Homes & Communities Agency

QUARTERLY SURVEY OF PRIVATE REGISTERED PROVIDERS

March 2015

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Introduction

The March 2015 quarterly survey report is based on responses from 253 private registered providers (PRPs) of social housing who own or manage more than 1,000 homes.

The survey results continue to indicate that the sector as a whole remains financially strong with access to sufficient finance. New finance continues to be raised through both capital markets and bank loans; the sector appears to remain attractive to lenders. Significant amounts of cash remain available to the sector; this is required to cover operating and development costs. However, individual providers and their boards do need to balance the risks of ensuring the availability of funds against the risk and costs of holding surplus cash.

Providers who make use of free standing financial derivatives have reported increased cash calls in the quarter and the head room on collateral provided to meet mark- to- market exposures has continued to decrease in the quarter, due to the recent falls in swap rates. These providers need to continue to monitor their position with regard to potential further calls.

Affordable home ownership (AHO) development forecasts anticipated a steep increase in activity in the final quarter of 2014/15 to coincide with the deadline for grant funded schemes under the 2011-2015 Affordable Homes Programme. Although the number of completions in the quarter was below the level that had been expected at the time of the September 2013 18 month pipeline forecast, there was still a very substantial increase in the number of completions compared to the previous quarter. As a result of the increased number of recently completed properties, the number of unsold AHO units also increased in quarter 4.

Market sales activity remains concentrated in relatively few providers. Similar to AHO, the number of unsold units increased in quarter 4. Development is forecast to increase over the next 18 months. The regulator engages with these providers to monitor the associated risks and boards should continue to factor the uncertain timing of future sales receipts into cashflow planning.

Income collection data suggests that a large majority of providers are continuing to manage the impact of welfare reform on their cash flows. Business plans typically incorporate assumptions allowing a degree of adverse impact from welfare reform measures, and increased revenue costs are likely to be incurred to adapt to changes. However, to date, most large providers (91%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plans. The regulator will continue to monitor income collection as universal credit is rolled out.

Summary of findings

Private finance

- the sector's total borrowing facilities are £75.9 billion, of which 74% is made up of bank loans; an increase of £4.1 billion since March 2014
- £63.4 billion is currently drawn, leaving undrawn facilities of £12.5 billion
- cash available to the sector is £4.8 billion (December: £4.6 billion)
- new facilities arranged in the year to March 2015 totalled £6.8 billion
- new facilities arranged in the quarter totalled £2.3 billion
- capital market funding, including private placements, contributed 56% of the new funding in the quarter and 60% for the year
- the debt repayment profile shows limited refinancing risk to March 2017, £2.9 billion (4.6%) of debt is repayable within 2 years (2014: £1.8 billion, 2.5%)
- there has been a decrease in debt repayable between 2 and 5 years, from £7.7 billion to £6.0 billion
- the sector's exposure to interest rate fluctuations is mitigated through the use of fixed interest rates. In total, £43.7 billion (69%) of drawn debt, is fixed for over one year (2014: £39.9 billion, 67% of drawn debt)
- over the next 12 months the sector forecasts drawdowns of £5.3 billion (December: £5.0 billion)
- 95% (December: 93%) of providers continue to anticipate that current debt facilities are sufficient for more than 12 months
- the number of providers continuing to make use of free standing derivatives remained at 47. The notional value of standalone derivatives was unchanged at £9.3 billion
- the current mark-to-market (MTM) exposure net of unsecured thresholds increased to £2.2 billion (December: £1.9 billion); collateral of £2.7 billion (December: £2.4 billion) has been given in the form of property or cash

Housing market

- on AHO, 2,401 first tranche sales were achieved in the quarter (December: 2,227), 4,999 homes remained unsold (December: 3,161) of which 978 had been unsold for over 6 months (December: 955)
- there were 4,286 AHO completions and acquisitions in the quarter (December: 2,562)
- pipeline AHO completions expected in the next 18 months are 16,197 (December: 18,515)
- on market sales, 645 sales were achieved (December: 481); 601 homes remained unsold (December: 448), of which 161 had been unsold for over 6 months (December: 169)
- there were 788 homes developed for market sale in the quarter (December: 477)
- pipeline market sales completions expected in the next 18 months are 5,834 (December: 5,092)
- total asset sales of £1 billion (December: £787 million) were achieved in the quarter generating a surplus of £372 million (December: £254 million)

Operating context

Headline figures indicate a continued recovery in the UK economy. The preliminary estimates released by the Office for National Statistics (ONS) showed that GDP had increased by 0.3% in the first quarter of 2015 and was 2.4% higher compared with the same quarter a year ago.

Inflation figures for the year to March were: Consumer Price Index (CPI) 0.0%; CPI including home ownership costs (CPIH) was 0.3% and Retail Price Index (RPI) 0.9%.

The Sector Risk Profile (September 2014), set out the importance of providers understanding business planning implications of differential inflation rates. It will be important that providers understand the potential implications for their businesses of the significant falls in CPI in recent months.

UK labour market statistics showed that, for December 2014 to March 2015, the unemployment rate decreased to 5.5%. 564,000 more people are in work compared with a year ago. Average weekly earnings (excluding bonuses) were 2.2% higher than a year ago.

The Bank of England base rate has remained at 0.5% since March 2009. Three month sterling LIBOR also remained low at 0.55% in March. Providers therefore continue to benefit from low interest rates on their variable rate debt. However, they will need to continue to monitor and review exposure to future interest rate fluctuations in setting treasury management strategies. The 15 year sterling swap rate fell to 1.72% in March 2015 (March 2014: 2.99%).

The Nationwide House Price index reported increased house prices of 0.1% in March - the report showed a 5.1% increase in the year to March 2015. The regional variations in annual increases ranged from 1.3% in Yorkshire and Humberside to 12.7% in London.

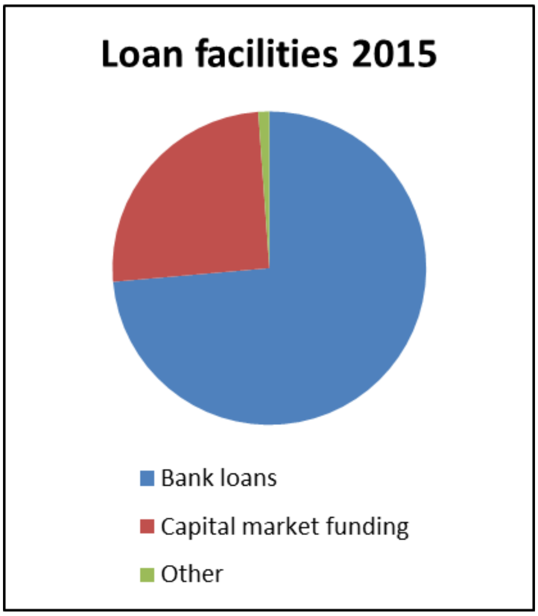
Financing market

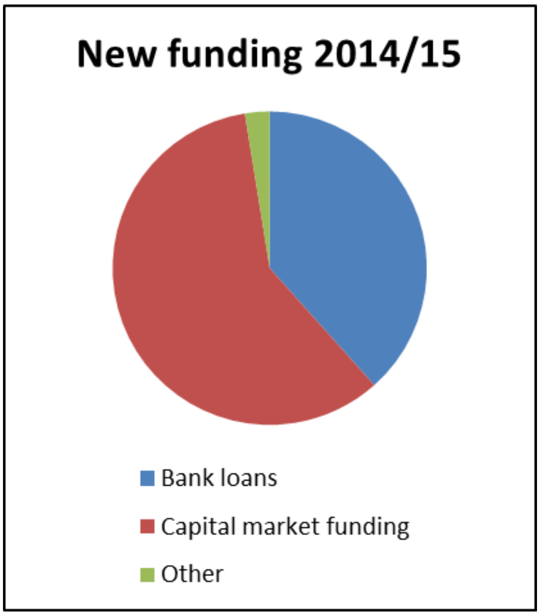
The sector currently reports facilities of £75.9 billion, of which £63.4 billion is drawn leaving undrawn facilities of £12.5 billion. Cash available to the sector is £4.8 billion (December: £4.6 billion).

Cash available to the sector has been reported to be over £4 billion in each of the last 5 quarters; 14 providers currently report available cash in excess of £75 million; this represents 32% of the sector total. Providers must ensure that cash is available to cover all future financial obligations as they fall due. However, boards must balance the risks of ensuring that funds are available against the risk and costs of holding surplus cash.

New facilities arranged in the quarter totalled £2.3 billion. New finance was raised from bank loans and capital market funding. 56% of the new funding came from the capital markets through bond issues, private placements and European Investment Bank funding through Affordable Housing Finance plc (AHF); 43% came from traditional bank and building society lending. The availability of new facilities continues to suggest that the sector retains the confidence of investors.

The charts below demonstrate that traditional bank and building society funding represent 74% (2014: 78%) of agreed facilities. However, capital markets contributed 60% of the new finance raised in the year. Other funding totals £859 million which represents 1% of total funding, and includes funding from sale and leaseback arrangements.





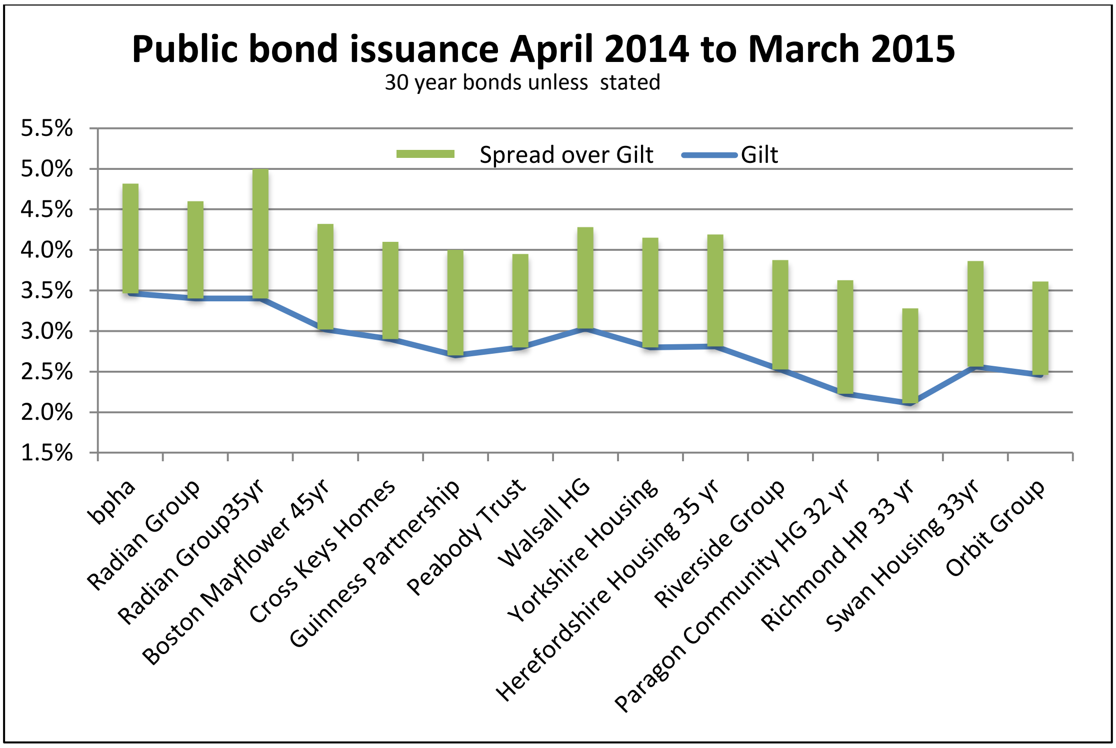
Providers have forecast drawdowns of £5.3 billion over the next 12 months. Security is currently reported to be in place for £73.9 billion of debt; this represents 97% of agreed facilities and 117% of drawn facilities. At sector level, there appears to be sufficient security in place to cover the forecast drawdowns over the next 12 months. However, it remains essential for individual providers to ensure that their facilities are secured in good time to enable drawdown.

The majority of providers (85%), continue to report that they have sufficient facilities in place to cover the next 18 months. However, providers need to continue to be aware of the current timescales for arranging and securing new finance. The regulator will continue to engage with providers reporting 18 months or less in respect of their available funding.

As reported in previous quarters, the maturity profile of existing debt suggests that the immediate refinancing risk of the sector remains low. Most of the new debt requirement over the next 2 years will be to fund providers' development programmes.

The regulator expects boards to understand the risks associated with arranging new finance and with maintaining an appropriate level of liquidity. Independent, professional advice should be taken as appropriate and boards should have the skills necessary to understand and critically appraise that advice.

Bond issues are typically for 30 year periods and have enabled providers to access longer term funding than is currently available from traditional banking sources. The chart below shows the bond rates and credit spread on bonds issued by providers.



Bonds have been issued in 2014/15 at coupon rates ranging from 3.30% (Richmond HP, February 2015) to 5.03% (Radian Group, May 2014). The weighted average coupon rate on funds raised during the year was 4.11%; the weighted average credit spread for the year was 1.30%.

The regulated social housing sector retains a strong credit rating, which enables it to issue long term bonds at fixed rate interest costs.

Security

Security is currently reported to be in place for £73.9 billion of debt; this represents 97% of agreed facilities and 117% of drawn facilities. At sector level, this is sufficient to cover the £5.3 billion forecast drawdowns over the next 12 months.

Providers also estimate that, in aggregate across the sector, additional security is available to support a further £29 billion of new borrowing. This suggests that overall available security would not be a constraint to additional borrowing. However, balance sheet capacity and the availability of cash to service additional debt would also need to be factored in to determine additional borrowing capacity, and some individual providers will have more limited available security than others.

Derivatives

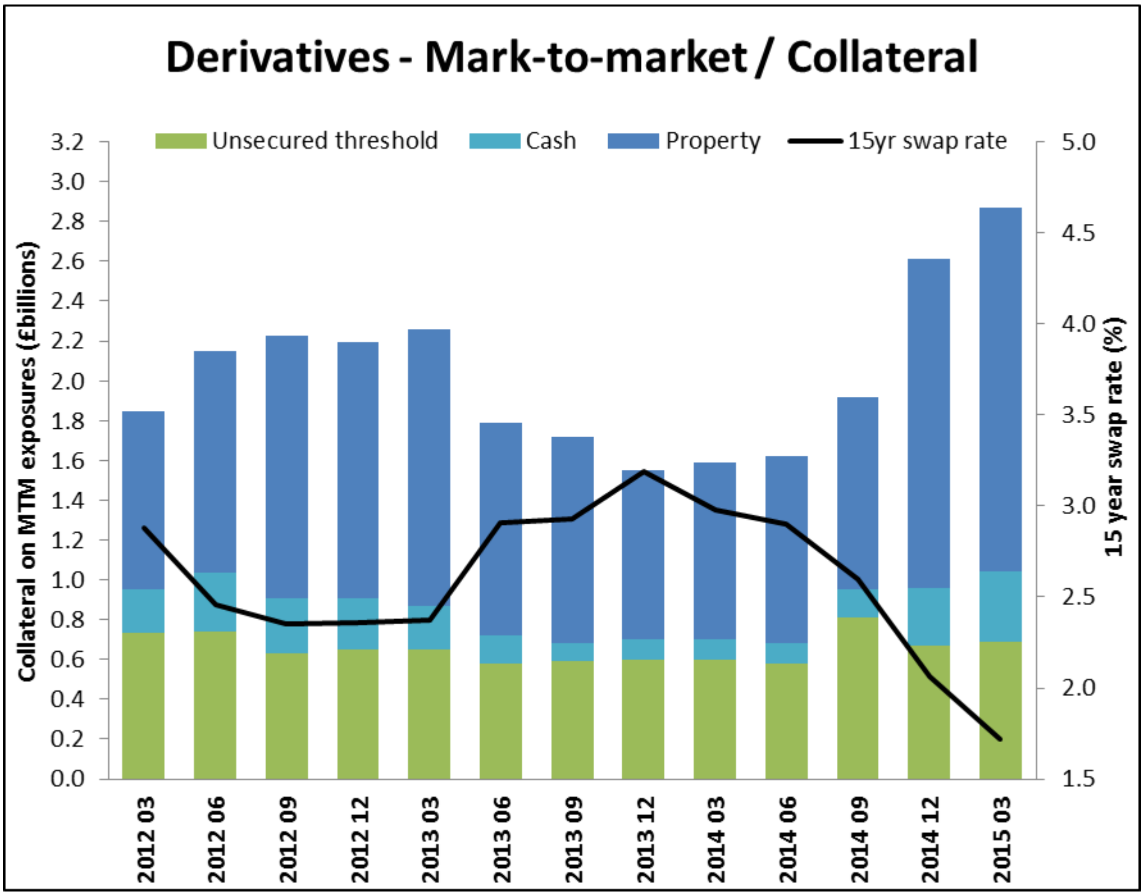
The number of providers reporting that they make use of free standing derivatives to mitigate against interest rate fluctuations remained at 47. The notional value of the instruments remain unchanged at £9.3 billion. The average term of the instruments is 14.7 years.

At sector level, collateral given in terms of security and cash continues to exceed current exposure levels which mitigates to a degree against liquidity risk. Swap rates have continued to fall in the quarter to March which has led to an increase in exposure to margin calls.
The mark-to-market (MTM) exposure net of unsecured thresholds increased to £2.2 billion (December: £1.9 billion). Collateral of £2.7 billion in the form of property and

cash has been given against this exposure (December: £2.4 billion). Cash collateral increased to £0.4 billion (December: £0.3 billion); the regulator is continuing to monitor providers' exposure to cash calls.

Excess collateral, totalling £533 million (December: £520 million) is reported by 34 providers. This provides some assurance that these providers are able to withstand a degree of future interest rate fluctuations. However, this quarter's increase in exposure has significantly eroded the excess collateral and providers must continue to monitor their position with regard to potential calls for increased collateral. The aggregated position is also likely to mask under- and- over-collateralisation between different counterparties within the same provider. The regulator is actively engaging with affected providers to gain assurance that they are effectively managing potential exposures to further increased margin calls.

Potential interest rate volatility means that collateral requirements remain a long term exposure. The likely impact of the adoption of Financial Reporting Standard 102 on loan covenant compliance also needs to be considered. Providers should assess their individual positions and have appropriate discussions with lenders. The regulator will continue to monitor this exposure and to assess its management as part of its financial regulation of individual providers.



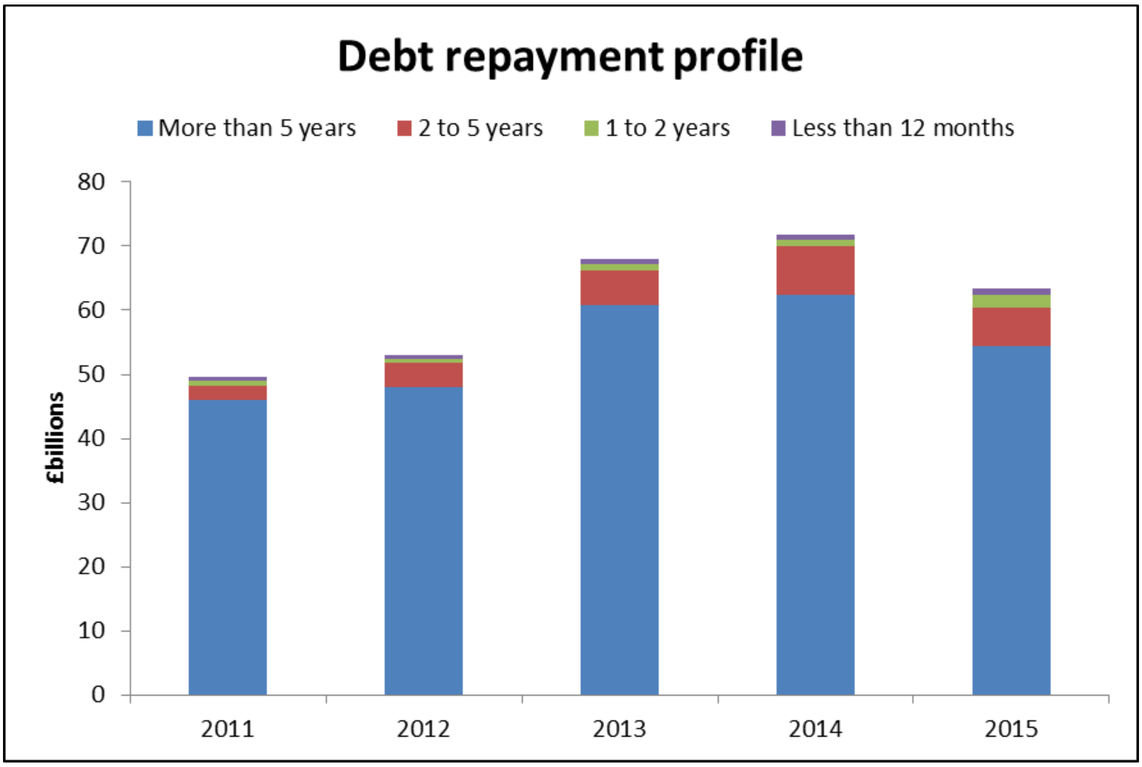
The chart above shows mark-to-market exposures, excluding excess collateral, and illustrates movements in exposure relative to the 15 year swap rate.

Debt repayment profile

The sector reports that repayments of £8.9 billion are due to lenders over the next 5 years as profiled below:

- April 2015 to March 2016 £1.0 billion
- April 2016 to March 2017 £1.9 billion
- April 2017 to March 2018 £2.0 billion
- April 2018 to March 2019 £1.8 billion
- April 2019 to March 2020 £2.2 billion

Long term debt continues to account for the majority of the sector's borrowing with 86% of current debt being due for repayment in over 5 years. This is illustrated in the debt repayment profile chart below[1]:



It should be noted that the debt repayment profile graph for the periods 2013 and 2014 is based on the value of **agreed facilities**. In 2015 the requirement reverted to the earlier methodology used in 2011 and 2012 and represents the value of **drawn facilities**.

The value of debt repayable over the next 5 years has fallen; shorter terms on offer for new bank debt, as well as maturing historic debt, has led to an increase in the sector's refinancing risk in the medium term.

The sector is due to repay £1.0 billion of debt in 2015/16 and £1.9 billion in 2016/17. This represents 4.6% of drawn facilities due for repayment over the next 2 years.

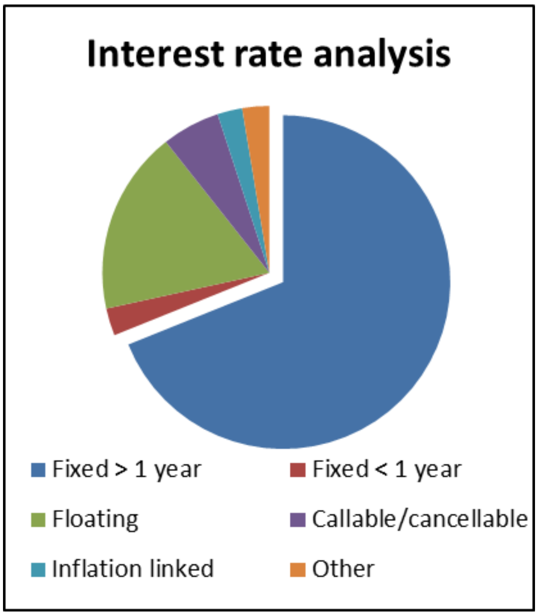
The sector's immediate refinancing risk remains low, with 1.5% (2014: 1.2%) of loans reported to be due for repayment within 12 months. Individual provider's exposure to

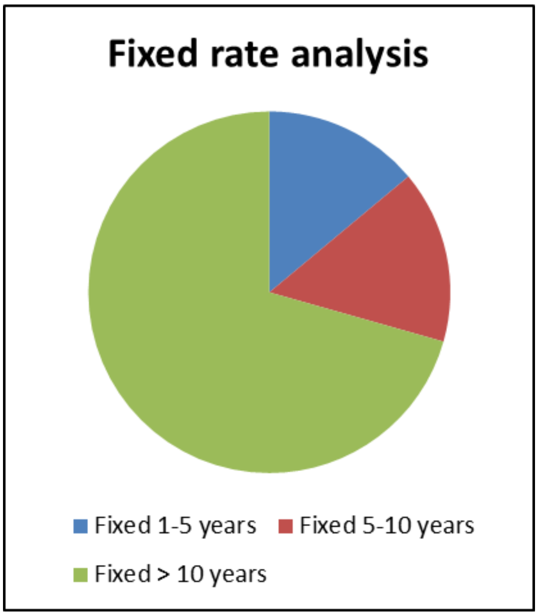
[1] 2015 debt repayment profile analysed drawn debt; previous years' data analysed agreed debt.

refinancing risk is covered by routine regulatory engagement. Boards are expected to ensure that timely arrangements are in place to manage refinancing risk.

Interest rate analysis

The charts below show an analysis of the sector's drawn debt by interest rate type and the period over which rates have been fixed.





Fixed rate debt (greater than one year), remains a high proportion of drawn debt, comprising 69% (2014: 67%) of the sector's borrowings. The analysis of the duration of fixed rates shows that 71% (2014: 47%) of total borrowing is at rates fixed for over 10 years. The use of long term fixes, through bonds, fixed rate bank debt or interest rate swaps continues to provide the sector with a degree of certainty on forecasting the costs of borrowing.

The total amount of debt reported as floating, fixed for less than a year or otherwise exposed to variations in cost through inflation linking or cancellable/callable options now amounts to £19.7 billion. This represents 31% of the total drawn debt (2014 : £19.4 billion, 33%).

Debt which is callable or cancellable represents 6% (2014: 7%) of the sector's total drawn debt. 83 providers (2014: 97) have reported that they hold this type of debt, which suggests that risk exposure is widely spread. 39 providers report that callable or cancellable debt comprises of less than 10% of their total debt portfolio, 36 providers report that it comprises of between11% to 30% and 8 providers report it comprises greater than 30%. The total amount of debt which is reported as callable or cancellable is £3.6 billion (2014: £4.3 billion); the earliest dates at which this may be called or cancelled are shown below:

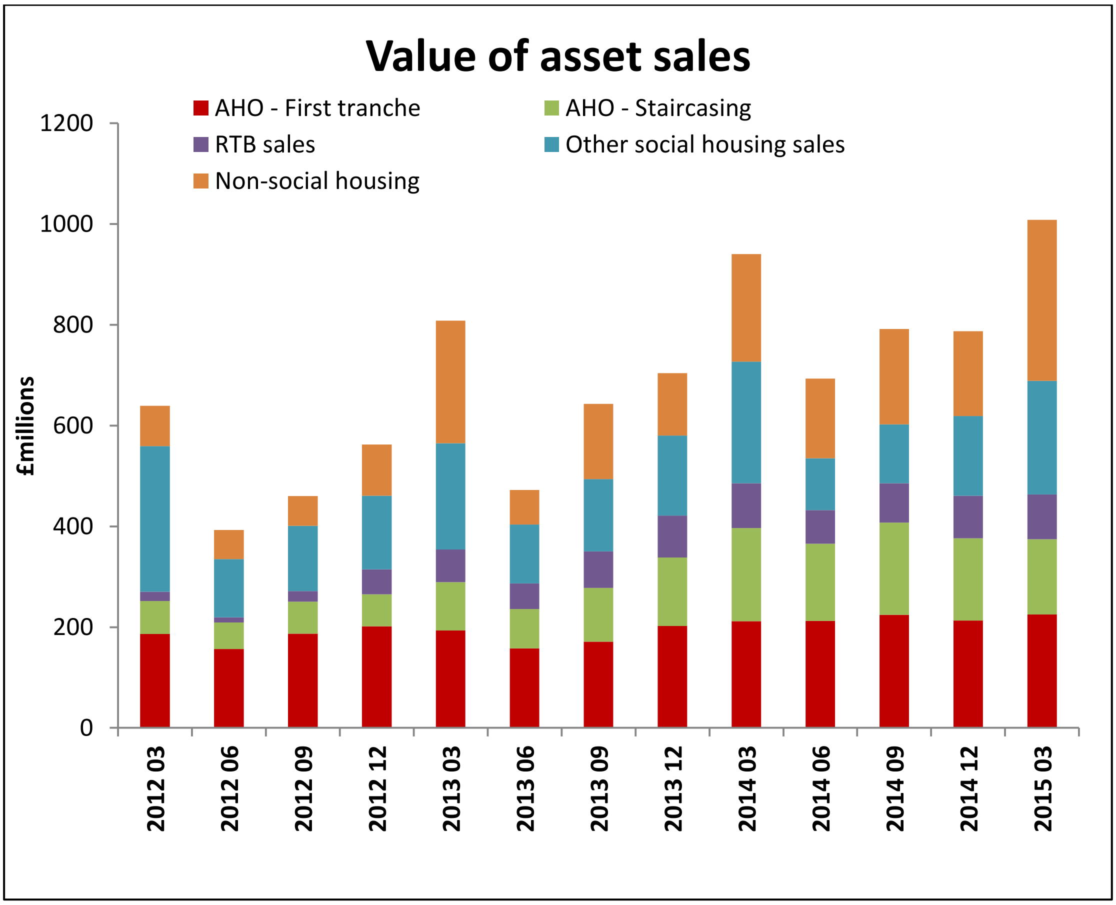
- within 1 year £0.7 billion, 21% (2014: 25%)
- 1 to 5 years £0.9 billion, 26% (2014:19%)
- 5 to 10 years £0.4 billion, 10% (2014: 12%);
- over 10 years £1.5 billion, 42% (2014: 44%)

Inflation linked debt or hedging, accounts for 2% (2014: 3%) of the sector's total borrowings. 71 providers report that they hold inflation linked debt or hedging; this remains unchanged from 2014. For most of these providers, inflation linked debt or hedging comprises of less than 10% of their drawn debt. 22 providers (2014: 20) report that inflation linked debt or hedging account for greater than 10% of their drawn debt. The total sector debt or hedging reported to be held at inflation linked interest rates is £1.5 billion. The regulator continues to engage with providers to monitor treasury management arrangements and risk exposure to fluctuating interest rates as part of the assessment of compliance with the governance and financial viability standard.

Housing market

In line with annual house price growth, the sector continues to deliver a significant sales programme. This includes shared ownership, social housing sales and market sales. Many providers aim to achieve growth through housing development including an element of housing built for sale. We expect providers to be aware of, and manage, the impact of sales risk on their development cash flows.

Total revenue from asset sales in quarter 4 (including AHO first tranche and staircasing, Right to Buy (RTB) and other social and non-social housing) was £1 billion (December: £787 million). Surpluses on sales were £372 million (December: £254 million). Sales revenue increased by 28% compared to December, surpluses showed growth of 46%. Both sales and surpluses were above the levels reported for March 2014. The chart below demonstrates the value of asset sales from March 2012.



The value of asset sales figures show:

- income from first tranche sales was £225 million; the surplus was £75 million. The margin of 33% was higher than both the previous quarter and March 2014 (December: 27%; March 2014: 24%)
- staircasing sales were £149 million; the surplus was £57 million. The margin of 38% was lower than the previous quarter but higher than March 2014 (December: 39%, March 2014; 35%)
- RTB sales generated income of £89 million with surpluses of £36 million. These sales continue to generate income for the sector, but providers will need to manage the loss of future rental income and the need for replacement stock
- other social housing sales were £226 million with surpluses of £83 million. The margin of 37% was lower than in the previous quarter but higher than March 2014 (December: 38%; March 2014: 52%). These sales include asset management sales, including some stock rationalisation transfers within the sector
- non-social housing sales were £319 million with surpluses of £121 million. The margin of 38% was higher than both the previous quarter and March 2014 (December: 23%; March 2014, 23%)

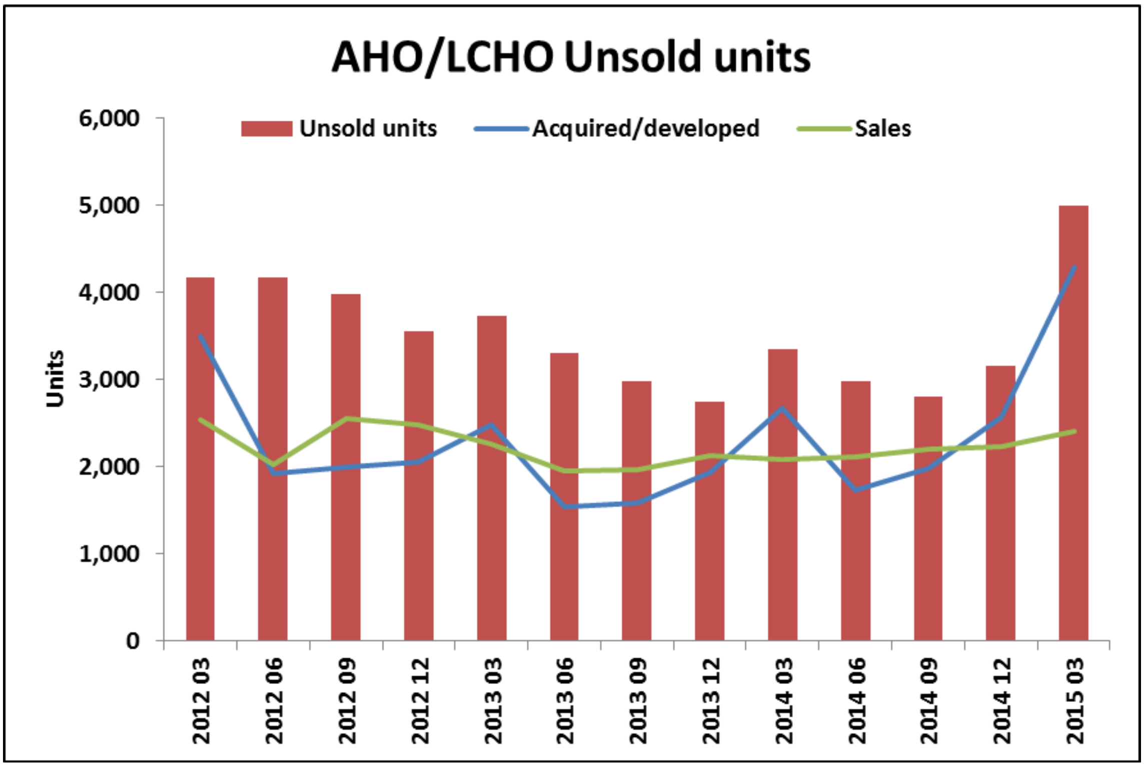
Affordable home ownership

The quarter 4 figures show[2]:

- 4,286 AHO homes were acquired or developed (December: 2,562)
- 2,401 were sold (December: 2,227)
- 4,999 were unsold at the quarter end (December: 3,161)
- 978 properties remained unsold for over six months (December: 955)

The figures demonstrate that sales continue to take place at a good margin, reflecting the current market conditions. However, the graph below demonstrates that the increase in acquisition and development in the quarter has led to a sharp increase in the number of unsold units.

[2] There is a reconciliation difference between units reported as unsold at quarter ends. This is due to a number of factors, including transfers between tenures and short term timing differences in providers recording units as completed and available for sale.



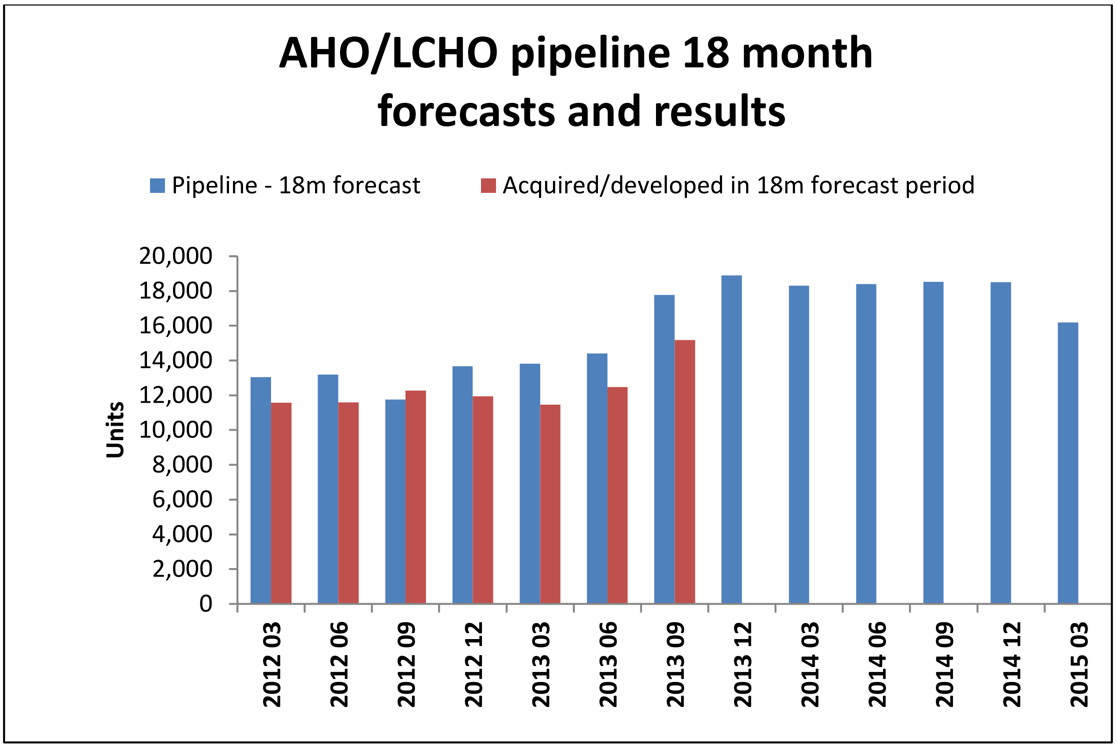
The graph above shows the number of units completed is a significant driver of the fluctuations in unsold stock numbers. The increased number of completions in the quarter (see below, AHO development forecasts and delivery) has led to a further increase in the stock of properties for sale. Providers will need to be aware of the uncertainty of future sales receipts in planning forward cash and funding requirements.

Significant levels of AHO development and sales activity are concentrated in relatively few providers; over half of all the unsold AHO stock at the end of quarter 4 was held by 25 providers. The regulator expects all providers engaging in AHO development to continue to manage the risks of housing market exposure.

AHO development forecasts and delivery

Providers reported that 16,197 AHO units are forecast to be completed over the next 18 months (December: 18,515). This represents 2,700 units per quarter; this is 7% higher than the average quarterly completion rate of 2,530 units over the previous 18 month period.

The September 2013 18 month pipeline forecast was 17,773 units; this period is now completed and 15,179 units have been delivered. Although this is 2,954 units below forecast, it is still a substantial increase compared to the previous quarter.



The regulator continues to engage with providers to gain assurance that the risks associated with development programmes are controlled and monitored by boards. In particular, providers need to be aware of local housing market conditions and to have mitigation plans in place to deal with the potential sales risks associated with large numbers of properties becoming available for sale. Providers need to be aware of the impact on business plans from delays in completions or sales.

Market sales

The quarter 4 figures show:

- 788 homes were developed (December: 477)
- 645 homes were sold (December: 481)
- 601 remained unsold (December: 448)
- 161 remained unsold for over 6 months (December: 169)

The number of sales increased in the quarter but was below the number of homes developed resulting in an increase in the number of unsold homes. There was a small reduction in the number of unsold units over 6 months.

Significant levels of development of market sales homes are concentrated in relatively few providers; over half of all the unsold market sales stock at the end of quarter 4 was held by 11 providers.

Development forecasts show 5,834 homes for market sale to be in the pipeline for delivery over the next 18 months - an average of 972 per quarter. This quarterly run rate is 74% higher than the quarterly average completions over the year. As with AHO products, providers will need to be aware of local housing market conditions and to have regard to the risks associated with meeting ambitious sales targets.

The sales risk exposure for market sales development remains concentrated in a small number of providers. The regulator continues to engage with these providers to monitor boards' understanding and management of the associated risks.

Non-regulated companies

The quarterly survey data shows that:

- 130 providers have investment in, or lending to, non-regulated subsidiaries, special purpose vehicles or joint venture companies. The total value of the investment or indebtedness is reported to be £3.2 billion
- 33 providers have given guarantees of £1.6 billion on the obligations or liabilities of other parties. Of these, 10 have given security
- 52 providers report that a joint venture or unregistered subsidiary is forecasting a loss in their 2015 accounts. Total losses are forecast to be £46 million

Where providers engage in activities with un-regulated companies, the regulator will seek assurance that boards understand the associated risks. In particular, the regulator will look for assurance that social housing assets are not being exposed to undue risk.

Impairment

There are 50 providers (2014: 47) reporting that they anticipate an impairment charge in their 2015 accounts. The total anticipated charge is £34 million (2014: £76 million), of which £25 million (2014: £33 million) relates to social housing assets. Of these 50 providers anticipating an impairment charge, 39 providers forecast less than £1.0 million, 11 forecast £1.0 million to £10 million. There is no current indication that impairment charges will impact on providers meeting the performance requirements of loan covenants.

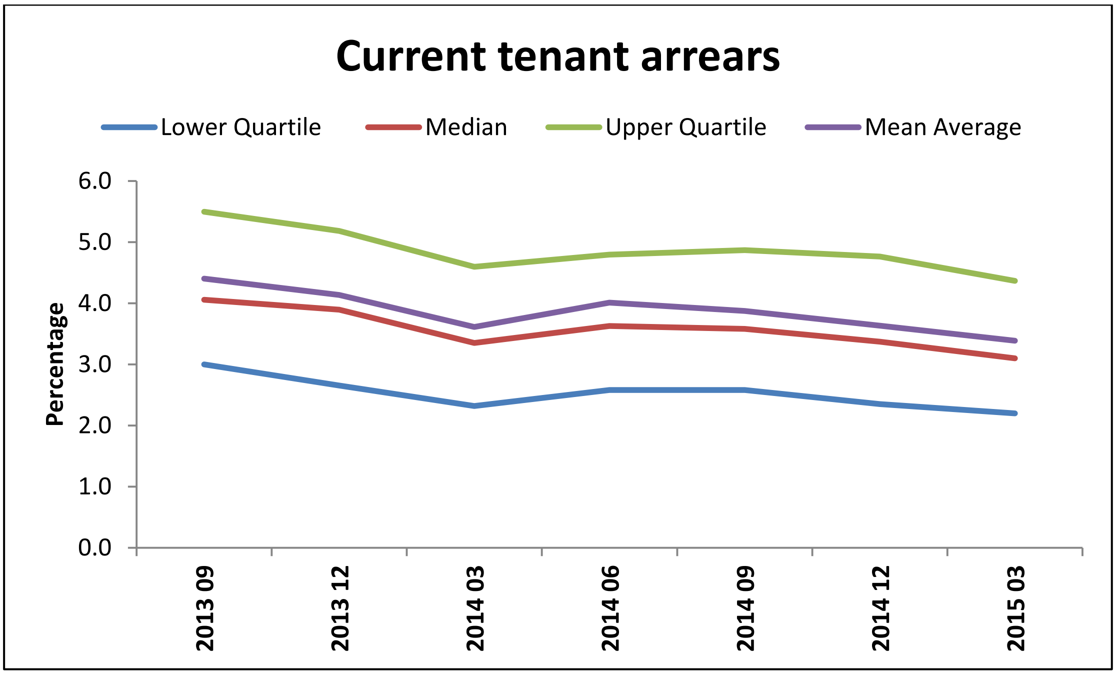
Income collection

As reported in the Sector Risk Profile (September 2014), welfare reform remains a key issue for providers to manage, particularly as direct payment of Housing Benefit under Universal Credit begins to roll out at greater scale in 2015. The risk profile of Affordable Rent and market rented products, along with changes to the rent policy from 2015, were also highlighted as a risk to be managed. These exposures reinforce the need for well managed income collection controls to maintain cash flows. The quarterly survey income collection questions are intended to assess the impact of the operating environment on income collection and cash flow. Data is collected for percentages for current tenant arrears, rent collection and voids[3]. The responses for each quarter appear to be reasonably stable and suggest that providers are continuing to manage the risks and to maintain cash flows within business plan parameters.

Most providers (March: 91%; December: 92%), continue to report that the current levels of arrears, rent collection and voids are within, or outperforming their business plans. However, as noted in previous quarters, these plans are typically based on assumptions that there would be a degree of adverse impact from welfare reform measures.

[3] The survey asked for current tenants' rent arrears as a percentage of annualised rent receivable; the percentage of rent receivable collected in the year to date and the percentage of rent receivable lost through voids in the year to date.

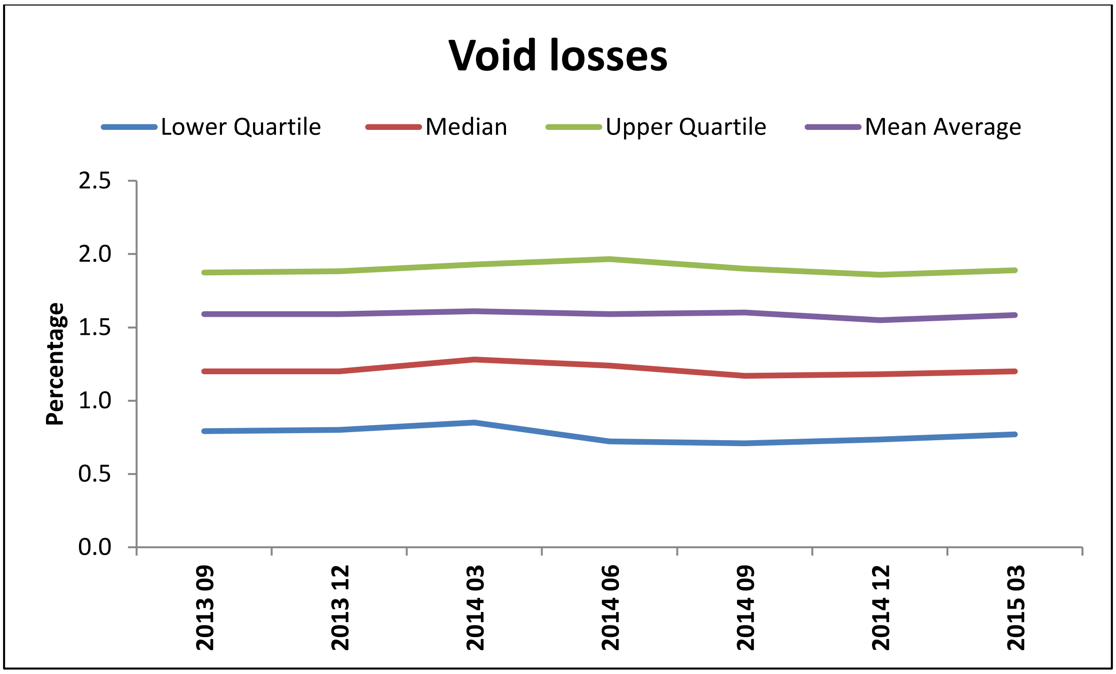
Current tenant arrears percentages are illustrated in the chart below.



Of the survey respondents, 94% (December: 93%), continue to report that current tenant rent arrears are below 6%. The sector aggregate current tenant arrears level, based on the latest published annual accounts data[4], is 4.7% (December: 4.8%). The current tenant arrears reported this quarter showed a decrease in comparison to the previous quarter. The mean average figure was 3.4% (December: 3.6%). The median level of rent arrears was 3.1% (December: 3.4%).

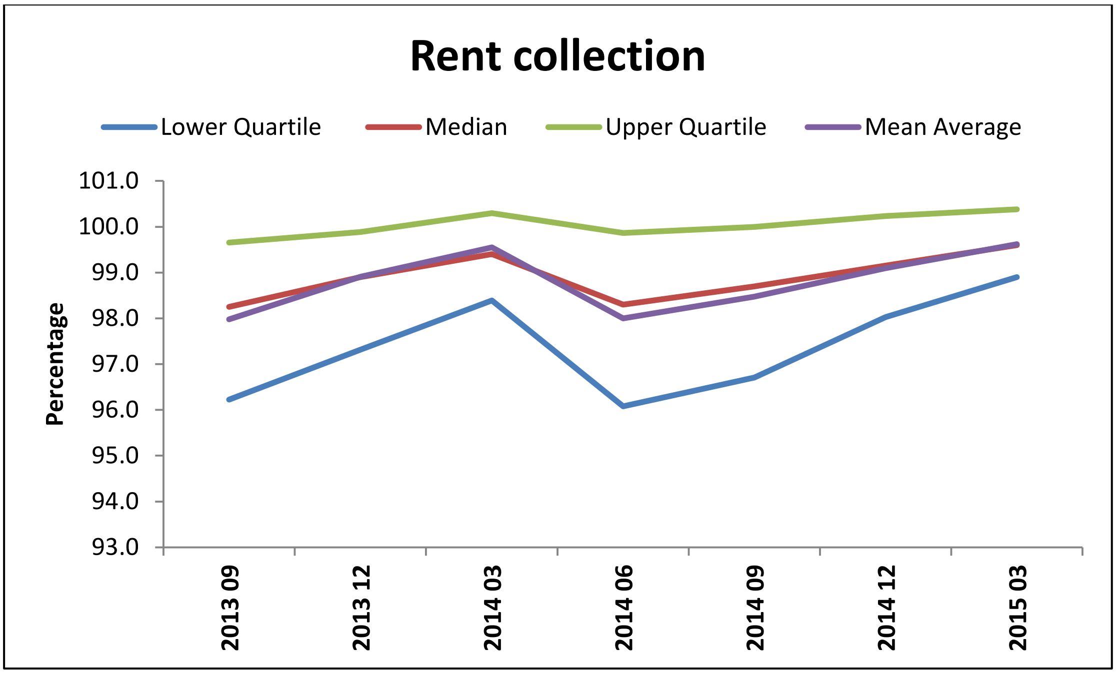
The chart below shows reported void losses; over three quarters of providers continue to report void losses of lower than 2%.

[4] 2014 Global Accounts of Housing Providers



The aggregate sector void loss percentage, as reported in the latest published sector annual accounts, is 1.8%. Neither average nor median void loss percentages reported are changed from those reported last quarter at 1.6% and 1.2% respectively.

Rent collection figures, presented in the graph below, show that 98% of providers report rent collection for the year to be in excess of 95%[5].



[5] Rent collected in advance may exceed 100% where rents have been paid in advance or previous arrears have been recovered.

Mean average and median rent collection percentages were both 99.6% (December: 99.1% and 99.2% respectively). The number of providers reporting rent collection rates of less than 95% fell to 4 (December: 10).

In commenting on rent collection, a number of providers make reference to the impact of housing benefit payment cycles which do not necessarily coincide with quarter end dates. This partly explains quarterly fluctuations in rent collection rates.

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