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Bricks and bonds

FRESH FROM A HIGHLY SUCCESSFUL RETURN TO THE BOND MARKET, MARTIN WATTS, HEAD OF TREASURY AT ONE OF THE UK'S BIGGEST HOUSING ASSOCIATIONS, OUTLINES HIS PHILOSOPHY TO **GRAHAM BUCK**.

The Haggerston area of east London has traditionally been among the capital's run-down districts, but signs of revival are multiplying. Central to its regeneration is an £87m redevelopment of the Haggerston West estate by Regent's Canal, which will provide more than 400 new homes and apartments by 2014.

The name behind this ambitious project is London and Quadrant (L&Q), one of the largest of the UK's 2,500 housing associations. The group, set up in 1963, works to combat homelessness through its provision of high-quality, affordable homes.

L&Q owns and manages nearly 70,000 homes in London and the South East with a market value of over £9bn and plans to add at least 10,000 more by 2015. The group not only features in the property pages; in January the business press reported that it had raised £300m through a bond issue priced at gilts plus a spread of 1.15%, taking group borrowings to almost £2bn. The Aa2/AA-rated 30-year bullet repayment deal was well timed. As the group's head of treasury Martin Watts notes, an offering by one of L&Q's peers only weeks earlier had carried a spread of 1.70%.

Watts, who joined L&Q in November 2006, credits his experience in corporate treasury for giving him a valuable grounding. His treasury career began at advertising company Zenith Optimedia in his late teens. When owner Cordiant Group demerged, splitting Zenith into two, Watts was asked by his boss, a "fantastic mentor", to set up a new department from scratch.

"I learned a lot from him during my two years with Zenith," he recalls. "It was at his recommendation I then moved on in January 2001 to the next stage of my career, at AstraZeneca, whose very efficient treasury department managed a wide range of exposures. I started off as a junior dealer focusing on FX before gaining valuable insight into cash management and policy to help broaden my skill set."

After nearly four years at the pharma giant, brief roles followed at both Vodafone and PricewaterhouseCoopers, the latter in the business recovery service unit dealing with such high-profile cases as Enron.

"This work showed me the wider implications of treasury management, and I also completed my ACT qualifications during this period. It wasn't easy and the studies require dedication, but they are fantastic exams to have behind you and enable you to apply theory to practice." Watts recently embarked on MCT and is enthusiastic about the range of skills that it offers.

He stresses that L&Q is run as a business with an independent board. Social objectives combine with a commercial discipline across all areas; hence the value of previous experience in the corporate sector.

"When a vacancy arose within the group I was initially hesitant, although I wanted something substantial to get my teeth into," he admits. "However, being offered the role of head of treasury when aged 28 was too good an opportunity to pass up. It might not mean I could take on the same position with a blue chip, but the job still demands the same core skills."

Added to this is L&Q's reputation as an employer of choice. It regularly ranks high in The Sunday Times 100 Best Employers list and The Financial Times' Best 50 European Companies to Work For.

Since joining, he has enjoyed an enviably free rein. "I initially reported to Waqar Ahmed, now the group finance director, who headed up treasury and investment. He quite literally invited me to displace him," Watts explains.

When chief executive Don Wood retired in 2008, finance director David Montague succeeded him and Watts was given sole control of treasury. "I quickly had to learn to deal with the challenges set by executives and group board. It's something I really enjoy and highlights the importance of how treasury fits into the wider organisation."

Over the years around £50bn has been pumped into social housing, but political and economic uncertainty are seen as major risks. "This is what our existing strategies and five-year plan are targeting," adds Watts.

As a social housing provider, L&Q is regulated by the Homes & Communities Agency and the Tenant Services Authority. Social housing must meet exacting quality criteria and design standards referred to as the "Decent Homes Standard", which includes energy efficiency, insulation and space standards.

A major unknown is future grant levels, which rose year on year before the credit crunch but are expected to decline as the government seeks to reduce its budget deficit. L&Q has been the biggest recipient of social housing grant over the past two years, receiving more than £350m, which Watts attributes to "a proven track record of delivering".

An uncertain political future may require alternative means of subsidising rents. "This is why we have to adopt commercial discipline by delivering operational excellence and investing in our people to ensure that every penny we earn is invested back into social housing."

L&Q first accessed the bond market back in 1998, when a special purpose vehicle was created and it issued £130m. "From then until 2007 banks were more than happy to lend at attractive prices and we put facilities of up to 40 years' duration in place to match our objective as a long-term holder of property assets," he says. "Then came the credit crunch, but for us it presented more of an opportunity

than a hindrance. With bank funding limited, we looked for alternative sources of funding through the bond market. With little long-dated sterling supply offered by corporates, L&Q was able to tap into investors' demand for long-dated fixed income as an alternative to equity."

Over the second half of 2008 and early 2009, Affinity Sutton, Sanctuary, Circle Anglia and Places for People had paved the way for registered social landlords to re-enter the bond market. Affinity Sutton completed just a day before Lehman's collapse, but the others then issued long-dated bonds at gilts plus 260bp to 285bp, which L&Q regarded as too expensive. As Watts points out, the sector has experienced zero defaults and quasi-government backing, and L&Q offers unsecured credit ratings of AA- with positive outlook and Aa2.

"We also know the markets are fickle. Like elastic bands, they can snap back without warning and we wanted them to settle," he adds.

So L&Q held off, meanwhile paring a total of 22 operating companies down to five to provide clearer lines to the board and a simpler governance structure. "It was vital that we went through this process to provide more transparency to key stakeholders including the regulator and the credit rating agencies."

While approaching the bond market again after a decade involved a change of culture, Watts says the group was keen to diversify its sources of funding. The sector still relies heavily on a limited number of banks, while the bond market offers a wider range of investors.

"Through sound treasury management, L&Q has always enjoyed good liquidity and has never been reliant on short-term facilities," he adds. "So we could afford to approach the market when we judged the time was right."

L&Q held off until January, when investors were reallocating their portfolios and the momentum of credit spreads was also favourable. The group had begun prehedging its gilts through gilt locks from October 2009 when it also started selecting "the right banks to target the right investors". Its collateral was social housing property at social housing values; a property valued at £200,000 at market rate would typically be assessed at around 60% of that figure, or £120,000, under the scheme.

For the bond issue, 3,300 properties went into the portfolio; a "huge exercise" involving "hefty" due diligence and strong working relationships with the group's lawyers. Once banks, lawyers and valuers had been chosen after a formal tender process and "all the ducks were in a row", roadshows and one-to-one investor meetings were held.

Priced at 1.15% above gilts, the issue book was built in just over an hour, attracting £1.1bn of demand, or three and a half times oversubscribed. The resulting 30-year bullet issuance combined with the prehedge strategy resulted in an effective yield to maturity of 5.4%, "so the strategy was spot on".

The coming months promise more bond issuance and the potential for private placements, with evidence of demand from Asian and US investors, although ongoing negotiations could see more banks coming in.

"I'd certainly return to the bond market without hesitation," he says. "Our offering went extremely well. I was delighted with our lead banks, our lawyers and our internal performance. We wouldn't have achieved this without the core experience gained in the corporate sector and our ability to adopt commercial discipline. I think we'll see more individuals come over from corporates to work in the social housing sector, bringing with them their ACT qualifications and developed skills either at ground or at board level. I know that the ACT supports this, as treasury departments within this sector become more complex and get involved in areas such as bond issuance and international accounting standards."

He adds that recent changes to the Housing & Regeneration Act give L&Q and its peers more independence and greater opportunity in how they procure housing. It could mean that "at some point in the future grants are replaced by equity. If this happens, the skills of an experienced treasurer will be more vital than ever."

Since 2004 L&Q has acquired five other housing associations. "We're likely to see further M&As as larger housing associations either enter into mergers or take over smaller ones," says Watts. "And this will mean continuing to demonstrate our 'large can be local' theme."

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