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*improving living in scotland*



**Consultation Response to the  
Scottish National Investment Bank Bill**

**31 October 2018**

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## ABOUT HOMES FOR SCOTLAND

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Homes for Scotland is **the** voice of the home building industry.

With a membership of some 200 organisations together providing 95% of new homes built for sale in Scotland each year as well as a significant proportion of affordable housing, we are committed to improving the quality of living in Scotland by providing this and future generations with warm, sustainable homes in places people *want* to live.

Visit [www.homesforscotland.com](http://www.homesforscotland.com) for further information and follow us on twitter @H\_F\_S

## PROCESS

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Homes for Scotland represents members on a wide range of issues affecting their ability to deliver much needed homes.

Our views are endorsed by committees and advisory groups utilising the skills and expertise of key representatives drawn from member companies.

Homes for Scotland hosted a consultation event with Scottish Government on 9 October. This consultation response echoes the views shared at this helpful session.

### Introduction

The home building industry in Scotland plays a central role in the physical, economic and social fabric of Scotland. Home building has become increasingly recognised by the Scottish Government as a driver of economic growth. The important contribution that home building can make to wider outcomes (such as improved health, educational attainment and the development of sustainable communities) is also gaining stronger recognition.

A healthy housing market is key to the economic wellbeing of Scotland. The Scottish Government wants the Scottish National Investment Bank (SNIB) to be the cornerstone of the Scottish economy, we believe strongly that housing should be the cornerstone of the Scottish National Investment Bank.

Homes for Scotland (HFS) is keen to work with the Scottish Government in the development of the SNIB. We are a solution driven organisation that is very well placed to help shape the support that will become available to ensure the opportunities to increase housing supply are maximised. We urge the Scottish Government to work closely with us on this exciting opportunity for Scotland.

### Consultation Questions

Given the nature of our organisation which is focused on housing delivery, we do not intend to respond to each of the technical governance questions set out in the consultation. Our response will concentrate on the sections that cover the opportunity, the bank's objective/purpose and the focus for investment activities.

To provide useful context we have also included more general observations in response to statements extracted from the consultation to emphasise the opportunity within the housing sector for SNIB.

Finally, we have offered a view on both ethics and the resourcing of the bank to outline what we see will add to the value that can be delivered through SNIB activities.

### **Question 1: Are the proposed objectives and purposes for the Bank the most appropriate to deliver the Implementation Plan's recommendations, and to fulfil the Bank's potential contribution to increasing sustainable economic growth?**

We are supportive of the proposed objectives and purposes for the Bank and see strong links to housing delivery in fulfilling the banks potential contribution to increasing sustainable economic growth.

**“The Bank will serve businesses who wish to innovate and grow but find the traditional routes to finance challenging. By providing a single point of access to investment, and adopting a strategic focus and risk appetite that is different, the Bank can fuel the economy and catalyse additional private sector investment.”** (P3, Ministerial foreword)

We see a significant role for the bank in housing delivery, offering investment to companies and in market areas where gaps in market provision currently exist. HFS is keen to see growth in the small scale home builder section of the market, we wish to encourage new entrants and enable existing companies to grow. There is also a particular role for the bank to provide investment for housing delivery in areas where the market is less strong and the risk therefore greater, to support development in rural areas and to enable regeneration in post-industrial areas. At this point, we are keen to raise awareness of an important project HFS is leading in collaboration with the Scottish Government to better support housing delivery from small scale home builders. This project is an excellent example of collaboration and the group is very well placed to help shape the development of the bank and we would therefore encourage early engagement. Details of the project are provided below.

## Small Scale Home Builders Project – Commenced June 2018

**Project Objective** - To reduce barriers to allow small builders to build more homes and encourage new entrants into the industry. The project aims to address the specific constraints experienced by small scale builders and develop solutions.

**Leadership and participation** - Chaired by Andy Pearson as Ambassador for Small Scale Home Builders on behalf of HFS. It is a collaborative project with strong engagement from the Scottish Government. Input is led by the 'More Homes Division: National Supply Strategy', however we also have the Financial Innovation Unit, Architect and Place, Planning and Analytical Services represented in this project. In addition to member companies of HFS, Heads of Planning Scotland (HOPS), the Association of Local Authority Chief Housing Officers (ALACHO) and Scottish Water are also represented.

**Background** - The continued constraints on bank lending to small scale home builders continues to be a major problem. This issue is not only affecting the companies concerned but is also seriously impacting on our overall ability to increase housing output and support a growing population. The role of planning for small developments, with a complex application process and with the conditions often attached, can also have an impact on development viability. The costs associated with unlocking smaller sites, especially in relation to fees, pre-consent reports and contributions: all required up-front, restricts a home builders ability to attract finance on fair and equitable terms. Mainstream lenders will not fund pre-consent investment.

In 2016 the Scottish Government undertook a survey to explore the obstacles to building. Sixty-six SMEs responded. Whilst builders were optimistic for the future, the respondents to this survey were facing a multitude of barriers to building. The findings suggest that developers' top obstacle was financial, and while fewer companies expected to experience this as a problem in the future it was still noted as the issue expected to be the remain as the biggest barrier.

**Disproportionate impact of barriers on small scale home builders** - Lenders risk appetite correlates directly to the risk and uncertainty of the development process. Most small builders are reliant on project finance agreed on a site-by-site basis. This approach to finance is inefficient, bringing with it additional disproportionate arrangement fees and legal costs which are reflected in interest rates and ultimately affect the viability of the project. Where builders are seeking to develop in rural areas, where the market is less confident, the interest rates goes up further to reflect the return on capital employed by the lender in funding the development. Additional factors such as the availability of road bonds seem to be stacked in the favour of building at scale, with little or no lenders operating in the market to support smaller companies with this facility.

**The number of homes that could be built** - The number of active home builders that build less than 50 homes a year for sale has decreased from 782 in 2007/8 to 465 in 2017/18, a drop of nearly 40%. The number of homes for sale being delivered pre-recession by these companies was 4,846. The companies of this scale that have remained active are currently building only 2,700 units for sale each year (source Registers of Scotland; 2018).

If we were able to return to the number of active builders of this scale that were in operation prior to the financial crash there would be scope to deliver an additional 1,800 units each year. If these companies were supported to grow, and more new companies were encouraged to enter the market, year on year this could have a significant impact on housing delivery in Scotland. It would also provide greater choice for home purchasers, and greater competition within the sector, which helps keep prices down and quality high.

In addition to supporting small scale home builders, we see a key role of the bank in the financing of infrastructure delivery, particularly where significant investment is required, for example secondary schools, new railway stations or motorway slip roads, where the capital costs are prohibitive.

Infrastructure funding and delivery is the biggest barrier to housing delivery. To date this remains an unresolved challenge for which the Planning (Scotland) Bill and wider planning review has not found the answers (something openly acknowledged by the Minister for Local Government, Housing and Planning). Scotland's local and public authorities are not fully geared up to deliver the infrastructure needed to support Scotland's growing population, and Scotland's home builders cannot fully fund it. The Scottish National Investment Bank must therefore play a role in providing the upfront investment needed to unlock the delivery of Scotland's infrastructure and housing needs.

Briefing Local Government and Communities Committee members recently on the Planning Bill, HFS pointed out that the ability of public authorities to predict and plan for infrastructure needs is not where it should be. It is vital that this significant issue is looked at in the round, across all portfolios. Scotland needs strong, whole-system arrangements for infrastructure planning, funding and delivery. We see the Scottish National Investment Bank as an important candidate for achieving that.

**“Where it identifies need, it will invest and lend on commercial terms, but with a different risk appetite to other financiers where required and appropriate, taking a longer term view on returns”**  
(P5, Introduction)

This approach to lending will support markets in their infancy. This could be home builders of any size innovating with new products or new approaches to delivery or a new housing tenure. It could, for example, support significant capital investment in off-site manufacturing facilities, to increase the delivery capabilities of the sector. It will also support traditional home builders in areas that traditional lenders will not invest. In the main this will be in rural areas with less of a track record of sales by companies with less of a track record of activity. The longer term view on returns will also be helpful in pump-priming infrastructure delivery where new roads or community facilities are required to open up housing sites with payback as households move into their new homes.

At this point, we are keen to draw attention to Homes England and the support available to our members and their competitors building homes in England to support housing delivery. The feedback we have received from home builders working with Homes England is very positive and we would be keen to see the Scottish National Investment Bank mirror, or improve upon, the offer in England to ensure Scotland can remain competitive. Funding is available through a 'Home Building Fund' and 'Infrastructure Loan Fund'.

It should be noted (for example from recent press coverage of Homes England and the Stewart Milne Group) that medium and larger sized Scottish based companies are benefitting from this support in England (see next page). This is supporting their growth plans, allowing them to buy sites for housing development in England. Scotland must compete to retain and attract further investment or the capacity for home building built up in Scotland could diminish which would seriously impact already low levels of housing supply.

While we focus on the encouragement of new entrants into the market, we must not lose sight of the fact that many home-grown housebuilders are now expanding into England. We must ensure that their investment decisions are not skewed in favour of England at a time when we would actually like to encourage more English developers to Scotland.

<b>Homes England</b>	
Purpose	There to complement the market - step in and fill the gap. Not aiming to compete. Will not necessarily be cheaper than banks. Finance deals similar. Min for 5 units £250k. Funding must be state aid compliant.
Who is using it and why?	Developers unable to get high street funding, stretch finance to make equity go further, including for SPVs, difficult sites i.e. contamination/listed building, those with limited experience - no track record but skilled Directors, specialist development leading the market - eco, mmc or housing for older people/disabled etc
Application process	Tried to move away from application forms, checklists and any prospectus. The Home Building Fund Website is the starting point. The initial enquiry is followed up by a telephone call from one of the team to establish how deliverable the proposal is. Thereafter fairly basic transaction information is requested by email. A customer meeting follows where they discuss the proposal in more detail.
Application timescale	Takes around 12 weeks, 3 <sup>rd</sup> party diligence usually comprises valuation, legal and monitoring surveyor costs which takes time but often the biggest delays are from the borrower not responding quickly or their lawyers not prioritising the transaction.
Fees	Typical arrangement fee is 0.5% for development loans and 1% for infrastructure loans. No non-utilisation or exit fees.
Interest rate	A typical development loan the margin range is normally between 4% and 6% plus the cost of funds. These loans are typically to SME borrowers with a modest covenant. Infrastructure loans are often to larger and stronger counterparties and margin range is between 3% and 5%.
Security	For most transactions they will take a first charge, a debenture and a pledge over bank account. For larger transactions they will also take collateral warranties from certain advisers/contractors.
Personal Guarantees	They would only take Guarantees in specialist cases and usually from other companies within the same ownership or from a related contractor which is completing some of the building works. They try to avoid personal guarantees.
Loan to value/cost ration	<p>The vast majority of SME transactions have 20% of costs as borrower equity with Homes England funding the 80% balance. If houses are being built then the Homes England loan is often less than 50% of costs and the 30% balance is met by sales recycling. This is where the sale proceeds of some of the houses on the site are used to meet development costs. No other mainstream lender will allow sales recycling as it carries significant risk and it does make Homes England different as a lender (if sales are delayed then there is no sales recycling and Homes England have a funding gap). If the development is an apartment block then sales recycling is not possible and the loan will be up to 80% of costs.</p> <p>The borrower equity contribution of 20% of costs often equates to the value of the land so in simple terms if SME developers bring Homes England the land then they will usually fully fund development costs (through loan and sales recycling). On larger transactions (200+ homes) the structure can be equity 15%, loan 15% and recycling 70% because these transactions are heavily phased over a period of time.</p> <p>Market norm is for developers to make a 20% profit on cost so the arithmetic means that the Homes England loan to gross development value is normally below 65%. In a downturn Homes England could still recover their loan if house prices fell to 65% of forecast. SME developers are investing 20% of costs and making a 20% profit on cost so they will usually make a 100% return on capital over 18-24 months.</p>
Staff	Staffed by ex-bankers mainly with some surveyors. Commercial rates paid to attract skilled staff.

The four priorities of the Scottish Government for supporting sustainable economic growth that are relevant to the bank are noted below (extracted from the Implementation Plan Report section of the consultation). Alongside each of them are statements to show how we see the priorities connecting to housing delivery.

**Investing in people and infrastructure to safeguard Scotland's future** - There is a significant undersupply of housing in Scotland. Housing is a fundamental need, investment in housing is an investment in infrastructure and people.

**Fostering a culture of innovation, entrepreneurship and research and development** - Traditional forms of lending can stifle innovation, as a consequence there is a culture of doing things the tried and tested way where costs can be safely measured and confidence from lenders exists. Very limited incentives exist to innovate given investment risks involved. Home builders are, in the main, risk averse and are not early adopters of new innovations. There is a role for the bank to push creativity and encourage businesses to innovate.

**Stimulating inclusive growth through a fair and inclusive jobs market and regional cohesion to provide economic opportunities across all of Scotland** - Housing delivery in rural areas is high risk due to the slower markets and the longer time that passes before a return in investment is realised. We need good quality housing options across Scotland. The SNIB has an important role to play in enabling investment in rural communities. Similarly, there is an important role for it to play in enabling regeneration in post-industrial Scotland, where values in marginal areas make investment unviable and unattractive to traditional lenders without government support.

**Promoting Scotland's international trade, investment, influence and networks** - A strong supply of good quality housing at affordable prices is essential at attracting companies to invest in Scotland. International employers will not select a location for their business that does not offer good quality housing options for their employees. We also see an opportunity for the SNIB to boost activity in the off-site manufacturing sector, with both products and skills able to be exported to strengthen the reputation of innovative delivery in Scotland.

**Question 2: Do you have views on the statement of the Vision which has been set for the Bank, in paragraph 3.2?**

***“Provide finance and act to catalyse private investment to achieve a step change in growth for the Scottish economy by powering innovation and accelerating the move to a low carbon, high-tech, connected, globally competitive and inclusive economy”.***

Whilst supportive of the ambition portrayed in this statement, we would suggest that it fails to capture the social opportunities that could be realised through SNIB's investment. Increased investment in housing delivery, particularly in areas of high housing demand and in rural and regeneration communities, can increase the social and economic wellbeing of Scotland. This is just as important (or arguably more so) to the success of Scotland on a global scale as innovation or technology.

**Question 3: Do you agree that the overall direction for the Bank should be set by Ministers through a Strategic Framework, including the setting of missions and performance objectives and a target rate of financial return?**

We are supportive of the overall direction for the Bank being set by Ministers through a Strategic Framework. We believe this approach will ensure the social opportunities within the bank are maximised, as well as the economic.

**Question 4: Do you have any views and suggestions on the example of missions, outlined in paragraph 4.7 and what are these?**

We see incredibly strong links between the missions outlined and housing delivery.



**Transitioning to a low carbon economy** – The bank can support innovation in housing delivery to expand the use of off-site manufacturing and low carbon technologies. Traditional lenders are interested in tried and tested methods of delivery and this can stifle innovation within the home building industry. The Scottish National Investment Bank is well placed to invest in this infant market, taking additional investment risk to achieve wider, strategic benefits.

### **Responding to an ageing population and wider population health –**

**Ageing population:** The ageing population and consequent growing number of single person households is a demographic change that must influence housing delivery and the bank is well placed to champion delivery of housing for older people in Scotland. Given the shortage of homes across all demographics in Scotland at present, there is little incentive to specialise, particularly in the homes for sale market. There is a role for the bank to attract creativity amongst mainstream and specialist providers to lead delivery in this section of the market. It is crucial that this is read within the current context within the home building industry in Scotland. McCarthy & Stone, the only specialist private provider of older people's housing, has confirmed that it is exiting Scotland. Whilst the business was performing well, and the market was strong, the business is proving more profitable in England and investment is therefore being targeted there instead. Housing for older people is a classic example of a market that must grow but is essentially in its infancy and needs support.

**Wider population health:** The links between housing and health are strong and well documented. The following statement is extracted from the Commission for Housing and Wellbeing (2015) *"In parts of Scotland, there continue to be serious and intractable problems of poor health and educational under-achievement. These are fully recognised by the Scottish Government and there are many programmes designed to address the serious health inequalities and educational challenges that still exist. Providing good homes must be a central part of addressing these problems."* The Commission linked health to housing in terms of homelessness, serious overcrowding, insecure and unaffordable housing, damp housing, fuel poverty and supporting independent living. Prioritising investment in housing through the bank has the potential to impact positively on the health of Scotland's people.

**Promoting inclusive growth through placemaking and regeneration** – The links between housing, placemaking and regeneration are obvious. We see a significant role for the bank in supporting companies to deliver homes in less strong markets, in particular rural areas and regeneration areas. We also suggest a role in supporting pioneers to demonstrate added value through design, incentivising the additional investment risk which traditional lenders may not support. Fundamentally, however the role for the Scottish National Investment Bank should be to help deliver the key infrastructure and community facilities that are required to support housing development and create successful places where people want to live.

**Question 6: Are there any arrangements or requirements not already considered that would strengthen and enhance the Bank's ethical approach to investment, and what are these?**

**Question 7: Do you agree with the principles approach that is proposed for the Bank, including publication of an Ethics Statement by the Board?**

In general, we would be supportive of the bank taking an ethical approach to investment and wish to re-emphasise the point made above on the social impact that the bank has the potential to have on Scotland.

At HFS we are currently exploring what positive impact we could have on the culture and behaviour of our member companies and we note the direction of travel announced by the First Minister at the recent SNP Party conference on the 'Business Pledge' and Scottish Government funding. We acknowledge the need for the Scottish Government and organisations like HFS to promote a strong ethical culture within business in Scotland. What we do need to be careful of however, is implementing requirements which make access to support from the Scottish National Investment Bank out of reach from those that need it the most.

Development of ethical arrangements should therefore be done in partnership with the business community and we would be delighted to assist with this, engaging with small scale home builders especially to develop requirements that encourage strong ethics but are realistic to avoid unintentionally locking any well-intentioned businesses out.

### **Resourcing of SNIB**

**Question 15: Do you have views on any criteria for the approach to remuneration for senior and specialist roles in the Bank?**

**Question 16: Do you have views on areas where the current approach to public sector pay would suit the needs of the Bank, are there other examples of variations in public pay policy that would be suitable for the Bank and any areas where some changes may be needed?**

It is absolutely essential that the right skills are sourced to resource the bank. The bank must be able to offer commercial rates of pay to attract the right employees. Those employed should also have their performance measured on commercial terms. We would like to see the performance measured on delivery, such as the number of housing units funded.

Homes England is an excellent example of this. Staffed by ex-bankers and surveyors, employees are challenged to seek out investment opportunities to delivery housing outcomes.

### **Summary**

We are excited by the opportunity presented by the establishment of the Scottish National Investment Bank. We see housing as a key area of investment to unlock many economic and social benefits for Scotland. Support for small scale home builders to realise their potential and investment for infrastructure to unlock wider delivery potential are presented as the priority opportunities for the bank. Homes for Scotland wants to play its part in positively shaping this opportunity for Scotland and we look forward to engaging with you in developing the detailed solutions.

For further information relating to any of this please contact Homes for Scotland at the address below.

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