Leveraging assets to reduce borrowing costs

experience from the

Co-operative Housing Finance Society in the UK

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CHFS was set-up in 1997 to do 3 things:

- to make it easier for new housing co-operatives to raise mortgage finance for new developments
- to reduce the margin on mortgage loans to new housing co-operatives
- to reduce the costs associated with setting-up mortgage loans for housing co-operatives
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It does this by doing 3 things:

- by enhancing the credit rating of loans to housing co-operatives by providing lenders with a twelve month mortgage interest guarantee;
- by standardising loan documentation and procedures to reduce the cost of raising mortgage finance, and
- by offering improved risk management through quarterly performance monitoring of CHFS guaranteed co-ops.
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It achieves this by leveraging primary housing co-op assets in the following way:

- Loans are secured on the **Open Market Vacant Possession** value of the co-operative’s housing assets.
- This enables **capital housing subsidy** to the co-operative to be used as security for the interest guarantee.
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Why?
Because commercial mortgage lenders:

- do not like “non-recourse loans”
- do not like lending to new organisations without a business and management track record
- do not want the task of monitoring a portfolio of relatively small commercial loans
- do not want the job of sorting out the risk of default should a breach of loan covenants occur
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How?
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Worked example: (Minster Housing Co-operative, Kent)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development costs:</td>
<td>£2,316,012</td>
</tr>
<tr>
<td>Capital subsidy:</td>
<td>£1,047,292</td>
</tr>
<tr>
<td>Net cost (mortgage):</td>
<td>£1,268,720</td>
</tr>
<tr>
<td>Open Market Value (OMV):</td>
<td>£2,272,000</td>
</tr>
<tr>
<td>Written-down OMV (72.5%):</td>
<td>£1,647,200</td>
</tr>
<tr>
<td>Residual equity (OMV- mortgage):</td>
<td>£378,480</td>
</tr>
<tr>
<td>12 months interest (7.123% 1999):</td>
<td>£82,678</td>
</tr>
</tbody>
</table>

Ratio – 12 months interest to residual equity = 4.58:1
The costs:

- 0.5% of mortgage principal charged and paid into CHFS guarantee fund
- 0.25% annual guarantee fee
- 0.5% of annual 12 month interest payable as annual fee to Co-operative Bank plc
- 0.25% payable to the bank as commitment (non-utilisation) fee
- small risk monitoring fee payable to CHFS
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The benefits:

- interest rate margins are lower – typically 0.85% over base rather than 1.5%
- set-up costs are lower
- loan documentation is standardised
- burden of annual monitoring of risk and administration of the loan is easier
- net savings for Minster of approx £5,500 per annum (£3 per household per week)
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The legal structure:

Mortgage Finance → Lender → Interest Guarantee

Fully mutual primary housing co-operative → Second Charge → CHFS

Management agreement with co-operative service agency

Coopers Lybrand performance monitoring

Charge over second charge

Standby cash facility

The Co-operative Bank Plc
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Where did the idea come from:

CHF Canada!
National Canadian Mortgage Insurance Fund
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The lessons:

- leverage your assets to arrange finance and reduce borrowing costs
- look to examples in other countries and adapt to meet your housing finance needs
- work to overcome concerns of commercial lenders and make lending for co-op housing an attractive commercial proposition
Where next?

- Possibility that CHFS registers as a Financial Service Provider to accept investments and become a prime lender in its own right
- Source ethical investments for new co-operative housing projects by issuing Co-operative and Mutual Housing Bonds
- Lending to Mutual Home Ownership projects
- Possibly using innovative mortgage financing such as the Canadian capital index linked loan
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