Homes & Communities Agency

QUARTERLY SURVEY OF PRIVATE REGISTERED PROVIDERS

2013/14 Quarter 4

March 2014

Quarterly Survey of Private Registered Providers

March 2014

Introduction

The March 2014 Quarterly Survey report is based on responses from 265 private registered providers (PRPs) of social housing who own or manage more than 1,000 homes. This report includes additional information on the sector's private finance position which is collected each year as part of the March survey.

The survey results continue to indicate that the sector as a whole remains financially strong. The sector continues to have access to sufficient finance. The continued move towards capital markets has enabled some providers to access longer term funding than is currently available from the traditional banking sector. Risk exposure to interest rate fluctuations is managed through the use of bonds, fixed rate bank debt or interest rate swaps. Providers accessing the capital markets and making use of alternative sources of funding need to understand and manage the risks associated with different debt categories.

The increased development activity forecast over the next 18 months, including that required to deliver the Affordable Homes Programme 2011-15, remains a challenge. Providers will need to continue managing the risks associated with delivering development programmes. The housing market risks associated with potential increased sales activity will also need to be managed.

Income collection data suggests that providers are continuing to manage the impact of welfare reform on their cash flows. Reforms included the launch of housing benefit size restrictions for working age claimants in the social rented sector (under occupancy) in April 2013. The Regulator will continue to monitor income collection as universal credit is rolled out.

Summary of findings

Private Finance

- The sector's total reported borrowing facilities total £71.8bn, 78% of which is bank loans
- This is an increase of £3.4bn since March 2013, representing a year on year increase of 5.0%
- £59.3bn is currently drawn, leaving undrawn facilities of £12.5bn
- Cash available to the sector is reported to be £4.4bn (December £4.2bn)
- The total new facilities arranged in the year to March 2014 were £5.6bn
- New facilities arranged in the quarter were reported to total £1.9bn
- Capital market funding, including private placements, contributed 41% of the new funding in the quarter and 52% for the year
- The debt repayment profile shows limited refinancing risk to March 2016. £1.8bn, 2.5% of debt is repayable within two years (2013 £1.8bn, 2.6%)
- There has been an increase in debt repayable in between two and five years, from £5.5bn to £7.7bn
- The sector's exposure to interest rate fluctuations is mitigated through the use of fixed interest rates. £39.9bn, 67% of drawn debt, is fixed for over one year (2013 £36.8bn, 63% of drawn debt)

- Over the next 12 months the sector forecasts drawdowns of £5.7bn (December £5.2bn)
- 91% 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 fell to 48 as one provider withdrew from this type of financial instrument. The notional value of standalone derivatives fell to £8.9bn (December, £9.3bn)
- The current reported mark-to-market (MTM) exposure net of unsecured thresholds is £1.0bn; collateral of £1.9bn is reported to have been given in the form of property or cash

Housing market

- On Affordable Home Ownership (AHO), 2,084 first tranche sales were achieved in the quarter (December 2,121), 3,349 homes remained unsold (December 2,751) of which 964 had been unsold for over six months (December 1,039)
- There were 2,678 AHO completions and acquisitions in the quarter (December 1,936)
- Pipeline AHO completions expected in the next 18 months are 18,299 (December 18,886)
- Total asset sales of £940m (December £704m) were achieved in the quarter generating a profit of £324m (December £225m)

Operating context

UK economic indicators showed continued economic growth in the first quarter of 2014. Preliminary estimates issued by 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 March were CPI 1.6%, CPIH 1.5% and RPI 2.5%. 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.

An annual increase of 1.3% in average weekly earnings (excluding bonuses) for the period January to March 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 6.8% (a reduction of 133,000 to 2.21m) in the three months to March 2014.

The Bank of England base rate has remained at 0.5% since March 2009. Three month sterling LIBOR also remained low at 0.52% in March. 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 9.5% in the price of the average UK house price in the year to March 2014. This headline figure contained significant regional variation, with an annual increase of 18.2% reported for London and 5.9% for the North of England.

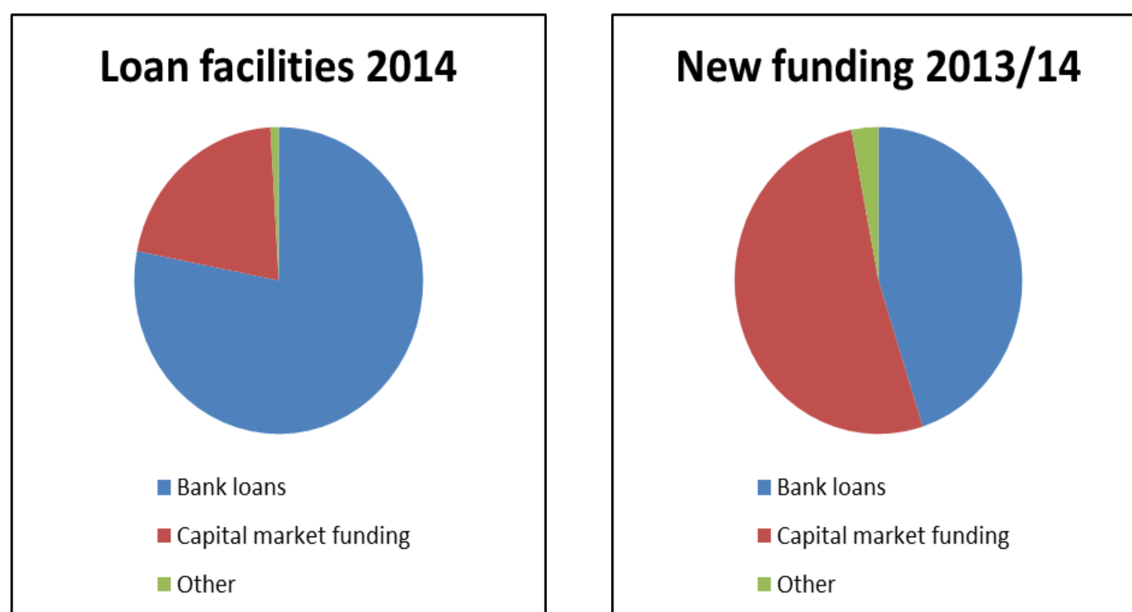
Financing market

The sector currently reports facilities of £71.8bn, of which £59.3bn is drawn leaving undrawn facilities of £12.5bn. Cash available to the sector is reported to be £4.4bn (December £4.2bn).

New facilities arranged in the quarter totalled £1.9bn. The total new facilities arranged in 2013/14 were £5.6bn (2012/13 £5.5bn). New finance was raised from bank loans and capital market funding. Over half of the new funding in the year came from capital markets. This included own name bonds, private placements and funding made available by the European Investment Bank through a bond aggregating vehicle.

The charts below illustrate that, although capital markets are contributing much of the new debt, traditional bank funding continues to represent 78% of the agreed facilities. The principal active bank lenders to the sector continue to be (in alphabetical order) Barclays, Lloyds, Nationwide, Royal Bank of Scotland and Santander.

'Other' funding totals £653m, less than 1% of total funding. Funding from sale and leaseback arrangements is included in this category.



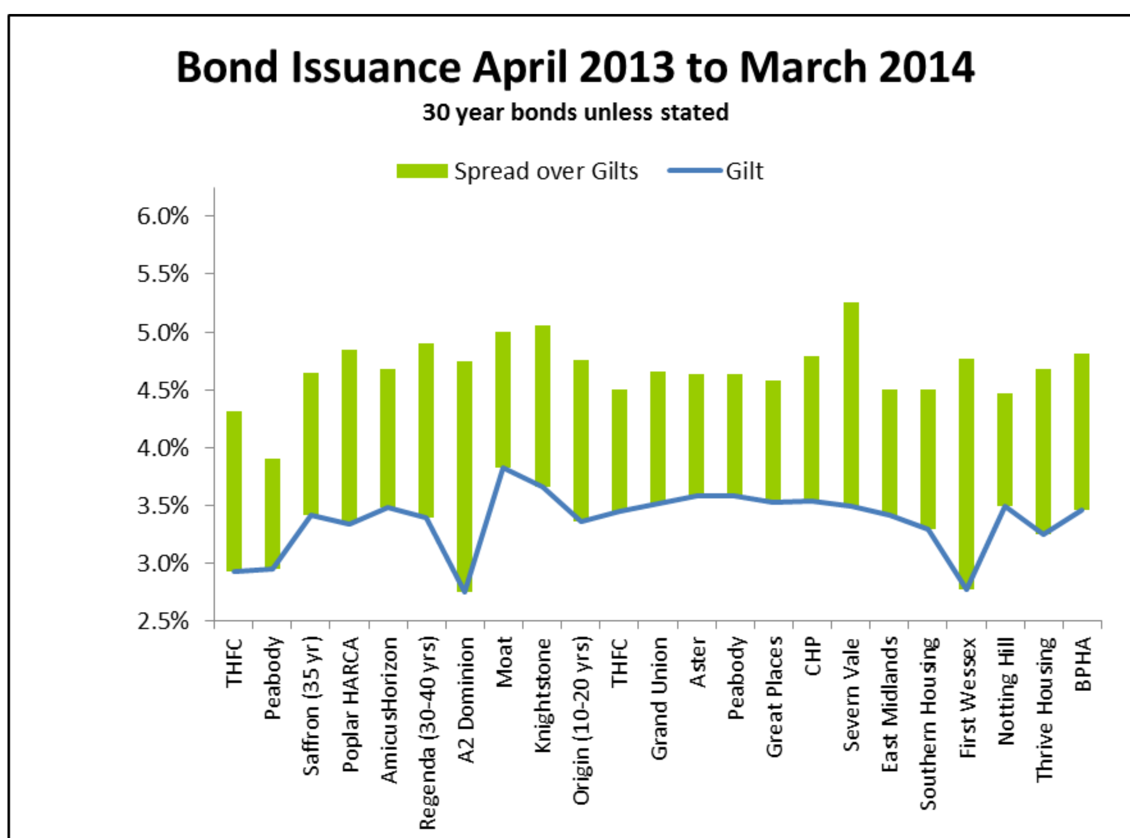
Providers are forecasting drawdowns of £5.7bn over the next 12 months. 84% of forecast drawdowns are from facilities secured and available, 8% agreed not yet secured and 8% not yet agreed. It remains essential for individual providers to ensure that security is in place in good time to enable drawdown.

The majority, 82%, of providers have facilities in place to cover the next 18 months. 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.

Where providers are raising new debt the Regulator expects boards to understand the risks associated with the individual deal, and its effect on the overall funding

portfolio, and how they would mitigate the impact of these risks crystallising. The Regulator expects boards to take appropriate independent, professional advice and to have the skills necessary to understand and critically appraise that advice. This should include boards understanding the full range of options that have been considered and why the particular deal suggested has been recommended, including any fees or other benefits due to their advisors. Taking on private finance is one of the most important decisions that boards need to make and the Regulator expects them to do this in a robust and considered manner and in a way that the whole board can understand the trade-offs and risks associated with a particular deal being adopted.

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[1] on bonds issued by providers.



Bonds have been issued in 2013/14 at coupon rates ranging from 3.9% (Peabody, May 2013) to 5.25% (Severn Vale, private placement, December 2013). The weighted average coupon rate on funds raised during the year was 4.64%; the weighted average credit spread for the year was 1.25%. Credit spreads ranged from 0.98% to 2.00%. There was a weak negative correlation between the cost of funds and the amount raised. The regulated social housing sector retains a strong credit rating and is able to issue long term bonds at fixed rate interest costs.

[1] The credit spread is the difference between the interest rate offered to investors in the bond and the interest paid on an equivalent risk free 'gilt' bond issued by the Government

Security

Security is currently reported to be in place for £69.6m of debt; this represents 96.9% of agreed facilities and 117% of drawn facilities. At sector level, this is sufficient to cover the £5.7bn forecast drawdowns over the next 12 months.

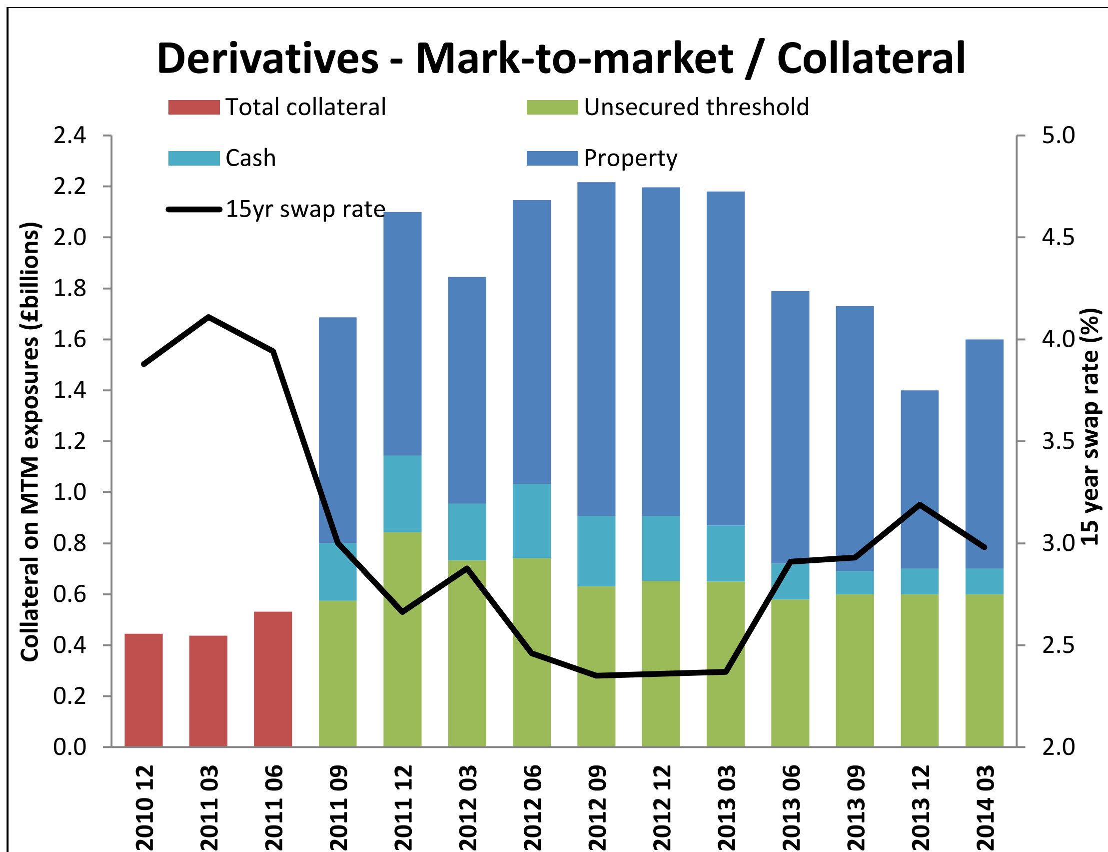
Providers also estimate that additional security is available to support a further £25bn of new borrowing. This indicates that available security is not a constraint to additional borrowing; however, balance sheet capacity and the availability of cash to service additional debt also need to be considered in determining borrowing capacity.

Derivatives

The number of providers reporting that they make use of free standing derivatives is now 48 (December, 49). One provider reports a change of position (since December 2013), with all financial instruments now embedded within its loan agreements. The notional value of the instruments is now £8.9bn (December £9.2bn). The average term of the instruments is 14 years.

Potential interest rate volatility means that collateral requirements remain a long term exposure. Financial Reporting Standard 102, which providers will need to adopt for the year ending March 2016, will require derivatives to be reported differently in annual accounts. Free standing derivatives must be reported at fair value, with movements taken through the Income and Expenditure Account, potentially increasing the volatility of reported surpluses. Any potential impact on loan covenants must 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 which remains as interest rates continue to be volatile. The mark-to-market (MTM) exposure net of unsecured thresholds is currently reported to remain at £1.0bn. Collateral of £1.9bn in the form of property and cash is reported to have been given against this exposure. Cash collateral is now reported to be £106m (December, £78m). The Regulator will continue to monitor providers' exposure to cash calls. Excess collateral, totalling £952m is now reported by 31 providers, providing assurance that these providers are able to withstand future interest rate changes.



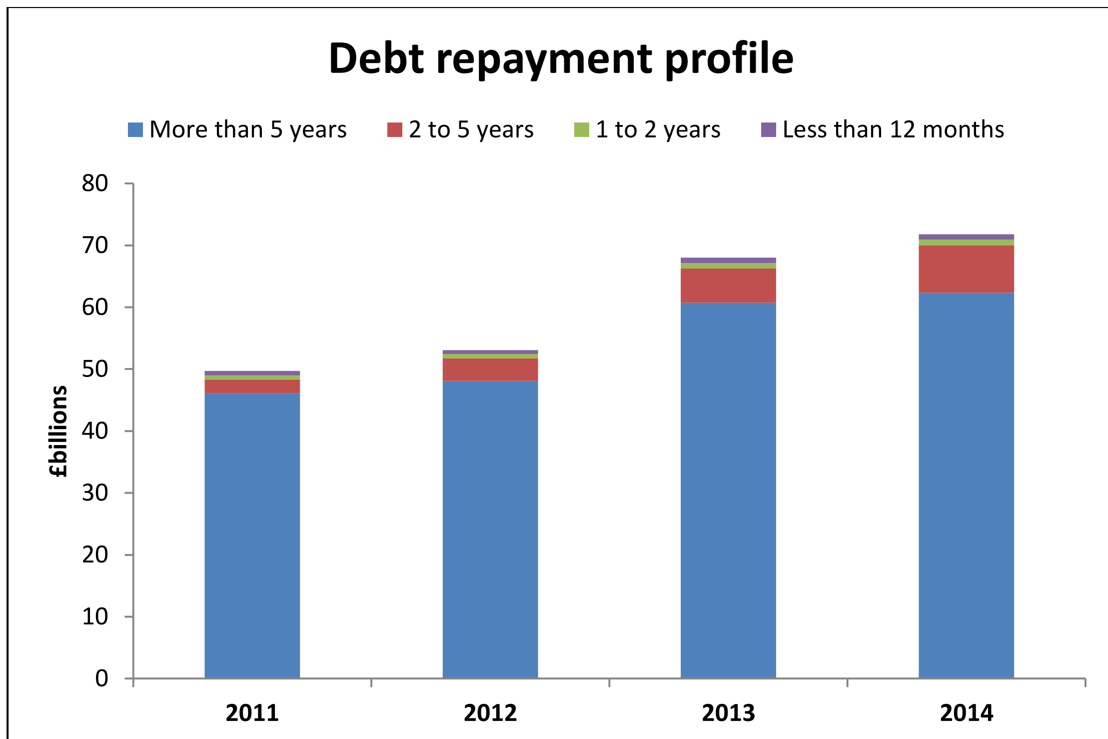
The chart above shows mark-to market exposures, excluding excess collateral, and illustrates movements in exposure relative to the 15 year swap rate.

Debt repayment profile

The sector reports that repayments of £9.5bn are due to lenders over the next five years as profiled below:

- April 2014 to March 2015 £0.9bn
- April 2015 to March 2016 £0.9bn
- April 2016 to March 2017 £2.6bn
- April 2017 to March 2018 £2.3bn
- April 2018 to March 2019 £2.8bn

Long term debt continues to account for the majority of the sector's borrowings with 87% of current debt being due for repayment in over five years. This is illustrated in the debt repayment profile chart below:

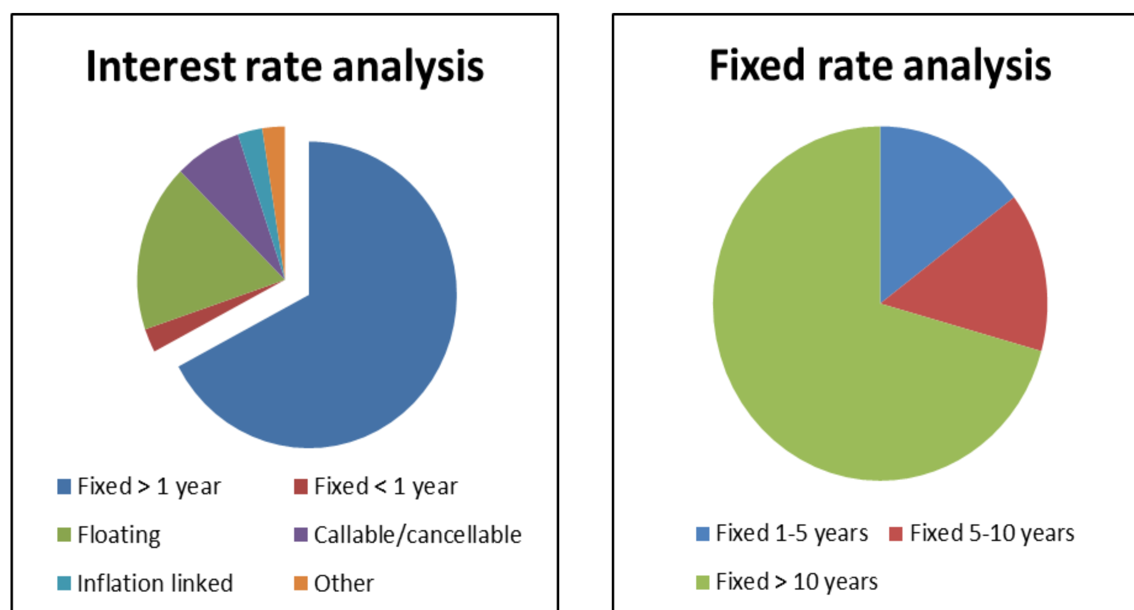


The value of debt repayable in two to five years and in over five years has increased as sector borrowings have increased. The shorter terms on offer for new bank debt, as well as maturing historic debt, has led to an increase in the sector's refinancing risk in the medium term. The use of long term capital market funding has increased the amount of debt repayable in more than five years.

The sector is due to repay £0.9bn of debt in 2014/15 and a similar amount in 2015/16. This means that the percentage of facilities due for repayment in the next two years is slightly lower than that reported in the previous three years. The sector's immediate refinancing risk remains low, with 1.2% (2013 1.3%) of loans reported to be due for repayment within 12 months. Individual provider's exposure to 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 an analysis of the period over which rates have been fixed.



Fixed rate (greater than one year) debt remains a high proportion of drawn debt, comprising 67% of the sector's borrowings. The analysis of the duration of fixed rates shows that 47% of total borrowing is at rates fixed for over ten 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 £19.4bn, representing 33% of the total drawn debt (2012/13 £20bn, 35%).

Debt which is callable or cancellable represents 7% of the sector's total drawn debt. This is unchanged since 2013; 97 providers report that they hold this type of debt, meaning that risk exposure is widely spread. The majority of these providers report that callable or cancellable debt comprises less than 10% of their total debt portfolio; 39 providers report that it comprises 11% to 30% and 11 providers report 31% to 50%. The total amount of debt which is reported as callable or cancellable is £4.3bn; the earliest dates at which this may be called or cancelled are shown below:

- Within one year £1.1bn, 25%
- One to five years £0.8bn, 19%
- Five to 10 years £0.5bn, 12%
- Over 10 years £1.9bn, 44%

Inflation linked debt or hedging accounts for 3% of the sector's total borrowings. This is unchanged from 2013; 71 providers report that they hold inflation linked debt or hedging. For most of these providers, inflation linked debt or hedging comprises less than 10% of their drawn debt. 20 providers report that inflation linked debt or hedging comprises between 11% and 30% of their drawn debt. The total sector debt or hedging reported to be held at inflation linked interest rates is £1.6bn. Providers

making use of long term financing linked to RPI will need to be particularly aware of basis risk associated with differential inflation rates as rent increases move to a CPI basis from 2015/16.

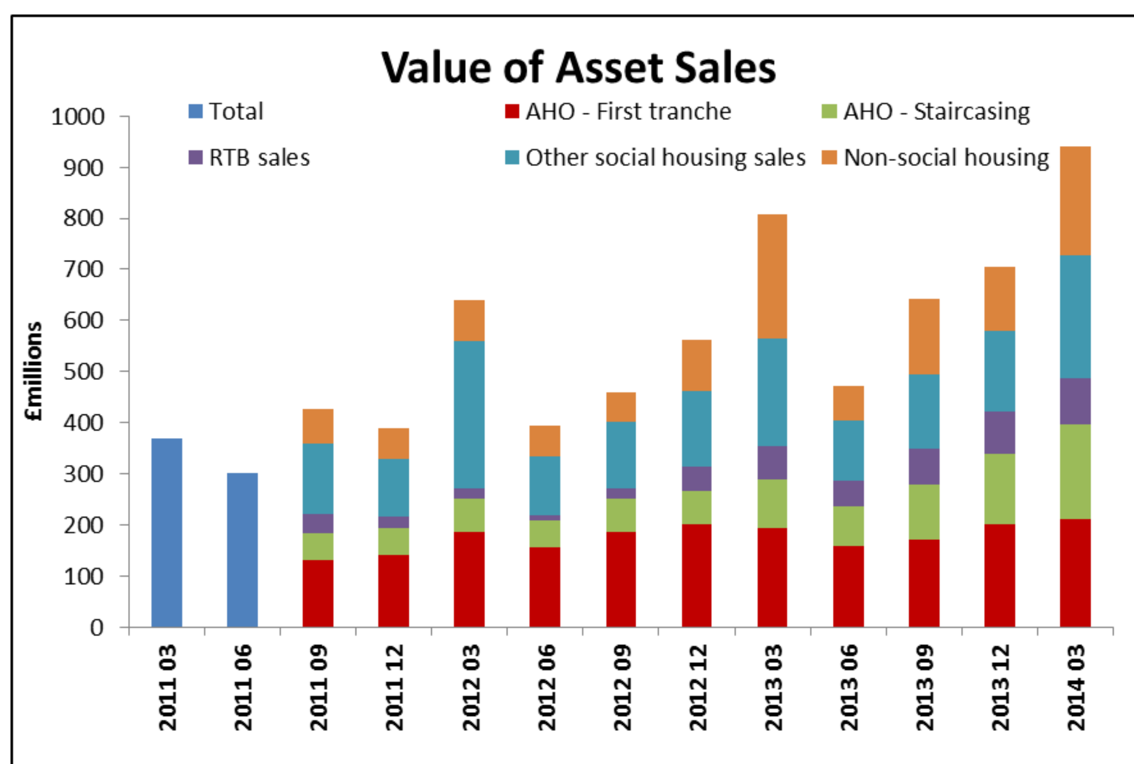
The Regulator continues to engage with providers to monitor treasury management arrangements and risk exposure to fluctuating interest rates as part of the assessment of compliance with the governance and financial viability standard.

Housing market

The sector continues to run a significant sales programme including shared ownership, social housing sales and market sales. Growth through development continues to be a key objective for many providers; providers therefore need to manage the impact of sales risk on 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 £940m (December £704m). The growth in the value of asset sales since March 2011 is shown in the graph below. Surpluses on sales were reported at £324m (December £225m).

Revenue and surpluses were higher in Quarter 4 than Quarter 3 across all categories. Sales for the year totalled £2.8bn compared with £2.2bn in 2013.



Income from first tranche sales was £212m, with surpluses of £51m. Staircasing sales were £185m. Income from RTB sales was £89m. As stated in previous quarters, income from RTB continues to provide 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 £241m included stock rationalisation transfers between providers, which do not represent a

loss of stock from the social housing sector. Non-social housing sales of £213m generated a surplus of £49m.

Affordable home ownership

The Quarter 4 figures show[2]:

- 2,678 AHO homes were acquired or developed (December 1,936)
- 2,084 were sold (December 2,121)
- 3,349 remained unsold (December 2,751)
- The number remaining unsold for over six months decreased to 964 (December 1,039)

The increase in the number of unsold units is the first since March 2013 and reflects a seasonal trend in completions of units available for sale at the year end. The number of units unsold at the year-end is lower than at March 2013 (3,734). The decrease in numbers unsold for over six months continued, with the total now reported at just over 25% of the peak in March 2009.

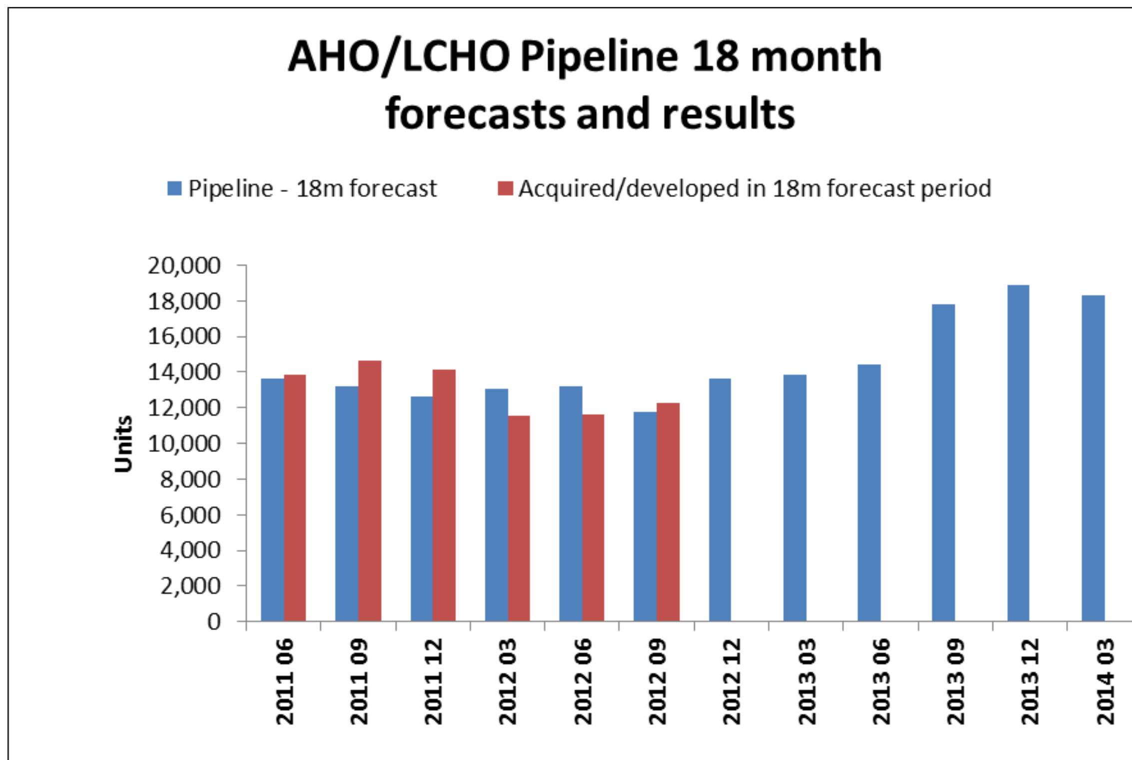
The number of sales achieved in the quarter showed a decrease of 37 units. As reported in the previous quarter and as illustrated below, the level of development activity is forecast to increase significantly. Providers need to continue to deliver planned sales performance and to manage the risks of housing market exposure.

Development forecasts and delivery

Providers report that 18,299 AHO units are forecast to be completed over the next 18 months. This forecast is not significantly changed from the previous quarter and continues to represent around 3,050 units per quarter. Quarterly completions and acquisitions have averaged 2,024 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 below, the current forecast is not significantly changed from the previous two quarters. However, the forecast delivery over the next 18 months continues to exceed the track record on delivery over the preceding 18 months by 6,000 units (49%).

[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.



We can now compare the 18 month pipeline forecasts to delivery of units developed or acquired for six 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 September 2012; the data shows that actual reported completions for this period exceeded forecast by 514 units. This suggests that past forecasting has been accurate.

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.

Non-regulated companies

The Quarterly Survey data shows that:

- 128 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 £2.4bn
- 30 providers have given guarantees of £0.9bn on the obligations or liabilities of other parties. Of these, 10 have given security
- 38 providers report that a joint venture or unregistered subsidiary is forecasting a loss in their 2014 accounts. Total losses are forecast to be £50m

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 47 providers reporting that they anticipate an impairment charge in their 2014 accounts. The total anticipated charge is £76m, of which £33m relates to social housing assets. Of these 47 providers anticipating an impairment charge, 31 providers forecast less than £1m, 15 forecast £1-10m and one over £10m.

There is no current indication that impairment charges will impact on providers meeting the performance requirements of loan covenants.

Income collection

As reported in previous quarters, the Sector Risk Profile (September 2013) identified welfare reform as 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]. The graphs below suggest that there was some further improvement in income collection rates in the current quarter. With data for just three quarters, it is not possible to draw firm conclusions or demonstrate trends in the results. 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.

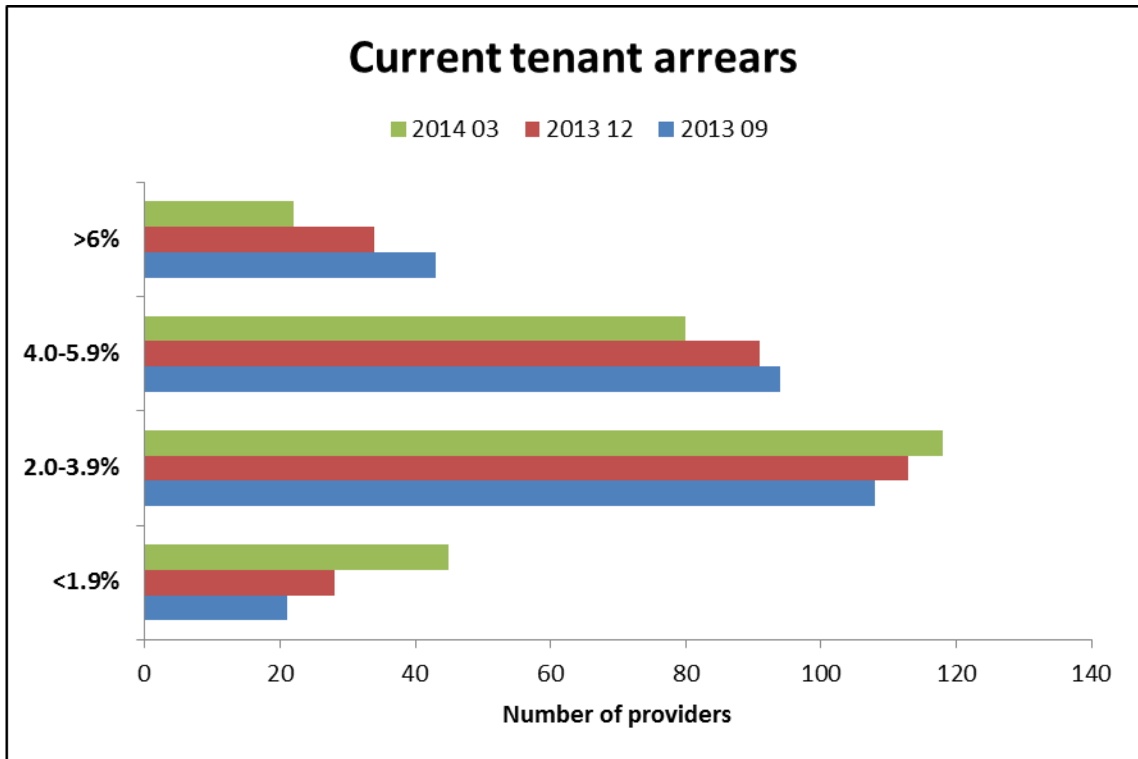
Most providers (92%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plans. However, as noted in previous quarters, these plans are typically based on assumptions that there would be a degree of adverse impact from welfare reform measures. Providers were also asked to provide narrative comments on their performance in these areas. Comments suggest that providers have taken active measures to mitigate the risk and have directed additional resource to rent collection. Six providers suggest that delays to the introduction of universal credit measures has meant that the expected impact on assumptions has not been as significant as forecast. Where performance is reported to be worse than the current business plan, losses from void properties continue to attract a number of comments. Four providers continue to make specific mention of higher volumes of voids in larger properties and suggest that this may be attributable to under occupation. This will continue to be monitored through regulatory engagement with those providers.

Reported current tenant rent arrears percentages are illustrated in the chart below. Of the survey respondents, 92% 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], was 4.8%.

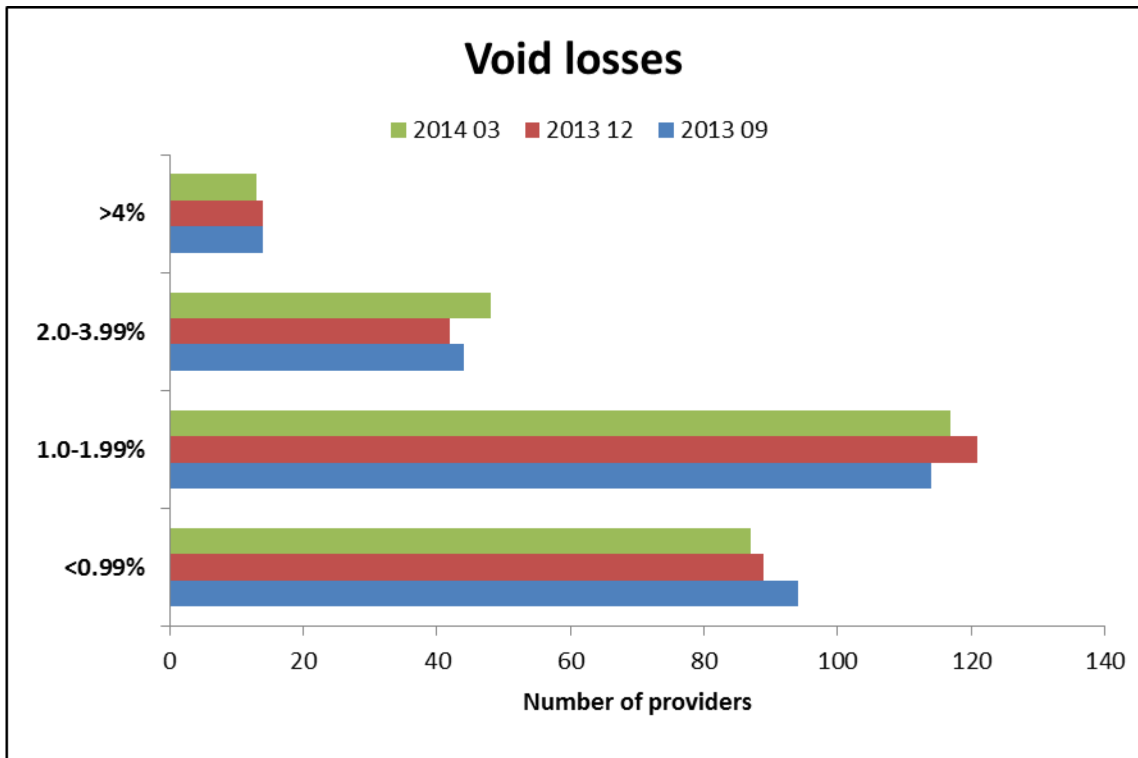
---

[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



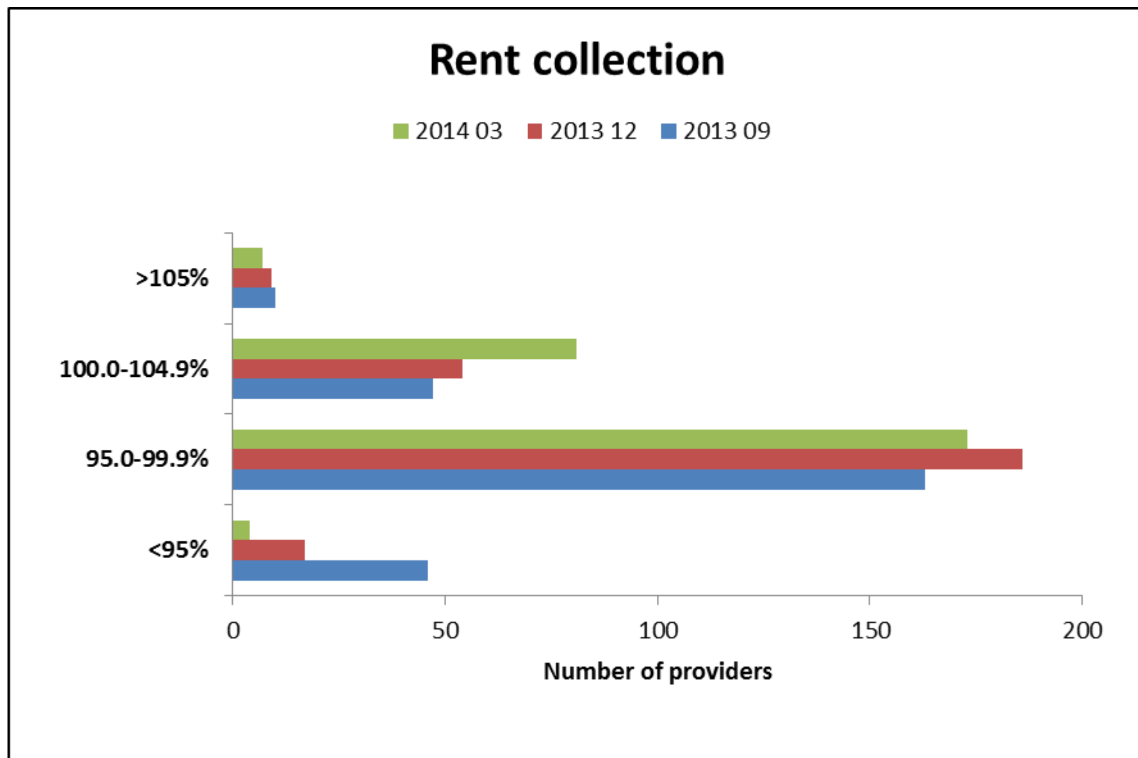
The current tenant arrears reported this quarter represented an improvement in comparison to the previous quarter. The average figure was 3.6%. The median level of rent arrears was 3.4%, down from 3.9% last quarter. The improvement was broad based, with arrears figures lower across all deciles of performance.



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 1.61% and 1.28% respectively (December, 1.59% and 1.20%). There was some further improvement from the providers in the highest decile for levels of voids which was offset by a slight deterioration in performance by providers in the lowest decile.

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].



Average and median rent collection percentages remain at 99%. The number of providers reporting rent collection rates of less than 95% fell to four. It is likely that housing benefit payment cycles have had a material impact on the changes to the reported figures with rent collection figures improved at the year end. Overall, the picture on income collection appears to remain stable.

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

homesandcommunities.co.uk
mail@homesandcommunities.co.uk
0300 1234 500

Homes &
Communities
Agency

Homes and Communities Agency
7th Floor
Maple House
149 Tottenham Court Road
London W1T 7BN

The Homes and Communities Agency is committed to providing accessible information where possible and we will consider providing information in alternative formats such as large print, audio and Braille upon request.

Publication date: June 2014