Homes &
Communities
Agency

Quarterly Survey for Q2
(July to September) 2016 to 2017

December 2016
Homes and Communities Agency

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Introduction

The quarterly survey report is based on responses from 239 private registered providers (PRPs) and PRP groups who own or manage more than 1,000 homes.

The survey is a key regulatory return in assessing the risks to PRPs' business plans and their compliance with economic regulatory standards.

The survey provides a regular source of information regarding the financial health of PRPs, in particular with regard to their liquidity position. The quarterly survey returns summarised in this report cover the period 1 July 2016 to 30 September 2016. Where any information received through the quarterly survey indicates a potential concern, this is followed up with providers.

Summary

The quarterly survey findings are:

- The sector remains financially strong with access to sufficient finance: £14.3 billion of undrawn facilities are in place.
- New finance of £1.1 billion was raised in the quarter from banks and capital markets.
- As a result of bond issuance and operating cash flows the sector has cash balances of £5.9 billion – this is forecast to reduce in the next 12 months to £3.9 billion as cash is used to fund planned capital expenditure.
- The sector forecasts strong operating cashflows with cash interest cover of 189% over the next 12 months.
- Investment in housing supply was £1.7 billion in the September quarter, broadly in line with the committed forecast of £1.8 billion.
- Over the 12-month forecast period expected investment in new housing supply is £10.4 billion of which £6.5 billion is contractually committed; actual investment in new housing supply for the 12-month period ending September 2016 was £7.0 billion.
- Affordable home ownership (AHO) activity increased in the quarter with a 26% quarter on quarter increase in homes developed to 2,516 and a 13% increase in first tranche unit sales to 2,766. This led to a 5% fall in the stock of unsold units.
- The pipeline of expected completions in the next 18 months indicates that this increase in activity is likely to continue with AHO completions expected to average 3,400 per quarter and market sales completions expected to average 1,560 per quarter.
- Market sale activity increased in the quarter. There was a 57% quarter on quarter increase in homes developed to 1,225 and a 25% increase in units sold (992). The stock of unsold properties increased by 23% to 1,242.

- Providers making use of free standing derivatives reported a 7% increase in mark to market (MTM) exposure to £3.7 billion as the 15 year swap rate fell from 1.13% in June to 0.80% at the end of September.

- In-aggregate providers continue to have headroom on available collateral. At sector level, headroom has increased. The regulator continues to seek assurance from providers affected by the fall in swap rates.

- Income collection data continues to show a stable performance, consistent in comparison to the corresponding quarter end last year.

Operating environment

At a headline level the economic operating environment for PRPs remained largely benign in the quarter, with little immediate impact from the Brexit referendum result.

Key metrics for the period covered include:

- Average house prices continued to grow, increasing by 7.7% in the year to September 2016. Following months of accelerating growth the rate of increase may now have stabilised with average prices increasing by 0.2% in the month of September[1].

- In the quarter ending September 2016, output in the construction industry was estimated to have decreased by 1.1% compared with the previous quarter ending June 2016[2].

- The Consumer Prices Index (CPI) rose by 0.9% in the year to October 2016, compared with a 1.0% rise in the year to September[3]. Although CPI inflation remains low, rates are set to increase with forecasters predicting that inflation will rise to 2.7% by December 2017[4].

- The Bank of England has changed the base rate for the first time in seven years, from 0.5% to 0.25%. The Bank also restarted its quantitative easing programme and introduced a new funding scheme for banks and building societies.

The survey results suggest that the sector is in a robust position to respond to any uncertainty and changes in the wider economic environment.

The key risks faced by the sector are considered in the Sector Risk Profile published annually by the regulator. The 2016 update was published in September.

The regulator will continue to monitor key market trends and to seek assurance that boards are actively engaged in responding to emerging risks.

[1] UK House Price Index
[2] ONS Statistical Bulletin: Construction output in Great Britain: Sept 2016
[3] ONS Statistical Bulletin; UK consumer price inflation: Oct 2016
[4] HM Treasury; Forecasts for the UK economy: a comparison of independent forecasts; November 2016 (mean CPI inflation rate from 25 forecasting organisations)

Private finance

- The sector's total agreed borrowing facilities are £81.5 billion, of which £57.0 billion (70%) is bank loans.
- £67.2 billion is currently drawn, leaving undrawn facilities of £14.3 billion.
- 96% (June 96%) of providers forecast that current debt facilities are sufficient for more than 12 months.
- New facilities agreed in the quarter totalled £1.1 billion. Bank lending accounted for 22% of the new funding in the quarter; capital markets, including private placements and aggregated bond finance, contributed 76%; the remaining 2% was local authority lending.
- Of the £81.5 billion agreed facilities £76.7 billion has been secured and £2.4 billion of facilities do not require security. There are further agreed facilities of £2.5 billion where security is not yet in place.

Cashflows

It is essential that providers have access to sufficient liquidity at all times and so the regulator engages with PRPs that have low liquidity indicators or are forecasting drawdowns from facilities not yet agreed or secured.

Summary cashflow forecast

Figures in £ billions	**3 months to 30 Sept 2016 (forecast)**	**3 months to 30 Sept 2016 (actual)**	**12 months to 30 Sept 2017 (forecast)**
Operating cashflows	1.5	1.8	5.9
Interest cashflows	(0.8)	(0.8)	(3.1)
Payments to acquire and develop housing	(2.4)	(1.7)	(10.4)
Disposals of housing fixed assets	0.5	0.4	1.6
Other cashflows	0.0	(0.1)	(0.1)
Cashflows before resources and funding[5]	**(1.3)**	**(0.3)**	**(6.2)**
Financed by:			
Net grants received	0.2	0.1	0.5
Net increase in debt	0.8	0.8	3.3
Use of cash reserves	0.3	(0.6)	2.4
Total funding cashflows	**1.3**	**0.3**	**6.2**

[5] There are rounding differences in the calculated totals; figures are reported in £000

- This is the second quarter to include the 1% rent cut implemented on 1 April 2016.

- Operating cashflow, net of interest, of £1.0 billion in the quarter ending September 2016 exceeded the forecast of £663 million.

- The sector forecast £2.4bn expenditure on new properties to be spent in the quarter, but the £1.7bn actually spent represents those schemes to which they were contractually committed. Suggesting that at aggregate level the sector did not take on any uncommitted new schemes.

- Cash interest cover for the three-month period was 231%. The sector continues to forecast strong operating cashflows with cash interest cover over the 12 months to 30 September 2017 projected to be 189% (12 months from June, 181%).

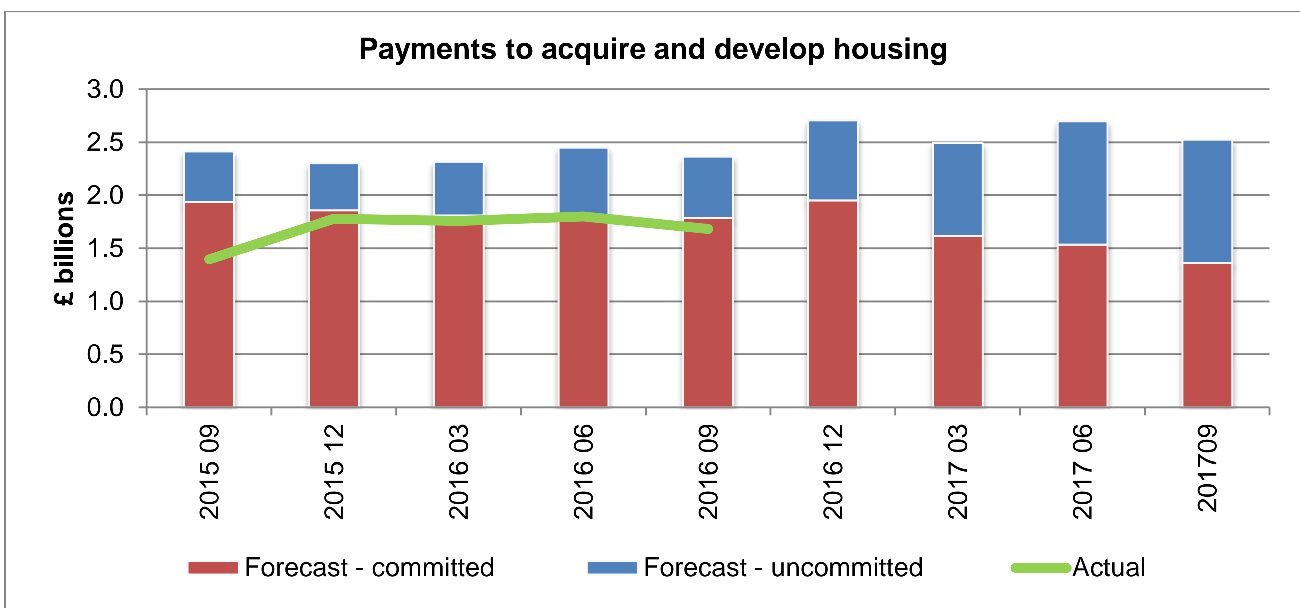
- Cash available to the sector at the September 2016 quarter end was £5.9 billion (June £5.6 billion); this is forecast to reduce to £3.9 billion over the next 12 months as cash reserves are used to fund capital investment.

- Cash held in secured accounts at September 2016 was £1.1 billion (June £720 million), this represents increased cash collateralisation of mark to market positions.

Development

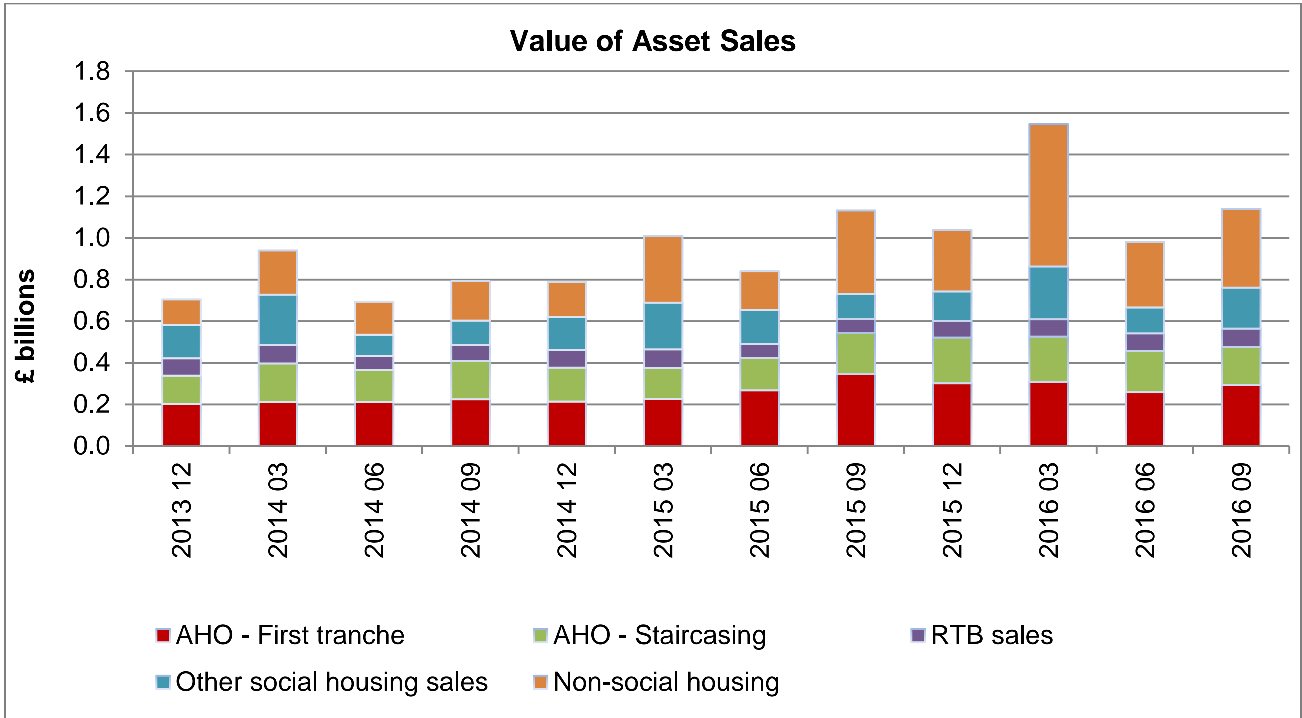
Actual payments of £1.7 billion to acquire and develop housing were slightly below the previous quarter and the contractually committed forecast spend of £1.8 billion. £7.0 billion was invested in the acquisition and development of housing in the 12 months to September 2016.

Payments of £6.5 billion to acquire and develop housing properties are committed in the next 12 months; a further £4.0 billion, not contractually committed, is included in the forecasts. In the short term, payments to acquire and develop properties generally track the committed level of spend. This is forecast at £2.0 billion for the quarter to December 2016.



Housing market

Asset sales revenue and surplus were higher than in June; this reflected the seasonal trend. The asset sales of £1.1 billion generated a surplus of £396million (June total asset sales £1.0 billion, surplus £324 million). Revenue was in line with September 2015 whilst surpluses were higher (September 2015 total asset sales £1.1 billion, surplus £363 million).

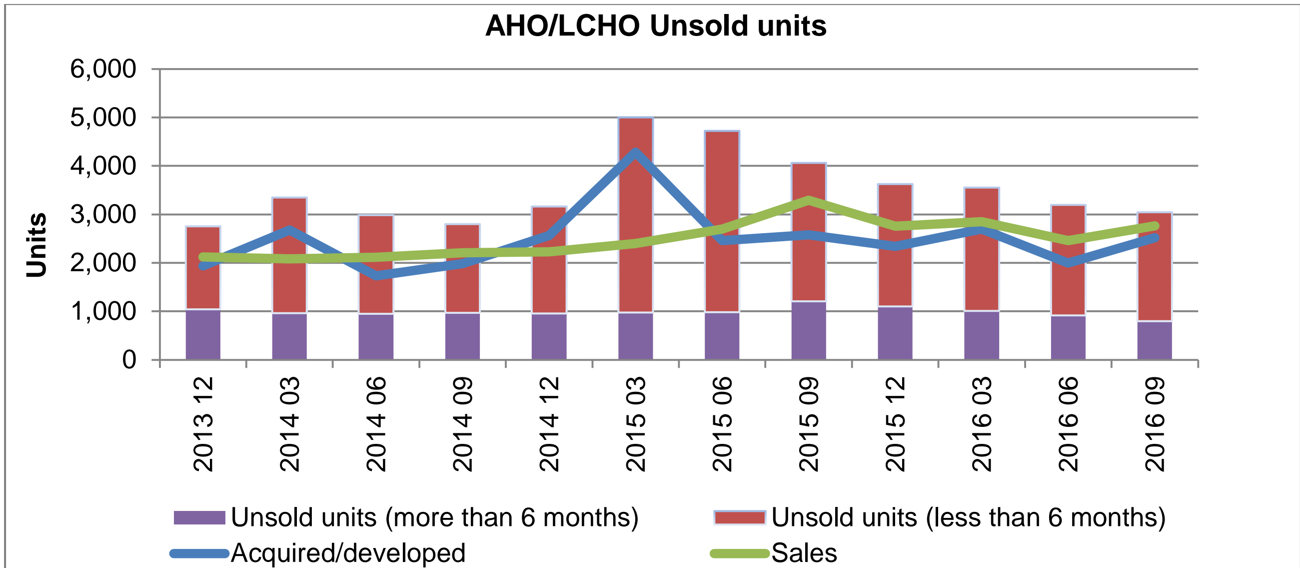


Asset sales in the September 2016 quarter were down 9% compared to the forecasts received in the previous quarter. Current asset sales (market sales and first tranche AHO sales) were £640 million, compared to a forecast of £732 million. Fixed asset sales were £445 million, compared to a forecast of £461 million.

The difference between forecasts and current asset housing sales achieved is concentrated in a small number of providers. Development programmes are subject to change and the variances are largely a result of delays in handovers of for sale properties from developers.

Where sales revenues are lower than forecast, the regulator has sought assurance that the individual providers have sufficient access to liquidity and that the delays do not have a material impact on viability. Although the providers currently remain in a strong financial position, the regulator will continue to closely monitor sales exposure.

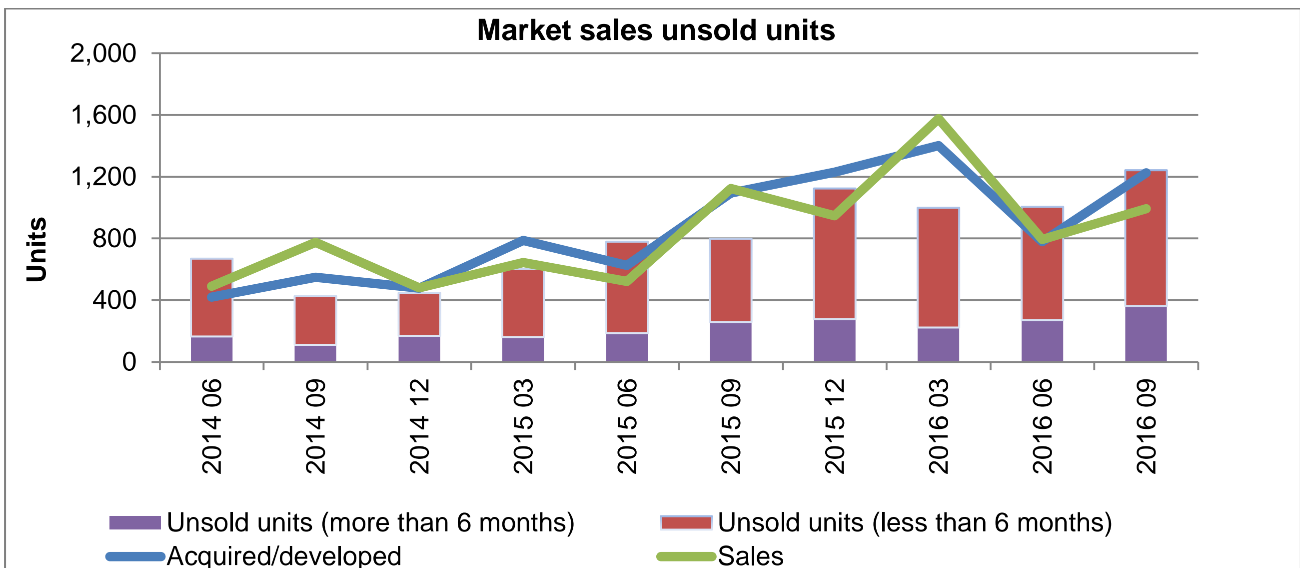
AHO unit sales continued to exceed completions. There were 2,766 first tranche sales in the quarter (June 2,457) compared to 2,516 AHO completions and acquisitions (June 1,995). This led to a 5% reduction in unsold units in the quarter; at the end of September 2016 3,041 homes remained unsold (June 3,199) of which 799 had been unsold for over six months (June 914). Half of the unsold AHO stock at the end of the quarter was held by 19 providers.



The pipeline of AHO completions expected in the next 18 months is 20,391 (June 18,545) of which 16,560 are contractually committed. Over the 18 months to September 2016, there were 14,582 AHO completions.

Development for sale is concentrated in relatively few providers. There were 992 sales in the quarter (June 794) and 1,225 homes were developed for market sale (June 778).

The number of unsold market sale units at September 2016 was 1,242 (June 1,007). For market sales, half of the total unsold stock at the end of the quarter was held by six providers.



The pipeline for market sale completions expected in the next 18 months is 9,361 (June 8,790) of which 8,262 are contractually committed. Over the 18 months to September 2016, there were 6,354 market sales completions.

Whilst there are likely to be quarterly fluctuations in the levels of for-sale development activity and sales achieved, the pipeline numbers demonstrate an overall trend for increased activity. In the 12 months to September 2017 the sector has forecast current asset sales of £3.2 billion. This compares to actual sales achieved in the year to September 2016 of £2.6 billion.

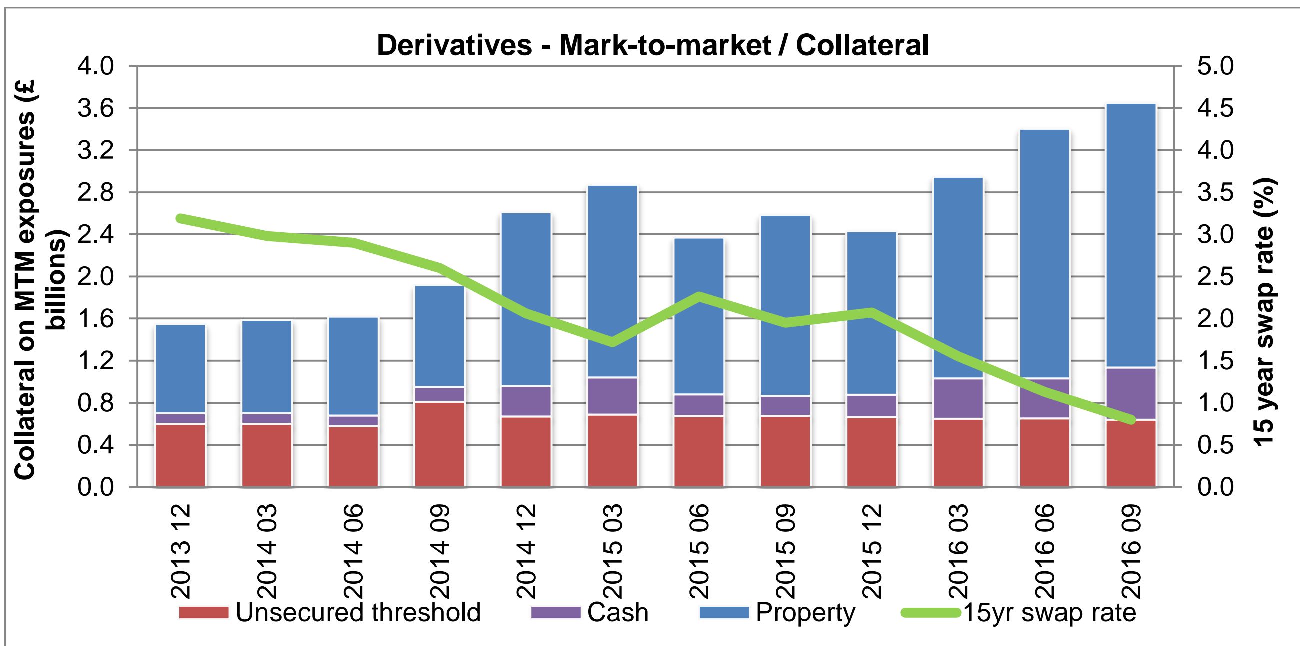
Derivatives

- Fifty providers currently make use of free standing derivatives. The notional value of standalone derivatives was £9.8 billion (June £9.7 billion).

- The current gross MTM exposure increased to £3.7 billion at the end of June (June £3.4 billion[6]).

- Unsecured thresholds and available security pledged to swap counterparties was £4.6 billion; of this total collateral, £3.2 billion (June £2.9 billion) has been employed in the form of property or cash, together with unsecured thresholds of £0.6 billion.

- The additional excess collateral available consists primarily of property pledged but not employed.



The graph above shows MTM exposures, excluding excess collateral. The decrease in the sterling 15 year swap rate over the quarter was reflected in an increase of £251 million in MTM exposure.

The additional collateral requirement was largely met through an increase in property and cash collateral in the quarter; the headroom of collateral available over current exposure increased by £252 million. Notwithstanding the adverse movement, collateral given in terms of security and cash continues to exceed the sector's current exposure levels. This provides some mitigation against liquidity risk. Interest rate volatility means that collateral requirements will remain a long-term exposure.

Individual providers must ensure that they have sufficient available security as a further fall in swap rates has the potential to increase MTM exposure. The regulator will continue to monitor on-going movements in the swap rate and engage with providers where there are significant levels of exposure.

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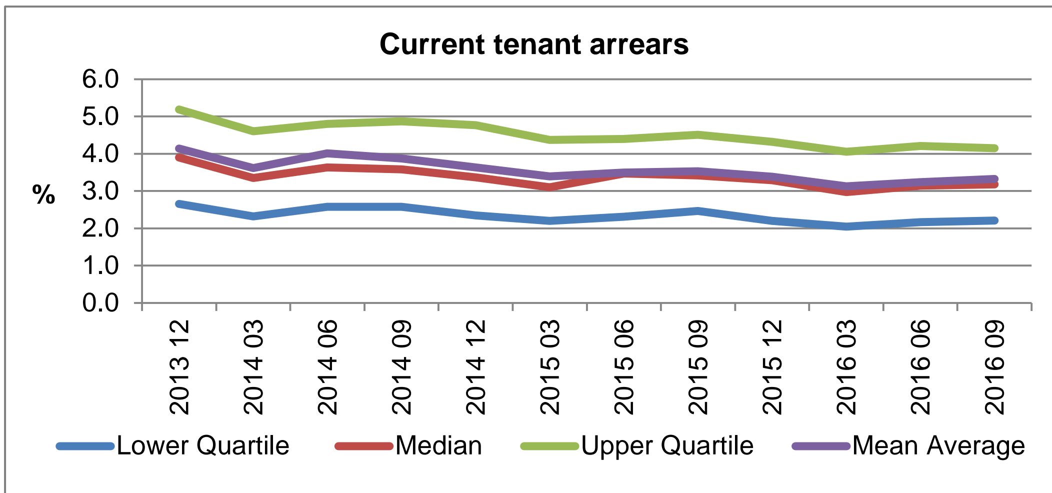
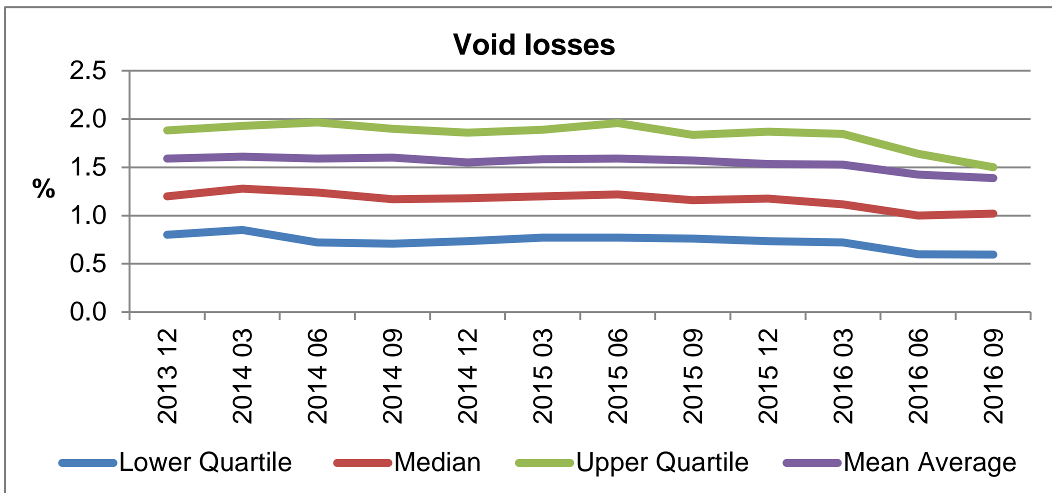
[6] The June MTM exposure has been restated from £3.5 billion to £3.4 billion. This follows a reporting correction by one provider.

Income collection

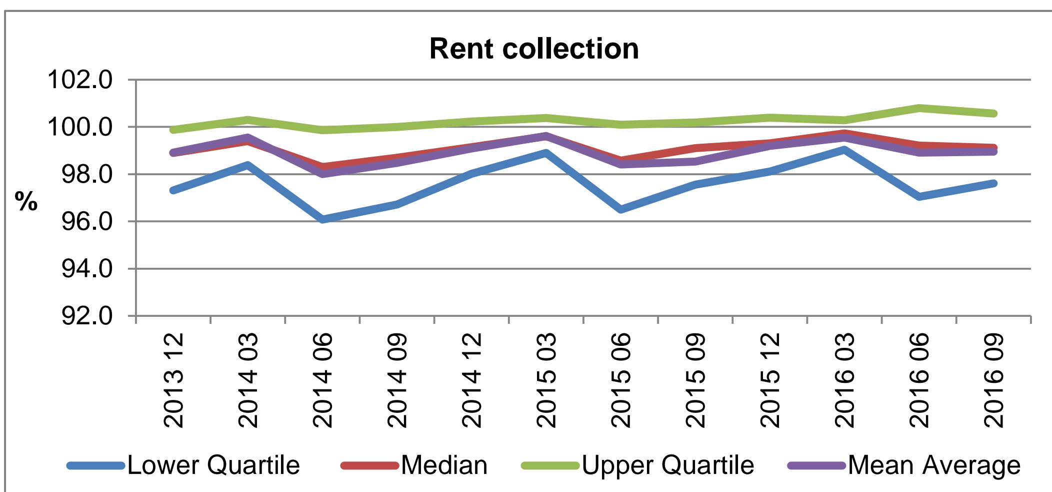
Most providers (93%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plan assumptions. The responses for each quarter remain reasonably stable, suggesting that providers are managing income collection risks and maintaining cashflows within business plan parameters. Housing benefit cycles are likely to have an impact on rent collection data.



Current tenant arrears increased slightly in the September quarter: the mean average and median were 3.3% and 3.2% respectively (June 3.2% and 3.1% respectively)



Mean average and median void losses were substantively unchanged from the previous quarter at 1.4% and 1.0% respectively.



Mean average and median rent collection were 99.0% and 99.1% (June, 98.9% and 99.2%). 18 providers reported rent collection rates of less than 95% (June, 24; September 2015, 19).

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December 2016

ISBN: 978-1-4098-4950-6