Homes & Communities Agency

QUARTERLY SURVEY OF PRIVATE REGISTERED PROVIDERS

September 2014

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Introduction

The September 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. 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.

Managing the risks of Affordable Home Ownership (AHO) development programmes, including delivery of the AHO element of the Affordable Homes Programme (AHP) 2011-15, remains a challenge. AHO development forecasts continue to anticipate a step increase in activity in 2014/15; there has been some increase in completions compared to 2013/14, but a much greater increase will be required to deliver the pipeline. Boards need to be aware of the March 2015 AHP completion deadline and the risks and costs associated with potential delays to the programme.

Market sales activity remains concentrated in relatively few providers. The regulator engages with these providers to monitor the associated risks.

Income collection data suggests that a large majority of providers are continuing to manage the impact of welfare reform on their cash flows. To date, most large providers (94%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plans. However, this is not to underestimate the impacts which are being managed by providers. 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. 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 total £73.5bn, 76% of which is bank loans.
- £60.7bn is currently drawn, leaving undrawn facilities of £12.8bn
- cash available to the sector remains at £4.2bn
- new facilities arranged in the quarter totalled £1.7bn
- capital market funding, including private placements, contributed 51% of the new funding in the quarter
- over the next 12 months the sector forecasts drawdowns of £4.7bn (June £5.4bn)
- 92% (June 90%) of providers continue to anticipate that current debt facilities are sufficient for more than 12 months. Providers must continue to ensure that they have secured facilities in place to cover their forecast drawdown requirements

- the number of providers continuing to make use of free standing derivatives was 47 (June 48). The notional value of standalone derivatives increased to £9.4bn (June, £9.1bn)
- the current mark-to-market (MTM) exposure net of unsecured thresholds is £1.1bn; collateral of £2.1bn has been given in the form of property or cash

Housing market

- on AHO, 2,205 first tranche sales were achieved in the quarter (June 2,116), 2,800 homes remained unsold (June 2,985) of which 968 had been unsold for over six months (June 947)
- there were 1,983 AHO completions and acquisitions in the quarter (June 1,734).
- pipeline AHO completions expected in the next 18 months are 18,521 (June 18,393)
- on market sales, 774 sales were achieved (June 490); 427 homes remained unsold (June 669), of which 112 had been unsold for over six months (June 165).
- there were 549 homes developed for market sale in the quarter (June 419)
- pipeline market sales completions expected in the next 18 months are 5,529 (June 5,275)
- total asset sales of £792m (June £694m) were achieved in the quarter generating a surplus of £237m (June £226m)

Operating context

Headline figures indicate a continued recovery in the UK economy. Initial economic growth figures released by the Office for National Statistics (ONS) showed that GDP had increased by 0.7% in Q3 2014 and was 3.0% higher compared to the same quarter a year ago. The initial reports show GDP to be 3.4% higher than the pre-downturn peak of Q1 2008.

Inflation figures for the year to September were: Consumer Price Index (CPI) 1.2%, CPI including home ownership costs (CPIH) was also 1.2% and Retail Price Index (RPI) 2.3%. CPI remains below the government's target of 2%; the September 2014 rate is the lowest for five years.

As discussed in the Sector Risk Profile (September 2014), future rental income increases on social rented properties will be linked to CPI. The rent increase formula for 2015/16 will be based on the September 2014 CPI rate + 1%. Providers need to be mindful of the business planning implications of differential inflation rates on income and expenditure.

UK labour market statistics showed that, for June to August 2014, the unemployment rate fell to 6.0%; 736,000 more people were in employment than a year ago. Average weekly earnings (excluding bonuses) were 0.9% higher than a year ago. Real terms reductions in earnings, combined with potential reductions in benefits, contribute to the increased need for active income management by providers.

The Bank of England base rate has remained at 0.5% since March 2009. Three month sterling LIBOR also remained low at 0.56% in September. 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 a fall of 0.2% in house prices in September. Annual house price growth was 9.4%; beneath this headline figure, the regional variations ranged from 4.3% in the North to 21.0% in London.

Financing market

The sector currently reports facilities of £73.5bn, of which £60.7bn is drawn leaving undrawn facilities of £12.8bn. Cash available to the sector is reported to remain at £4.2bn.

Cash available to the sector has been reported to be over £4bn in each of the last four quarters; 11 providers currently report that they each have over £75m available, this represents 29% of the total. Providers need to ensure that cash is available to cover operating costs and to fund development programmes. However, boards need to 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 £1.7bn. New finance was raised from bank loans and capital market funding. 51% 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); 40% came through traditional bank and building society lending and 9% through local authority lending. The evidence of the availability of these new facilities suggests that the sector retains the confidence of lenders.

Providers are forecasting drawdowns of £4.7bn over the next 12 months. Security is currently reported to be in place for £70.1bn of debt; this represents 96% of agreed facilities and 116% 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, 80%, of providers, 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 two years will be to fund providers' development programmes.

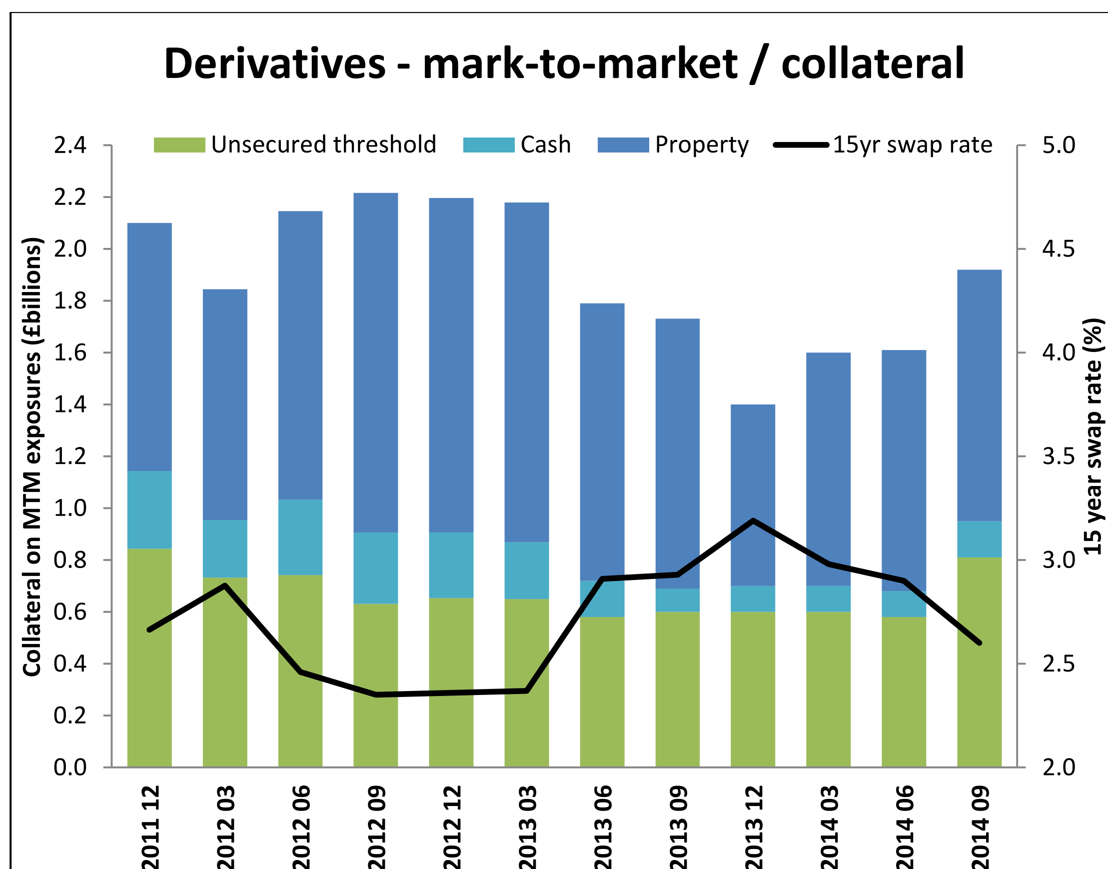
The regulator expects boards to understand the risks associated with arranging new finance and with maintaining an appropriate level of liquidity. Independent, professional advice should be taken as appropriate and boards should have the skills necessary to understand and critically appraise that advice.

Derivatives

The number of providers reporting that they make use of free standing derivatives reduced to 47 (June 48). The notional value of the instruments is now £9.4bn (June £9.1bn). The average term of the instruments remains at 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. 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.

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 reported to be £1.1bn (June £1.0bn). Collateral of £2.1bn in the form of property and cash is reported to have been given against this exposure (June £2.0bn). Cash collateral is now £143m (June £103m). The regulator will continue to monitor providers' exposure to cash calls. Excess collateral, totalling £992m is now reported by 33 providers, providing assurance that these providers are able to withstand future interest rate changes.



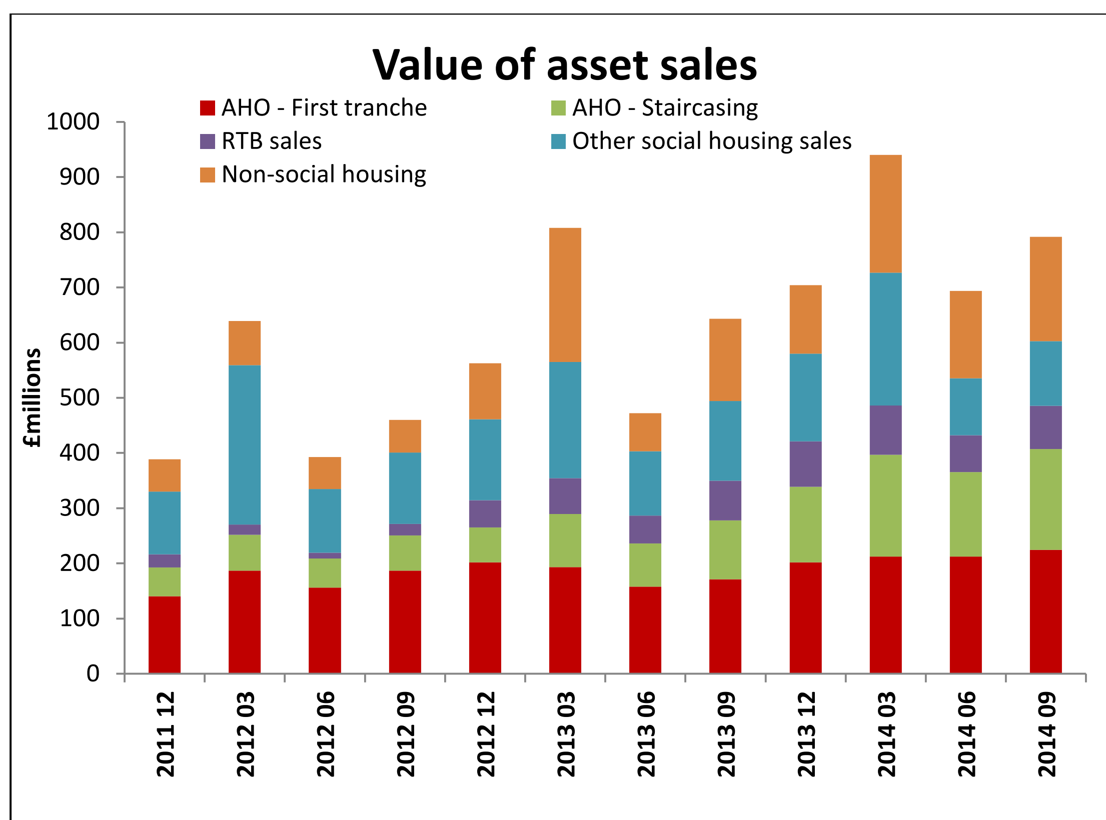
The chart above shows mark-to market exposures, excluding excess collateral, and illustrates movements in exposure relative to the 15 year swap rate.

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 2 (including AHO first tranche and staircasing, Right to Buy (RTB) and other social and non-social housing) was £792m (June £694m). The growth in the value of asset sales since March 2011 is shown in the graph below. Surpluses on sales were reported at £237m (June £226m).

Sales revenue and surpluses were both above the level reported in June; reflecting the normal seasonal trend. Both sales and surpluses were above the levels reported in September 2013.



Analysis of the sales figures shows that income from first tranche sales was £224m, with surpluses of £54m. The margin of 24% was higher than both the previous quarter and a year ago (June 22%; September 2013 21%). Staircasing sales were £183m, with surpluses of £67m. The margin of 36% on staircasing sales was comparable to the previous quarter and higher than a year ago (June 37%; September 2013 32%).

Income from RTB sales was £78m, with surpluses of £32m. These sales show a high margin of 41% (June 34%; September 2013 39%) and generate cash for the sector. However, as noted in previous quarters, 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 were £117m, with surpluses of £47m. The margin of 40% in the current quarter was lower than in the previous quarter and a year ago (June 51%; September 2013 55%). These sales include asset management disposals. The volatility of this margin is likely to reflect the condition of stock and the circumstances of disposals.

Non-social housing sales of £189m generated a surplus of £38m. The margin of 20% was lower than the previous quarter (June 29%), but was unchanged from

September 2013. This fluctuation may reflect the fact that open market sales numbers have been maintained through variations in selling prices.

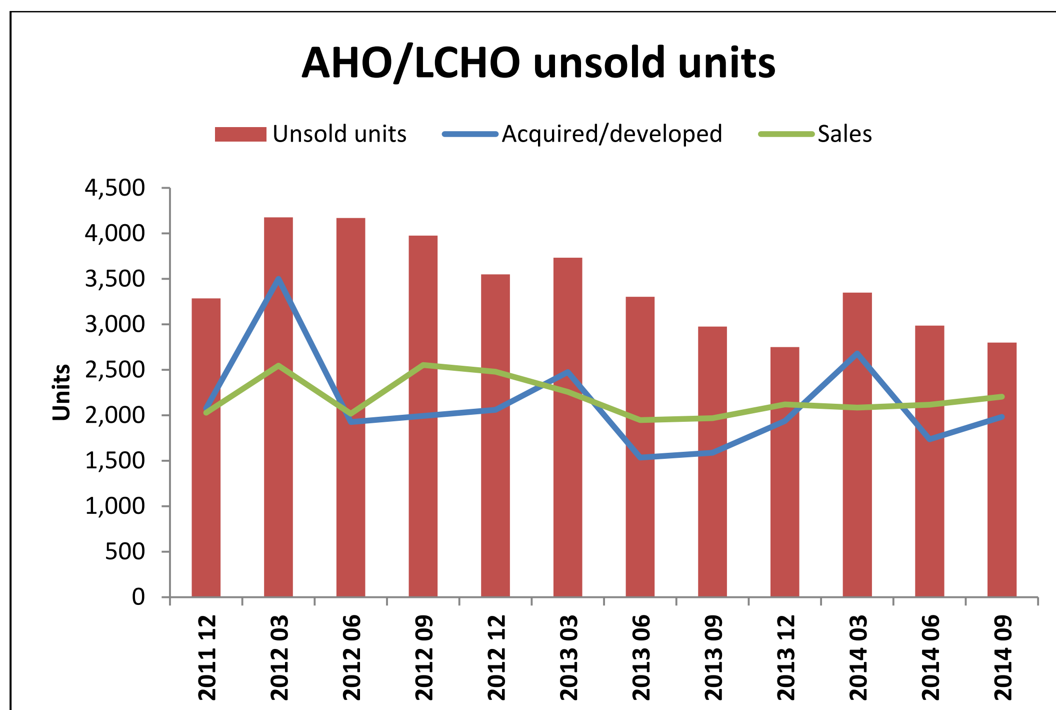
Affordable home ownership

The Quarter 2 figures show[1]:

- 1,983 AHO homes were acquired or developed (June 1,734)
- 2,205 were sold (June 2,116)
- 2,800 remained unsold (June 2,985)
- 968 properties remained unsold for over six months (June 947).

The figures demonstrate that sales continue to take place and that the stock of unsold AHO units has further reduced. The rate of reduction in unsold units is driven by both sales volume and the number of homes acquired or developed in the period.

The chart below shows the relationship between the numbers of unsold units reported at the quarter end dates and the numbers of units acquired/developed and sold in the corresponding quarters. This shows that sales have remained relatively stable over the previous 18 months. Greater fluctuations are seen in completions; the peaks in completions showing at the March year end dates drive increases in the stock of unsold units. As sales are achieved at a steady rate, this is reflected in the reduction in stock numbers. Given the forecast increases in pipeline completions over the next two quarters (see below, AHO development forecasts and delivery), providers will need to manage the risks of significant increases in the numbers of unsold units at March 2015.



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 2 is held by 22 providers. Providers engaging in AHO development need to continue to

[1] There is a small reconciliation difference between units reported as unsold at quarter ends. The June figure for properties unsold over six months has been restated following a correction by one provider.

deliver against planned sales performance and to manage the risks of housing market exposure.

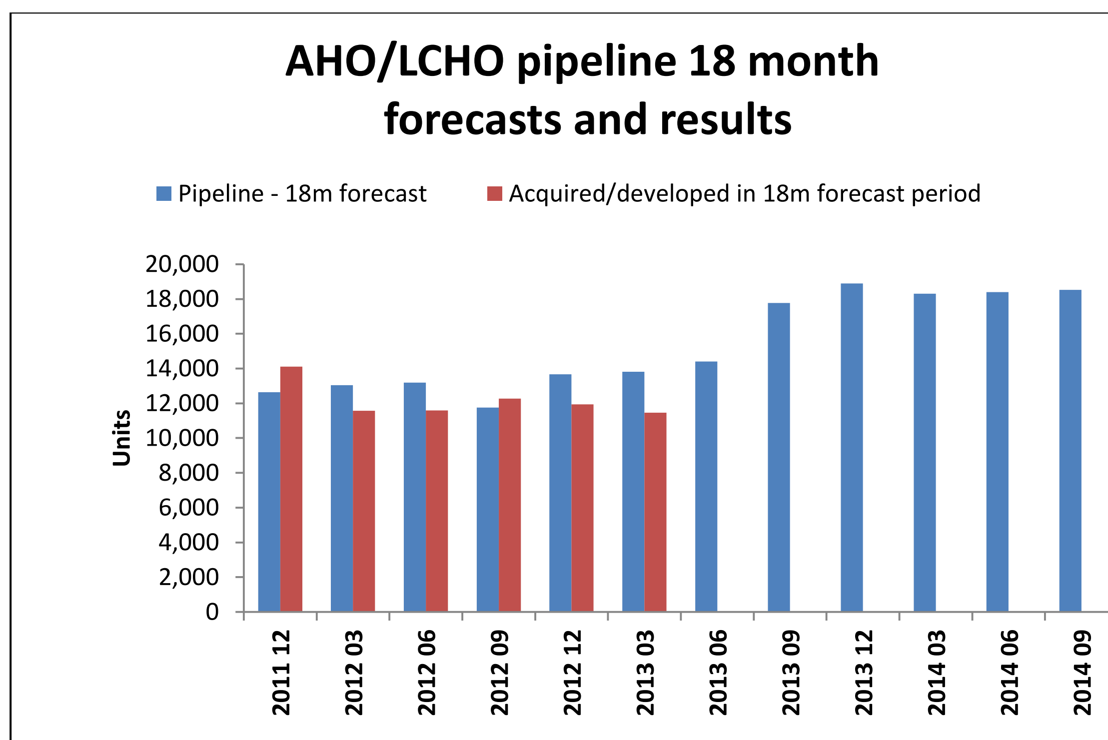
AHO development forecasts and delivery

Providers report that 18,521 AHO units are forecast to be completed over the next 18 months (June 18,393). This represents around 3,087 units per quarter. Quarterly completions and acquisitions have averaged 1,909 over the previous 18 month period. As noted previously, more activity is expected as the AHP 2011-15 delivery period comes to an end. Providers need to be aware of the March 2015 completion deadline and the risks and costs associated with potential delays to the programme.

As can be seen in the chart below, the pipeline forecast for AHO units has not changed significantly over the previous four quarters. Forecast delivery over the next 18 months exceeds the track record on delivery over the preceding 18 months by 7,066 units (62%).

The track record on development completions shows that the 18 month pipeline target has only been achieved in two of the six quarters from 2011/12 Q3 to 2012/13 Q4. The most recent forecast for which the 18 month pipeline period has been completed is March 2013; the data shows that actual reported completions for this period were 2,366 units below forecast.

The step increase in the September 2013 forecast is expected to be delivered over the course of 2014/15. If forecast numbers are to be achieved, this will require a significant increase in completions over the next two quarters. There has been some increase in completions compared to 2013/14, but a much greater increase will be required to deliver the pipeline. The 18 month pipeline forecast in September 2013 was for completions of 17,773 units; in the first four quarters of this period, 8,331 completions have been achieved. To meet the forecast, 9,442 completions will be required in the final two quarters.



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

The Quarter 2 figures show:

- 549 homes were developed (June 419)
- 774 homes were sold (June 490)
- 427 remained unsold (June 669)
- 112 remained unsold for over six months (June 165)

These numbers present a positive picture, with sales exceeding development and a resulting reduction in the stock of unsold units, including those unsold for over six months. However, as noted above (Housing market), sales of non-social housing properties in this quarter were achieved at lower margins than in the previous quarter.

Development forecasts show 5,529 homes for market sale to be in the pipeline for development over the next 18 months, an average of 922 per quarter. This quarterly run rate of development is 90% higher than the average number of homes developed in quarters 1 and 2. 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 continues to be concentrated in a small number of providers. The regulator engages with these providers to monitor boards' understanding and management of the associated risks.

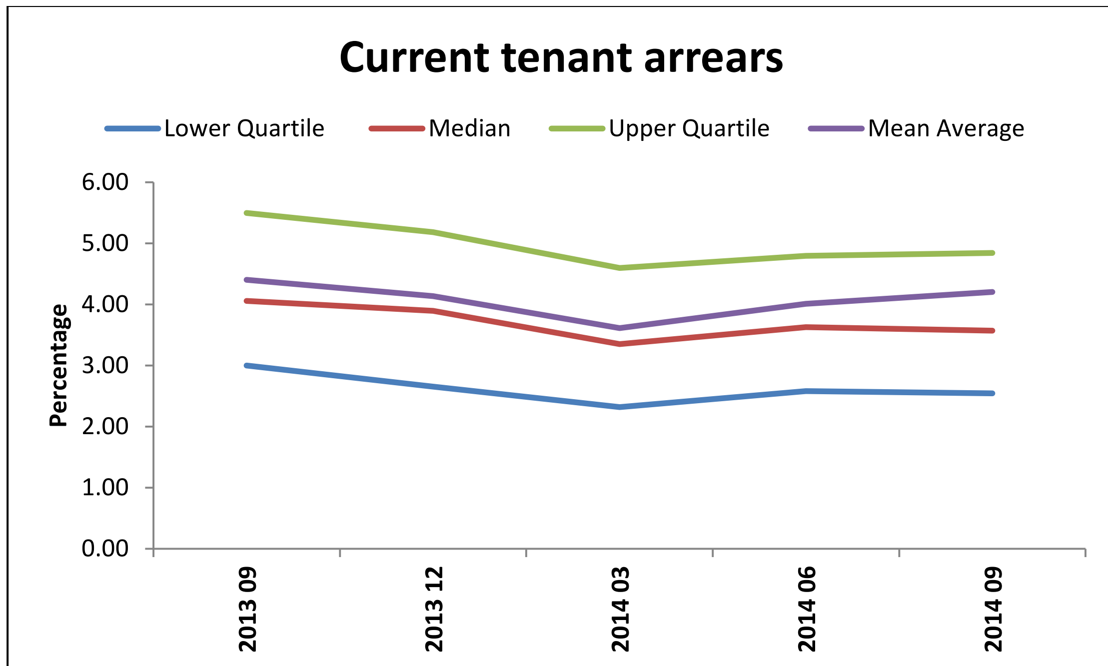
Income collection

As reported in the Sector Risk Profile (September 2014), welfare reform remains a strategic risk to be managed by providers. The risk profile of Affordable Rent and market rented products, along with changes to rent policy from 2015, were also highlighted as a risk to be managed. These exposures reinforce the need for well managed income collection 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[2]. The responses for each quarter appear to be reasonably stable and to suggest that providers are continuing to manage the risks and to maintain cash flows within business plan parameters.

Most providers (94%) 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.

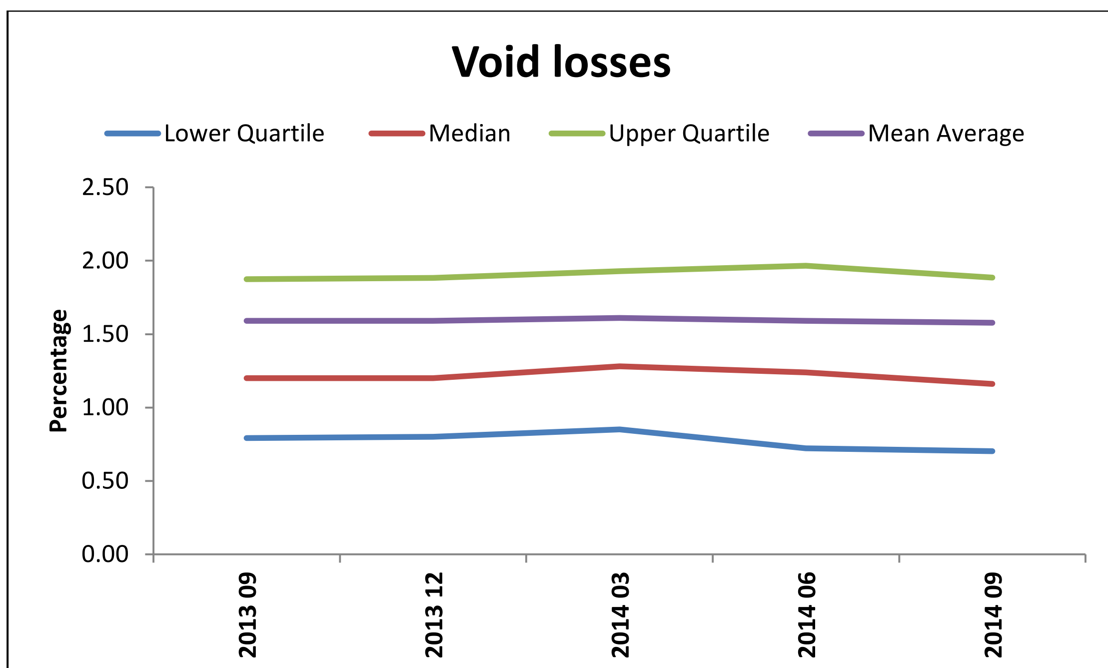
[2] The survey asked for current tenants' rent arrears as a percentage of annualised rent receivable; the percentage of rent receivable collected in the year to date and the percentage of rent receivable lost through voids in the year to date.

Reported current tenant rent arrears percentages are illustrated in the chart below.



Of the survey respondents, 88% 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[3], 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 4.2% (June 4.01%). The median level of rent arrears was 3.57% (June 3.63%).

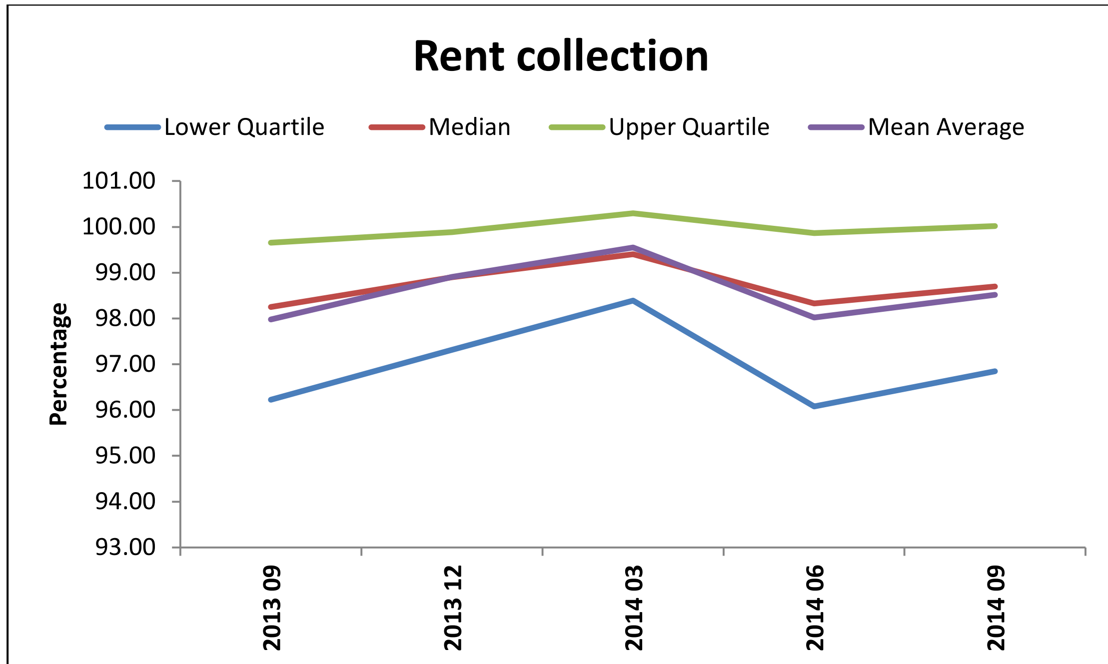
The chart below shows reported void losses; over three quarters of providers continue to report void losses of lower than 2%.



[3] 2013 Global Accounts of Housing Providers

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 1.58% and 1.16% respectively (June 1.59% and 1.20%).

Rent collection figures, presented in the graph below, show that 88% of providers report rent collection for the year to be in excess of 95%[4].



Mean average and median rent collection percentages were 98.52% and 98.70% respectively (June 98.02% and 98.33%). The number of providers reporting rent collection rates of less than 95% fell to 30 (June 41).

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

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