Housing Alliance

Potential Changes to the Investment Framework for Credit Unions

Consultation Paper CP109

June 2017

Introduction

The Housing Alliance is pleased to have the opportunity to make a submission on CP109 on potential changes to the investment framework for credit unions. Our group (Clúid Housing, Co-operative Housing Ireland, Oaklee Housing, and Respond!) represents four of Ireland's largest housing providers and potentially the most significant customers of credit union investment in Approved Housing Bodies (AHBs).

We strongly support the proposed inclusion of Tier 3 AHB delivery as a permitted investment class for credit unions. Credit union investment can help to deliver their own community development objectives and to assist AHBs in meeting delivery targets set in national housing policy.

More widely, the Housing Alliance recognises the vital role played by credit unions as financial service providers for many of our tenants. We are of the view that the development of the proposed investment class will assist in securing the long-term viability and vitality of the credit union movement.

In this submission we note that:

- Diversification of credit union investments is necessary to balance credit union investment portfolios, improve returns, and enhance dividends to members,
- Social housing provision is supported as an investment class by the 1997 Credit Union Act,
- Tier 3 AHB housing provision, backed by the Payment and Availability Agreement, (P&AA) represents an exceptionally low risk investment opportunity for credit unions,
- An SPV offers the most sensible mechanism to pool and manage credit union investments in housing provision,
- A concentration limit would allow for credit unions to broaden their investment portfolios while maintaining liquidity requirements,
- A 30 year maturity limit would link AHB investments more clearly to P&AA term lengths.

Housing Alliance

The Housing Alliance is a group of four national housing associations: Clúid Housing, Co-operative Housing Ireland, Oaklee Housing, and Respond!

Members of the Housing Alliance are responsible for approximately 12,500 social housing tenancies which represents over a third of all housing provided by Irish housing associations. We have built up a very substantial body of expertise in all aspects of development, housing and property management.

The Housing Alliance represents some of the largest developing Approved Housing Bodies (AHBs). Our four organisations will be responsible for a considerable proportion of all new social housing delivered. In 2016 the spend on social housing by AHB's was All four are regulated as Tier 3 AHBs by the Regulation Office of the Housing Agency and are approved for lending by the Housing Finance Agency (HFA). We have a collective housing delivery pipeline in excess of 6,000 new social housing units planned for the coming three years. This pipeline of supply gives confidence that there is a market for the borrowings. The

Housing Finance Agency had advanced loans of €190m to AHBs by the end of 2016 and approved a further €260m in loans in the same year.

Housing funding

As noted by CP109, traditional AHB delivery was previously supported through the provision of capital grants. General needs housing was supported by the Capital Loan and Subsidy Scheme (CLSS), which was discontinued at the end of the last decade. Specialist housing (older people, people with disabilities, homeless accommodation, etc.) continues to be supported by the Capital Assistance Scheme. Both schemes provide mortgage based finance with the mortgage paid by the State while the housing remains available to its client group. Through these schemes members of the Housing Alliance have developed a significant asset base, valued at in excess of €1.2 billion, with net assets of more than €200 million.

Since the end of CLSS, delivery supported by the Capital Advance Leasing Facility (CALF) and Payment and Availability Agreements (P&AA) has been the primary source of new general needs housing supply. CALF is a low interest, unsecured loan of up to 30 per cent of the value of the project, provided by the Department of Housing, Planning and Local Government (DHPLG) repayable at the end of the term.

The remaining value of projects is funded by AHBs using external finance. Repayments of these loans are supported by the P&AA, which is provided by DHPLG through the Local Authority at a level linked to market rents and reviewable at four-yearly intervals in line with the CPI. Importantly, the P&AA allows for continuation arrangements in the event of AHB failure, ensuring that the payments and service to tenants will be seamless.

All members of the Housing Alliance are approved for borrowing by the HFA and have drawn down funds from the HFA/EIB. Members have also been able to access other private finance from non-State providers. The capacity of members of the Alliance to engage with alternative finance arrangements is demonstrated by a track record of delivery with more than 3,000 homes provided in the years since 2010.

Housing delivery

The national housing action plan, Rebuilding Ireland, identifies AHBs as key delivery partners for new social housing, recognising “their track record both in terms of housing provision and management”. This builds upon support for the sector in the 2011 Housing Policy Statement and 2014 Social Housing Strategy. There is clear and ongoing Government policy support for AHBs playing a central role in social housing delivery.

As a response to the policy imperative to support increased housing supply, the Housing Alliance has developed a strong pipeline of new housing projects. These include traditional construction on AHB-owned sites but also includes procurement of ‘turnkey’ developments, refurbishment and regeneration projects delivered on behalf of Local Authorities, and other forms of delivery partnership. Many of these alternative forms of delivery reduce or eliminate the risks associated with traditional construction projects.

All schemes proposed for CALF and P&AA funding undergo a rigorous internal project assessment process. This process is linked to detailed development plans and financials modelled with the individual entities 30 year plans. The approval of the Local Authority is sought through the planning process and through the confirmation of housing need to mitigate the demand risk of the proposals. A value for money assessments is also undertaken by the Housing Agency, with oversight from DHPLG.

Credit Unions

Credit unions perform a vital role in local communities across Ireland. As social housing providers, we recognise the key role that credit unions play in promoting sound money management, in providing access to travel, education, and home improvements, and in tackling the challenges associated with money lenders. The ongoing sustainability of the credit union movement is vital to us and to the tenants we represent.

The challenges facing the credit union movement are set out in the consultation paper and include low levels of lending to members and low rates of return from the investments permitted under the current regulations. Combined, these have led to low levels of income for the movement with associated low dividends for members on their savings. While credit unions have embraced the need for change with mergers and rationalisation, there remains a threat to the long-term sustainability of the movement without increased lending or diversification of investment.

The proposed addition of investments in Tier 3 AHBs as a permitted investment class offers the opportunity for higher yields for local credit unions than are possible under the current range of permitted classes. Crucially, it would also allow for credit unions to invest in a highly visible way in the delivery of services of value to the local community, and to strengthen their bonds with their members.

The proposal is in line with government policy, set out in the key recommendation in Rebuilding Ireland: "the government should seek to mobilise as quickly as possible, all possible sources of funding, including funding from the Housing Finance Agency, Irish Strategic Investment Fund, the Irish League of Credit Unions, and Irish Pension Funds to increase the supply of social and affordable housing".

Consultation Responses

1. Do you have any comments on the current level of diversification in credit union investment portfolios? Are there any barriers to the use of existing diversification options within the current investment framework? If so, please provide details and any suggestions to address these.

We recognise and support the need for credit unions to have adequate liquidity levels. However, the current investment framework set out in the 2006 Guidance Note on Investments is highly restrictive for credit unions. The current environment of historically low ECB interest rates, result in poor returns to credit unions on investments. Combined with low rates of lending, these investment restrictions have resulted in lower income levels for credit unions than could otherwise be achieved. We are of the view that over the longer term these low rates of return represent a threat to the viability of the movement.

If adequate safeguards are put in place, we view investments in Tier 3 AHBs as a secure way of increasing the diversity of credit union investments, delivering greater returns to members and improved social outcomes.

2. Do you have any comments on the potential introduction of additional investment classes for credit unions and the appropriateness of the classes being considered by the Central Bank?

We support the introduction of Tier 3 AHBs as an additional investment class (see questions 8 – 13, below).

Questions 3 - 7

We have no comment to make on the potential for additional investment classes, or supranational and corporate bonds.

8. Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale.

The Housing Alliance does believe that it is appropriate for credit unions to undertake investments in Tier 3 AHBs.

The consultation paper notes that at the end of 2016, credit unions had assets of €16.1bn, loans of €4.1bn, and investments of €11.4bn. Given the range of permitted investments under the 2006 Guidance Note, it is clear that the movement as a whole has more than adequate levels of liquidity and is suffering from falling rates of investment income. Diversification of the investment portfolio can be undertaken to provide for improved investment returns and a more varied maturity profile.

A more diverse range of investment opportunities was envisaged by the Commission on Credit Unions and reflected in the 2012 Act. Section 43 (3) of the 1997 Act allows for investments in projects "of a public nature".

Investment in Tier 3 AHBs would provide for the development of social and affordable housing for households in housing need. Investing a limited portion of credit union funds currently on deposit at banks would provide a higher rate of return, change the maturity profile of investments, retain the security of the investment and deliver key social objectives.

For the AHB sector, credit union investment would offer a welcome additional finance option alongside the HFA and conventional finance providers. It would assist in promoting credit unions to our tenants and would offer an opportunity to showcase the potential for local social investment by the movement.

9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?

As the level of social housing investment by any individual credit union is likely to be low relative to the scale of overall delivery, the Alliance is of the view that the most appropriate structure to pool and manage investments would be a Special Purpose Vehicle (SPV) established by credit unions themselves.

The establishment of an SPV would allow for the professional management of investment on behalf of credit unions by appropriately qualified financial professionals, thus reducing the risk to individual credit unions. Pooling resources would also allow smaller credit unions to access to the investment opportunity and could allow for flexibility in the maturity profile of individual investments.

10. What do you consider to be the risks associated with this type of investment and what mitigants do you feel are available to manage these risks?

The Alliance is of the view that investments restricted to loans backed by the P&AA and directed to Tier 3 AHBs represents a relatively low risk investment for credit unions. The structure of the investment, organised around CALF and the P&AA, provides a number of key safeguards for credit unions.

- Tier 3 AHBs represent the largest and most professionalised housing providers. AHBs in this category are subject to statutory oversight by the CRO or Registry of Friendly Societies, the Residential Tenancies Board, and by the Charities Regulatory Authority. All Tier 3 AHBs are also subject to regulation by the regulation office of the Housing Agency. Tier 3 regulation incorporates a rigorous financial standard since 2015 and will include an additional governance standard from November 2017. The establishment of the Housing Regulator on a statutory footing is expected imminently,
- All of the AHB members of the Housing Alliance have already secured access to HFA and EIB finance and to finance from conventional finance providers,
- A portion of all delivery costs are supported by CALF. CALF is a long-term, low interest, unsecured bullet loan provided by the State. The provision of this loan mitigates the level of exposure of the private lending party and provides them with a first charge on the financed property in the event of default,
- The primary source of funding for repayment of the loan is the P&AA. This is a State-backed income stream funding by DHPLG through the Local Authority. The P&AA is set at a proportion of market rent and is revised every four years in line with CPI. The agreement allows for continuation arrangements in the event of AHB failure, allowing for the Local Authority and/or another AHB to step in and complete the agreement,
- The P&AA is supplemented by rental income from the tenants of the properties. This differential rent is set by reference to the Local Authority rent scheme and provides for the management and maintenance of the properties, tenancy management services, cyclical maintenance, and the development of a sinking fund,
- There is a high level of oversight of all project proposals including AHB internal processes as well as Local Authority, DHPLG, and Housing Agency approvals.

11. How can the ALM issues associated with such investments be addressed by credit unions?

The consultation paper notes that all credit unions are currently in compliance with liquidity requirements and that the movement as a whole is, on average, operating well in excess of the minimum requirements. The paper also notes the relatively short maturity profile of credit union investments as a consequence of the 2006 Guidance Note, with a majority of investments due to mature in one year or less. Finally, the “relative stickiness” of credit union savings is noted, with only a slight reduction in levels during the height of the financial crisis.

In light of the above, the Alliance is of the view that, subject to an appropriate concentration level (see question 12, below) investments in Tier 3 AHBs would represent a prudent diversification of the credit union investment portfolio with limited impacts on liquidity requirements.

12. Given the existing mismatch between the maturity profile of the sector's funding and assets and the likely maturity profile of such investments, the Central Bank is of the view that the concentration limit would need to be set at a level that reflects this. Do you have any views on what an appropriate concentration limit would be for such an investment? What liquidity and ALM requirements could be introduced to mitigate these risks and potentially facilitate a larger concentration limit?

As noted above, we believe that some level of concentration limit would be appropriate to ensure prudent investment management and to meet ongoing liquidity requirements. The Alliance does not have a view on the specific concentration limit that should apply.

13. Do you have any comments on the proposal to include investments in Tier 3 AHBs in the list of authorised classes of investments set out in credit union investment regulations with a 25 year maturity limit?

The Alliance notes that all credit union investments are currently subject to a maturity of limit of 10 years and, therefore, that the proposed maturity limit of 25 years represents a significant extension of the current maturity profile. However, as noted above, the repayment of the debt funding on CALF-backed housing projects is principally financed by the P&AA. For this reason, it appears sensible to link the maturity profile of the investment to the term of the P&AA. The typical term of a P&AA is between 25 and 30 years and we would propose that allowing up to a 30 year maturity limit for Tier 3 AHB investments.

Questions 14 – 17

We have no comment to make on counterparty limits or collective investment schemes.

Conclusion

The Housing Alliance is pleased to have the opportunity to contribute to the consultation CP109. We look forward to engaging with the future development and delivery of proposals in this area. We would welcome the opportunity to meet to discuss the potential contribution of AHB delivery as an investment class for credit unions in more detail.

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Housing Alliance

Background information

What is the Housing Alliance?
The Housing Alliance is a group of larger developing Approved Housing Bodies (AHBs) which together provide housing for more than 12,500 households. Our current members are Clúid Housing, Co-operative Housing Ireland, Oaklee Housing, and Respond! Housing Association.

Housing Alliance members are currently responsible for approximately 12,500 tenancies which represents over a third of all AHB dwellings and we have an ambitious development programme with more than 6,000 homes in the pipeline.

What are AHBs?
AHBs are independent not-for-profit providers of high quality rental housing, mainly for people from local authority housing waiting lists.

All four members of the Alliance are 'Tier 3 AHBs', subject to the highest level of regulation by the Regulation Office of the Housing Agency.

Why have you come together?
We have come together because, as larger developing AHBs working to meet pressing housing need, we have a number of specific common interests. We believe that promoting agreed policy positions on selected issues collectively is more likely to have an impact than if we advance these issues individually. We also believe we can benefit from shared good practice in a number of areas such as development of new housing, housing management, and housing finance.

The Housing Alliance, for the first time, brings together leading bodies from both the voluntary and co-operative sectors who are focused on growth and delivery.

What are you trying to achieve?
Our overall aim is to push for changes that will lead to an increased supply of high quality rental housing; and to ensure that our existing housing and property management standards are continuously improved for the benefit of the communities we serve.

How was your group formed?
We had been sharing information and meeting informally for some time, and it became clear that a more formal arrangement would enable us to strengthen our links together.

Will membership of the Housing Alliance change in the future?
We hope that as the AHB sector continues to develop, other AHBs with common interests will join the Housing Alliance.