

Revolving Loan Fund for Community-Led Housing Schemes - Financial Transaction Capital

1. Summary

The biggest barrier faced by people wishing to develop Community Led Housing (CLH) in Wales is access to suitable funding including; pre development, land acquisition, secured lending and grant intervention for affordable (if not developing with an RSL partner).

Creating a revolving loan fund (the Fund) using financial transaction capital would allow the pipeline of existing groups to progress their schemes, and help develop a thriving community led housing movement across Wales.

The Fund would enable the CLH movement to; increase the provision of additional affordable housing, maximise and retain locally the social and economic benefits of development, and sustain the infrastructure of dedicated (accredited) community led professional support that exists in Wales.

The Fund would deliver an overall positive net present value to any funding from the Welsh government.

2. Scoping.

A study was undertaken to scope the use of Financial Transaction Capital to create a revolving loan fund to increase provision of affordable housing delivered by co-operative and community led housing by addressing key financial barriers.

The development of new homes is a capital-intensive activity, that requires significant amount of upfront financial resource and investment, and which often poses challenges for established, well capitalised businesses. Community Led Housing (CLH) groups face a range of additional funding needs and challenges, reflecting the fact that many groups are relatively new, lack a track record and are under-capitalised as a consequence of either not have a significant existing asset base, equity capital or alternative income streams which can be leveraged.

Despite these challenges, CLH in all its forms is successfully making an increasingly important additional contribution to new housing supply in areas where many of the barriers to delivery have been addressed. One of the most significant barriers is the ability to access appropriately priced and structured finance through the development process.

Based on analysis of the existing funding landscape, there are a number of key barriers facing groups in Wales. These include:

- Shortage of grant funding/risk capital for covering upfront pre-development costs such as site searches, development appraisals and undertaking planning applications;
- Lack of dedicated funding for land acquisitions, in particular to allow groups to secure non-public land;
- Low depth of market for secured lending with groups often reliant on a small number of specialist social lenders;

- Lack of a single financial pathway, with groups reliant on making multiple applications to multiple different funders;
- Absence of grant for groups looking to deliver affordable housing but who are not registered social landlords.

The impact of these financial barriers is significant, and often acts as the major impediment to allowing highly motivated groups from being able to deliver the affordable housing they wish in their local area. To deliver schemes groups are often forced in to partnership with organisations, which in many cases reduces the benefits retained locally by the community and to the detriment of the affordability of the units delivered.

3. Addressing the Challenges

We are proposing Welsh Government supports the creation of a revolving loan fund (the Fund). The vision of the Fund would be to:

- Increase the provision of additional affordable housing across Wales delivered by Community Led Housing groups by addressing the key financial barriers facing groups.
- Support groups to maximise and retain locally the social and economic benefits of development by allowing groups to deliver schemes independently and at lowest cost possible.
- Reinforce the growing infrastructure of dedicated community led professional support that exists in Wales.
- Deliver finance in a form that preserves capital over the life of the Fund and delivers an overall positive net present value to any funding from the Welsh government.

The fund will look to provide finance to Groups at three distinct points in their development journey to address the key financing challenges that arise from the under-capitalisation of groups, combined with the absence of significant levels of grant and appropriately priced risk capital/equity. The Fund has been developed with the aim of addressing gaps in existing financing landscape and thereby would look to work with existing senior bank lenders and other funders to ensure that the nature of finance offered is supportive, and does not crowd out existing offers.

4. The Fund

The Fund will look to offer the following loans:

1. Pre-Development Loans: These will be available to groups to cover the professional costs associated with developing site appraisals, securing an option on land, submitting planning applications and procuring contractors. These loans will be unsecured and repayment would be outcome contingent – the Fund would write off loans in the event that a group was unsuccessful with a scheme, without recourse to any non-project assets owned by the group. Interest would be charged at a nominal fixed rate. Repayment would be due at successful sale/refinancing of the completed development.

2. Development Loans: These will be available to groups to cover the shortfall in funding available from development finance providers. Loans may be used to purchase sites, or cover construction costs not fully covered by senior development finance. Loans would be secured through a second charge over land/development. Interest would be accrued at a fixed rate set at a small premium to the senior lender, with interest paid on successful sale/refinancing of the completed development.

3. Long term mortgage finance: These loans will be provided to groups as a source of long term finance and bridge the gap between site valuations and maximum loan to values from senior mortgage lenders, once development had been completed. Loans would be secured on the property with a second charge. Interest would be charged at a fixed rate reflecting a small premium to the senior lender and paid on an annual basis. Principal would be repaid over a period of up to 30 years against an agreed amortisation schedule.

For schemes which fall outside of the criteria of senior mortgage lenders (potentially due to size, location or bespoke nature of scheme), the Fund would consider offering a senior first charge whole loan to an equivalent loan to value. The fund would look to preserve overall capital value over the life of the Fund, using interest earned to cover costs associated with bad debts and scheme administration.

5. Type of Housing

The Fund will be focused on the development of affordable residential housing. The Fund will look to support a wide range of potential tenures and housing types which meet demonstrable local need.

The Fund will provide finance to qualifying CLH Groups who are targeting development that meets the following conditions:

- Housing that meets demonstrable local housing need;
- Housing that is affordable. Groups will need to demonstrate that the aims of their housing development is to deliver homes that are affordable either in relation to the local community and the individuals in housing need, or in relation to local planning policy;
- Affordable housing allocation should aim to exceed that required under standard local planning policies or if these are absent at least the maximum of either 40% of units or 40% of habitable bedrooms;
- Where the development is not able to deliver on target affordable levels, that there is clear economic and social rationale for the development and articulation of the additional social impact and charitable objectives the development will achieve relative to a benchmarked of a typical private market development in the equivalent local context;
- The Fund will support developments that have an element of mixed development (market alongside affordable housing) if the market element is being used to cross-subsidise affordability.

6. Management of the Fund & Modelling

The Fund could be managed by The Development Bank Wales and would be self-financing.

Two sets of financial models have been developed to show accumulative peak investment required, the Fund breakeven point and potential number of homes developed.

1. Baseline model

Cumulative funding peak need Year 5 = £12,650,000 (max requirement of FTC monies)

Cumulative operating cash flow breakeven Year 13 (payback date for working capital)

Potential number of homes delivered 253

2. Extended financial model (preferred option)

Cumulative funding peak need Year 19 = £25,000,000 (max requirement of FTC monies)

Cumulative operating cash flow breakeven Year 15 (payback date for working capital)

Potential number of homes delivered 1200.

Author Jocelle Lovell - Interim Head of Inclusive Communities - The Wales Co-operative Centre in partnership with Tim Rothery of Structured Solutions Ltd.

The scoping work was undertaken by Tim Rothery of Structured Solutions Ltd and The Wales Co-operative Centre.

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