Homes & Communities Agency

QUARTERLY SURVEY OF PRIVATE REGISTERED PROVIDERS

2014/15 Quarter 1

Quarterly Survey of Private Registered Providers

June 2014

Introduction

The June 2014 quarterly survey report is based on responses from 257 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. Capital market finance continues to provide longer term funding than the traditional banking sector. The use of long term fixed rate bonds provides mitigation against exposure to interest rate fluctuations. However, providers accessing the capital markets and making use of alternative sources of funding do need to understand and manage the associated risks. As recently reported by Moody's[1], the sector remains attractive to investors and they anticipate the trend towards capital market funding will continue.

Managing the risks of development programmes, including delivery of the Affordable Homes Programme 2011-15, remains a challenge. Development forecasts anticipate a marked increase in activity in 2014/15. However, there is no evidence from the survey results of this increase materialising in quarter 1. The delivery period for the increased numbers of homes, first forecast in September 2013, is now imminent. The housing market risks resulting from increased sales activity will also need to be managed. Providers will need to be particularly aware of the potential cash flow implications of any delays in development and sales programmes.

This quarter, we publish additional information relating to properties developed for market sale. This shows significant levels of market sales activity concentrated in relatively few providers. The regulator engages with these providers to monitor the associated risks and seeks assurance that they are being mitigated effectively.

Income collection data suggests that providers are continuing to manage the impact of welfare reform on their cash flows. For the first time since the survey included questions on income collection, the sector reported a small increase in current tenant arrears and a reduction in rent collection. However, this is likely to be due to seasonal rent payment patterns, and it remains too early to draw firm conclusions on trends in income collection. The regulator will continue to monitor income collection as Universal Credit is rolled out.

Summary of findings

Private finance

- the sector's reported borrowing facilities total £72.7 billion, 77% of which is bank loans
- £59.8 billion is currently drawn, leaving undrawn facilities of £12.9 billion
- cash held by the sector is reported to be £4.2 billion (March £4.4 billion)
- new facilities arranged in the quarter were reported to total £1.1bn
- capital market funding, including private placements, contributed 62% of the new funding in the quarter

[1] Moody's Investors Service Special Comment, July 2014, English Housing Associations: Financial Disintermediation - A One Way Trip

- over the next 12 months, the sector forecasts drawdowns of £5.4 billion (March £5.7 billion)
- 90% (March 91%) of providers anticipate that current debt facilities are sufficient for more than 12 months. This percentage has fallen from 95% in June 2013
- the number of providers continuing to make use of free standing derivatives remained at 48. The notional value of standalone derivatives increased to £9.1 billion (March, £8.9 billion)
- the current reported mark-to-market (MTM) exposure net of unsecured thresholds is £1.0 billion; collateral of £2.0 billion is reported to have been given in the form of property or cash

Housing market

- on Affordable Home Ownership (AHO), 2,116 first tranche sales were achieved in the quarter (March 2,084), 2,985 homes remained unsold (March 3,349) of which 964 had been unsold for over 6 months (March 964)
- there were 1,734 AHO completions and acquisitions in the quarter (March 2,678)
- pipeline AHO completions expected in the next 18 months are 18,393 (March 18,299)
- on market sales, 490 sales were achieved; 669 homes remained unsold, of which 165 had been unsold for over 6 months
- there were 419 homes developed for market sale in the quarter
- pipeline market sales completions expected in the next 18 months are 5,275
- total asset sales of £694 million (March £940 million) were achieved in the quarter generating a profit of £226 million (March £324 million)

Operating context

The economy was reported to have regained the Q1 2008 pre-recession peak in output with UK economic indicators showing continued growth in the second quarter of 2014. Preliminary estimates issued by the Office for National Statistics (ONS) showed annual GDP growth of 3.1% compared with the same quarter a year ago; the estimated growth for the quarter was 0.8%.

Inflation figures for the year to June were: Consumer Price Index (CPI) 1.9%, CPI including home ownership costs (CPIH) 1.8% and Retail Price Index (RPI) 2.6%. CPI remained below the government's target measure of 2% in June. Differing calculation methodologies and baskets of goods lead to RPI generally giving a higher measure of inflation than CPI. As stated in the Sector Risk Profile (September 2013), providers need to understand the implications of differential CPI and RPI on income and expenditure in their business planning and financial forecasts, particularly given the move from RPI- linked to CPI- linked rent increases from April 2015 onwards.

An annual increase of 0.7% in average weekly earnings (excluding bonuses) for the period March to May was reported by ONS. This continued real term reduction in average incomes, combined with reduced benefits, contributes to the continued need for providers to actively manage income collection. UK unemployment figures fell to 6.5% and an increase of 254,000 people in employment was reported for the 3 months to May 2014.

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 June. Providers have therefore continued to benefit from low interest rates on their variable rate debt. However, they will need to continue to monitor and review exposure to future fluctuations in interest rates in setting treasury management strategies.

The Nationwide House Price Index reported an annual percentage increase of 11.8% in the average UK house price in the year to June 2014. House prices were reported to have regained their 2007 peak. The headline figure continues to contain significant regional variation, with London prices now exceeding the 2007 peak by 30%; in the UK as a whole, prices are 1% above peak. Excluding London, prices remain 0.4% below peak.

In July, the HCA and the Greater London Authority announced funding allocations for their respective 2015-18 investment programmes. Allocations of £1.3 billion, to deliver over 60,000 homes, were announced. This will give the registered providers involved greater clarity of their future funding needs.

Financing market

The sector currently reports facilities of £72.7 billion, of which £59.8 billion is drawn leaving undrawn facilities of £12.9 billion. Cash held by the sector is reported to be £4.2 billion (March £4.4 billion).

New facilities arranged in the quarter totalled £1.1 billion. New finance was raised from bank loans and capital market funding. Over half of the new funding (62%) came from capital markets. This included an own name bond issue of £300 million by Radian, private placements and the first long term government guaranteed bond arranged though Affordable Housing Finance (AHF) plc. The AHF bond had a credit spread of 0.37% and raised £180 million for English providers. As noted in Moody's special report (July 2014), the sector remains attractive to investors and the trend towards bond funding is likely to continue.

Providers are forecasting drawdowns of £5.4 billion over the next 12 months. Debt facilities of £69.9 billion are currently reported to be secured; this represents 96% of agreed facilities and 117% of drawn facilities. At sector level, this appears to be sufficient to cover the £5.4 billion forecast drawdowns over the next 12 months. However, it remains essential for individual providers to ensure that facilities are secured in good time to enable drawdown.

The majority, 80% (March 82%), of providers continue to report that they have sufficient facilities in place to cover the next 18 months. This percentage has fallen from 86% in June 2013. Providers need to continue to be aware of the current timescales for raising new finance. The regulator continues to engage with providers reporting 18 months or less in respect of their available funding.

As reported in March, 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.

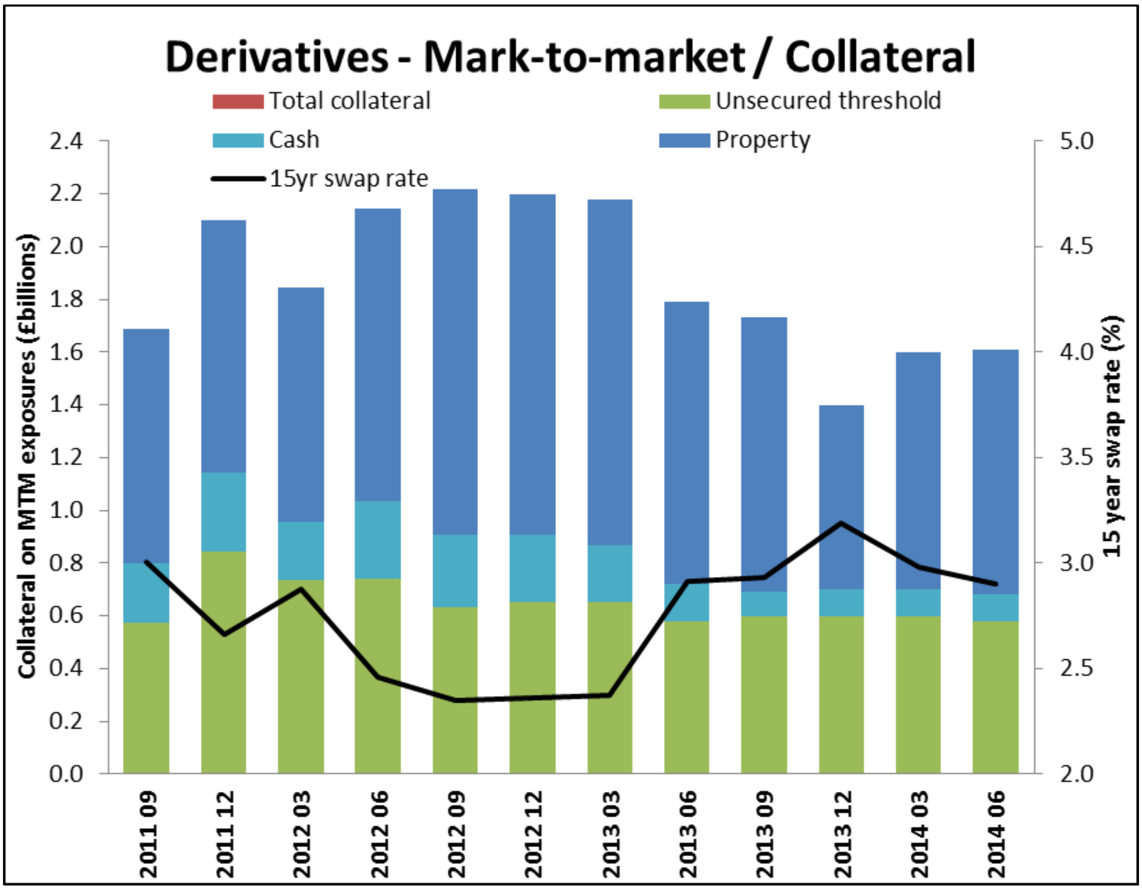
The regulator expects boards to understand the risks associated with arranging new finance. Appropriate independent, professional advice should be taken and boards should have the skills necessary to understand and critically appraise that advice.

Derivatives

The number of providers reporting that they make use of free standing derivatives remains at 48. The notional value of the instruments is now £9.1 billion (March £8.9 billion). The average term of the instruments is 14 years.

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 by providers. The regulator will continue to monitor this exposure and to assess its management as part of its financial regulation of individual providers.

At sector level, collateral given in terms of security and cash continues to exceed current exposure levels and to provide some mitigation against liquidity risk. The mark-to-market (MTM) exposure net of unsecured thresholds is currently £1.0 billion. Collateral of £2.0 billion in the form of property and cash is reported to have been given against this exposure. Cash collateral is now £103 million (March, £106 million). The regulator will continue to monitor providers' exposure to cash calls. Excess collateral, totalling £930 million, is now reported by 35 providers, providing assurance that these providers are able to withstand future interest rate changes.



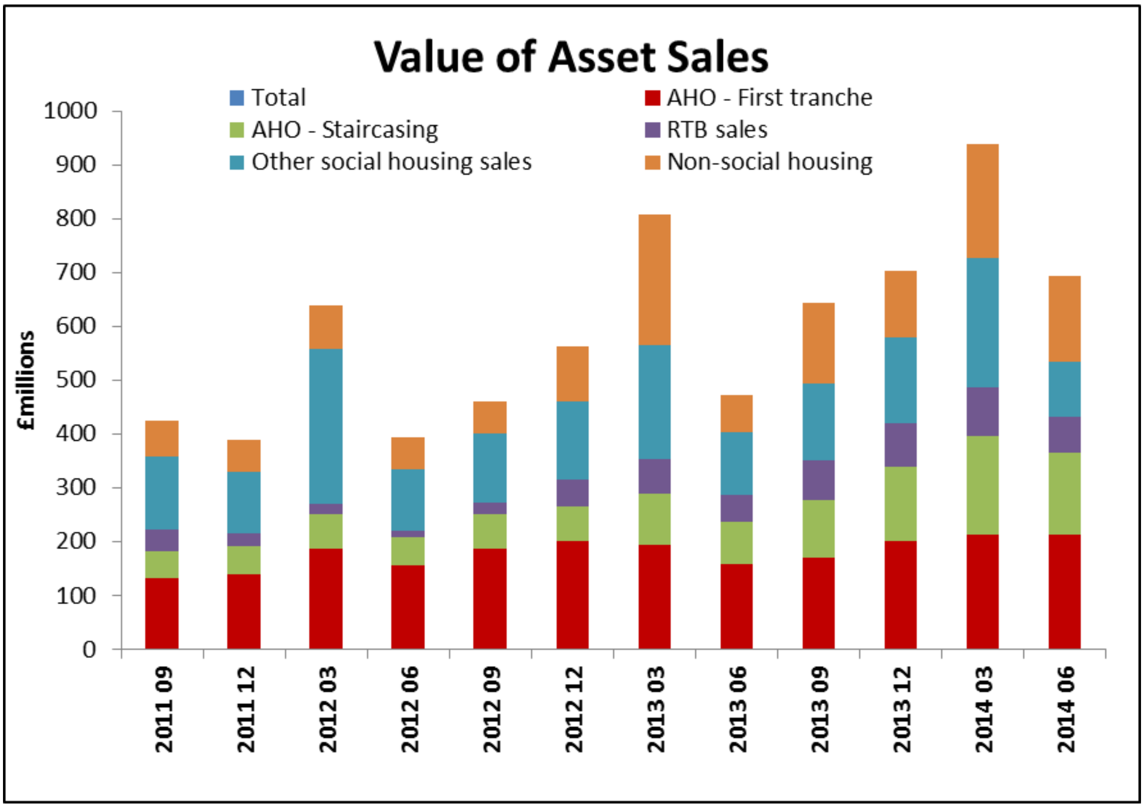
The chart above shows mark-to-market exposures, excluding excess collateral, and illustrates movements in exposure relative to the 15 year swap rate.

Housing market

The sector continues to achieve 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; providers therefore need to be aware of, and manage, the impact of sales risk on their development cash flows.

Total revenue from asset sales in quarter 1 (including AHO first tranche and staircasing, Right to Buy (RTB) and other social and non-social housing) was £694 million (March £940 million). The growth in the value of asset sales since September 2011 is shown in the graph below. Surpluses on sales were reported at £226 million (March £324 million).

Sales revenue and surpluses were below the level reported in March. However, this reflects the normal seasonal trend; both sales and surpluses remained significantly above the levels reported in June 2013.



Income from first tranche sales was £212 million, with surpluses of £47 million. Staircasing sales were £153 million. Income from RTB sales was £67 million, providing cash to the sector. However, the longer term risks associated with the loss of rental income and the need for replacement stock do need to be managed. Other social housing sales of £103 million include asset management disposals and stock rationalisation transfers between providers, which do not necessarily represent a loss of stock from the social housing sector. Non-social housing sales of £158 million generated a surplus of £46 million.

Affordable Home Ownership

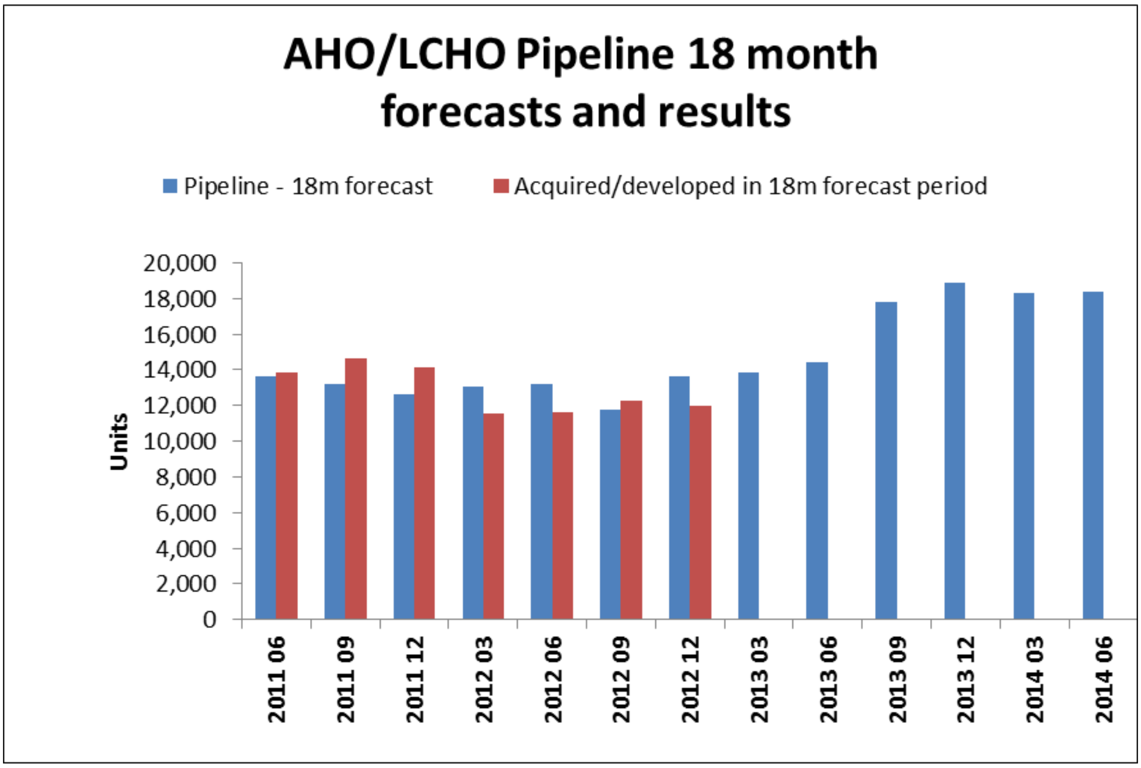
The quarter 1 figures show[2]:

- 1,734 AHO homes were acquired or developed (March 2,678)
- 2,116 were sold (March 2,084)
- 2,985 remained unsold (March 3,349)
- The number remaining unsold for over 6 months was unchanged at 964

The figures demonstrate that sales continue to take place and that the stock of unsold AHO units has further reduced. However, the key driver of the reduction in unsold homes was a significant decrease in the number of homes acquired or developed in the period. Significant levels of activity are concentrated in relatively few providers; over half of all the unsold stock is held by 20 providers. Providers engaging in AHO development need to continue to deliver against planned sales performance and to manage the risks of housing market exposure.

AHO development forecasts and delivery

Providers report that 18,393 AHO units are forecast to be completed over the next 18 months. This forecast is not significantly changed from the previous quarter and represents around 3,066 units per quarter. Quarterly completions and acquisitions have averaged 1,992 over the period since April 2012. As noted previously, more activity is expected as the Affordable Homes Programme 2011-15 delivery period comes to an end.



As can be seen in the chart above, the current pipeline forecast for AHO units is not significantly changed from the previous three quarters. Forecast delivery over the

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

next 18 months continues to exceed the track record on delivery over the preceding 18 months by 6,447 units (54%).

We can now compare the 18 month pipeline forecasts to delivery of units developed or acquired for 7 quarters. The track record against forecasts is included on the chart above. The most recent forecast for which the 18 month period has been completed is December 2012; the data shows that actual reported completions for this period were 1,720 units below forecast. This suggests that the forecast increases in completions are not yet being delivered. The step increase in the September 2013 forecast is expected to be delivered over the course of 2014/15.

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 continue to be mindful of local housing market conditions and to be aware of, and have mitigation plans in place to deal with, potential sales risks where large numbers of properties become available for sale. Providers will need to be aware of the potential impact on business plans if completion targets, or sales, are delayed.

Market sales

In quarter 1, data was collected relating to property developed for market sale. The figures show:

- 419 homes were developed
- 490 homes were sold
- 669 remained unsold
- 165 remained unsold for over six months

Development forecasts show 5,275 homes for market sale to be in the pipeline for development over the next 18 months, an average of 879 per quarter. This quarterly run rate of development is more than double the homes developed in quarter 1. As with AHO products, providers will need to be aware of local housing market conditions and have regard to the risks of potential delays in achieving sales targets. Sales risk exposure through development for market sale is concentrated in a relatively small number of providers; over half of the pipeline activity is forecast to be undertaken by 9 providers. The regulator engages with these providers to monitor boards' understanding of the associated risks.

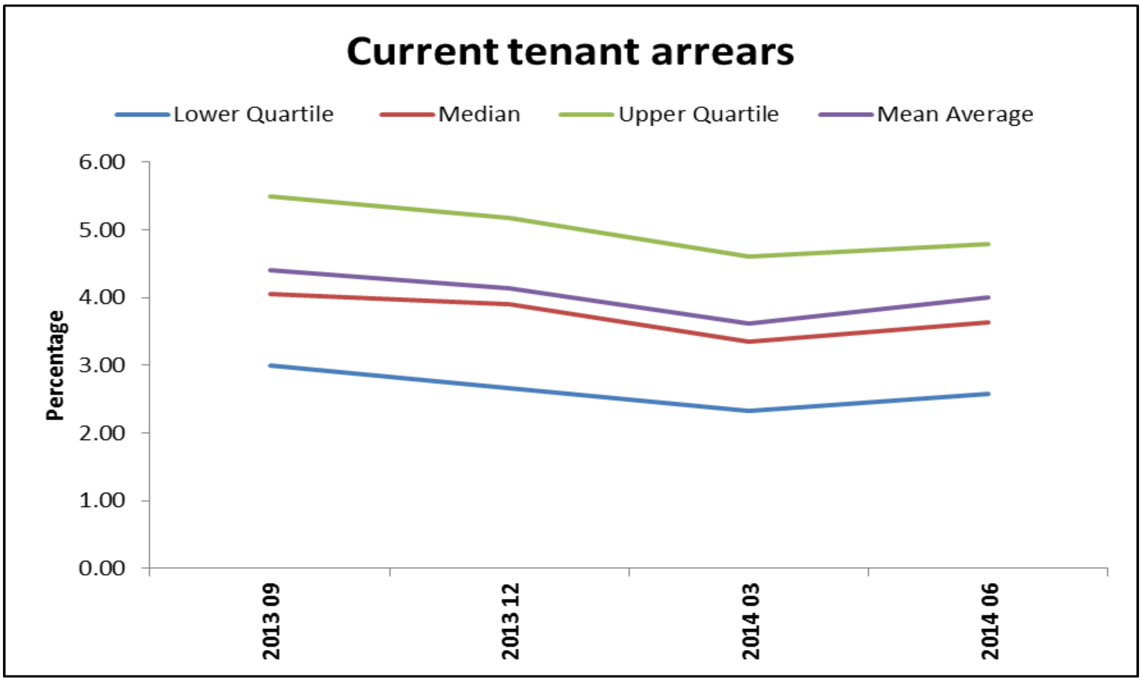
Income collection

As reported in the Sector Risk Profile (September 2013), welfare reform is a strategic risk to be managed by providers. The risk profile of Affordable Rent and market rented products was also highlighted as a risk to be managed, along with changes to rent policy from 2015. The potential impact of these factors on the operating environment reinforces the need for well managed income collection to maintain cash flows.

Since 2013-14, quarter 2 income collection questions have been included in the survey; these are intended to assess the impact of the operating environment on income collection and cash flow. The survey asks for percentages for current tenant arrears, rent collection and voids[3]. With data available for just 1 year, it is not possible to draw firm conclusions or demonstrate trends in the results. The reported figures for the current quarter show rent collection to be lower than the previous quarter. However, it is likely that this reflects a seasonal trend following the financial year end. Whilst the cycle of housing benefit payments and rent debits does affect these percentages, responses for each quarter appear to be sufficiently stable to suggest that providers are continuing to manage the risks and to maintain cash flows within business plan parameters.

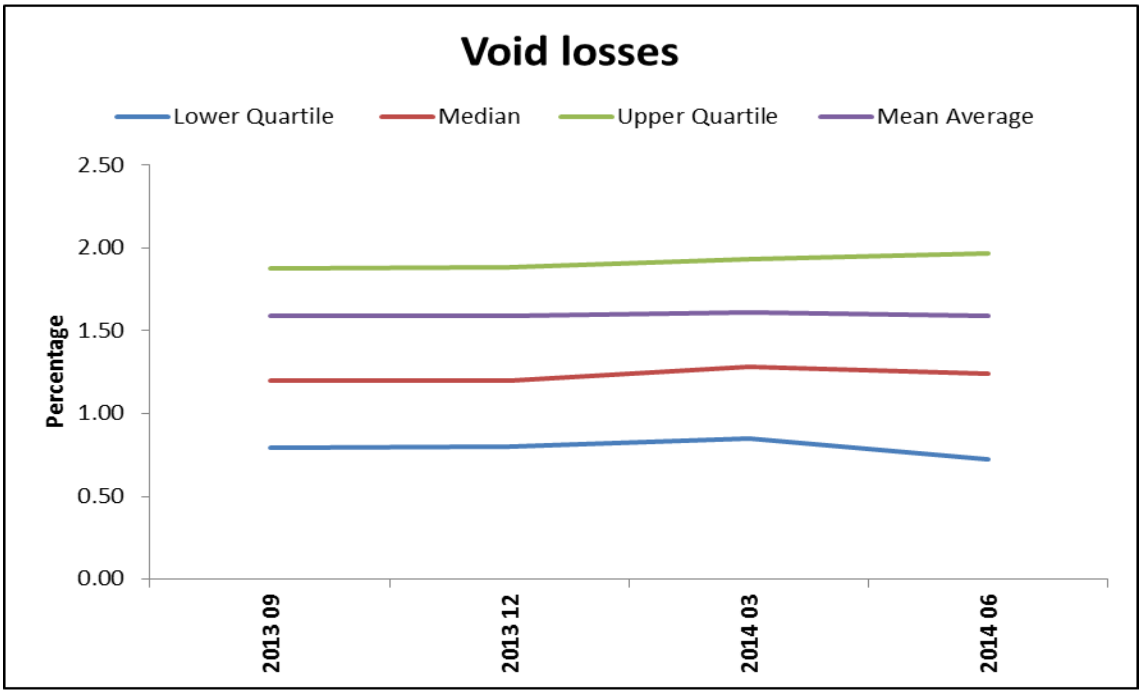
Most providers (91%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plans. However, as noted in previous quarters, these plans are typically based on assumptions that there would be a degree of adverse impact from welfare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

Reported current tenant rent arrears percentages are illustrated in the chart below. Of the survey respondents, 88% 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 4.8%.



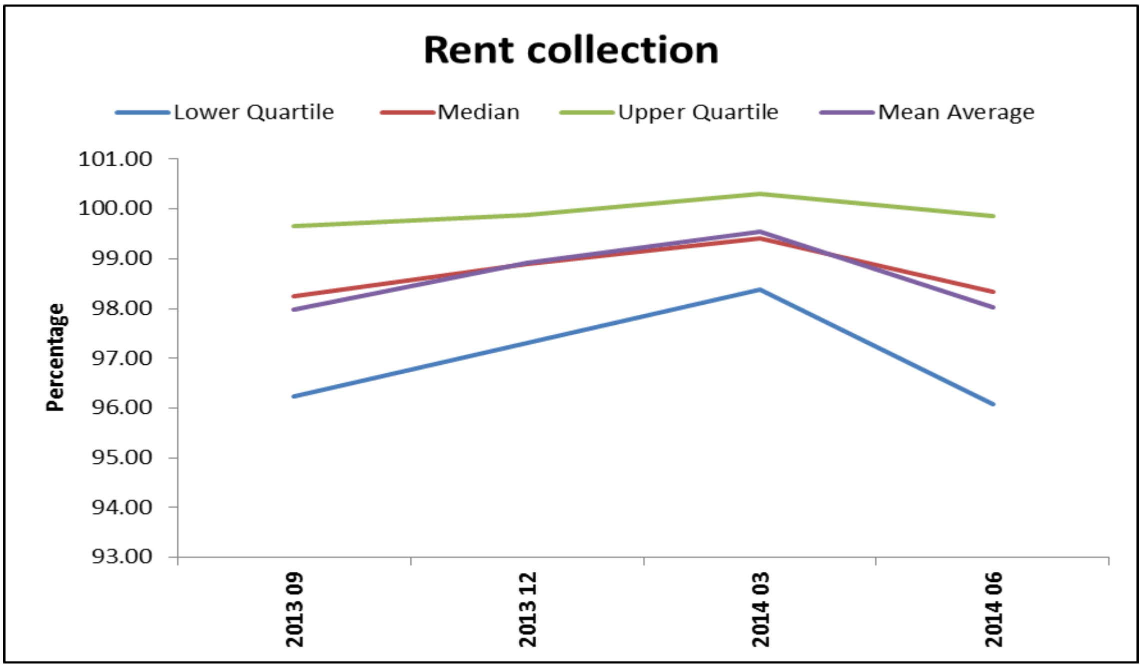
The current tenant arrears reported this quarter showed a small increase in comparison to the previous quarter. The mean average figure was 4.01% (March 3.61%). The median level of rent arrears was 3.63% (March 3.35%).

[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.
[4] 2013 Global Accounts of Housing Providers



The chart above shows reported void losses; over three quarters of providers continue to report void losses of lower than 2%. The aggregate sector void loss percentage, as reported in the latest published sector annual accounts, is 1.75%. Neither average nor median void loss percentages reported are significantly changed from those reported last quarter at 1.59% and 1.24% respectively (March 1.61% and 1.28%).

Rent collection figures, presented in the graph below, show that 84% of providers report rent collection for the year to be in excess of 95%[5].



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

Mean average and median rent collection percentages were 98.02% and 98.33% respectively (March 99.55% and 99.40%). The number of providers reporting rent collection rates of less than 95% increased to 41 (March 4). It is likely that Housing Benefit payment cycles have had a material impact on the changes to the reported figures; in the previous quarter, rent collection figures were seen to have improved at the year end.

As stated above, it must be emphasised that the income collection data covers one full year only. It is therefore not yet possible to draw any firm conclusions on trends.

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