Investments

7.2.1. Collective Investment Schemes are clearly authorised investments. However, property schemes are specifically excluded.

7.2.2. In order for a social housing scheme to be authorised, the Class 5 Collective Investment Schemes would need to be expanded, along the following lines (see underline):

> *"Units or shares in open-ended retail collective investment schemes, <u>including Approved Housing Body property schemes, but excluding all</u> other property schemes, authorised by the Financial Regulator"*

## 7.3. Likely Regulatory Considerations In An Expansion to the Guidance Note

7.3.1. The overarching duty of the Regulator is set out in S.84 of the Credit Union Act 1997 as follows:

> *The Registrar shall administer the system of regulation and supervision of credit unions provided for by or under this Act with a view to—*
> *(a) the protection by each credit union of the funds of its members, and*
> *(b) the maintenance of the financial stability and well-being of credit unions generally*

7.3.2. In this regard, the likely considerations of the Regulator are likely to be the impact that a social housing scheme would have on the safeguarding of member funds and the stability and well-being of credit union in general. In this regard, it is likely that any regulatory analysis would centre on key risks, namely counterparty risk and liquidity risk. Therefore, points made in the risk analysis made in Section 6 of this report would be central to any analysis.

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