<u>Finance/business journalist of the year:</u>

Housing regulator to inspect finances of dozens of specialist HAs after First Priority problems

This exclusive story was about the housing regulator launching an investigation into the financial viability of around 30 small housing associations.

Through my contacts, I obtained a copy of a letter that the regulator had sent to the leadership teams and boards of these organisations.

The story revealed how the regulator was taking action in response to the emergence of a new finance model among smaller associations, and the potential ramifications for the financial reputation of the entire sector. With £80bn of private finance invested in the market and a 'no loss through default' record, the collapse of a housing provider has the potential to impact the wider sector's availability and cost of finance, and hence, investment in new and existing social housing.

I broke this online and we ran an updated version on the front page of the magazine, also enclosed in this submission.

UK's largest HA leaves SHPS

I was first to report news of the country's biggest housing association leaving the sector's main pension scheme.

The Social Housing Pension Scheme is a multi-employer, last man standing scheme, so the departure of Clarion is significant to all 500 of its members.

It comes at a time when pension deficits are a major area of focus for housing associations, and against a backdrop of Plcs running into controversy over the way they have managed pension schemes.

Having broken stories of three other HAs leaving the scheme already, this was another major finance scoop.

This demonstrates the value and mission of a specialist housing finance magazine – the ability to find and spot the big story, understand it, build it out and deliver an exclusive, in-depth report that has major significance for the wider audience and sector.

Interview: Luminus looks to a 'brighter future'

This exclusive interview set out the underlying reasons for the financial difficulties of a housing association that had previously garnered headlines about its eccentric leadership, and its subsequent rescue by a much larger provider.

While so much before this had focused on personalities, this was about the finance, which was ultimately the root cause for the viability issues, regulatory action and takeover.

Crucially, it explained the connection between safety issues and its weak financial position.

While the unique culture of the organisation had often been the focus in the press, this piece explained how that impacted financial management.

Through a combination of interviews, off-record steers and digging into financial documents, I was able to provide the finance story behind the colourful headlines.

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SOCIAL HOUSING

FINANCE, BUSINESS AND GOVERNANCE IN HOUSING VOL 30/NO 5/MAY 2018

Regulator homes in on lease-backed HAs

Getty

by **Luke Cross**

The English social housing regulator is taking a "closer look" at lease-backed specialist housing associations in the wake of First Priority Housing Association's financial troubles.

The Regulator of Social Housing (RSH) has also warned that while it remains committed to protecting the social housing sector's financial stability, it "cannot magic up value where it doesn't exist".

Simon Dow, the new chair of the Regulator of Social Housing, gave his first public speech at the Social Housing Finance Conference in early May, with a comprehensive overview of the risks facing the sector.

Along with the concentration risk of 11 large associations owning a quarter of the sector's stock, one area of focus is new and emerging business models (see p10).

Addressing the conference a fortnight after the RSH wrote to around 30 specialist associations to seek assurances on finance, lease and governance structures, Mr Dow said the plan is to "take a closer look at this area to make sure we have as good an understanding as we can".

Speaking about its role in protecting the stability of the sector, Mr Dow said there may be instances where the RSH might not be able to resolve situations as they have done in the past, particularly where there is "no value in the registered entity".

He said: "We have never offered guarantees to lenders and we do not intend to begin now. We'll always do what we can to protect tenants and creditors, before the worst happens and indeed afterwards – but we can't magic up value where none exists."

As revealed by *Social Housing*, the RSH contacted dozens of associations at the end of April that it identified as having similar lease-based financial arrangements to First Priority, whose financial difficulties were revealed in February. It is focusing in particular on specialist supported housing RPs which have leases in place with investors and delivery partners, as opposed to traditional housing associations with asset-backed funding structures.

In the letter, seen by *Social Housing*, the RSH says it has been carrying out work to look more closely at organisations with fewer than 1,000 homes, which are typically subject to a lower level of regulatory engagement. It says that "in light of the recent issues at First Priority", it will conduct "a tailored piece of work with a cross section of providers who we believe operate a similar model".

The RSH is looking for assurance that providers are financially viable and well managed, and has asked for documents such as budget, cashflows and lease information by 11 May.

The regulator also wants to see details on due diligence practices, board relationships and assurance processes. Some of the providers are the main housing operating partners to social housing real estate investment trusts, while others have relationships with property investors and private equity funds.

● **Continued on p7**

L&G to become a landlord

Legal & General (L&G) is vying to become the leading private affordable housing provider in the UK, as part of a plan to establish institutional investors as landlords.

The insurance, pensions and investment management giant is looking to shake up the "underinvested" affordable housing sector by launching its own for-profit registered provider, called Legal & General Affordable Homes, which plans to deliver 3,000 homes per year.

L&G's ambition is to create a sustainable funding model in which institutional investors are long-term holders of social housing assets, "working alongside best-in-class affordable housing operators".

While institutions have invested in the not-for-profit housing association sector through debt and long-dated bonds, it marks a new direction that would see a mainstream investor take direct ownership of housing assets.

The move also follows a flurry of equity investment in the affordable housing sector, with the launch of a number of social housing real estate investment trusts (REITs) and recent news of US private equity giant Blackstone taking a stake in a for-profit RP that has been buying up affordable homes via Section 106 deals.

Nigel Wilson, chief executive of Legal & General, said this "important sector" has now been added to L&G's plan to invest £15bn in infrastructure.

He said: "Affordable housing is a classic example of underinvestment with minimal new equity capital being deployed to the sector.

"This is not a sustainable position – either for the sector or for the 1.3 million households currently on a waiting list."

● **See p3 for more**

Housing regulator to inspect finances of dozens of specialist HAs after First Priority problems

NEWS 03 May 2018 BY LUKE CROSS

The English social housing regulator has written to around 30 housing associations seeking assurances around finance and governance in the wake of First Priority Housing Association's financial troubles.

The Regulator of Social Housing (RSH) has contacted dozens of housing associations which it has identified as having similar lease-based financial arrangements to First Priority, whose financial difficulties were revealed in February.

It is looking for assurance that registered providers are financially viable and properly managed, and is asking for documents such as budget, cashflows and typical lease information, by the end of next week.

The regulator is also asking whether any conflicts of interest have been identified. It wants to see details on due diligence practices, board relationships and assurances process.

It is focusing in particular on specialist supported housing RPs which have leases in place with investors and delivery partners, as opposed to traditional housing associations with asset-backed funding structures.

Recipients of the letter include a number of providers offering specialist care services for vulnerable adults, such as Falcon Housing Association and Westmoreland Supported Housing, Harbour Light Assisted Housing, Trinity Housing Association, Encircle Housing and Empower Housing Association, among others. All those associations have been contacted by *Social Housing* for comment.

Some of the registered providers in receipt of the letter are the main housing operating partners to social housing real estate investment trusts (REITs), including Civitas Social Housing and Triple Point Social Housing REIT, with whom they have long-dated, index-linked lease arrangements.
Some of the associations that received the letter also have relationships with other property investors and private equity funds.

In the letter, sent last week and seen by *Social Housing*, the regulator says it has been carrying out work to look more closely at organisations with fewer than 1,000 homes, which are typically subject to a lower level of scrutiny such as its in-depth assessments, stability checks and regulatory judgements.

It says that "in light of the recent, issues in First Priority Housing Association" it has decided to conduct "a tailored piece of work with a cross section of providers who we believe operate a similar model".

The RSH's head of small providers, Chris Meskill, requests a number of financial documents, along with detail on of a 'typical' lease and any nominations agreements and "a summary of any potential or actual conflicts of interest which have been identified".

The letter also asks for answers to a number of questions, such as the level of due diligence and other information the board receives before it makes the decision to enter into a new lease or nomination agreement; information the board receives to give its members assurance key risks are managed; and how the board identifies and manages "any actual or potential conflicts of interest".

The regulator's call for detail on leases has followed repeated warnings to associations about understanding the risk inherent in their financial arrangements, particularly where there is a correlation between rental income from tenants and indexed payments to third parties.

Jonathan Walters, deputy director of strategy and performance at the Regulator of Social Housing, told *Social Housing*: "We will be interested to see what we get back from the other providers. It is possible that none of them will share the issues at First Priority HA and they are all well managed, strong, financially robust businesses."

Mr Walters added: "As well as seeking assurance, we will also be looking at governance along with risk management, and asking whether their boards are acting in the best interests of their organisation."

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First Priority uncertain over financial future, latest accounts reveal

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New regulator warns against forgetting social purpose

First Priority's financial troubles were set out in a regulatory notice saying the HA was relying on the "goodwill" of its creditors and lease counterparties as it attempts to unravel a "matrix" of financial difficulties.

The HA – which has 26 landlord counterparties across 227 properties with 759 tenancies in place – saw its leadership and board replaced, with sector treasury specialists placed as non-executives.

Restructuring experts Begbies Traynor have been appointed and there is understood to be ongoing dialogue between five freeholders and the HA about whether the former will take a reduction on their lease income.

One option could for the freeholders – which include Civitas Social Housing and social impact investor Funding Affordable Homes – to take ownership of the properties and pass management to another landlord. As First Priority has no assets, it is unlikely to be a target of a takeover.

Civitas has paved the way for social housing REITs since its £350m float in November 2016, and has since successfully raised hundreds of millions more.

It was moved to reassure the financial markets earlier this year about First Priority, saying it was in "active dialogue" with the HA and that "any inability" for the HA to meet its lease obligations on 45 properties was "currently not expected to impact the company's dividend targets".

Responding to last week's letter, a spokesperson for Civitas said it works with 13 housing associations and seeks to build long-term relationships with all its partners.

He pointed out that supported housing is now typically provided and managed by housing associations that have been established over the past decade and are now growing in size, working closely with local authorities to meet urgent needs.

He said: "We work closely with all our housing association partners to encourage best practice and an institutional-standard approach.

“We ensure that a detailed programme of due diligence is undertaken. This commences with understanding the commissioning and demand needs of each local authority, together with the needs of specific individuals. “We consider the underlying long-term supply of and demand for specialist supported housing and then benchmark the rents.”

The spokesperson added: “We care passionately about the long-term, positive role that Civitas and private capital can play in the sector and we will continue to ensure that we achieve both sustainable economic and social outcomes.”

Max Shenkman, head of investment at Triple Point, said: “We maintain an active dialogue with the regulator and view their request for information from some of the housing associations with whom we work as a positive. The regulator’s questions are similar to those that we ask as part of our ongoing due diligence and review of the housing associations we lease assets to.”

He said the company is focused on funding supported living properties that are newly developed, “with sustainable rents that enjoy strong local authority support”.

“We will continue to work with selective housing associations to develop new supported housing stock in order to house vulnerable tenants in the UK, “ he added.

Care and support finance

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Luminus looks to a 'brighter future'

Huntingdon-based provider set for a name change as it looks to leave the past behind after joining the Places for People group. **Luke Cross** finds out more

A name change is on the cards for Luminus as it looks to break from its past.

The 7,600-home Huntingdon-based provider joined the Places for People (PfP) group in February after a torrid few years which saw a damning regulatory review, the overhaul of its leadership team and a £47m write-off on a commercial investment.

A new board proposed merger as the way forward, due to the association's limited financial and staff resources.

Since then, PfP has helped Luminus streamline an over-complex structure, including parting ways with development partner Almaren Ltd, which has itself fallen into administration.

So how else will PfP help Luminus change from an organisation that has continually booked a deficit – rising to a £53m loss in 2017 – and builds 100 homes a year, to a financially stable one that delivers 1,000 properties over five years?

Social Housing spoke to Nigel Finney, now managing director of Luminus, and David Cowans, group chief executive of PfP.

Learning from what went wrong

By early 2017, Luminus had exposed its tenants to the risk of serious harm, with a treasury position that was unsustainable. The two shortfalls were linked.

Over the years, the large-scale voluntary stock transfer's response to its weak financial position was that it had prioritised customer satisfaction and staff motivation – and had "lead the entire housing sector" in occupational health and safety. But its lack of financial capacity meant it could not even replace all of its boilers.

Then Luminus found itself on the English housing regulator's grading under review list, before a downgrade to non-compliant for major failings across its governance and risk framework and allowing gas safety certificates to lapse across more than 1,000 of its homes. While most of the certificates were overdue for a short period, Luminus' board had not informed the regulator or understood the causes of the failure. An independent report by consultancy Altair flagged non-compliance on portable appliance testing; electrical installation certification; fire alarms and fire detection equipment, lifts, doors and more.

Alongside this, the regulator drew attention to a £48m commercial investment in an external property development company. The board had not shown it had properly understood the risks or benefits of the investment, effectively challenged or monitored it, or understood whether it was in fact delivering Luminus' objectives.

Dr Chan Abraham, Luminus' chief executive, left the group in June last year after 17 years, with Tom Miskell coming in as interim CEO. New board members were put in place. PfP's Mr Cowans and Chris Phillips also sit on the board today.

Mr Finney, who has been at the organisation for more than 15 years and was latterly director of operations, is now managing director of Luminus as a PfP subsidiary.

He says the regulatory process showed "what needed to change and what had gone wrong".

"What's important to me is that we have very clearly learned from these lessons and put things right," he tells *Social Housing*.

Mr Finney says the financial problems meant the group "did not have the capacity to deal with some of the issues of the past".

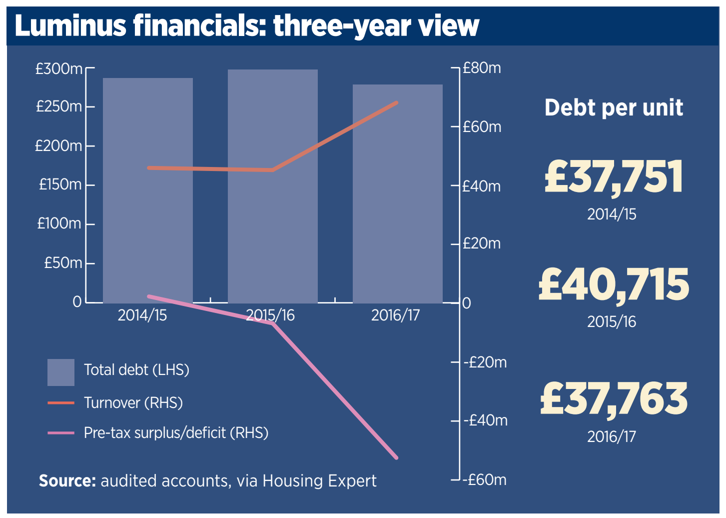
He also points to a significant cultural switch since then, triggered by staff shortly after Dr Abraham's departure.

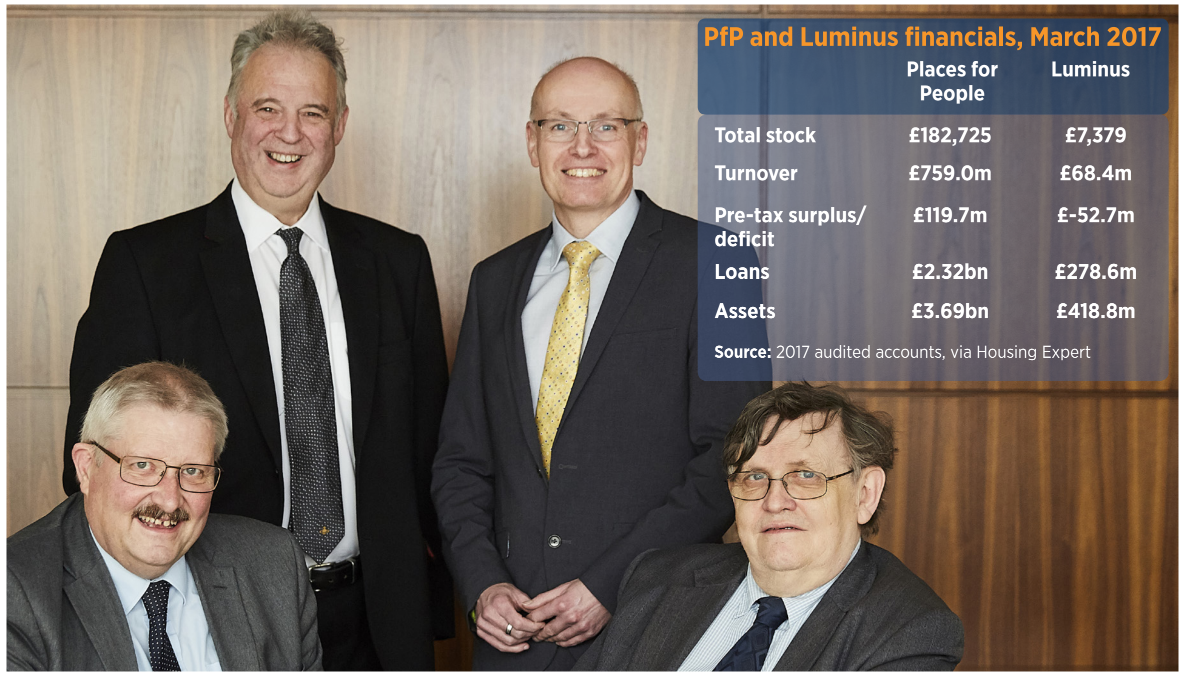
"We asked them about what they were feeling and what they would like to see change, and they came up with a range of suggestions," says Mr Finney, who adds that a key point was that the merger "was something they were part of, not something that was being done to them". It completed in eight months.

Mr Finney adds that the staff suggested a potential change of name. "They, we and the board see it as signalling a bright new future for Luminus," he says.

Mr Finney says that the safety issues flagged by the judgement had been resolved well ahead of the merger, by mid-January 2018. Work included new reporting systems, reorganising teams to put a greater focus on compliance, and new procedures. PfP has a "sophisticated" system where all subsidiary providers report into the centre on compliance, says Mr Finney.

He says he would expect the regulator to consider Luminus as part of its wider review of PfP.





PfP and Luminus financials, March 2017	Places for People	Luminus
Total stock	£182,725	£7,379
Turnover	£759.0m	£68.4m
Pre-tax surplus/deficit	£119.7m	£-52.7m
Loans	£2.32bn	£278.6m
Assets	£3.69bn	£418.8m

Source: 2017 audited accounts, via Housing Expert

From left to right: Luminus chair Mike Forrest, with PfP group chief executive David Cowans, Nigel Finney and Chris Phillips

He says Luminus was looking for an organisation that would bring "financial stability" while preserving a local presence in Huntingdon and Cambridgeshire, along with skills, resources and a track record of merger. PfP was also the most straightforward financial offer that could help Luminus resolve its "treasury difficulties".

Treasury and health and safety have been centralised to PfP, as with other subsidiary organisations under the PfP group 'partnership' structure.

Luminus will now benefit from back office support and savings, and PfP's treasury expertise, which has already helped it restructure its loans with main lender Nationwide Building Society.

Financial weakness

Luminus booked deficits for several years due to its high debt burden, significant debt servicing requirement on loans of around six per cent interest rates and lack of unencumbered security. It relied on the flow of completed new properties for headroom.

By 2015, the regulator reported that Luminus had incurred significant costs for loans which could not be accessed due to a lack of available assets as security.

The group had £240m with Nationwide Building Society – with which it also required annual business plan approval and had a cap on new homes it could sell – along with a £43m private placement with Canada Life and a £5m loan from Huntingdonshire District Council. A subsidiary, Luminus Finance, was the principal borrower, with money on-lent to other parts of the group. Luminus Finance also had two further unregistered subsidiaries: a commercial development company, Luminus Developments, and a social enterprise company.

In a bid to create an additional, non-regulated revenue stream, Luminus was anticipating returns from £48m of long-dated investments made from several parts of the group into a special purpose vehicle, Homes & Communities Finance (HCF2 Ltd), and the activities of development partner and private house builder Almaren Ltd.

The new Luminus leadership opted to recognise a £47.8m impairment on its commercial investments last year. It meant Luminus reported a £52.7m deficit in the last financial year to March 2017 (see chart, bottom left).

Almaren Ltd and three associated companies were placed into administration in February and March 2018. The administrator's report said the company had "mixed results" with projects and that the 2008 financial crash had "a significant, detrimental and lasting effect on the financial position of Almaren Group". The closing out of a financial derivative, agreed with Lloyds in 2008, had cost the company £20m. The report said a dispute with Luminus around funding also meant Almaren had to halt a flagship development scheme.

Following the takeover by PfP, Luminus' facility with Nationwide has been restructured, while the private placement with Canada Life and loan from the council stay intact.

As part of obtaining consent for the merger, PfP agreed to repay £60m to Nationwide, reducing the building society's overall exposure to the group. The breakage costs have not been disclosed.

Debt will stay with Luminus for the time being, but with a longer-term plan to bring Luminus into PfP's group of registered provider guarantors for its wider debt programme, as was done with Derwent Living.

Luminus Homes, which holds the majority of the group's stock, is set to change from a non-charitable registered provider to become a community benefit society, at which point Oak Foundation's sheltered housing stock will be transferred. Oak will become dormant. Other subsidiaries will be wound down, while the Ferry Project, which is a hostel and homelessness services provider, continues.

'Welcome to the ruthless pragmatic party'

A differential approach is welcome at PfP, as long as it works, says Mr Cowans.

"We're very happy with a differential approach, if it works. This is the world headquarters of the ruthless pragmatic party," he says.

"People who live in properties we provide deserve good standards. You don't find anybody, when you put it to them like that, who disagrees."

Luminus was the second organisation in 15 months to join PfP after being downgraded to a non-compliant rating by the Regulator of Social Housing. Derwent Living joined the group in December 2016.

Mr Cowans does not reject outright the description of PfP as a "white knight", but instead says the approach is a "well-worn and known strategy" where the group looks to find people running organisations with a "similar view of the world we do".

"We would fix them because we wouldn't want anybody managing stock if it's not done to the highest standards.

"The challenge for them is to bring their proposition to a quality that's commensurate to the group's quality."

PfP's partners will benefit from scale and retaining the local presence, with support to better manage stock where required. Treasury management is centralised, as is health and safety. Footprint also comes into play, with PfP keen to see its partners managing group stock in their local areas.

Mr Cowans rejects any suggestion of PfP targeting weaker providers.

"We'd be happy to talk to anybody. Cotman joined the group because it could see the arguments for mutual benefit; Derwent was between the two; and Luminus joined because it needed a different place to develop expertise and skills, and had a desire to make a difference in the world."

Cultural fit?

Much is made of cultural fit when it comes to mergers. There has been no shortage of headlines over the years about the culture at Luminus.

So would Mr Cowans suggest there is a cultural fit between PfP and Luminus?

"I'm suggesting that on the things that matter – the desire to provide good-quality properties and create places – there is.

> "We have an opportunity for an organisation to create itself in the image it'd like to have."
> **David Cowans, Places for People**

"I couldn't comment on what happened before, because I wasn't there. Am I massively interested? No. I'm bothered about moving forward."

He also rejects the suggestion that a culture put in place by a chief executive over 17 years takes time to overhaul.

"I think weak cultures dissolve fairly quickly, if you want my honest opinion. People are primarily focused on doing a good job, and if you can create something that's focused on doing a good job, people will quickly align with that."

He adds: "I don't think they would have done what they did if they weren't desirous of a different culture... They were seeking it."

Asked specifically about the previous regime, Mr Cowans goes as far as saying: "I wouldn't have done it like that."

"The reality is organisations are complicated, and made up of many people, and they are very focused on doing a good job. If you can tap into that, then that changes the culture for the good relatively quickly, in my experience.

"Now we have an opportunity for an organisation to remake itself; to create itself in the image it'd like to have – and we as a group are full-square behind them."

He adds: "Sometimes the past is best built away from; sometimes it's built on and sometimes it's built away from."

Fixing problems

Regulatory intervention flagged a number of serious shortfalls, including around safety. Mr Cowans says: "There needed to be much more of a focus on practical housing and maintenance activities, on what we call neighbourhood management – and I didn't hear anybody I spoke to disagree with that."

Referencing the Ferry Project for homelessness, he adds: "When you get beyond the rhetoric and into the practicality, there are some good things being done."

Staff and resources were provided to support putting this right quickly.

The PfP CEO has also been to see Huntingdonshire Council and other stakeholders about potential partnership and joint venture opportunities, which PfP has done elsewhere.

The main area was resolving some "very complicated" loan agreements, which Luminus could not have done on its own, adds Mr Cowans.

"We're not putting any cash in – we have restructured their position."

PfP divides its structure and treasury into registered and non-registered streams.

Bringing Derwent into the group set back plans to increase its unsecured debt. Luminus increased the overall proportion of secured debt by four per cent.

PfP says it has a continued "proactive approach" to increasing the unsecured proportion in the group, such as last year's secured bond buyback through the proceeds of an unsecured issuance.

The merger also sees the end of Luminus' investments and relationships with third parties, such as Almaren.

"They had a set of arrangements with a separate business which we don't think is necessary – and neither do they," says Mr Cowans.