Social Housing Finance Conference (12 May 2016)

Sir Merrick Cockell: 'How do funders view the sector today?'

Good afternoon.

In my experience it's always a risk to agree to a speaking engagement close to an impending election and even more so to speak just after one.

This is particularly true if the topic has been raised by the candidates during their campaigns.

The danger can be rushing in changes to your script as you take in to account the victor's stance, incorporating last minute surprises, or analysing if something central is to their policies or just a campaign promise,

So while I'm going against my better judgement today, thankfully I needn't worry about any of the problems I've raised.

Housing has been central to Council elections across the country, particularly in London.

- Both the main mayoral candidates led their campaigns with housing.
- Both have promised to build more than 50,000 new homes a year.
- And both have campaigned on making these houses affordable.

In fact Sadiq Khan and Zac Goldsmith's names could have been completely interchangeable in my speech given housing's prominence and the large targets the candidates set.

So now that the circus of an election is over, it's time that the new Mayor needs to honour these commitments.

Meeting them will be no easy feat.

However, given that I am Chairman of London City Hall's pension fund, I'm expecting a call shortly to have this very discussion….

And it's a call that is welcome.

We believe housing plays an important part in pension funds' investment portfolios due to the long term cash flow profile and inflation linked characteristics.

Pension funds need to think about their liabilities as much as their assets. They need to have a clear view of how much they owe and when liabilities are due in order to know what level of returns they need to make and in what time frame. The focus needs to be about taking a real long-term, strategic approach to identify and invest in quality assets.

As the Chairman of the LPFA I represent one of the 89 pension funds that make up the Local Government Pension Scheme.

With the exception of the LPFA and the Environment Agency, all these funds are owned and administered by Local Authorities – bodies that are direct beneficiaries both financially and socially, of social housing.

The provision of social housing involves a variety of stages and more thought is needed than just throwing money at the problem.

In our experience investment is difficult. For example, we are investing approximately £60m for around 150 units in a housing development in East London. This project has been progressing for nearly two years.

Now, for a £5bn pension fund, that doesn't really represent a huge amount of value given the time and effort involved.

What funds need in order to see value in these projects is that they are of sufficient scale. This is obviously difficult for social housing, with much of what is viewed being individual projects, such as flats.

Secondly, long-term capital – like pension funds – does not like too much risk. Therefore, investing from the start of a development is not likely to be very productive.

In order to contain much of the planning and construction risk we need qualified partners who are more knowledgeable and capable of managing development risk, such as housebuilders. But these sources of capital are not long-term – they want to finish a development and then recycle their capital in order to move on to the next project.

Indeed, for the scale of development that is required to take place, it is vital that the model adopted addresses the need for development risk capital to make appropriate profits and then be recycled, quickly.

Therefore, an efficient 'production line' needs to be established. This ensures that the limited risk capital available is recycled rapidly to finance further development and the long-term capital – which is much lower cost – comes in as soon as development is finished in order to benefit from the long-term income.

The shorter the period that risk capital is in play, the lower the overall cost of development and the more houses can be built in a given timeframe.

Planners can therefore play their part by supporting a sensibly financeable approach to provision. Being unrealistic or inflexible about the type of affordable housing that the market may be able to support or insisting on a particular source of capital for the long-term ownership might stifle plans to deliver affordable housing that are in fact financeable or economically viable in the long term.

Responsible councils also need to consider where the risk of rental arrears will fall. If that risk is pushed towards long-term providers of capital, then there will be less money available, and that which remains interested will demand a higher return for their money.

So, either councils have to take on and manage that risk themselves, or they need to promote projects that reduce the risk, such as the shared ownership model.

Later today you will hear from Trevor Castledine from Lancashire County Pensions Fund regarding shared ownership. The Fund's approach to investing in social housing through a 'captive' non-regulated housing association is a good example of this.

Housing associations represent long maturities at reliable rates which provide the necessary predictability for pension funds. In addition they provide an underlying asset that provides a social benefit for a Local Authority.

I am also Chairman of the UK Municipal Bonds Agency.

The UKMBA aims to reduce local authority reliance on Treasury funding and provide cheaper borrowing. In time it will facilitate inter local authority borrowing and access to other funding sources and help access capital funding below their minimum loan size thresholds.

This means that no matter what houses UK councils are looking to build, from social, affordable or market, the UK MBA can support them and reduce their financing costs.

It is also agnostic to the underlying use of funds, which essentially means that bonds can be tailored to meet councils' needs. Be that inflation linked housing bonds, a very attractive asset class for pension fund investors, or assisting local authorities looking at lending to registered social landlords directly.

In addition, if local authorities are establishing their own housing companies; the UK MBA could be used as a source of finance.

This will help local authorities invest capital in local priorities, such as housing.

In time, the agency will also look to allow local authorities to lend to each other, matching lending and borrowing needs, and cutting out the middleman. In future, I'd like to see retail bonds so that individuals as well as institutions can invest directly in their areas, see decent returns but also see the social benefits in housing.

This, combined with capital from the pension sector in appropriate projects, would almost certainly help many stalled initiatives become a reality.

Thank you.