

Meet the new boss?

Credit rating Agencies and the Financialisation of Housing Associations in England

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Overview

- **Financialisation: different levels of analysis**
- **The growth of the bond market in the HA sector in England**
- **The role of CRAs**
- **The changing nature of HA regulation**
- **Future tendencies and counter-pressures in the impact of CRAs on large HAs**
- **Situating the role of CRAs in the sector**

Financialisation

*'neo-liberalism both promoted and legitimated the financial sector and its role in the economy. It did so by fiercely attacking the notion that industry created more value than did finance and services, it helped to develop new models of the financial sector and it promoted what became known as 'financialization'. **This signified the attempt to reconstruct the finances of every organization and of every individual citizen to allow them to borrow and to raise spending.** This tendency had long existed within modern financial economies, but now it was raised to a new height'*

Gamble 2008: 79. emphasis added.

Financialisation: interconnected levels of analysis

- at the level of *political economy*: circuits of capital and globalisation (Aalbers, 2016; Aalbers and Christophers, 2014; Gamble, 2009)
- at the level of the *sector*; the post-crash financial culture (Lanchester, 2010; Kay, 2015)
- at the level of *institutions*: shifts in culture and focus and the consequences (Fernandez et al, 2015; Aalbers et al, 2017)
- at the level of *national and local housing markets* and its consequences for displacement and renewal (Fields and Uffer, 2015)
- at the level of *financial instruments*: mortgages - switch from facilitating home owners to facilitating global investment (Aalbers, 2008)
- at the level of the *household*: the rise of investor subjects (Martin, 2002; Langley, 2008) '*financial rationales and values have infused areas of life that were once held to be more or less private and beyond the direct reach of capitalist financial calculation*' (Christopherson et al, 2013)

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Financialisation and Housing Associations

“The presumption of rights of access to housing, education and health care are being replaced by the acceptance of individual financial participation and calculation. Housing... is a site of individualised life course management..”

Bryan and Rafferty (2014: 414)

Housing associations in England:

- **large asset base**
- **insulated from sharp end of market risk (esp. through grant and rent subsidy)**
- **ripe for special attention from the bond markets in the wake of the GFC**

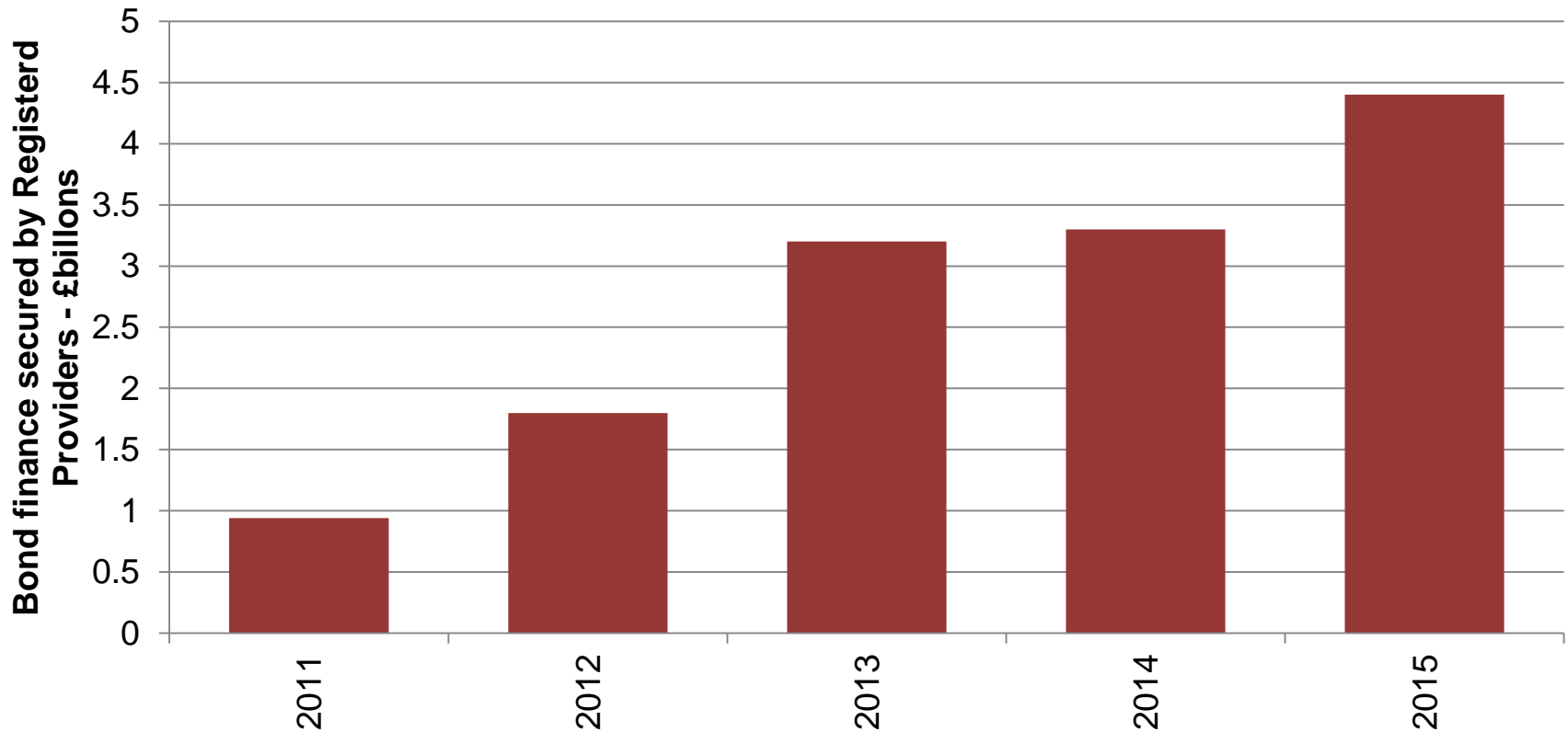
The development of bond finance

- ***“why does a [Dutch] social housing provider bet on interest rate fluctuations?”*** (Fernandez et al 2015:. 3)
- **UK HAs began issuing investment bonds post 2007/08 crash**
- **Push and pull - Response to caution, covenants and high borrowing rates from bank loans and interest from financial sector**
- **Amounts rose sharply to £4bn by 2012: equivalent to all bond issues made in the previous 25 years**
- **A new terrain: HAs accounted for 45% of all UK corporate bonds (>20 yrs) issued in 2014 and 80% of those in first quarter of 2015**
- **in 2015 41 bond issues or private placements were made with HAs, totalling £4.4 billion**

Financialisation and institutional change in HAs

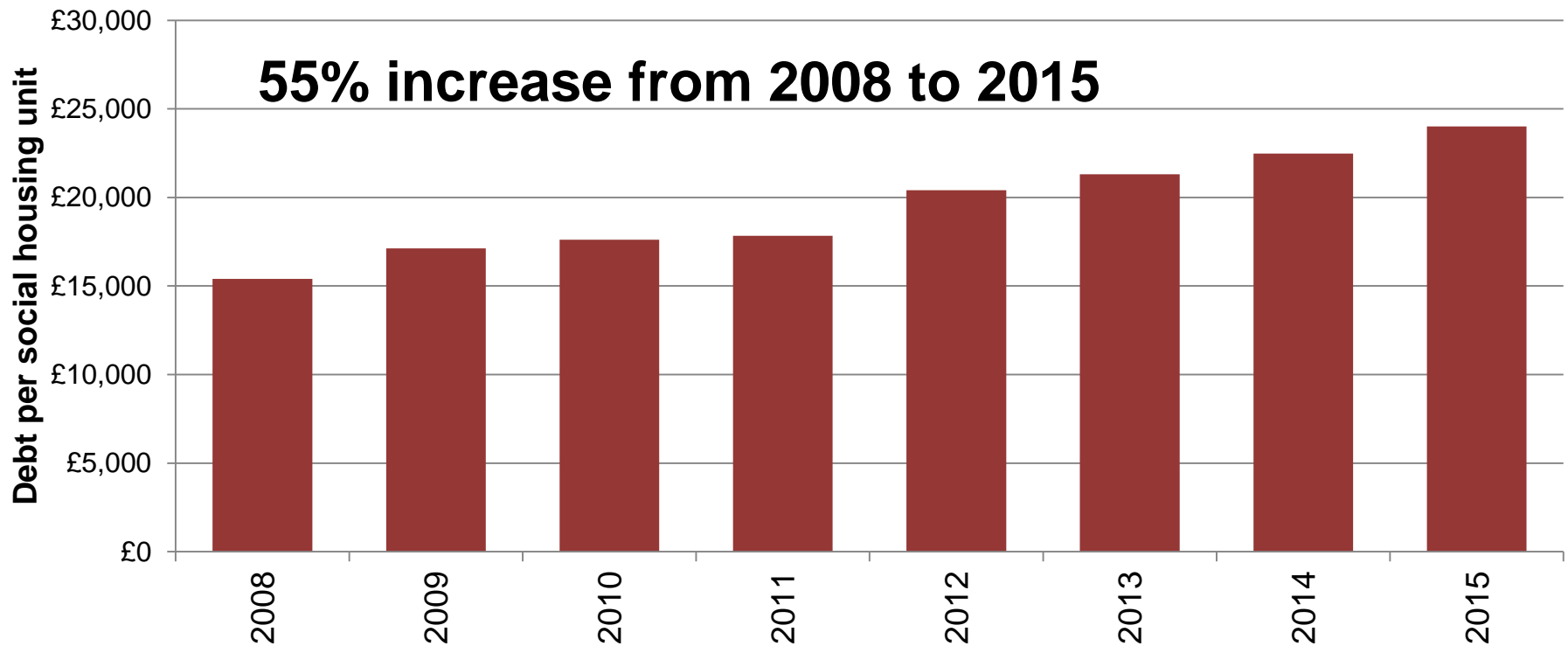
- **akin to building society deregulation in the mid-80s? (Martin and Turner, 2002)**
- **consolidation and merger prevalent**
- **a shift to London and the south**
- **re-branding and de-localising**
- **shift in ethos of Board membership - focus on commercial acumen and monitoring financial risk**
- **sharp increase in CEO pay**

The growth of bond finance



Analysis by Ben Pattison, CRESR. Taken from: HCA global accounts 2012 to 2015

Debt gearing of Housing Associations



Analysis by Ben Pattison, CRESR. Taken from: HCA global accounts 2012 to 2015

Research Questions

- **How has financialisation changed the relationship between housing associations, policy actors and the financial sector?**
- **How much influence have credit rating agencies acquired over larger HAs since the GFC?**
- **To what extent has this role affected the balance between social mission and commercial activity?**
- **What are the implications for the 'hybrid' status of HAs (Mullins), the future of regulation and the future structure of the HA sector?**
- **Will the influence of CRAs in the sector inevitably increase?**

Methods

- **work in progress**
- **analysis of available financial data**
 - Global accounts of G15 housing associations
 - Financial market reports
 - Data from Homes and Communities Agency
- **interviews with eight HA chief executives/ finance directors in 2016**
- **interviews with an officer from one credit rating agency and a recent employee from another**

The Role of CRAs (1)

- **generally under-researched area**
- **interest here is in corporate bond issues not household credit rating**
- **not independent agencies: private sector, profit seeking organisations embedded within the workings of the capital markets**
- **turned 'uncertainty' into 'risk'**
- **Moody's- global revenue of US\$ 3.5 billion and dividend payment of \$ 272 million (2015)**
- **CRAs have become central players in increased debt levels in all economic sectors, as borrower/investor relations turned from financial institutions to financial markets**
- **Moody's, Standard and Poor (S&P) and Fitch constitute 95 per cent of the global market (40% Moody's; 40 % S and P ; 15% Fitch)**

The Role of CRAs (2)

- **not a great track record:** *The three credit rating agencies were key enablers of the financial meltdown. The mortgage-related securities at the heart of the crisis could not have been marketed and sold without their seal of approval. Investors relied on them, often blindly. In some cases, they were obligated to use them, or regulatory capital standards were hinged on them. This crisis could not have happened without the rating agencies (US Inquiry into the Financial Crisis)*
- **determine the credit (default) risk level of bonds: shorthand signals to (eg) pension funds**
- **CRAs codify to remedy severe information deficit (Stiglitz, 2000) among lenders - even if they do get it wrong (eg CDOs in the US)**
- **potential conflict of interest as paid by bond issuer: CRAs became too eager to please their customers (Carruthers, 2010)**
- **pre GFC they became over-stretched and insufficiently vigilant : financial community is prone to herding and hubris**

Credit rating scores

- **AAA/AA/A**
- **BBB/BB/B**
- **CCC/CC/C**
- **D (default)**
- **may be nuanced with a + or -**
- **the new performance metric for power-hungry CEOs!**

CRAs and the HA Sector

- **Use accounting information to calculate performance**
- **Metrics include operating margins, interest cover (diversity) and gearing measurements; thresholds rather than targets**
- **Similar role to auditors in that give assurance to users of the information they publish about issuers of financial instruments**
- **Higher ratings produce lower interest rates for borrowing**
- **Total HA debt now > £80 billion**
- **On the government balance sheet (for now) after ONS reclassification**

The Privatisation of Regulation (1)?

- **ensure new entrants to corporate bond market speak the language of finance and internalise the metrics of the CRAs**
- **preparing for a bond issue - tests level of in-house expertise in HAs**
- **HAs use consultants to offer a shadow rating before they go out for assessment**
- **initial assessment very thorough (especially Moody's) and ongoing - with six monthly checks extending *'it's initially a lot more effort to get it, but once you've got it, it's light touch'***
- **broad overview of capability: governance, Board membership, strength of local markets (*'we needed to convince them the North was not all flat caps'*) as well as core financial viability**

The Privatisation of Regulation (2)?

- **CRAs more competitive than banks** : *'banks basically offer a safety net covenant just to make sure you don't go any lower than this, whereas the agencies, they don't mean to but they create a more competitive thrust to improve your rating or look at other people. It is more of a competitive thrust to improve your finance..(with) incentives to improve.'*
- **A long -term disciplinary function.** *'if we get a ratings downgrade it's not the end of the world; you've still got your bond, you've still got your money... but it's the next time you go out for capital funding, you don't want to look like you've been bouncing up and down the ratings, so it's a long term thing'.*
- **HCA following in the wake of CRAs? - the IDA.** *'I think that (IDA) ended up being of a similar level of intrusiveness as the credit rating and focused very much on similar issues around viability and governance...they followed the rating agency's process a bit I think, they (HCA) focus a lot more on operating margin levels, surplus and ratios within your core business to see how efficient you are and all that sort of stuff'*
- **HCA role is also in flux - tomorrow (April 6th) sees deregulation on disposal, restructuring, merger and acquisition. And will become Homes England!**

Impacts of credit rating

- **on operational priorities**
- *'the lettings business churns out at the moment in the margin of mid to high thirty per cent. but the sales element churns out twenty to twenty five per cent'* CRAs press for an operating margin of 30 per cent or over
- **on financial standing** *'they poured over the business plan'. 'Relaxed? They are never relaxed!'*
- **on organisational structure**; use of SPVs or dormant companies to issue bonds (to avoid banks repricing existing debts). But rating is then assigned to the group as a whole
- **on logics, rationales and behaviours? Governmentality**
- *'the planning team, the treasury team, the finance director, the executive team...we are all aware of the impact of doing various things we are rated on.'* **OR...**
- *'it's not transforming your business - it's just a way of raising cash.'*

But..

- **not a comprehensive capture of the HA sector: contradictions and counter-currents remain**
- **many HAs will retain strong social purpose (for now..): one G15 has refused bonds and another accepted lower credit rating**
- **several major mergers have failed or have been problematic, partly due to clashes of culture**
- **bond issue for Northern HAs are rare: 'most of them (national HA CEOs) think the north isn't worth being in, the really big ones, more and more say 'we're massive, we're going to do this, do that, but it's in the south..they're not bothered about sweeping up the north'**
- **future of bond markets uncertain**
- **CRA pressure for more social rent for HAs in the North**
- **still some oppositional space - e.g. SHOUT.**

Issues for the future

- **continuing conflict between i) pressure from CRAs to de-risk and ii) government policy to encourage more market - based activity**
- *'It is not our role to reward HAs for following government policy. We report on their ability to repay debt.'* (CRA officer)
- *'anything that smacks of sales risk is a down point for them, so the fact that we had a big core business of social housing they found very comforting. They were a little but wary of care and support, because it's not directly core business, but they were more wary of setting up a huge for sale programme (CEO, large Northern HA)*
- **prospect of HA sector split into three parts?**
- **the impact of future reclassification of HAs as private sector bodies; government as no longer the backer of last resort**
- **what will happen if an HA fails? (eg Cosmopolitan in 2013 and Vestia in Netherlands) (Aalbers et al 2017)**
- **possible future transfer of assets to a private equity fund to acquire the portfolio - major implications for the sector and for tenants!**

Situating CRAs in the HA sector

- **selective and partial impact**
- **and inconsistencies in approach between CRAs**
- **blends with and shapes wider trends - eg HA Board membership, risk-based focus, changes in HCA regulation**
- **CRAs as 'gate keepers ' but also 'gate openers'**
- **an intermediate point between regulation and deregulation for major players?**

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