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Report

March 2021

Practical Implications of Negative Interest Rates for Affordable Housing Providers

Altair

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¹ This individual wishes to remain anonymous and comments do not reflect that of current MPC policy.

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About Altair

Altair Consultancy and Advisory Services Limited (Altair) is a specialist management consultancy providing professional services to local authorities, housing associations, charities, property companies, regulators and government departments. It advises on all aspects of the development and management of affordable housing for rent and sale, and on the effective management of organisations operating in this sector.

Altair is a wholly owned subsidiary of Aquila Services Group plc. which also includes Aquila Treasury and Finance Solutions Limited (ATFS) and Oaks Consultancy Ltd.

ATFS are specialist independent treasury advisers, providing a range of services to the housing, education and wider public sectors. They advise on debt, accessing the capital markets, interest rate risk management, treasury strategy and policy, strategic treasury management, joint ventures and funding for commercial subsidiaries. ATFS work both on bespoke projects and as retained advisers across the UK, and with particular expertise in the Scottish and Irish housing markets.

Oaks works with organisations across the sport, education, public and third sectors. Oaks provides support with strategy development, business planning, income generation and other critical business functions. They work with international sport-for-development charities, Premier League football clubs and National Governing Bodies of sport through to multi-academy trusts and schools.

Disclaimer

Altair was commissioned by the Research Sponsors to conduct a research review of the practical implications of Negative Interest Rates (NIRs) on the housing association sector. The views, findings and recommendations included in this Report are entirely those of Altair.

The Report is not for the purpose of guiding or influencing the conduct or decisions of any person and the Report should not be relied upon by any party without our written consent. Altair does not accept a duty of care to any person in respect of this Report or any actions taken or decisions made by any party as a consequence of the Report.

List of Abbreviations

Term	Abbreviation
Bank of England	BoE
Bank of England Prudential Regulation Authority	PRA
Chained Volume Measure	CVM
Consumer Price Index	CPI
Corporate Bond Purchase Scheme	CBPS
Energy Performance Certificate	EPC
English Regulator of Social Housing	RSH
Environmental and Social Governance	ESG
Existing Use Value - Social Housing (Valuation Method)	EUV-SH
For-Profit Registered Provider	FPRP
Gross Domestic Product	GDP
Housing Association	HA
Large Scale Voluntary Transfer (Housing Association Type)	LSVT
Market Value – Subject to Tenancy (Valuation Method)	MV-STT
Monetary Policy Committee	MPC
Negative Interest Rate	NIR
Negative Interest Rate Policy	NIRP
Private Registered Provider	PRP
Quantitative Easing	QE

Glossary of Terms

Term	Definition
Affordable Rent	A sub-market rental tenure introduced by government which allows HAs to charge 80% of the local market rent for a home
Base Rate	The interest rate that a central bank, such as the Bank of England, will pay to commercial banks to hold money and what it charges them to borrow
Chained Volume Measure (CVM)	A measure applied to a set of economic data (e.g. GDP) from successive years, put in real terms by computing the production volume for each year in the prices of the preceding year, and then 'chain linking' the data together to obtain a time-series of production figures, mitigating the effects of price changes
Consumer Price Index (CPI)	A standard measure of inflation, it measures changes in the price level of a weighted average market basket of consumer goods and services purchased by households but excludes a number of housing costs
Corporate Bond	A bond (debt) issued by a corporation to raise financing
Deflation	A decrease in the general price level of goods and services
Impact Equity	A type of equity issued by investors who consider development impact and other ESG criteria in their investments
Inflation	An increase in the general price level of goods and services
Loan to Value Ratio	A figure used by lenders to express the ratio of a loan to the value of assets used as security
Market Rent	The amount of rent paid for a home under market conditions, i.e. in the private sector
Mark to Market	A method of measuring the fair value of assets and liabilities including financial instruments such as loans and interest rate derivatives
Negative Interest Rate (NIR)	Occurs when a central bank enacts Negative Interest Rate Policy by reducing the base rate to below zero

Term	Definition
Quantitative Easing (QE)	A tool that central banks can use to inject money directly into the economy through the purchase of government and corporate securities to increase the money supply and encourage lending and investment
Private Registered Provider (PRP)	A registered provider of social housing that is not a local authority
Social Rent	A sub-market rental tenure set according to a government formula which considers the relative value of the property, the size of the property and relative local income levels

Executive Summary

In 2020, the Bank of England (BoE) asked financial institutions how prepared they were for Negative Interest Rate Policy (NIRP), which would see the BoE drop the base rate from its current 0.1% to negative.

A central bank enacts NIRP to stimulate a struggling economy when interest rates are already low and when other monetary and policy tools have been used. The action reduces the base rate to below zero, which means financial institutions pay the central bank to hold their money. Because deposit-taking banks may pass these cuts on to their customers, NIRP is intended to discourage consumers from saving and instead encourages borrowing, investment and spending. Deposit-taking banks are also discouraged from holding balances and encouraged to lend. Both actions are intended to increase economic output and improve employment.

The NIR environment is underpinned by poor economic conditions continuing despite concerted efforts by government to improve them. If people and businesses perceive that the economic outlook is weak for the foreseeable future, they may be reluctant to spend or invest. NIRP, if implemented, could improve these conditions but it could also exacerbate them.

NIRP could have significant consequences for the housing association (HA) business model. To better understand these consequences, ten HAs commissioned Altair to undertake a research review of the practical impacts that Negative Interest Rates (NIR) could have on their businesses and on the wider affordable housing sector.

HAs are not for profit organisations offering sub-market priced “social housing” to people in need. They make up the majority of private registered providers (PRPs) regulated by the English Regulator of Social Housing (RSH). Today there are around 1,300 active HAs in England.²

NIRP and the NIR environment could significantly impact HAs, who may experience greater demand for services and investment, less income and greater financial pressures posed by exposures and security. The impacts HAs may face are summarised below:

- **Impact on Tenants and Residents:** Tenants’ ability to pay rent, demand for home ownership and demand for services will be affected by changes to benefit levels and employment status.
- **Inflation Impact on Income and Costs:** Social housing rent settlement is tied to inflation. Rent settlement policy could change as the result of negative price inflation. Inflation could also impact costs, in particular if prices increase at different rates and differently to rents.
- **Security and Valuation:** HAs provide security to their lenders in the form of rental streams and assets, both of which may be impacted by the NIR environment. Risks on Mark-to-Market valuations on interest rate derivatives will increase, so HAs will need to put up more cash or security. Covenant breaches could result in regulatory intervention and higher debt charges.
- **Cash and Cost of Finance:** NIRP could result in a cost of holding cash. This is more likely for corporate entities which could include some HAs. If NIRP is successful, HAs

² Similar sectors and regulatory models exist in Scotland, Wales and Northern Ireland. While this research considers an English context, its findings may be relevant in other jurisdictions.

should have greater access to low-cost finance. But if NIRP does not work as intended, it may mean banks tighten their lending.

- **Housing Market and Sales Exposure:** HAs are exposed to the market through their rental and sales programmes, both of which could be negatively impacted if housing markets suffer in the future. NIRP's effectiveness could determine if mortgage availability increases or decreases.
- **Economic, Social and Environmental Responsibility:** HAs may face reduced income and tightened capacity to borrow in a time where they are expected to invest billions to make their homes carbon neutral and fire safe.

The true impact of NIRP and the NIR environment will likely depend on future government decisions on rent settlement and grant. For now, HAs should monitor their capacity impacted by open market exposures and their covenants including security. In a worst-case scenario, HAs could face impairment as the result of unrecoverable asset value loss.

HAs may be able to respond to these challenges by leveraging the opportunities of NIRP and the NIR environment. Four strategies have been developed and assessed by HA research sponsors for their suitability, feasibility and acceptability, with the aim of testing how the wider sector may respond. These strategies and assessments are summarised in Table 1 below.

Table 1: Summary of Impacts of an NIR Environment on HAs

Strategy	Summary	Assessment
1. Borrow Cheaply Now and Invest	HAs leveraging the preferential borrowing opportunities in an NIR environment to invest in future assets (e.g. land banking for future development) or income generating activities, e.g. new services or housing assets.	Positive Some sponsors felt it unacceptable to invest in non-income generating assets. Sponsors' assessments of suitability, feasibility and acceptability of the strategy were high.
2. Look to Impact Equity	HAs utilising a leasing model to increase capacity to deliver homes and services. Impact equity investors, for instance, may provide equity for the homes, which are managed on long leases by HAs.	Mixed, Some Strongly Negative Overall, some sponsors see the strategy as having real potential to increase capacity, while others are strongly opposed to the strategy's model. Sponsors' assessment of feasibility of the strategy was moderate whereas their assessments of suitability and acceptability were low.
3. Reduce Balance Sheet Debt	HAs freeing up security by reducing their debt levels, making room for borrowing at more preferential rates in the future.	Moderate Sponsors noted that they are already closely managing debt and are unlikely to reduce debt further without incurring significant costs. Sponsors' assessment of feasibility of the strategy was moderate whereas assessments of suitability and acceptability were moderate to low, since the strategy was assumed to be ineffective at achieving the desired aims.
4. Outsource Services	HAs pursuing opportunities presented by the NIR environment, e.g. outsourcing, to deliver more cost-effective services.	Low The majority of sponsors felt the strategy would not achieve any further efficiencies for their organisations. Sponsors' assessment of suitability of the strategy was high whereas their assessments of feasibility and acceptability were moderate to low.

Introduction

In 2020, the Bank of England (BoE) asked financial institutions how prepared they were for Negative Interest Rate Policy (NIRP), which would see the BoE drop the base rate from its current 0.1% to negative. NIRP could have significant consequences for the housing association (HA) business model. To better understand these consequences, ten HAs commissioned Altair to undertake a research review of the practical impacts that Negative Interest Rates (NIR) could have on their businesses and on the sector.

About the Research

In December 2020, a group of ten HAs operating across England commissioned Altair to undertake a research review of the practical impacts that NIRP set by the Bank of England could have on the HA business model and on the affordable housing sector.

The Sponsors

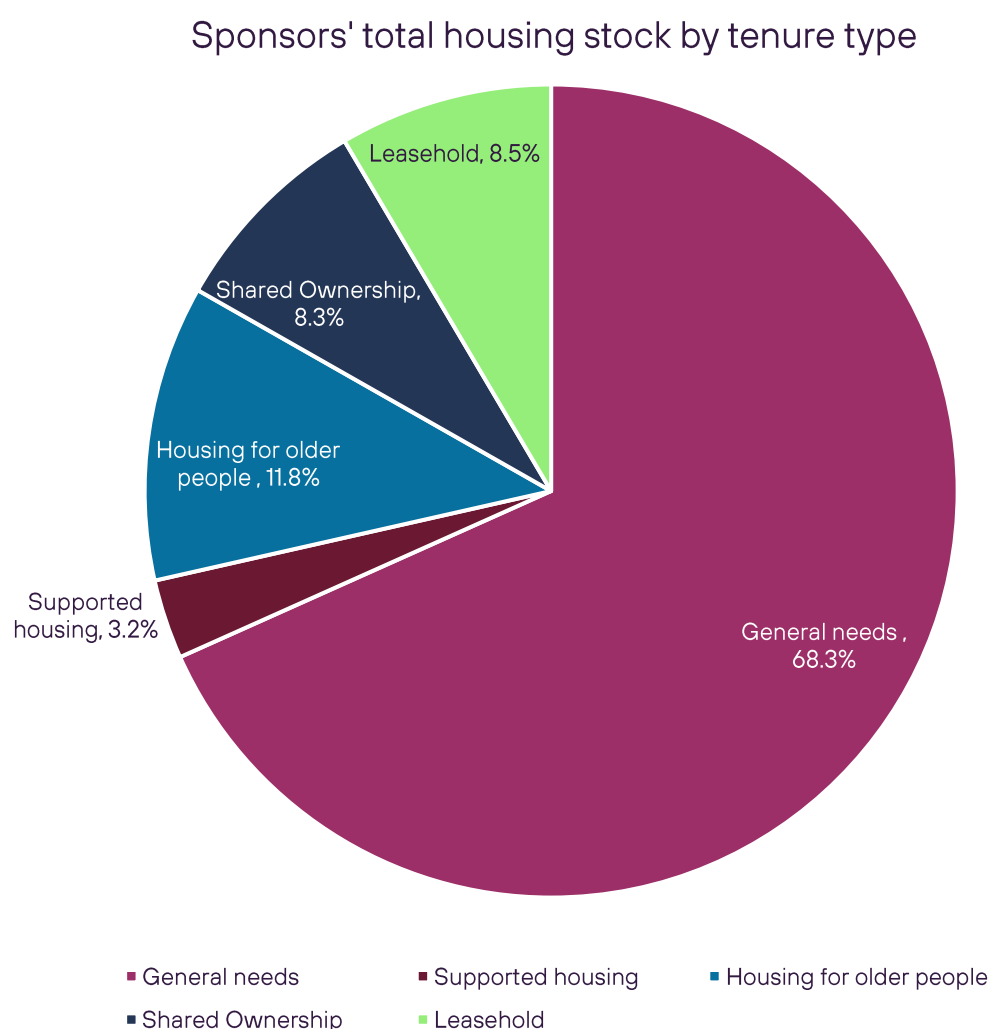
The sponsors for this research are:

- **A2Dominion:** A2Dominion owns around 37,000 homes and operates across London and the south east. A2Dominion has an extensive development programme and offers homes across a variety of tenures, including homes for sale and rental homes for key workers, older people and students.
- **Catalyst:** Catalyst operates in London and the Home Counties, managing over 34,000 homes. Catalyst is a member of the G15 group, consisting of London's largest HAs. Catalyst provides a range of homes for rent including social rent, key worker housing, and sheltered housing. Home ownership opportunities include shared ownership and outright sales.
- **Coastline Housing:** Coastline owns and manages just under 5,000 homes. It operates exclusively in Cornwall. Coastline offers a mix of affordable rent, shared ownership and supported housing. Coastline's development programme as a proportion of its existing units makes it the third fastest growing association in terms of building new affordable properties.
- **Eastlight Community Homes:** Eastlight Community Homes is the largest Community Gateway association in the country, following the merger of Colne Housing and Greenfields Community Housing. Eastlight is a newly formed organisation with 12,000 homes in Essex and Suffolk.
- **Guinness:** Guinness owns circa 65,000 homes and operates in 155 local authority areas across England. Guinness' tenures include homes for social and affordable rent, shared ownership and outright sales and homes and care services for older people.
- **Housing 21:** Housing 21 operates in nearly 200 local authority areas, managing around 20,000 retirement and extra care living properties and provides over 42,000 hours of social care each week.
- **Karbon Homes:** Formed in 2017 following a three-way merger, Karbon Homes operates across the North East of England and Yorkshire, managing almost 30,000 homes across diverse communities. Karbon Homes is developing affordable rented housing, Rent to Buy and shared ownership products as well as homes for older people.

- **LiveWest:** LiveWest owns and manages over 38,000 homes across the South West. LiveWest offers homes for affordable rent, shared ownership and also outright sales. Formed in March 2018 through the merger of Knightstone Housing and DCH, LiveWest is a member of Homes for the South West, a group of the largest developing organisations in the South West.
- **The Riverside Group:** Riverside manages almost 56,000 homes across 160 local authority areas in Northern England and Scotland. Riverside offers a variety of affordable homes, care and support services.
- **Vivid Homes:** Vivid Homes owns 31,000 homes in the south of England spanning Hampshire, Surrey, Berkshire and West Sussex. Vivid Homes offers a range of tenures such as social and affordable rent, shared ownership, market sale and market rent.

Together, sponsors own around 330,000 homes in London, the South East, South West, North, Yorkshire, Midlands and East of England equivalent to c. 11% of all social housing, low-cost home ownership and leasehold stock³. Sponsors include national organisations operating across a wide geographical area. Sponsors' stock composition by tenure is included in Figure 1 below.

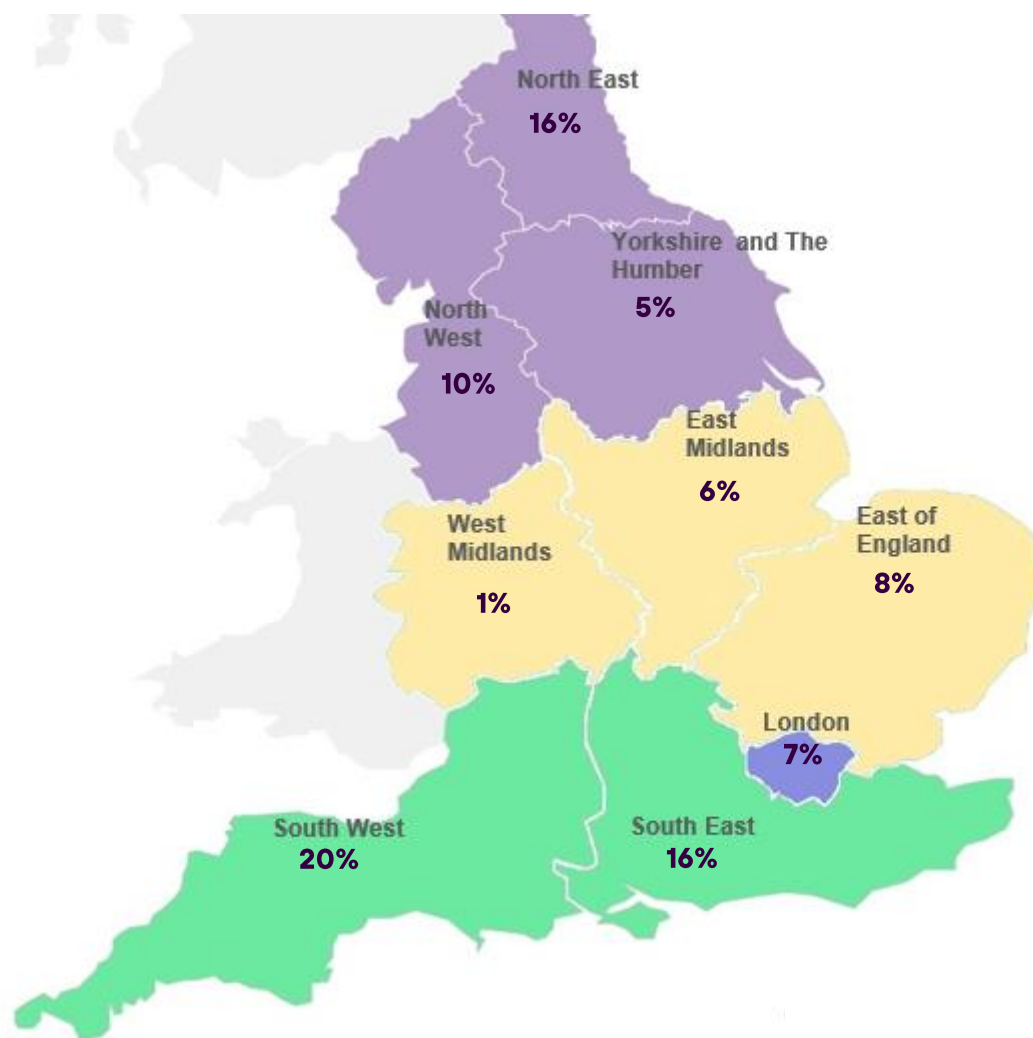
Figure 1: Sponsors' total housing stock by tenure and type



³ Regulator of Social Housing, "Private registered provider social housing stock and rents in England 2019 to 2020" (February 2021), <https://www.gov.uk/government/collections/statistical-data-return-statistical-releases>

The map shows what percentage of the total regional stock is owned and managed by the group. For example, of all the social housing stock in North East, the group owns and manages 16% of the stock in that region.

Figure 2: Sponsors' stock as a proportion of total social housing stock by region



Sponsors consist of large and small, traditional and Large Scale Voluntary Transfer (LSVT), and specialist and general needs providers. More about different types of HAs is included in Section 1 of this report.

Including these various types of HAs in the study group allows us to test and analyse how different business plans respond to NIRP. Having a breadth of HA types also means the outputs of this review can be applied to the wider HA sector.

Approach to the Research

Altair undertook primary and secondary research including a desktop review, interviews and data collection, financial modelling and analysis to address the research question:

What are the ways HAs can identify, respond to and strategise for a negative interest rate world?

The objective of the research is to deepen the sponsors' understanding of the NIR environment and to share conclusions with stakeholders in the affordable housing sector,

including but not limited to tenants, HM government, banks and building societies, mortgage providers, the corporate bond market and the construction supply chain.

The scope of the project included:

- Identifying the indicators of a NIR environment and its potential impacts and risks
- Providing options for how providers may respond to NIRP if it happened today
- Developing practical strategies HAs may implement in future to leverage the opportunities of and/or minimise risks of an NIR environment

Our approach to this research was based on five key activities, outlined in Table 2 below.

Table 2: Research Activities and Purpose

Research Activity	Purpose
Project Inception Workshop	To identify potential impacts of NIRP on affordable housing providers and their business planning assumptions and to develop the research question
Desktop Research	To gather data on the impacts and effectiveness of NIRP in other jurisdictions where it had been applied historically. Also, to gather the current macroeconomic forecasts by, and opinions of, lead experts and economists on the triggers for and likelihood of implementation of NIRP by the BoE and potential economic indicators of an NIR Environment with a focus on the availability of finance and terms in the capital markets
Impact Modelling	To identify and collate housing providers' current business planning assumptions and to apply a series of scenarios to collated business plans, showing the potential high-level impacts
Expert Interviews	To test how experts feel NIRs could impact affordable housing providers and their stakeholders and what strategies they may employ to address these impacts
Strategy Workshop	To refine the strategies identified with sponsors, ensuring they are suitable, feasible and acceptable

About this Report

This report contains findings from the research. Its purpose is to provide an overall view of the current position including drivers for NIRP and potential impacts on the HA business model and the wider affordable housing sector. It also contains several strategies HAs may implement to respond to the challenges and opportunities posed.

This report is underpinned by desktop research and analysis, interviews as well as confidential modelling of sponsors data to illustrate the impact of NIRP and resultant macroeconomic scenarios on their plans.

Section 1: History and Context

A contextual overview and history of negative interest rates and the HA business model

1 About Negative Interest Rates

A central bank enacts NIRP to stimulate a struggling economy when interest rates are already low and when other monetary and policy tools have been used. The action reduces the base rate to below zero, which means financial institutions pay the central bank to hold their money. Because deposit-taking banks may pass these cuts on to customers, NIRP is intended to discourage consumers from saving and instead encourages borrowing, investment and spending. Deposit-taking banks are discouraged from holding balances and encouraged to lend. Both actions are intended to increase economic output and improve employment.

What drives Negative Interest Rate Policy?

NIRP is an unusual monetary policy tool. Historically it has been used rarely by central banks because it could disrupt financial infrastructure. It is proposed when a government wishes to stimulate an economy in recession. This is usually due to structural issues impacting an economy, e.g. low growth, high unemployment and/or low inflation. NIRP works by encouraging reluctant financial institutions to lend or consumers to spend their savings now instead of holding them.

Theory of NIRP

The value of goods depreciates over time. Under healthy economic conditions, the value of capital also depreciates over time as the result of positive price inflation, which makes goods more expensive to buy next year than this year. Positive price inflation encourages consumers to spend, since they get more for every £1 spent today than they would next year for the same £1 held.

Economic downturn disrupts this. Consumers stop spending because they are out of work or because they have little confidence in their future job stability. Companies stop investing because consumer demand is low and economic outlook is uncertain. As a result, prices drop resulting in deflation and potentially negative price inflation.

Negative price inflation exacerbates economic downturn. This is because consumers are incentivised to hold capital since £1 will now buy more next year than it will today.

During the 1930's senior economists Irving Fisher and John Maynard Keynes reviewed the conditions of the Great Depression and concluded that holding money should be a cost and advocated for a tax on capital. Under healthy economic conditions, inflation is the "tax" on capital, but when negative price inflation occurs, government interventions may be required. In the 1930s, some jurisdictions in the USA implemented a real tax on holding dollar bills but the policy was abandoned. Today, the way to "tax" capital to encourage spending is by enacting negative interest rate policy (NIRP).

How Does Negative Interest Rate Policy Work?

The BoE's mission is to maintain monetary and financial stability and to maintain price stability which the UK Government has decreed will be to maintain CPI at or around 2% per annum. The BoE through its Monetary Policy Committee (MPC) has a toolbox of monetary policies to do so and the MPC sets monetary policy to meet the 2% inflation target. One of most used tools is interest rate policy – expressed as the BoE base rate or Bank Rate. The BoE uses base rate to stimulate a struggling economy or to dampen an overheating one.

The Base Rate

The BoE base rate is the “single most important interest rate in the UK”⁴ as it determines how much interest the BoE pays to financial institutions to hold money and what it charges them to borrow. The BoE Bank Rate is currently slightly positive at 0.1%. This means institutions receive £1 per year in interest for each £1,000 they have deposited with the BoE.

NIRP occurs when a central bank reduces the base rate to below zero. It is an unusual monetary policy tool used by a government through its central bank to urgently respond to economic downturn and resulting deflation.

Negative Real Rates versus Negative Base Rates

NIRP should not be confused with negative real rates, which may occur when there is a positive, low base rate but inflation and/or other fees means investors and consumers receive a negative return on their investments or savings. As shown in Table 2 below, historically there have been periods of negative real rates as well as negative base rates.

Table 3: Examples of Negative Real and Base Interest Rates

Type of NIR	Description	Examples
Negative Real Rate	When the positive or near zero nominal interest rate is lower than the “cost” of inflation or other fees	UK (2009 – Present) ⁵ : Base Rates 0.1-1% and CPI 0.2-4.5% USA (2009-Present) ⁶ : 0.25-2.5% and CPI -0.4-3.2%
Negative Base Rate	A rarely used monetary policy tool when the base rate is already low and there is an urgent need to respond to economic crisis	Switzerland (2019) -0.75% base rate Japan (2019) -0.1% base rate Sweden (2015-2017) -0.1 - -0.5% base rate

Since 2008 several European Central Banks (2014) and the Bank of Japan (2016) have reduced base rates to below zero. Despite these examples of negative base rates, the lowest negative rate applied by a central bank is -0.75% in Switzerland.

What does a negative base rate do to the economy?

Bank rates, whether positive or negative, have little direct impact on the economy. Instead, they change the incentives for saving or spending money. Take the example above where under negative price inflation, £1 will buy more next year than it will today.

⁴ Chan, S.P. “What are negative interest rates”, BBC, (2021), <https://www.bbc.co.uk/news/business-52772950>

⁵ Office for National Statistics, “Inflation and Price Indices” and Bank of England, “Official Bank Rate history” (2021)

⁶ US Federal Reserve Data found via US Inflation Calculator “Consumer Price Index Data from 1913 to 2021” (2021) <https://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/>

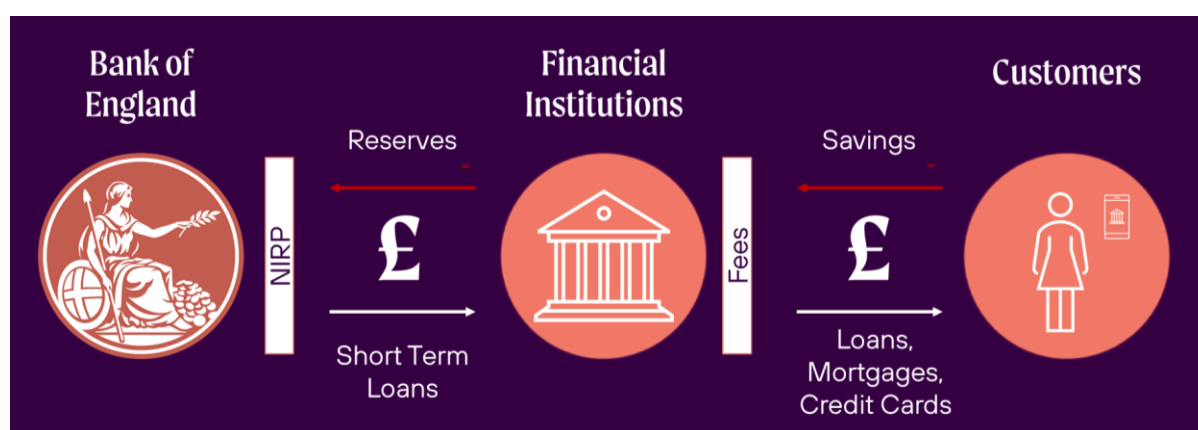
Under NIRP, institutions would instead pay an interest charge on their reserves. At a negative rate of 0.1% applied on all reserves, the same £1,000 deposit would be reduced to £999 after one year.⁷

Banks required to pay to store their reserves may pass these costs to customers, so holding savings becomes less attractive. While it may still be true that £1 will buy more next year, paying a bank to store £1 until next year may be less profitable than spending it on the more “expensive” goods now. In reality, these “goods” could be discretionary goods for consumers (e.g. cars and washing machines) or capital goods (e.g. machinery and IT equipment) for businesses.

And changing the borrowing rate for money makes investment more attractive to companies who may be able to secure more preferential lending rates than they will in the future when economic conditions improve. This incentive is often in conjunction with other measures. For example, the 2021 UK Budget introduces accelerated tax allowances for new investments.

As shown in Figure 3 below, NIRP results in cash deposited by financial institutions at a central bank yielding a storage charge rather than the opportunity to earn interest income. In theory, banks would rather lend money to borrowers and earn at least some interest as opposed to being charged to hold their money at a central bank. In practice, banks will lend at NIR plus a margin plus fees (reflecting risk and some profit element).

Figure 3: How Money Flows through Financial System under NIRP



A NIR does not imply that rates applied to households and businesses will turn negative. It may do, but this is because it is one element which affects the exchange rate and a range of asset prices set by financial markets. Fees and other charges may replace the margins banks would have made from positive interest rates.

If effective, NIRP should create economic growth by:

- Stimulating spending
- Making borrowing cheaper
- Increasing employment
- Stimulating inflation

⁷ Tenreyro, S. Bank of England, “Let’s talk about negative rates”. Speech, 11 January 2021. <https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/january/lets-talk-about-negative-interest-rates-speech-by-silvana-tenreyro.pdf?la=en&hash=254710E731E1D2347AE5BEE0907934C1EDC6742D>

In the bond markets, NIRP creates a steepened yield curve by increasing the gap between the yields on short-term bonds and long-term bonds. A steepening yield curve typically indicates that investors expect rising inflation and stronger economic growth.

Why Now?

NIRP is an unusual policy tool and is implemented when a central bank acts in response to a series of existing and/or expected economic conditions. These conditions are known as the NIR environment, which considers drivers for as well as potential outcomes of NIRP.

So why is the BoE considering NIRP now? The NIR environment is defined by three assumptions:

1. **Historic reasons** for why central bank should not use NIRP no longer apply in the current context
2. **Economic fallout** from the COVID-19 pandemic is still unknown, and is international in nature
3. **Other monetary policy tools implemented** by the BoE have been implemented and there is still more to be done to support the economy. Historical parallels for the current economic crisis are few so the efficacy of the usual tools will be questioned and the 'toolbox' readied with all possible interventions

1. Historic assumptions no longer apply

NIRP's implementation track record is short and there are no examples of very low NIRs (less than -0.75%). There are two potential reasons why NIRP has not been widely used historically: the "zero-bound" assumption and the currency dilemma. The context presented by modern consumer banking trends and the international economic downturn created from the COVID-19 pandemic may help explain why these two reasons may not apply today.

The first potential reason why NIRP has not been widely used is the "zero bound" assumption. Historically, interest rates were thought to be "zero-bound" or have a lower limit of 0% for the short-term interest rate. This is because it was assumed after an interest rate became negative, consumers would withdraw cash to avoid paying to keep their money in a bank or savings account. Withdrawing cash is highly unlikely, as it poses significant security risks to individuals and companies alike. And in today's world, bank accounts are required to pay for services, which are increasingly made available online and so require functionality offered by debit transactions.

The second potential reason NIRP has not been widely used is because it has been largely found that reducing base rates could result in devaluation of currency. Between March 2008 and April 2009, for example, when the BoE cut its base rate from 5% to 0.5%, sterling's exchange rate fell by as much as 25% against all major currencies.⁸ This is a dilemma if one country experiences and responds to economic recession by offering low-cost government debt, driving inflation and reducing the competitiveness of exports. This may impact trade and encourage consumers and investors to swap currencies. But today, the impacts of the COVID-19 pandemic are felt among all trading currencies – the USD, GBP and the Euro, so a move to NIRP might be part of an international consensus. Also, with high rates of borrowing in all countries to fund COVID-19-related policies, governments have a vested interest in keeping rates low.

⁸Office for National Statistics; Explanation beyond exchange rates: trends in UK trade since 2007, http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/dcp171766_324876.pdf

2. Covid-19 economic fallout is unprecedented and still largely unknown

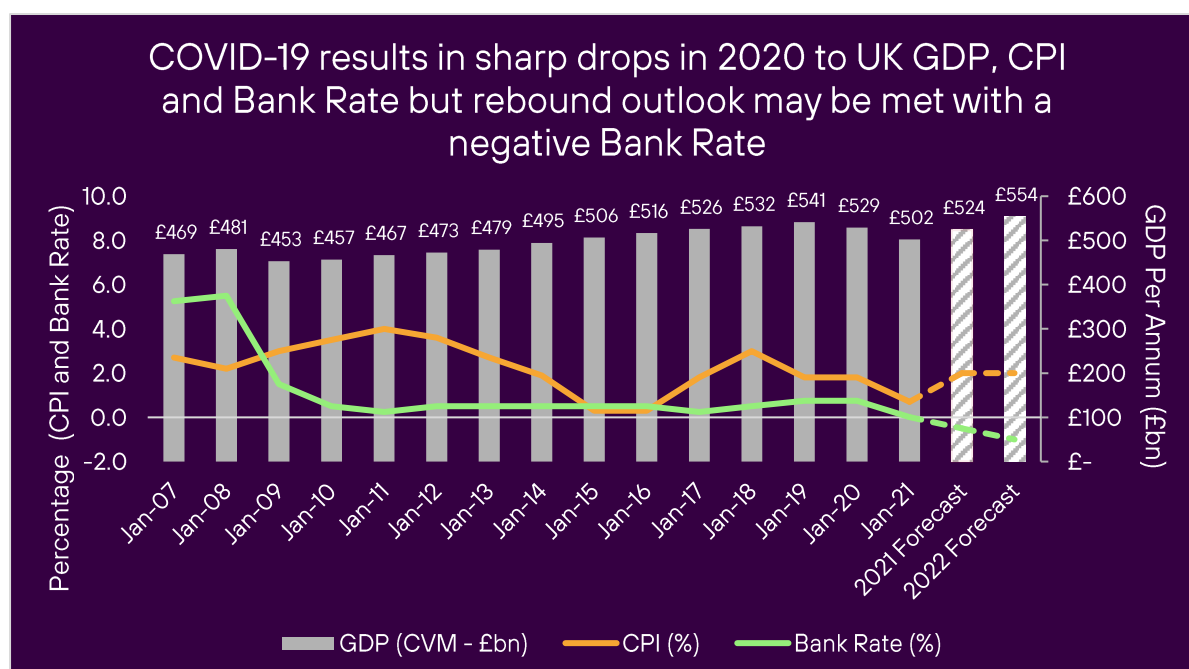
The UK has experienced periods of low economic growth and deflation since the 2008 Financial Crisis. Post-financial crisis in 2008, the BoE lowered the Bank Rate from 5% to 0.5% to support the UK’s economic recovery.

Most recently, the Brexit referendum and transition period and the policy response to the COVID-19 pandemic creating closures of businesses have contributed to a reduction in national Gross Domestic Product (GDP) and deflation while employment levels have remained high.

As seen in Figure 4 below, the economic fallout from the COVID-19 pandemic has negatively impacted output and price inflation. Note: GDP figures are provided as a Chained Volume Measure (CVM), which is adjusted for inflation to give a measure of ‘real GDP’.

Figure 4: 2011-2021 and 2021/22 Projected UK GDP, CPI and Bank Rates

Data Sources: ONS⁹, Bank of England¹¹, Forecasts from HM Treasury¹²



In the year to September 2020:

- **Gross Domestic Product** contracted by 8.6%¹³, down from a projected modest increase between +0.1 and +0.5% as the result of Brexit and global growth stabilisation¹⁴

⁹ Office for National Statistics, "Inflation and Price Indices" (2021)

¹⁰ Office for National Statistics, "Gross Domestic Product: chained volume measures (CVM): Seasonally adjusted £m" (2021) <https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/abmi/pn2>

¹¹ Bank of England, "Official Bank Rate History", (2021),

<https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp>

¹² HM Treasury, "Forecasts for the UK economy: a comparison of independent forecasts", (February 2021)

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/962029/Forecast_February_2021.pdf

¹³ Office for National Statistics, "GDP quarterly national accounts, UK: July to September 2020" (2021)

<https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/quarterlynationalaccounts/julytoseptember2020>

¹⁴ Bank of England, "Economic Outlook", (January 2020), <https://www.bankofengland.co.uk/monetary-policy-report/2020/january-2020/the-economic-outlook>

- **Inflation** using the Consumer Price Index (CPI) measure annual rate is +0.7%, lower than the Bank of England's 2% growth target¹⁵
- **Unemployment** is up from 3.8% to 5% since the start of the pandemic with expectations of worsening to 7.75%¹⁶ likely as the result of the Coronavirus Job Retention Scheme (furlough scheme) ending¹⁷

Some forecasts predict a "V-shaped recovery" in 2021 and 2022, including GDP growth of 4.3% and 5.8% consecutively and a return to CPI of 2% in 2021 and 2022. Others think that any recovery will take much longer and may have sub-optimum plateaus at different stages.

Despite optimistic forecasts about a return to 2% CPI, there is still uncertainty about the duration of the economic impacts of COVID-19 and what consumers will do when they emerge from lockdown conditions. Some commentators suggest that there is as much as £162bn of savings principally held by higher earners that has accumulated during lockdown, a figure expected to increase to around £250bn by end June 2021. However, it will require consumer confidence to unlock this, something that might be in short supply if employment is not stimulated and "the end of Covid-19 pandemic" is compromised by new virus variants.

Worth noting that even if the UK economy shows recovery post Covid, BoE might be forced into NIRP if the third wave in Europe means that the EU adopts NIRP and capital flows into UK. BoE would need to react which could involve a NIR with controls to keep spending and lending restricted, for example larger deposits for house purchases. This is likely to be inherently unstable but could happen.

3. Other tools are insufficient

Another potential reason why the BoE is considering NIRP is because the BoE has few remaining tools to respond to the ongoing economic downturn caused by the COVID-19 pandemic.

So far, HM Government has responded to the conditions posed by the pandemic through numerous fiscal and monetary responses:

- **Fiscal policies** include spending by government to improve the economy by supporting businesses, employees and public health. Notable examples include £46.4bn¹⁸ of spend on wage replacement as part of the furlough scheme and £68 billion in guaranteed loans for businesses¹⁹
- **Monetary policies** include the BoE's actions to incentivise lending and spending and to disincentivise saving during, between and after national "lockdown" periods

As described previously, changing base interest rates is one of the most common monetary policy tools used by the BoE. Interest rate policy is usually not enough, and the BoE has historically implemented other tools alongside it during economic recession. One of these is quantitative easing (QE), which occurs when a central bank purchases government bonds to

¹⁵ Office for National Statistics, "CPI ANNUAL RATE 00: ALL ITEMS 2015=100" (2021), <https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7g7/lmm23>

¹⁶ Bank of England, "Presentation: Monetary Policy Report" (February 2021) <https://www.bankofengland.co.uk/-/media/boe/files/events/2021/february/agency-mpr-presentation.pdf?la=en&hash=087C11A4AD5CD349A167C579829567542C54B302>

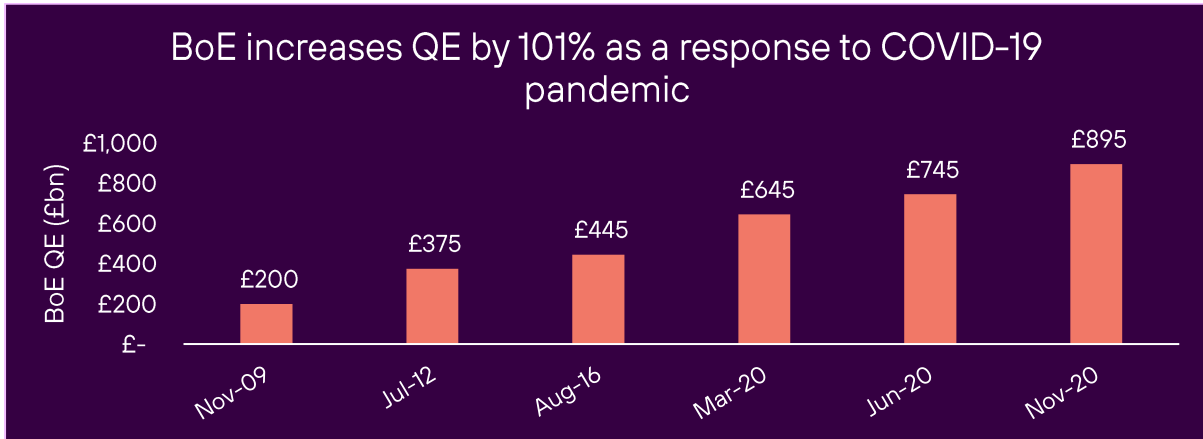
¹⁷ Office for National Statistics, "Unemployment Rate" (2021), <https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/timeseries/mgsx/lms>

¹⁸ Clark, D. Statista. "Value of claims made by companies from the job retention scheme in the United Kingdom between April 20 and December 13, 2020" (2021) <https://www.statista.com/statistics/1122100/uk-cost-of-furlough-scheme/>

¹⁹ Gov.uk, "Chancellor extends furlough and loan schemes" <https://www.gov.uk/government/news/chancellor-extends-furlough-and-loan-schemes>

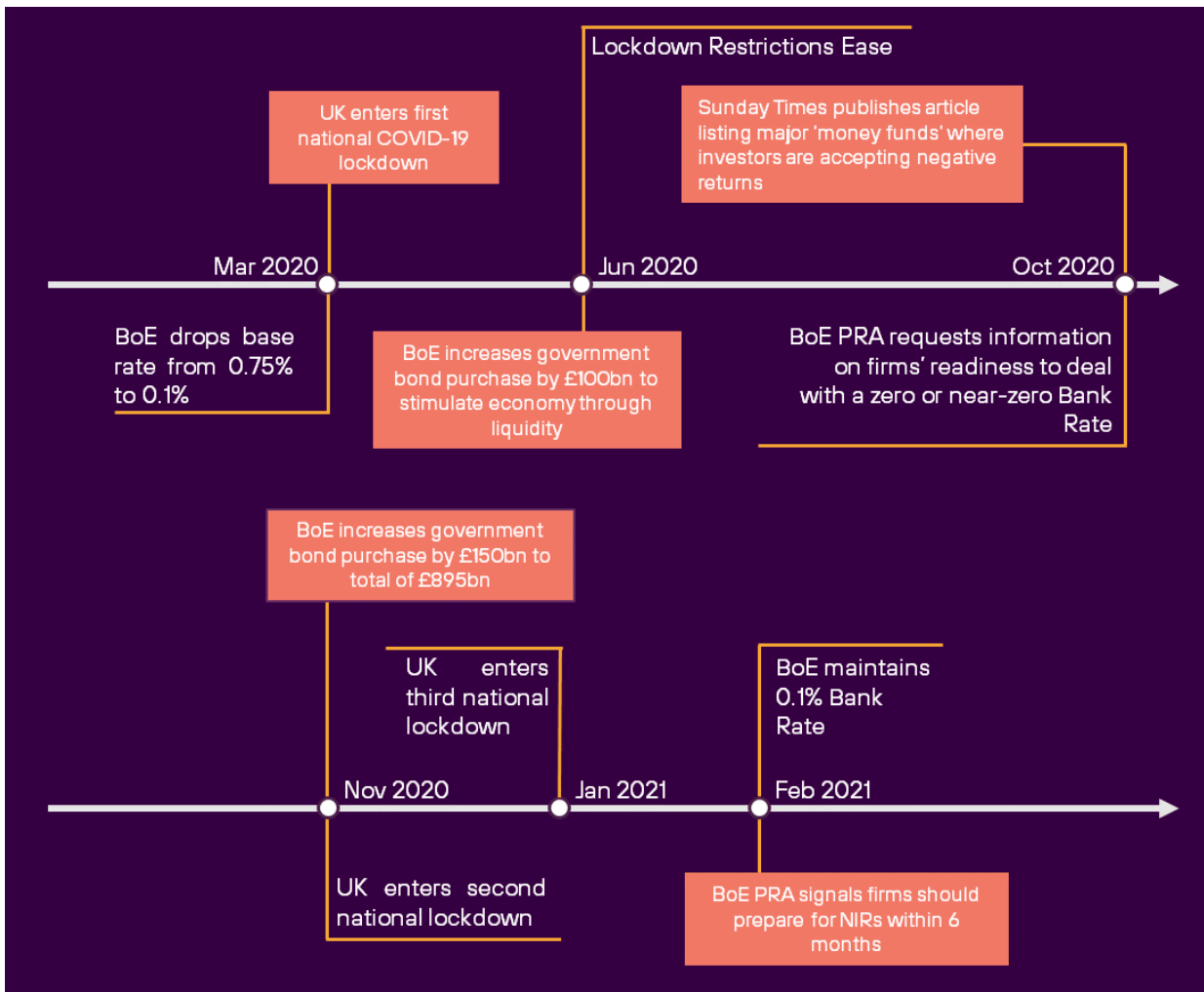
introduce liquidity into the market. In recent history, QE has been used to combat real or anticipated downturn related to the 2008 Financial Crisis, Brexit and most recently the COVID-19 pandemic. As shown in Figure 5 below, QE has increased significantly over the past year.

Figure 5: BoE Quantitative Easing 2009-2020



As shown in Figure 6 below, measures used in 2020 include the reduction of the base rate from an already low 0.75% to 0.1% and purchase of an additional £450bn in government bonds through QE.

Figure 6: Timeline of Monetary Policy trends during COVID-19 pandemic 2020- 2021)



How Effective is Negative Interest Rate Policy?

There is a great deal of speculation about the effectiveness of NIRP to encourage spending.

Arguments for and Against NIRP

In theory, NIRP should result in economic growth driven by increased spend and resulting price inflation. Proponents of NIRP say that in times of economic recession, it effectively boosts the economy without significant capital investment or other costs to government. Other proponents say that NIRP could be useful only at certain negative levels, which have not been used in practice so far. Naysayers say NIRP is not powerful enough to disrupt economic conditions and that NIRP may in fact create unintended consequences such as reducing banks' incentives to lend because it reduces their profitability and increases exposure to potential bad debts.

What we do know is that it is hard to prove the effectiveness of NIRs since they are often implemented in poor economic environments and alongside other policy tools. As for many economic policy tools, segmenting NIRP and showing its impact on a whole economy is extremely difficult.

What is likely to matter more than tested effectiveness is the views of policymakers.

Each of the arguments for and against effectiveness of NIRP is included in the table below.

Table 4: Claims and Evidence For and Against Effectiveness of NIRP

	Claim	Evidence
Arguments For NIRP	NIRP works in times of recession if accompanied by other fiscal and monetary policies	Reflecting on the Great Depression and the 2008 Financial Crisis, Economist Yi Wen says ²⁰ achieving a “V-shaped” recovery is possible post-COVID-19 pandemic if government uses aggressive stimulus including taking interest rates below zero. BoE Economist Silvana Tenreyro in a speech in January 2021 concluded they are effective in economies in recession and points to the several Euro area studies which found that negative rates lowered loan rates and stimulated credit growth and that overall negative rates provide sufficient stimulus to struggling economy. ²¹
	NIRP may increase bank profitability	The European Central Bank claims ²² NIRP results in: better macroeconomic conditions which could increase banks’ business volume, improved outlook and lower rates to help boost creditworthiness of borrowers, which reduce costs for banks, and securities held by banks may increase in value. Tenreyro echoes this conclusion and cites studies which show, in jurisdictions where NIRP has been used, there has been either no negative impact on bank profitability or a positive impact when considering overall economic improvement. She claims there is little evidence to suggest that if implemented in the UK, NIRP would operate differently from usual. ²³
	NIRP does not impact currencies, especially when considering larger international macroeconomic conditions	Japan and Switzerland have had long term negative interest rates but their financial institutions are sustained because of strong currencies where people are willing to deposit cash. In 2015, Switzerland introduced NIR of -0.75%; Swiss Francs appreciated against the Euro. ²⁴ Similarly in Japan in 2016, currency values rose to 18-month highs against the U.S. dollar despite expectations NIRP would apply downwards pressure on the yen’s exchange rate. This was due largely because the yen was considered a safe haven compared to the USD, where investors feared volatility in the market. ²⁵ It could be argued that Japan is an anomaly because government debt is owned domestically and therefore is insulated from global market forces (interest rates and exchange rates).

²⁰ Wen, Y. “How to Achieve a V-Shaped Recovery amid the COVID-19 Pandemic” <https://www.stlouisfed.org/on-the-economy/2020/may/achieve-shaped-recovery-covid19-pandemic>

²¹ Tenreyro, S. “Let’s talk about negative rates” Speech given at UWE Bristol webinar, (11 January 2021), <https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/january/lets-talk-about-negative-interest-rates-speech-by-silvana-tenreyro.pdf?la=en&hash=254710E731E1D2347AE5BEE0907934C1EDC6742D>

²² Boucinha et al for the European Central Bank, “Negative rates and the transmission of monetary policy” (March 2020) https://www.ecb.europa.eu/pub/economic-bulletin/articles/2020/html/ecb.ebart202003_02~4768be84e7.en.html#toc5

²³ Tenreyro, S. “Let’s talk about negative rates” Speech given at UWE Bristol webinar, (11 January 2021)

²⁴ The Fred Blog, “S’weird in Switzerland” (2016) <https://fredblog.stlouisfed.org/2016/08/sweird-in-switzerland/>

²⁵ Warnock et al. “Japan’s Negative-Rate Experiment Is Floundering”, (April 2016) The Wall Street Journal Online; <http://www.wsj.com/articles/japans-negative-rate-experiment-is-floundering-1460644639>

	<p>NIRP is effective only if negative rates are significant enough to impact consumer patterns, e.g. overriding sentiment about</p>	<p>Nineteenth century German economist Silvio Gesell proposed -5.0% as the sufficient level of tax on capital required to achieve equilibrium in an economy. This is far below the lowest NIR seen to date which is -0.75% in Switzerland. Economists argue²⁶ that the rates must be deep enough to lift inflation and real interest rates. The -5.0% mark has most recently been endorsed by an independent study by the American Federal Reserve²⁷.</p>
<p style="writing-mode: vertical-rl; transform: rotate(180deg);">Arguments Against NIRP</p>	<p>NIRs alone do not have enough power to change consumer spending patterns enough to encourage positive price inflation.</p>	<p>BoE economist Gertjan Vlieghe cites research that in some instances, cuts in negative territory are less effective than cuts in the negative range. In some instances, however, they are as effective.²⁸</p> <p>Economist Tony Hughes explains²⁹ that banks are reluctant to charge savers because they want to maintain a consistent deposit base. In Germany, savers are among those experiencing negative rates on deposits but, so far, the majority of those affected are institutions or individual savers with large sums such as €100,000 or more.³⁰</p>
	<p>They negatively impact banking sector profitability and potentially consumer confidence.</p>	<p>Senior economist Azad Zanganal cites³¹ some cases where negative interest rates exist, banks have been reluctant to pass on the cuts to borrowers, choosing instead to counter reduced interest rates by either increase banking fees or charges. Others have reduced lending altogether, the opposite of what NIRP intends.</p> <p>Many commentators highlight that NIRP might reduce bank profits because banks were reluctant to move deposit rates below zero. As a result of not pushing the rate onto customers, profits suffered because banks earned less on loans.</p> <p>Negative interest rates also have the potential to create the “reversal interest rate”, which is the rate at which monetary policy becomes contractionary for lending. It occurs when banks' asset revaluation from duration mismatch is more than offset by decreases in net interest income on new business, lowering banks' net worth and tightening their capital constraints.³²</p>

²⁶ Rogoff, K. “Kenneth Rogoff: The case for deeply negative interest rates” (May 2020) <https://think.ing.com/opinions/the-case-for-deeply-negative-interest-rates>

²⁷ Leibniz Information Centre for Economics in a working paper 'Negative Nominal Interest Rates: History and Current proposals' – a CAWM discussion paper no 43 citation Ilgmann, Cordelius, Menner and Martin (2011) in collaboration with the University of Munster (WWU).

²⁸ Vlieghe, G. “An update on the economic outlook” Speech given at Durham University, (22 February 2021), <https://www.bankofengland.co.uk/speech/2021/february/gertjan-vlieghe-speech-an-update-on-the-economic-outlook>

²⁹ Hughes, T. “Are Deposits Safe Under Negative Interest Rates?” (June 2016) <https://www.moodysanalytics.com/risk-perspectives-magazine/risk-finance-accounting-converge-ifrs9/innovation-zone/are-deposits-safe-under-negative-interest-rates>

³⁰ Shroders, “Negative rates explained: should UK investors prepare?”, (October 2020), <https://www.schroders.com/en/insights/economics/what-happens-if-uk-interest-rates-turn-negative/>

³¹ Shroders, “Negative rates explained: should UK investors prepare?”, (October 2020)

³² Brunnermeier et al, “The Reversal Interest Rate”, (December 2018), <https://www.nber.org/papers/w25406>

When and How is NIRP likely to happen?

NIRP in the UK is not certain but attention to its possibility has increased significantly over the past year, starting around March 2020 when BoE dropped the base rate to 0.1%.

BoE Signals NIRP

On 4th February 2021, the BoE's Prudential Regulation Authority (PRA) CEO issued a letter³³ to financial institutions stating that on the basis of firms' responses to an October 2020 exercise to assess operational readiness for a zero or negative Bank Rate, the PRA understands that the majority of firms would be able to implement tactical solutions to accommodate NIR within six months without material risks to safety and soundness. With this the PRA committed to supporting institutions to prepare tactically for implementation of NIRP at any point after six months.

And a February 2021 speech by Gertjan Vlieghe³⁴ suggests that banks will be ready for NIRP in six months, answering the question on whether or not the policy may be feasibly implemented. The same speech provides a series of scenarios, ranging from positive recovery post-COVID-19 "upside" scenarios to slower recovery "downside" scenarios each with potential future base rate policies. Vlieghe suggests appropriate responses could be:

- **An upside scenario** where the current rate is held until 2022, and then increased incrementally to 1% by 2024
- **A central scenario** where the current rate of 0.1% is held until 2023, and increased to 0.5% in 2024
- **A downside scenario** where the current base rate is dropped to -0.75% in the beginning of 2022, where it is held until it is increased to 0.0% in 2024

The BoE may be signalling NIRP to financial institutions now to achieve some benefits of the policy without implementation. Vlieghe suggests since talks about NIRP started in spring 2020, the yield curve has shown forward interest rates out to five years in negative territory. In previous years when NIRP was not discussed, the base rate acted as a lower bound for forward interest rates.

What would NIRP look like if implemented?

If the BoE does implement NIRP, it could be that the base rate is set to a moderate figure of around -0.75% and is incrementally reduced to rates like -2.0% or -3.0%. Such an approach would discourage rapid reaction today, such as removing deposits or equity sell off. However as discussed previously, there is no precedent for this, and it is unlikely the BoE would do so if other major economies – such as the USA and EU did not also implement similar policies.

In any case, it is likely the BoE will wait until after 2021 to see how consumers react to the easing of lockdown restrictions. Current unknowns include what consumers will do with estimated £250bn in savings³⁵ to be accumulated by June 2021 while the economy was "closed" as well as understanding the true impact on unemployment when the furlough scheme ends. Government and the BoE are likely to allow these unknowns to play out before applying any further stimulus measures.

³³ Woods, S. "Feedback: operational readiness for a zero or negative Bank Rate", PRA (4 February 2021) <https://www.bankofengland.co.uk/-/media/boe/files/letter/2021/february/letter-from-sam-woods.pdf?la=en&hash=6A6B74676ED80C9433C46E4AB5D107635198167E>

³⁴ Vlieghe, G. "An update on the economic outlook" Speech given at Durham University, (22 February 2021)

³⁵ BBC, Bank of England Presentation to the Press, (4 February 2021) <https://www.bbc.co.uk/news/business-55934405>

2 About Housing Associations

HAs are not for profit organisations offering sub-market priced “social housing” to people in need. HAs are the largest providers of social housing in the country and they make up the majority of private registered providers (PRPs) regulated by the English Regulator of Social Housing (RSH). Today there are around 1,300 HAs in England.

History and Types of Housing Associations

The HA model dates to the nineteenth century and has evolved today to be the most common way of providing affordable housing.

Affordable Housing in the Twentieth Century

HAs first appeared in the nineteenth century, where they were part of the emergence of various philanthropic and voluntary organisations. These early HAs responded to problems of poor housing conditions, mostly in inner city areas, and grew steadily as city populations increased during industrialisation. Early examples include Peabody Trust, the Metropolitan Association for Improving the Dwellings of the Industrious Classes and research sponsor Guinness Trust. Today, HAs that originally emerged from philanthropic or community groups are known as traditional HAs. In addition to Guinness Trust, research sponsors that are traditional HAs or have merged from traditional HAs include A2 Dominion, Catalyst, Riverside and LiveWest.

During much of the twentieth century the major provider of affordable housing was local government, which led slum clearance and post-war reconstruction efforts delivering affordable homes for those in need with subsidies from central government. Due to changes in government policy, local authorities still build and manage affordable housing though they own far fewer homes than other kinds of social housing providers. Today, local authorities own around 1.6 million social homes³⁶, compared to PRPs who own around 2.6 million social homes.³⁷

HAs were marginal players at least until 1974, when a subsidy regime created from the 1974 Housing Act was put in place enabling them to build rented housing to be let at fair rents.

From public to third sector

In the 1990s, there was substantial growth in HAs from government impetus to transfer housing stock from local authorities to newly formed HAs if tenants voted to do so. A main driver for the policy was HAs' third sector status and access to private finance that could fund housing improvements. The HAs would be known as Large Scale Voluntary Transfer HAs (LSVTs). Post-transfer, LSVTs were required to carry out improvement works on their properties as part of their obligations to tenants. LSVTs took out debt to fund these, and so tended to be much higher geared compared to traditional HAs.

³⁶ Gov.uk, “Local authority housing statistics data returns for 2019 to 2020” (2020)

<https://www.gov.uk/government/statistical-data-sets/local-authority-housing-statistics-data-returns-for-2019-to-2020>

³⁷ English Regulator of Social Housing, “Current registered providers of social housing” (2020)

<https://www.gov.uk/government/publications/current-registered-providers-of-social-housing>

Of the sponsors, Coastline Housing, Eastlight Community Homes (a merger of Greenfields Community Housing and Colne Housing), Karbon Homes and Vivid Homes are LSVTs or organisations which merged from one or more LSVTs.

For-Profits Emerge

In 2008, the Housing and Regeneration Act made a big change to the status-quo when it first allowed For-Profit Registered Providers (FPRPs) to enter the market and register as social housing providers with the RSH. The aim of the policy was to allow for these organisations to contribute to the gap between demand and supply of housing. Currently there are around 50 FPRPs who currently own circa 2,500 homes. FPRPs are not considered HAs, although apart from their for-profit/not-for-profit status, there are many similarities between them.

Like all PRPs, registered FPRPs are required by the RSH to meet regulatory conditions such as investing in and maintaining homes. However, FPRPs may use additional surplus beyond that required to provide a good level of service to tenants to either build their business for later sale or to make dividends to shareholders. In practice, FPRPs are new and their models are diverse, and many that operate today are building their businesses through growth so are investing rapidly rather than making returns to shareholders. In some cases, FPRPs are being set up by capital investors for exit within 10-15 years.

Regulation of HAs

Registered HAs are regulated by the RSH. All HAs are subject to governance and financial viability reporting to the RSH to provide assurance over appropriate protection of affordable housing stock and tenants. In 2020, the UK government announced the regulatory regime would be strengthened to include more active consumer regulation to protect and empower tenants.

The RSH's role in ensuring the viability, efficacy and probity of organisations who receive government subsidy/investment has remained constant throughout the decades. Today, the effective regulatory regime is credited with enabling the borrowing of over £70 billion in the affordable sector at favourable rates.

HAs and Private Finance

The UK social housing sector has responded to decreased public funding and changes in macroeconomic policies and political priorities over time.

HAs access private finance

The Housing Act 1988 introduced private finance to HAs or "mixed funding" which reduced HAs' requirements and expectations on government grant and revenue streams. This led to the first housing borrowing and the creation of 'club' deals and brokers, such as The Housing Finance Corporation. These changes created a new relationship between government and providers of affordable housing.

Since the late 1980s and throughout the 1990s, grant rates from government have been falling year on year, compensated by an increase in and private borrowing by HAs and the development of a cross-subsidy model, involving the development of open market, for sale properties to generate surpluses, to be reinvested in the provision of rented homes.

Before the 2008 global financial crisis, HAs were largely funded by a combination of government grant and long-term bank loans. But with tighter capital requirements post financial crash, as well as Basel II and capital cover requirements, banks became less willing

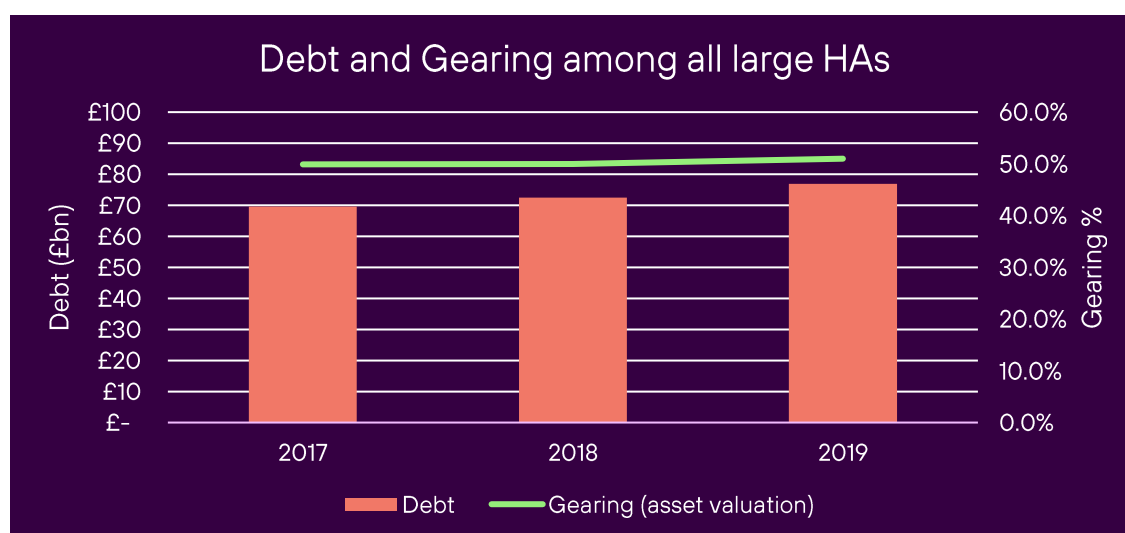
to lend over long-term periods under either a variable or fixed rate basis. Basel II is the second of Basel Accords, published in 2004. It intended to amend international banking standards to control how much capital banks were required to hold to guard against financial and operational risks. Note: Basel II was not fully implemented before the crash to be effective. This iteration is now partially superseded by Basel III, which consider the outcomes of the crash.

Today, total debt in the HA sector is increasing. Over the year to March 2019, debt among PRPs increased by 6% to £76.9bn. This debt was backed by property-related assets of £164bn.

Figure 7 below shows current total debt and gearing among large (over 1,000 home) HAs, accounting for 95% of all private social housing stock.

Figure 7: 2019 Debt and Gearing among all large HAs (over 1,000 units)

Source: Regulator of Social Housing Global Accounts³⁸



Of total HA debt, 61% is from existing bank loans.

Due to their long-term CPI linked rental income streams, backed by government through the welfare benefits system, regulated nature and socially-driven platforms for operation, HAs are seen by investors as safe, secure and ethical investments with assured returns and a zero-default record. 2019 was a record year for HA arrangement of new debt facilities. In total, the sector agreed new facilities of £13.5bn (2018: £10.1bn, 2017: £7.6bn). Providers also agreed new bank lending of £6.5bn in the year. In March 2019, the sector had access to £20.8bn in undrawn loan facilities.

HAs access capital markets

HAs have looked to the capital markets since the 2008 financial crisis and the capital markets have contributed to dramatic growth in bond issues by UK HAs to fund the provision of social housing.

³⁸ English Regulator of Social Housing, "2019 Global Accounts of private registered providers" (January 2020) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852013/2019_Global_accounts_of_private_registered_providers.pdf

A variety of bond transactions are seen, but the three main types are:

- “Own name” public bond issues: by an HA or a member of its group to raise finance for that HA or its group (e.g. Clarion plc issues the bond on behalf of Clarion HA)
- “Pooled funding” issues: by a funding vehicle that raises finance on an aggregated basis and on-lends it to a variety of HAs (e.g. investment funds)
- “Private placements” arranged directly with investors, such as pension and insurance funds.

In 2019, a total of 42 bond issues or private placements took place (2018: 48, 2017: 26), raising a combined £6.7bn (2018: £4.9bn, 2017: £2.6bn).

Some HA bonds have been included in the BoE’s Corporate Bond Purchase Scheme (CBPS), lowering the yields on corporate bonds and reducing the cost of borrowing for organisations. Set up in 2016, the CBPS is part of the government’s QE programme.

About the Housing Association Business Model

General Needs versus Specialist HAs

HAs can be general needs or specialist housing providers. The former provide mostly social and affordable housing for people without care and support needs. General needs HAs provide a range of rental and home ownership options for tenants and residents.

Their rental businesses are focussed on landlord services – repairs and maintenance, income collection, allocations and voids. They may offer some services such as care and support to vulnerable adults or older people and additional, non-core services.

Specialist housing organisations are those whose businesses are focussed on specialist or additional services. Research sponsor Housing 21 is a specialist provider. Specialised services can have higher operating costs, so these organisations may have lower operating margins. They also have slightly different exposures and supply chains to general needs providers.

Services provided

Rental housing is the most common tenure among HAs with 85% of social housing offered by PRPs provided for low-cost rental³⁹. Rental products include general needs housing, housing for older people and supported housing which may be offered at social rents (set against a government formula) and affordable rents⁴⁰ (set not to exceed 80% of the full market rental value for the home). Both social and affordable rents are sub-market.

In addition, at increasing rates, HAs are also building and offering home ownership products such as shared ownership. Over the past year, there was an 8% increase in homes provided for low-cost home ownership among PRPs. Home ownership options include shared ownership where a shared owner may purchase a percentage of a property and pay rent on the rest. Shared owners have the option to buy further “shares” of their property to achieve full ownership. This is called staircasing. HAs can also offer homes for outright sale but these homes are not considered social housing.

The HA business model shows similar primary and secondary income streams and costs.

³⁹ English Regulator of Social Housing, “Private registered provider social housing stock in England – stock profile” (February 2021)

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/962940/PRP_statistic_2019-20_STOCK_briefing_notes_v1.0_FINAL.pdf

⁴⁰ Properties described as “affordable rent” refer to rent charged and does not refer exclusively to homes build using grant from the Homes England Affordable Homes Programme

HA Income

HAs' primary source of income is rents. The rent increase formula for social housing is set by government. Rents are currently allowed to increase by CPI + 1% annually. HAs may also receive secondary income from outright home sales and initial and staircasing purchases of homes for shared ownership. Some HAs may also have additional income from non-social housing activities such as office blocks, student accommodation or garages. Specialist HAs also receive income from specialist services, such as care and support contracts with residents or with local authorities.

HA Costs

HAs' core costs are management costs, routine and planned maintenance costs, and major repairs. Some organisations also have service charges to cover the cost of providing communal or shared services to a building and, in some cases, the upkeep of the surrounding estate. Service charge costs are usually passed onto the tenant, however, not all the cost may be recovered. This cost difference is therefore borne by the HA.

HAs have statutory duties to ensure their homes meet the current 'decent homes standard', building regulations and statutory and regulatory health and safety requirements (which includes fire safety) and therefore will incur costs to ensure that their homes are safe and meet these standards.

The UK government has stated that social housing should be upgraded to a minimum of Energy Performance Certificate (EPC) band C by 2030, and then carbon-neutral by 2050. To meet these targets, the sector is set to spend vast sums to upgrade existing stock and ensure new developments meet the standards.

Other costs borne by HAs include depreciation charge on their housing assets, rent losses from bad debts and void properties.

Many HAs have ambitious growth programmes to increase the number of social homes they provide. The drivers for these growth ambitions vary, but the main reason is the desire to address the shortage of affordable housing across the country. HAs also lead town centre and estate regeneration programmes to improve whole local areas and the lived experience of people who live in them. Some provide additional support services to tenants which can include employment support, apprenticeships, care support, community hubs to name a few.

In order to finance growth, most HAs raise debt.

HA Debt

HAs typically have two key covenants for debt raised with banks: interest cover and gearing ratios. The gearing ratio is an indicator of a HA's appetite for growth. It assesses how much of the assets are made up of debt and the degree of dependence on debt finance. Most HAs have a gearing covenant of around 60%. The interest cover measure is a key indicator for liquidity. It compares the surplus generated by the HA from its activities to its interest costs on its debt. Most HAs have an interest covenant of around 110%. HAs use their assets as security for the debt raised.

Investors look upon the RSH favourably as there are safeguards in place, including the governance and viability standards, to ensure HAs are unlikely to default. This helps with HAs credit ratings on the bond market.

Section 2: Impact of NIR and Strategies to Respond

An overview of how affordable housing providers are uniquely impacted by the NIR environment, and strategies HAs may implement to leverage the opportunities of an NIR environment.

3 Impacts of NIRs on Housing Associations

NIRs directly and indirectly impact HAs' financial strength. Most notably, the NIR environment could pose a risk to HAs' security and rental income streams. Combined with rising costs as the result of wider macroeconomic conditions, some HAs may be unable to fund future strategies – such as delivery of net-zero carbon or more homes.

How NIRP Impacts HAs

The NIR environment is underpinned by poor economic conditions continuing despite concerted efforts by government to improve them. It includes the “before NIRP” and “after NIRP” stages. When central banks consider NIRP, they do so in response to certain economic conditions. NIRP, if implemented, could improve these conditions but it may also exacerbate them. The outcomes related to the NIR Environment which could ultimately result in NIRP and NIRP itself could significantly impact HAs, who may experience greater demand for services and investment, less income and greater financial pressures posed by exposures and security. Several potential impacts of NIRP on HAs are detailed below.

Impact on Tenants and Residents

People are impacted by an NIR environment in many ways. These include high levels of unemployment, underemployment (resulting in employee reduced hours) and wage reductions as the result of decreased spending in the economy. NIRP may mitigate this in the medium and longer terms by improving overall economic conditions. NIRP can also impact tenants directly through changes to interest rates on savings and mortgages.

Tenants' Ability to Pay Rent

Social housing tenants are economically active, and many have remained employed despite the COVID-19-related economic downturn and therefore continue to pay rent. Other tenants may be supported by benefits (e.g. Universal Credit) or by the government's furlough scheme. As a result, rental arrears and voids figures currently remain contained across the affordable housing sector. In the future, furloughed tenants may face temporary inability to pay rent if they lose their jobs when the scheme ends but should ultimately be supported by unemployment benefits. Tenants who experience reduced hours or pay cuts that do not trigger or increase benefits entitlement may however face a more lasting reduction to income.

According to latest figures on new social housing lettings, around 40% of lead tenants in general needs social housing are employed.⁴¹ Risks related to income collection are concentrated amongst general needs providers because general needs tenants are more likely to be economically active and therefore vulnerable to joblessness. Low-income social housing tenants that work in insecure, part-time jobs and in services sectors could be most adversely affected by economic downturn. These tenants may experience joblessness,

⁴¹ Ministry of Housing, Communities & Local Government, “Social housing lettings in England, April 2019 to March 2020” (December 2020), <https://www.gov.uk/government/statistics/social-housing-lettings-in-england-april-2019-to-march-2020>

reduced hours or a reduction in wages. Those tenants working in public sector and essential services, such as education and health, may be less adversely affected.

Conversely, supported housing tenants are less likely to be employed and more likely to be unable to work due to long term illness or disability. Specialist care and support HAs may as a result face a reduced risk of income collection compared to general needs HAs as the result of a higher proportion of tenants supported by benefits. This assumes government does not reduce access to or value of benefits.

In addition, NIRP could directly impact tenants' ability to pay rent. For example:

- If NIRP results in banks applying a charge to savings, some tenants may be worse off. This is an unlikely outcome as we see in jurisdictions where NIRP is applied in practice that banks are not likely to charge lower value savers.
- NIRP may result in tenants taking on excess debt if costs of debt are low.

Other Impacts of an NIR environment on tenants and residents

While the ability to pay rent is one way joblessness amongst social housing tenants and residents impacts HAs, other areas, like demand for services such as employment and benefits support may also be apparent.

Government may introduce a benefit cut to reduce overall public spend as a response to lower taxation receipts and increasing borrowings. This could have an impact on tenants' overall incomes.

A change to or reduction in benefits could change demand for benefits support. HAs experienced a large demand for benefits support during the transition to Universal Credit, which resulted in many HAs putting in place resource and support for tenants to liaise with the Department for Work and Pensions. HAs are incentivised to provide this support both as social organisations and because it supports rent collection.

NIRP will also have direct impact on the amount tenants and residents receive on interest for savings and pensions. This could encourage tenants to invest in housing through homeownership, but this is unlikely as these savings may be hard to access if invested in longer term products.

However, if NIRP is effective at encouraging banks to lend (e.g. through mortgages) there may be an increase in demand for homes for sale or shared ownership. Lower income households may lose out however if banks will only lend on lower loan to value mortgages or to those posing less of a credit risk. Government is addressing this issue through a government guarantee scheme for high loan to value (around 95%) mortgages.

Conversely, joblessness or job insecurity could negatively affect tenants' aspirations for homeownership. This could increase the demand for social rented property and reduce demand for outright sale and shared ownership.

Another potential impact is a rise in anti-social behaviour as the result of widespread youth unemployment.

Inflation Impact on Income and Costs

The NIR environment includes the before NIRP and after NIRP stages. When central banks consider NIRP, they do so in response to certain economic conditions. One of these conditions is existing or anticipation of future low or negative price inflation.

Inflation and rents

Price inflation impacts HAs directly through the annual rent increase formula set by government known as rent settlement. The current rent formula runs from 2020 to 2025, at which point it will be reviewed. It permits PRPs to increase rents by up to CPI (annual rate) +1% each year. The current rent settlement policy was welcomed by HAs after four years of annual rent decrease of -1%. This was introduced in 2015 in an effort to reduce the amount of rent government pays HAs through the benefits system. Today, 56% of social renters (including all renters who rent from an HA or local authority) receive Housing Benefit⁴² and many HAs report that 70-80% of their tenants are in receipt of Housing Benefit or its replacement, Universal Credit.

In the year to January 2021, CPI rose by 0.7%. However, during 2020, the monthly year-on-year rate of CPI dropped from pre-pandemic highs of 1.8% in January to as low as 0.2% in August. There are fears that CPI will drop further in 2021, perhaps into negative territory as the result of joblessness post-furlough scheme and low demand for goods and services by consumers as the result of poor economic outlook.

Under the current rent settlement, CPI of 0.7% means HAs can increase tenants' rents this year by up to 1.7%. While this is still an increase to tenants, it is a smaller amount than most HAs would have planned for in their business plans, which would have assumed CPI at closer to the BoE's target rate of 2.0%, so a 3.0% rental increase.

Current rent settlement means rent cuts will only come into play if CPI drops below -1.0%. While this is unlikely, it is entirely possible. In 2015, CPI fell to -0.1% and the unprecedented impacts on consumer spending posed by COVID-19 could result in a greater drop.

HA business plans are very sensitive to rents as these are the major source of HA income. As rents are already set at below market levels, margins are thin. Rents also enable HAs to invest in both their existing and new homes – making them environmentally friendly and safe for tenants.

Could rent settlement change?

It is unknown if and how government will modify rent settlement if CPI becomes negative. It is largely a political decision as it directly impacts government's housing benefit bill and the construction industry. Government could retain existing policy, but it is not impossible that government could change existing rent settlement policy before its 2025 renewal date. In 2015, government made a U-turn on rent settlement, reversing the 2013 CPI +1% policy to an absolute decrease of -1% in 2016. There is, however, a precedent where the Rent Formula was applied even though this led to a rent decrease. In 2010/11 the rent formula (which was RPI +0.5% at the time) was based on a negative September 2009 RPI of -1.4% which, when the 0.5% additional allowance was added, gave a decrease of -0.9% for the year.

There are two ways government could change existing policy:

- **Increase to rent settlement:** Government could permit HAs to increase rents by more than CPI +1%. This is unlikely as it will increase the housing benefit bill and the cost of rent to tenants who pay directly. The main group to benefit from this policy is HAs, as it would secure their income and allow them to deliver on other initiatives – such as new build and community outreach programmes – which may be required in an NIR environment.

⁴² Office for National Statistics, "English Housing Survey 2019 to 2020: headline report" (December 2020), <https://www.gov.uk/government/statistics/english-housing-survey-2019-to-2020-headline-report>

- **Decrease to rent settlement:** To combat the deficit created by COVID-19 policies and potentially to justify a public sector pay freeze, government may wish to reduce the amount of rent HAs can charge every year. This lowers the rents paid by tenants and by government through benefits. A change to existing rent settlement policy to a lower rate coupled with negative price inflation could be very damaging to HAs' business plans, as it erodes their key source of income. The four years of 1% rent cut was estimated to have resulted in a 12% reduction in average rents by 2020⁴³. In addition to the impact on the operating profit and cashflow, it also affected asset valuations. In short, one year of rent cuts is felt in all 30 years of an HA business plan.

If NIRP is successful, it should result in an increase in price inflation which will mitigate some of the risks highlighted. However, NIRP is not likely to be implemented until early 2022 at the earliest and its intended impacts may not be felt for another three or more years. HAs will look to plan for the impact on inflation created as part of the drivers for NIRP as well as the influence NIRP will have on price inflation.

Inflation and costs

Price inflation is an aggregate and does not imply all prices increase or decrease at the same rates. Smaller builders are already reporting an increase in home maintenance and improvement work, as households reassessed their living and working space during lockdown⁴⁴. Combined with some of the shortages in materials and resulting increases in prices related to Brexit, HAs could face the risk of differential inflation, which could mean that even as rents drop (as the result of negative overall price inflation), HA operating costs could increase in some areas. These areas include labour, materials and advisory costs for:

- New build
- Routine and cyclical repairs and maintenance
- Green technologies and services
- Fire safety improvements.

Specialist care and support providers may also feel the impact of not being able to reduce wages to meet a decrease in income. This could be exacerbated by the impact of Brexit on their ability to recruit and retain care and support staff.

Index-Linked Contracts and Agreements

HAs will also need to consider the impact of NIRs and CPI changes on their contracts which may be linked and/or have zero floors e.g. CPI-linked maintenance contracts, RPI-linked funding and equipment leasing.

HAs may also need to review other types of income which may have inflationary links e.g. shared ownership lease, commercial property leases, care and support contracts.

In an NIR environment, rents could decrease while service contracts could have a zero floor – and so may not decrease with rents or at the same rate, creating pressure on finances.

Security and Valuation

The NIR environment has significant impacts on HAs' ability to maintain sufficient levels of security to satisfy their lenders. In theory, security falling below a certain level, enough to breach lending covenants, means banks may take action to foreclose the debt and ultimately

⁴³ Wilson, W., "Rent setting: social housing (England)", House of Commons Library (11 March 2019) <https://researchbriefings.files.parliament.uk/documents/SN01090/SN01090.pdf>

⁴⁴ Bank of England, "Agents' summary of business conditions - 2020 Q3" (September 2020) <https://www.bankofengland.co.uk/agents-summary/2020/2020-q3>

seek repossession of the assets charged. For many HAs a breach in one loan is treated as a breach of all loans. This exposes the HA to increased costs and a standstill, at least, on new borrowing.

The ability of an HA to meet its typical covenants is impacted by rental income and asset valuations.

Interest cover from rents

Negative price inflation and/or government changes to rent settlement could decrease HAs' rental income. If rental income decreases enough over the business plan period, it may not be possible to reduce costs proportionally. Further, if an HA's financial projections show an inability to meet debt servicing requirements in the future, this is likely to result in regulatory action and potential covenant breaches. It would also impact credit ratings, potentially offsetting the benefit of reducing interest rates.

Security valuations

Security is also significantly impacted by valuations. This is because HAs use their assets for loan security. The indicator banks and HAs use to monitor this is known as an asset cover ratio. The asset cover ratio determines an HA's ability to cover debt obligations with its assets after all liabilities have been satisfied.

HAs with less valuable stock, such as those based in the North East and North West, are likely to have tighter asset cover ratios than HAs with more valuable stock, such as those in London and the South East. So, it would seem decreases in value caused by poor economic conditions are more likely to threaten HAs with less valuable stock. However, valuation methods in the sector show that this may not be the case.

There are two types of valuation methods in the social housing sector:

- **Existing Use Value - Social Housing (EUV-SH):** assumes retention of homes in the social sector and that homes will be re-let as social housing.
- **Market value – Subject to Tenancy (MV-STT):** assumes that homes may be sold outside the regulated social housing sector, and in essence acts as a market value in that properties may be bought and sold in a commercial way.

EUV-SH valuations are less volatile to housing market change being based on the future net cash flows for the property. So those northern HAs who are most likely to use EUV-SH are less likely to see fluctuations. This is important as these are the same HAs who are likely to be at greater risk of breaching asset cover ratios.

HAs on MV-STT should consider if they can switch and if there are other options to mitigate the risk, e.g. sufficient security so rents service the costs. Other options include developing a formula where sufficient properties are provided to meet annual loan (e.g. debt service) costs and are ringfenced. In effect, this is the standard funding model operated by the Housing Finance Corporation, the UK's leading affordable housing aggregator.

Furthermore, HAs with free standing derivatives usually have to provide security if the derivative falls into negative value. HAs with stand-alone derivatives may have to provide security or collateral if the Mark-to-Market value exceeds a pre-agreed threshold. This is a real risk for HAs that have executed free standing derivatives and are subject to a Collateral Support Agreement but theoretical if the fixed rate is embedded until and unless either the borrower defaults or the borrower wishes to release security from that particular lender.

Additional uncertainty exists around how valuations consider fire safety and zero-carbon works, which could also reduce valuations in the future. Nationally, HAs should pay close attention to fluctuations in the market and resultant impact on valuations and their available security and understand how these changes might affect their debt covenants.

Potential outcomes of security reduction

Whether triggered by rent cuts or reduction in asset values, a reduction in security poses a real risk to HAs. If the problem is widespread, banks may not enforce their covenants (e.g. pressuring reliance on default charges) as this could trigger further drop in asset values like those caused from mass home foreclosures during the 2008 Financial Crisis. But whether or not the banks enforce their covenants, the RSH will monitor HA financial health closely.

Some of the potential outcomes of a reduction in HA security include:

- Widespread regulatory viability downgrades, which could have an impact on credit ratings, reputation and ability to borrow.
- Lenders may implement a margin call (an increased interest rate), more security or fees from the HA if security falls below a threshold.
- HAs may not be able to borrow more to deliver their plans, e.g. development, zero-carbon upgrades and fire safety programmes.
- In an extreme scenario, HAs may not have viable business plans and the HA will come under increased regulatory scrutiny, regulatory intervention, and the HA will be forced to consider being acquired by another HA with stronger balance sheet.

Cash and Cost of Finance

In addition to the potential for reduction in security, the NIR environment also poses other risks to the availability of finance for HAs.

NIRP should incentivise banks to loan more to HAs instead of maintaining costly reserves with the BoE. Banks will in theory compete to lend, and so rates may reduce. This assumes that HAs, subject to security and other restrictions, could have the opportunities to borrow more cheap debt now. Debt is already getting less expensive in the sector with rates of less than 2% per annum for long term corporate bonds, so this outcome is possible.

What is the impact of NIRP on cash?

NIRP in theory could result in a cost of holding cash. Banks are not likely to charge small depositors to hold cash, but HAs, and in particular large HAs, may be subject to similar cash holding charges that have been applied to corporate depositors. Banks usually evaluate size by company turnover.

If banks charge HAs to hold cash, HAs and especially those who borrowed in 2020 as a COVID-19 risk mitigation measure, may wish to reconsider how much cash they hold and the risks of doing so.

What happens if NIRP does not work as intended?

There is a potential that NIRP results in opposite outcomes than intended – namely less debt that is not less expensive. For example, banks may deliberately shrink their balance sheets to avoid the BoE storage penalty posed by NIRP. This would mean reducing assets (e.g. future loan repayments) to reduce liabilities (customer savings and deposits requiring storage). This would have an opposite effect to that intended by NIRP, reducing lending capacity to HAs.

And banks are not guaranteed to pass savings onto lenders. While they may be able to borrow at lower rates, they may apply higher fees to the transactions.

It should also be noted that many HAs are on fixed rate loans already, and that new facilities make up a small proportion of HA borrowing every year. Much of HA borrowing activity occurs through refinancing, and so intended benefits of NIRP would be marginal in practice. In a worst-case scenario, costs will remain the same or increase where rental income decreases.

The NIR environment, including its potential impact on HA income and security, could also result in credit rating pessimism. While in the past year, large HAs have had their credit ratings reaffirmed despite risks posed by COVID-19, these assessments have come with “negative outlooks” which suggest HAs’ income could reduce in the next few years.⁴⁵ Lower credit ratings may result in decreased appetite from lenders to lend to HAs or HAs borrowing at less favourable rates.

What are the opportunities if NIRP is successful?

The NIR environment could benefit HA borrowing and create opportunities elsewhere.

It could have a positive impact on HAs with variable rate finance, since rates should go down. On the other hand, those HAs with fixed-rate finance will not have this benefit.

In a world where returns are very low and some investors are already accepting negative longer-term returns⁴⁶, the “slightly positive and low” characteristics of the HA income model may be increasingly more attractive to institutional and capital markets investors, like bonds and pension funds. While there are some risks to HA income, generally HAs are considered a “safe bet”. In addition to the longer-term nature of the income model, there are several reasons why HAs are investable:

- During times of economic recession, need and demand for affordable housing will increase as the result of joblessness and resultant affordability pressures. And when market conditions return, demand for affordable housing remains.
- A large proportion of HA income is “guaranteed” through the government’s housing benefit system. While the transition to Universal Credit (a combined benefit) challenged this initially, HAs have adjusted to the change and can request the housing cost element be paid directly to them via the Direct Rent Payment service. Direct payments reduce the risk of tenants falling into arrears.
- Apart from the exposure to CPI posed by rent settlement, social housing rents are protected from drops in home prices and private rents.
- The social housing sector has a strong regulatory system which acts to protect tenants and social housing assets.

Market and Sales Exposure

While HAs primarily provide social rented homes at rates set by government, many HAs including those with mixed portfolios also provide homes at other rental points and home ownership tenures and commercial properties with indirect and direct exposures to real estate and wider commercial markets.

⁴⁵ Brady, D. “Two housing associations in England have had their credit ratings affirmed despite the coronavirus crisis, albeit with ‘negative’ outlooks.” (May 2020), <https://www.insidehousing.co.uk/news/news/two-housing-associations-have-credit-ratings-affirmed-despite-pandemic-66459>

⁴⁶ Atherton, M. Sunday Times. “Negative rates are here already for some investors” (25 October 2020), <https://www.thetimes.co.uk/article/negative-rates-are-here-already-for-some-investors-gwzxxkcg>

In an NIR environment, these exposures could have an impact on HA business plans especially for those HAs with higher proportions of affordable and market rental housing or those with large development programmes with open market sale and shared ownership.

Rental Market

HAs with a large portfolio of affordable and market rented properties may see a reduction in income in an NIR environment. Reasons include lower rents, particularly in London and cities, and a potential increase in arrears as the result of joblessness post-furlough scheme.

The effects of COVID-19 have had some negative impact on the private rental market, but overall demand has been supported by lower rents.⁴⁷ One of the exceptions is central London, where a decrease in demand by commuters has resulted in an oversupply of rented homes. HAs providing homes at market rent are more likely to be based in London and the South East and may see a tightening on the margins received on market rented properties.

So far, there remains only a small increase in rent arrears. There is a concern that when the furlough scheme ends arrears could increase across all rental tenures.

Sales Market

The effects of the NIR environment on the housing sales market are still relatively unknown, but so far house prices have continued to rise despite economic conditions. Over the year to December 2020, UK average house prices increased by 8.5%⁴⁸. Reasons experts provide for housing market buoyancy include changing housing needs and desires created as the result of pandemic-related social change and government-enacted Stamp Duty exemption on a portion or whole property price.

If house prices continue to rise, developing HAs could see an improved position post-NIRP implementation. New and variable rate borrowing may be cheaper, improving the position of existing and new homeowners. Lower rates of borrowing for HAs may result in sustained or improved viability of programmes in the future and there may even be room for HAs to expand their programmes.

Over the medium term, NIRP should improve or maintain stable housing market conditions as it encourages employment and a healthy level of price inflation, which all contribute to house prices.

But in the short term or if NIRP is unsuccessful, there could be a slight drop in house prices as the result of worsening or continued economic recession and lower land prices. Some HAs could do well from such a change, and especially those with existing borrowing capacity, as it could provide an opportunity to purchase inexpensive land now with cheap debt for development. This was one of the outcomes of the post-2008 Financial Crisis and allowed many HAs to pursue a period of successful new build development. But HAs with large, planned development programmes and existing land holdings could see that shared ownership is no longer viable or that open market sale does not create sufficient surplus for reinvestment.

⁴⁷ Bank of England, "Agents' summary of business conditions - 2020 Q2" (June 2020)

<https://www.bankofengland.co.uk/agents-summary/2020/2020-q2> and "Agents' summary of business conditions - 2020 Q3 (September 2020) <https://www.bankofengland.co.uk/agents-summary/2020/2020-q3>

⁴⁸ Office for National Statistics, "UK House Price Index: December 2020"

<https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/housepriceindex/december2020>

Another negative consequence could be the potential for banks' reduced appetite to lend to risky first-time buyers. This could be partially offset by the government's upcoming "95%" mortgage guarantee scheme.

If borrowing rates are more favourable for HAs in future, government may lower grant rates but this is currently unknown.

HAs could mitigate some of these risks by converting some homes intended for sale to affordable rental if modelled as viable.

Despite price growth during 2020, there are some indications of a slowing housing market. For example:

- There is regional variation in house price change. In the year to December 2020, the North West was the English region to see the highest annual growth in average house prices (11.2%), while London saw the lowest (3.5%). This gap could continue to widen in particular if consumer shifts result in a decrease in demand for homes in London.
- Parts of the market are already constrained by a lower availability of high loan to value mortgages likely due to a combination of high demand for mortgages and banks' hesitancy to lend in light of future economic uncertainty.
- Housebuilding starts are down 8% in the year to September 2020⁴⁹. This follows a 52% quarterly drop in starts over the April to June 2020 period⁵⁰, during the height of the first lockdown. Drivers for this trend are likely to do with an overall economic outlook post- COVID-19 but could also include the end of government programmes in 2021 such as the Help to Buy equity loan scheme.

Impact on Mortgages

Under NIRP, banks should be more willing to lend and at more competitive rates. They may also provide loans (including mortgages) to riskier borrowers to increase margins, although this is unlikely given regulations barring banks from doing so. If mortgages are more readily available, this could support a strong housing market and prices. This could be positive for HA development programmes and increase demand for homes for outright sale and shared ownership.

But if economic conditions worsen alongside implementation of NIRP, banks' appetite to lend to some borrowers (e.g. first-time buyers) and for some homes (e.g. those in areas where prices are more likely to fall) could fall sharply due to lower margins and higher risk. As a result, banks may expect some borrowers to contribute higher deposits.

In addition to exposure to house markets, some HAs may also be exposed to services such as care and support and student accommodation which could be negatively impacted by changes to demand, costs and income.

⁴⁹ Ministry of Housing, Communities and Local Government "Housing supply: Indicators of new supply, England Statistical Release January to June 2020" (September 2020)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/922911/Housing_Supply_Indicators_Release_June_2020.pdf

⁵⁰ Ministry of Housing, Communities and Local Government "Housing supply: indicators of new supply, England: July to September 2020" (November 2020)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/952057/Housing_Supply_Indicators_Release_September_2020.pdf

Social and Environmental Responsibility

HAs are under increased social, political, regulatory and business pressure to respond to Environmental, Social and Governance (ESG) ambitions. Some of these come at a steep cost. HAs require around £104bn in investment to retrofit all the UK's social homes to make them carbon neutral⁵¹ and around £10bn⁵² to make their homes fire safe.

In a world where income is lower due to rent cuts and higher arrears, and where security is lower due to stock and revenue stream devaluation, housing associations will struggle to find the cash or to borrow to deliver these ambitions.

But if NIRP is effective at making borrowing less expensive to HAs and if homes retain their value enough to support these investments, this may pose a real opportunity for HAs to deliver on these ambitions.

⁵¹ Health, L. "The cost of net zero: social landlords' decarbonisation plans revealed", Inside Housing <https://www.insidehousing.co.uk/insight/insight/the-cost-of-net-zero-social-landlords-decarbonisation-plans-revealed-68497>

⁵² Apps, P. "Cost of fire safety work for housing associations will 'easily exceed' £10bn" Inside Housing, (2 March 2020) <https://www.insidehousing.co.uk/news/news/cost-of-fire-safety-work-for-housing-associations-will-easily-exceed-10bn-65265>

4 Strategies to Respond to NIR Opportunities

The following strategies have been developed drawing on insights provided by experts. The strategies have been discussed and scored with the research sponsors in a workshop, to test their applicability for a range of HAs.

Suitability, Feasibility and Acceptability Criteria

To understand how the strategies could be received by the sector, sponsors were asked to rank each strategy according to three criteria: its suitability, feasibility and acceptability (SFA) as shown in the table below. While more detailed modelling on an organisation's business plan may be required to assess suitability, feasibility and acceptability of a strategy, the sponsors' views provide an indication of potential wider reception of the strategies within the sector.

The table below contains a summary of the criteria and prompting questions for sponsors.

Table 5: Suitability, Feasibility and Acceptability Criteria

Factor	Guiding Questions
Suitability	<p>Does the strategy meet the requirements of your organisation and business model?</p> <p>Does the strategy fit when considering your current level of fixed interest debt?</p> <p>Does the strategy fit with dependency on rental yields and / or the cross-subsidy model?</p>
Feasibility	<p>Is the strategy financially viable for your organisation within your current business plan?</p> <p>Does your organisation have the skills and resources to implement the strategy?</p>
Acceptability	<p>Does the strategy help achieve efficiency?</p> <p>How acceptable would the strategy be to key stakeholders e.g. executive, board, RSH, staff, residents and external partners such as local authorities and lenders?</p>

Strategies and Assessments

Strategies that HAs could employ to respond to an NIR Environment and that have been tested with research sponsors include:

1. Borrow Cheaply Now and Land Bank

2. Leverage a Leasing Model backed by Impact Equity
3. Reduce Balance Sheet Debt
4. Outsource Services

Each strategy is described in more detail below. Each strategy contains a summary, the benefits, disbenefits and risks and the outputs of the SFA workshop exercise with sponsors.

Strategy 1: Borrow Cheaply Now and Invest

About the Strategy

The strategy would involve HAs leveraging the preferential borrowing opportunities in an NIR Environment to invest in future assets (e.g. land banking for future development) or income generating activities, e.g. new services or housing assets.

The strategy assumes:

- Banks will lend more cheaply but may require more security and be less likely to accept new development schemes as security.
- HAs' borrowing capacity may be limited.
- Capital markets investors may see HAs as a safe bet and make more favourable offers to HAs.

As a result, HAs could use new cheap debt to purchase assets such as land at low values. If purchasing land, HAs may then hold the assets (and service the debt costs) until it is appropriate to develop the sites. It should be noted that credit ratings agencies may grow more pessimistic towards HAs with increased exposure to new build development so this risk should be considered alongside other risks of the strategy.

Benefits, Disbenefits and Risks

The benefits, disbenefits and risks of the strategy are included in the table below.

Table 6: Benefits, Disbenefits and Risks of Strategy 1

Benefits	Disbenefits	Risks
<ul style="list-style-type: none"> • Cheap borrowing provides opportunity to build new homes in future • Surplus on new homes could be reinvested for more social housing or other purposes (zero carbon or fire safety) 	<ul style="list-style-type: none"> • Could max out HA borrowing capacity • Land bank must be managed with resultant skills and resource implications • Planning policies may prevent HAs from land banking • Land prices could fall resulting in impairment 	<ul style="list-style-type: none"> • Could max out HA borrowing capacity • Land values could fall further resulting in need for disposal and realised losses • Reduced HA income may risk ability to develop on land holdings in the future

Suitability, Feasibility and Acceptability

Sponsors feedback on the strategy shows the following SFA rankings. Commentary is also included below:

- Suitability: High
- Feasibility: High

- Acceptability: High
- **Overall Assessment: High**

Results were surprising, with some larger HAs commenting that they already held substantial land banks and so this may not be the source of investment if this strategy were to be pursued. One sponsor raised that in a NIR and deflationary or negative inflation environment, there could be pressure on interest cover so they would not wish to invest in non-income generating / reducing value assets.

Medium / smaller HAs would consider the strategy as an option though there would be pressure on asset cover ratios if investing in assets was not easily available for security.

Furthermore, sponsors expressed that holding cash raised under bond issues would become less attractive so other options would need to be considered, e.g. paying down of suppliers and other non-loan liabilities

Strategy 2: Leverage a Leasing Model backed by Impact Equity

The strategy would involve HAs leveraging a leasing model to increase capacity to deliver homes and services. Impact equity investors, for instance, may provide equity for the homes, which are managed on long leases by the HAs. Impact equity investors are still relatively small in the sector but are emerging. The funds are managed by firms like CBRE and Cheyne Capital.

The model works by funds partnering with HAs to fund the development and acquisition of new homes which are provided back to the HAs on long-dated leases, often with an index-linked annual payment.

Equity capacity is much lower than debt finance in the sector but offers some additionality particularly if banks are increasingly reluctant to lend.

The benefits, disbenefits and risks of the strategy are included in the table below.

Table 7: Benefits, Disbenefits and Risks of Strategy 2

Benefits	Disbenefits	Risks
<ul style="list-style-type: none"> • Equity not subject to regulatory debt ratios, so it increases capacity for HAs to deliver more with their debt (like zero carbon or fire safety) 	<ul style="list-style-type: none"> • Not cheaper than debt as equity investors take on more risk (sometimes actually expensive and index-linked) • HAs should expect a stronger relationship with the investor as they will be taking on greater risk • HAs do not acquire long terms assets (though there may be a final purchase option) 	<ul style="list-style-type: none"> • If values increase, no asset to secure future borrowings • Could compromise independence of HA governance especially if goals diverge • Could impact other borrowing capacity, including where lenders have first charge • Rents may not increase sufficiently in future to support lease costs

Suitability, Feasibility and Acceptability

Sponsors feedback on the strategy shows the following SFA rankings. Commentary is also included below:

- Suitability: Low
- Feasibility: Moderate / Low
- Acceptability: Low
- **Overall Assessment: Mixed with some strong negative views**

Generally, the strategy was unpopular although some HAs would consider it as a way of increasing capacity where borrowing for development was unavailable to them. Sponsors are aware of the negative publicity and RSH views on long term leases so would generally avoid this as an option.

Some participants were aware of latest types of lease which are more favourable to the HA and therefore may meet RSH viability requirements. These could include 10–15-year options that are not CPI+1 linked, and which have break clauses or force majeure clauses. HAs could consider these as an option where Balance Sheet capacity or security for new debt is an issue.

Strategy 3: Reduce Balance Sheet Debt

The strategy would involve HAs freeing up security by reducing their debt levels, making room for borrowing at more preferential rates in the future.

The strategy applies in particular to HAs with significant development programmes. It assumes:

- HAs with existing variable debt could use a reduction in base rate as an opportunity to reduce debt on their balance sheets.
- Increased breakage costs could make this impractical for fixed rate debt though this would need to be weighed up against the cost of carry of exec cash raised through capital market issues.
- HAs with significant variable rate debt that are concerned about future borrowing capacity may decide to reduce total borrowings by reducing their development programmes.
- HAs may then decide to restart the programmes when capacity increases and lower interest rates make schemes more viable (potentially in a future with lower land and build costs).

The benefits, disbenefits and risks of the strategy are included in the table below.

Table 8: Benefits, Disbenefits and Risks of Strategy 3

Benefits	Disbenefits	Risks
<ul style="list-style-type: none"> • HAs pay less for their existing and future debt • Savings increase capacity to deliver more with new debt (like zero carbon or fire safety) 	<ul style="list-style-type: none"> • HAs may not be able to quickly respond to policy ambitions for new development or a favourable market • Costs of debt restructuring may outweigh benefits 	<ul style="list-style-type: none"> • HAs may risk overall viability if rely on cross-subsidy from development • Rates could continue to go more negative in the future

Suitability, Feasibility and Acceptability

Sponsors feedback on the strategy shows:

- Suitability: Moderate
- Feasibility: High
- Acceptability: Low
- **Overall Assessment: Moderate**

When tested with sponsors, the strategy was moderately popular.

Sponsors expressed that they are already closely managing debt (e.g. through Revolving Credit Facilities) and are already able to pay down as much as possible so had little room to restructure and reduce debt without incurring significant costs.

Sponsors also noted that that Mark to Market valuations and therefore breakage costs would increase, but there would be a point where they would look to restructure financing to utilise cash which could prove an opportunity.

Strategy 4: Outsource Services

The strategy would involve HAs looking at opportunities presented by the NIR environment, such as outsourcing, to deliver more cost-effective services.

Historically, outsourcing has had some success in helping HAs deliver value for money.

In an NIR environment where costs disproportionately increase compared to income (i.e. rents tied to inflation), HAs may wish to outsource some functions to make savings.

Commercial housing management companies may offer more competitive offers especially if other parts of the market – e.g. institutional rental or student housing margins suffer as the result of the COVID-19 pandemic.

Sponsors noted that other opportunities could include combining services. Sponsors all had growth ambitions and stated that they were able to increase efficiencies and make savings on corporate functions as they did so. Many noted that services that were previously outsourced had been brought in house as RPs had grown/ merged.

Table 9: Benefits, Disbenefits and Risks of Strategy 4

Benefits	Disbenefits	Risks
<ul style="list-style-type: none"> • HAs pay less for outsourced services • Savings increase capacity to deliver more with new debt (like zero carbon or fire safety) 	<ul style="list-style-type: none"> • Outsourcing will take time to implement • Growing / larger associations may be able to deliver services more efficiently in house. 	<ul style="list-style-type: none"> • Outsourced services can be difficult to manage and therefore fail to deliver VfM • Outsourced services may be of lower quality

Suitability, Feasibility and Acceptability

Sponsors feedback on the strategy shows:

- Suitability: High
- Feasibility: Moderate / Low
- Acceptability: Low
- **Overall Assessment: Low**

When tested with sponsors, the strategy was generally unpopular. Sponsors all had growth ambitions and stated that they were able to increase efficiencies and make savings on corporate functions as they did so. Services that were previously outsourced had been brought in house as RPs had grown/ merged.

Other Tactics for HAs to Consider

HAs may also wish to consider other tactics to respond to opportunities and challenges posed by NIR environment. These include:

- **Holding and Use of Cash:** Under NIRP, banks may require organisations of a certain size to pay to hold their cash. Strategy 1 suggests HAs may use their cash. In addition to this, HAs may also wish to re-consider when they make payments for services or contracts and instead of waiting until the end an invoicing period, pay upfront or at the beginning of the contract wherever possible.
- **Methods of Providing Security:** In order to make better use of existing property security, some larger RPs and especially those with "hard-to-secure" stock, are negotiating with lenders to share the security portfolios rather than having discrete properties charged to their loans. The lender is allocated a percentage of the portfolio, which is managed usually digitally by a Trustee, as security for their debt which reflects the minimum requirement to secure that debt and the security requirement for individual debt can go up or down as the debt increases through further drawings or reduces through repayment.

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