Homes & Communities Agency

# Quarterly Survey for Q4 (January to March) 2017

June 2017
Homes and Communities Agency

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# Introduction

This quarterly survey report is based on regulatory returns from 233 private registered providers (PRPs) and PRP groups who own or manage more than 1,000 homes.

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 from 1 January 2017 to 31 March 2017. The March survey includes additional annual data, particularly relating to private finance. Where any information received through the quarterly survey indicates a potential concern, this is followed up with providers.

# Summary

The quarterly survey findings are:

- New finance of £877 million was agreed in the quarter from banks and capital markets.
- Over the year, total new finance was £7.6 billion; this included significant refinancing activity in a small number of providers which contributed to loan repayments of £3.1 billion in the year.
- The sector remains financially strong with access to sufficient finance: £14.9 billion of undrawn facilities are in place.
- £4.4 billion (6.3%) of drawn debt is repayable within two years (2016: £3.3 billion, (5.0%)).
- 71% of drawn debt is at interest rates fixed for over 12 months (2016: 69%).
- The sector has cash balances of £5.8 billion – this is forecast to reduce in the next 12 months to £4.4 billion as cash is used to fund planned capital expenditure.
- The sector forecasts strong operating cashflows, with cash interest cover of 198% over the next 12 months.
- Investment in housing supply was £7.3 billion in the year to 31 March 2017; this exceeded the committed forecast of £5.8 billion.
- Over the 12 month forecast period expected investment in new housing supply is £10.6 billion of which £7.1 billion is contractually committed.
- Affordable Home Ownership (AHO) activity increased in the quarter with a 9% quarter on quarter increase in homes developed to 3,074 and a 16% increase in first tranche unit sales to 3,111. Taking into account transfers between tenures, there was a 2% increase in the stock of unsold units to 3,454.
- Market sale activity increased in the quarter with a total of 1,307 units sold, up 19% in comparison to the previous quarter. The number of homes developed fell by 14% to 1,167, resulting in a 12% decrease in the stock of unsold properties to 1,271.

- Development of homes for-sale increased in the year to 31 March 2017 with 10,401 AHO units and 4,524 market sale units completed, a 3% and 4 % increase respectively on the year to 31 March 2016.

- The pipeline of expected completions in the next 18 months indicates that this increase in development activity is likely to continue. AHO completions, including committed and uncommitted development, are expected to average 4,033 per quarter and market sales completions are expected to average 1,724 per quarter.

- Providers making use of free standing derivatives reported no change in the mark-to-market (MTM) exposure of £2.7 billion as the swap rates remained relatively stable, moving from 1.36% in December to 1.39% at the end of March. In aggregate providers continue to have headroom on available collateral on MTM exposures.

- Income collection data continues to show a stable performance, showing a slight improvement in comparison to the previous year end figures.

# Operating environment

At a headline level the economic operating environment for PRPs remained relatively benign in the quarter. Key metrics for the period covered include the following:

- A headline fall in average house prices, with a decrease in England of 0.6% in the month of March. However, in the year to March 2017 there was an increase of 4.1%.[1]

- In the quarter ending March 2017, output in the construction industry was estimated to have increased by 0.2% compared with the previous quarter ending December 2016 and by 2.7% in comparison with the quarter ending March 2016.[2]

- The Consumer Prices Index (CPI) rose by 2.3% in the year to March 2017, compared with a 1.6% rise in the year to December[3]. The rate has been increasing steadily; rates are set to further increase with forecasters predicting that inflation will rise to 3.0% by December 2017.[4]

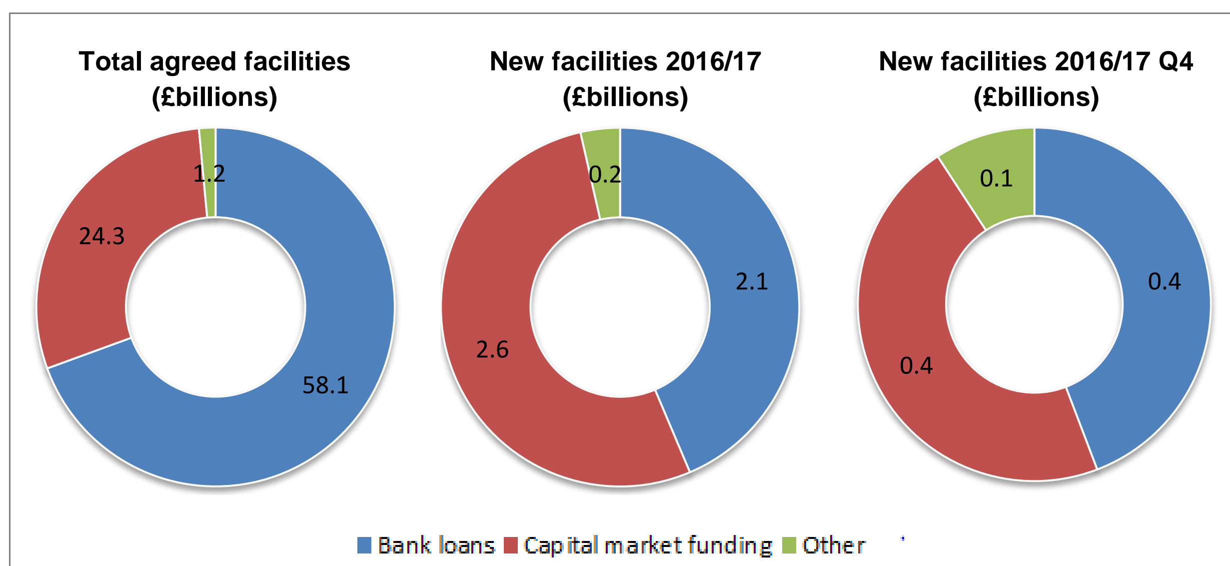
- The Bank of England base rate remained at 0.25%.

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] Construction output in Great Britain - Office for National Statistics
[3] ONS Statistical Bulletin; UK consumer price inflation: March 2017
[4] HM Treasury; Forecasts for the UK economy: a comparison of independent forecasts; April 2017

## Private finance

- The sector's total agreed borrowing facilities are £83.6 billion, £58.1billion (69%) of which is bank loans.
- New facilities, including refinancing, agreed in the year totalled £7.6 billion.
- New facilities agreed in the quarter totalled £877 million.
- Capital markets, including private placements and aggregated bond finance, contributed 54% of the new funding in 2016/17; bank lending accounted for 43%; the remaining funds were local authority lending.




- Of the £83.6 billion agreed facilities, £77.8 billion has been secured and £3.5 billion of facilities do not require security. There are further agreed facilities of £2.3 billion where security is not yet in place.
- £68.8 billion is currently drawn, leaving undrawn facilities of £14.9 billion.
- 94% (December, 96%) of providers forecast that current debt facilities are sufficient for more than 12 months.
- Providers estimate that, aggregated across the sector, additional security is available to support an additional £33.6 billion of new borrowing. However, there is a wide range in the level of available security reported by individual providers. Other factors, including balance sheet capacity and the ability to generate cashflow to service additional debt, also need to be considered in determining the borrowing capacity of individual providers.

# 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* | **12 months to 31 Mar 2017 (forecast)** | **12 months to 31 Mar 2017 (actual)** | **12 months to 31 Mar 2018 (forecast)** |
|---|---|---|---|
| Operating cashflows | 5.7 | 6.4 | 6.1 |
| Interest cashflows | (3.1) | (3.5) | (3.1) |
| Payments to acquire and develop housing | (9.3) | (7.3) | (10.6) |
| Disposals of housing fixed assets | 1.4 | 2.0 | 1.6 |
| Other cashflows | (0.0) | (1.0) | (0.2) |
| **Cashflows before resources and funding[5]** | **(5.4)** | **(3.5)** | **(6.2)** |
| Financed by: | | | |
| Net grants received | 0.6 | 0.5 | 0.5 |
| Net increase in debt | 3.1 | 2.9 | 4.3 |
| Use of cash reserves | 1.7 | 0.2 | 1.4 |
| **Total funding cashflows[5]** | **5.4** | **3.5** | **6.2** |

- The year to 31 March 2017 is the first complete year to include the 1% rent cut implemented on 1 April 2016.

- Operating cashflow of £6.4 billion in the 12 months to 31 March 2017 exceeded the forecast of £5.7 billion.

- Interest cashflows of £3.5 billion exceeded the forecast of £3.1billion; the interest costs included £540 million refinancing costs in Quarter 3 in one large provider.

- The sector forecast £9.3 billion expenditure on new properties in the year; the £7.3 billion actually spent was higher than forecast spending of £5.8 billion on contractually committed schemes.

- Cash interest cover for the year to 31 March 2017 was 180%[6] (2016, 206%) in line with the forecast of 184%.

- The sector continues to forecast strong operating cashflows with cash interest cover over the 12 months to 31 March 2018 projected to be 198%.

- Cash available to the sector at 31 March 2017 was £5.8 billion (2016, £5.6 billion); this is forecast to reduce to £4.4 billion over the next 12 months as cash reserves are used to fund capital investment.

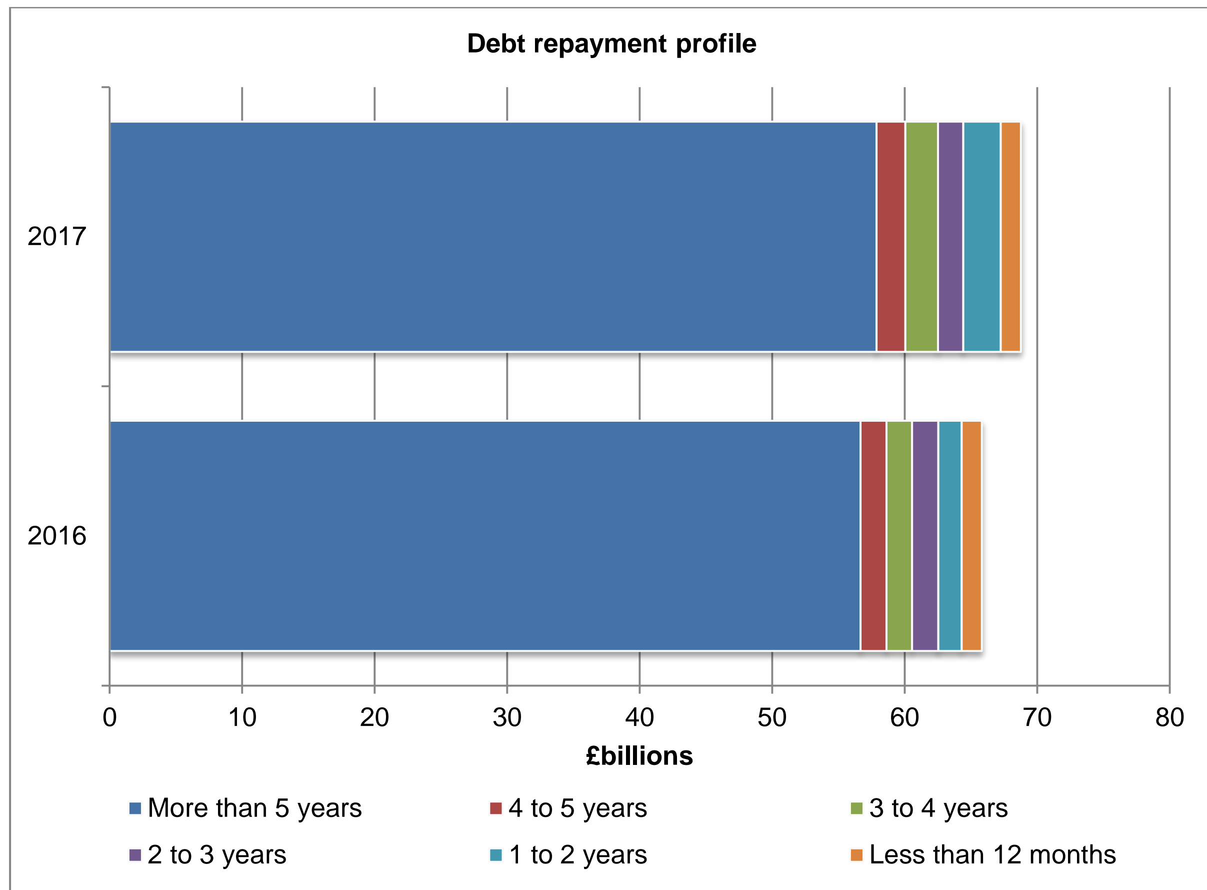
- Cash held in secured accounts at March 2017 was £723 million (2016, £513 million).

[5] There are rounding differences in the calculated totals; figures are reported in £000
[6] In 2017 this ratio has been adversely affected by the refinancing costs incurred by one provider in the quarter 3. Excluding this provider, the ratio was 219%

## Debt repayment profile

The value of debt repayable over the next two years is £ 4.4 billion, representing 6.3% of the sector debt (2016: £3.3 billion, 5.0%). The sector's immediate refinancing risk remains low, with 2.2% of loans reported to be due for repayment within 12 months (2016: 2.3%).

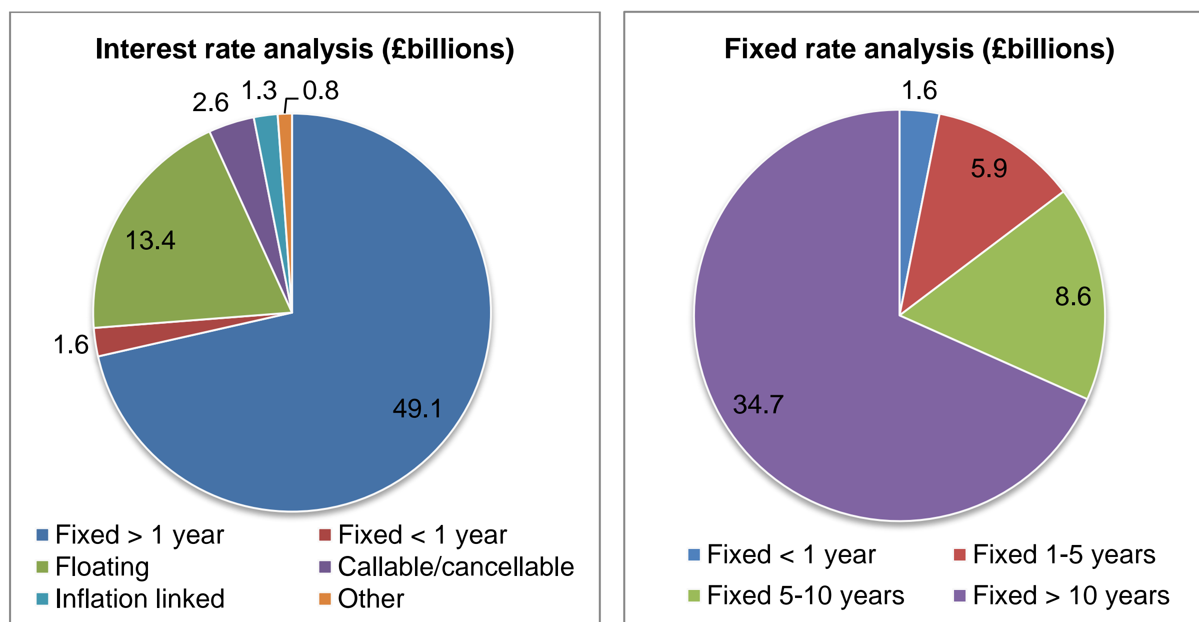
Long-term debt continues to account for the majority of the sector's borrowing with 84% of debt being due for repayment in over five years. £10.9 billion (2016: £9.2 billion) will become repayable over the next five years as profiled in the chart below.




The exposure of individual providers to refinancing risk is covered by routine regulatory engagement. Seven providers have 10% or more of total debt due for repayment within 12 months; for most (227) providers, 50% or more of total debt is due for repayment in more than five years. It is the responsibility of providers' boards to ensure that arrangements are in place for the effective management of refinancing risk.

# Interest rate profile

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

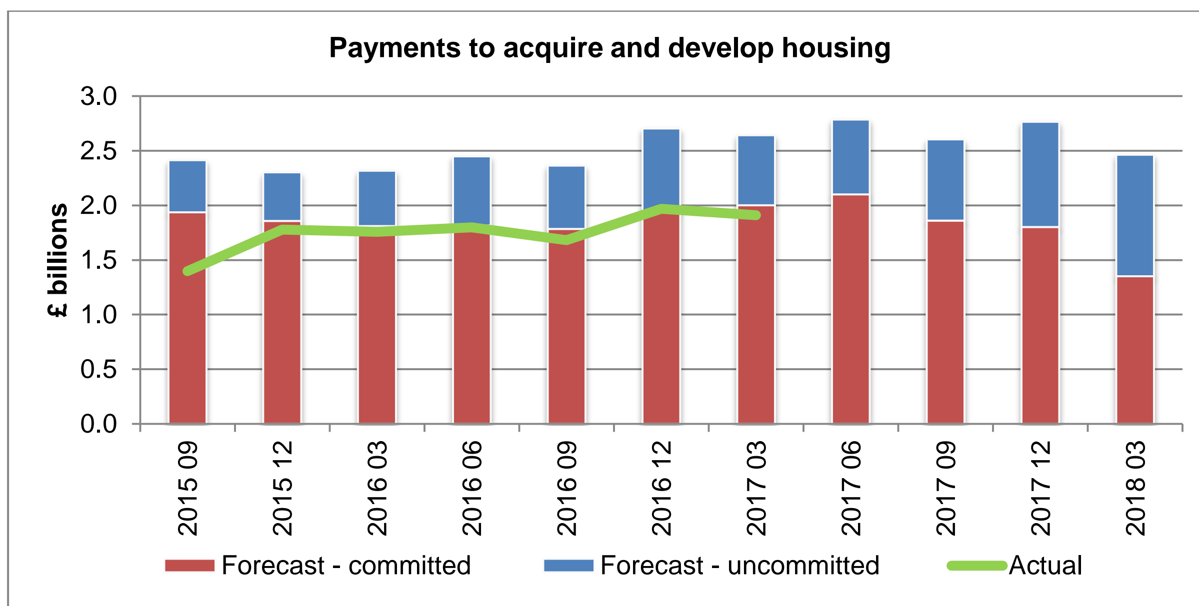



- Fixed rate debt (greater than one year) comprises 71% of the sector's drawn borrowings (2016: 69%).
- 50% of total drawn debt is at rates fixed for over 10 years providing the sector with a degree of certainty on forecasting the costs of borrowing.
- The total amount of debt reported as floating, fixed for less than a year or otherwise exposed to fluctuation through inflation linking or callable/cancellable options, amounts to £19.6 billion. This represents 29% of drawn debt (2016: £20.3 billion, 31%).
- £2.6 billion, 4% (2016: £3.3 billion, 5%) of drawn debt is callable or cancellable.
- 70 providers (2016: 80) report that they hold callable or cancellable debt. Of these providers, 42 (2016: 38) report that this comprises less than 10% of drawn debt.
- 35% (2016: 26%) of callable/cancellable debt may be called or cancelled within one year; for 27% (2016: 33%) the earliest date is over 10 years.
- £1.3 billion, 2% (2016: £1.4 billion, 2%) of drawn debt is inflation linked.
- 65 providers (2016: 71) report that they hold inflation linked debt or hedging. Of these providers, 53 (2016: 53) report that this comprises less than 10% of drawn debt.

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.

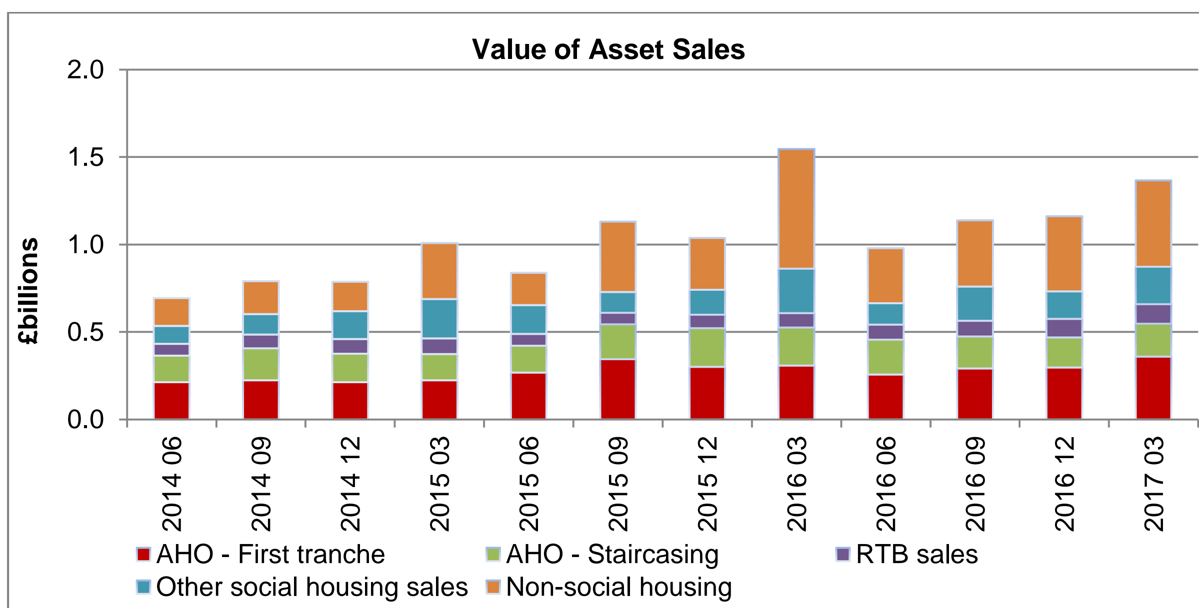
# Development

In total, £7.3 billion was invested in the acquisition and development of housing in the 12 months to March 2017. Payments of £7.1 billion to acquire and develop housing properties are committed in the next 12 months; a further £3.5 billion, not contractually committed, is included in the forecasts.




# Housing market

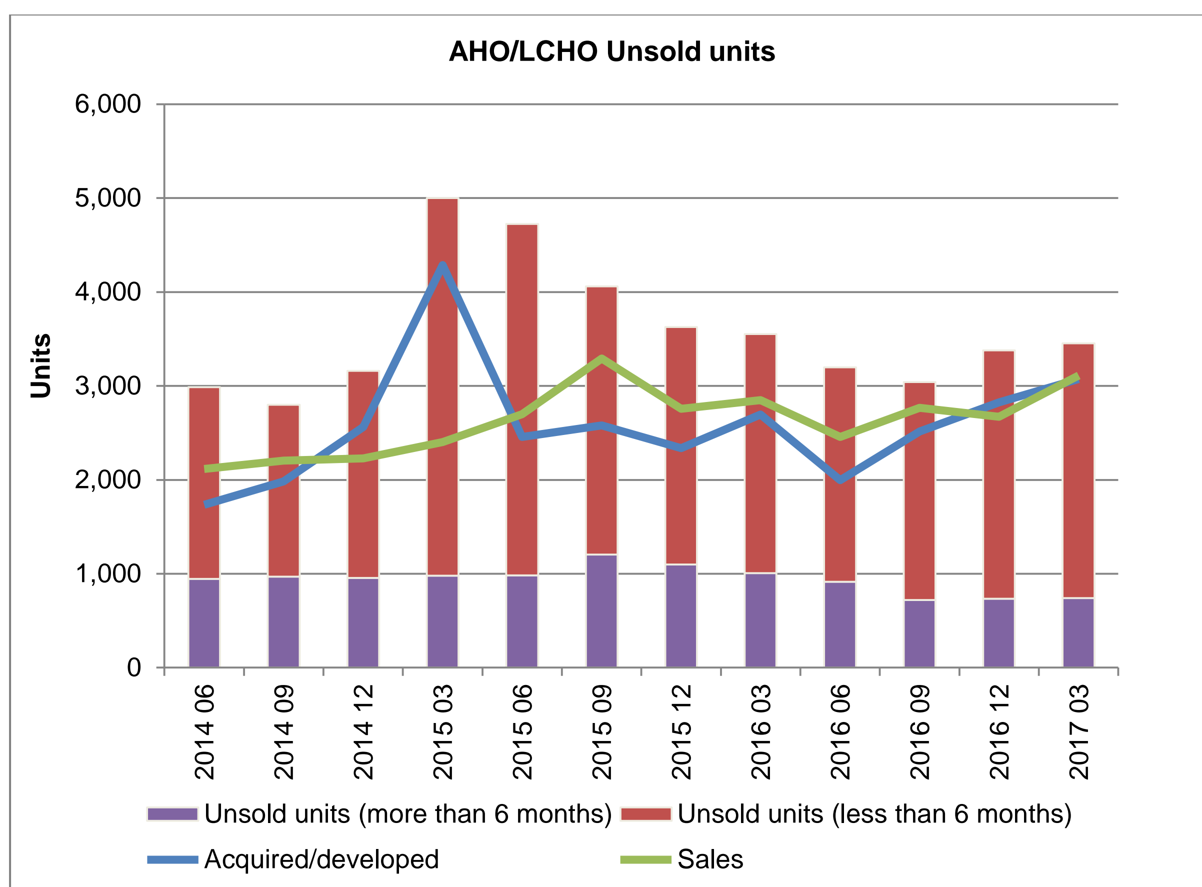
Asset sales revenue and surpluses were both higher than in the quarter to 31 December. Total asset sales of £1.4 billion generated a surplus of £488 million (December, total asset sales £1.2 billion, surplus £374 million). Revenue and surplus were both lower than the same quarter a year ago (March 2016, total asset sales, £1.5 billion, surplus £520 million).



Asset sales in the March 2017 quarter were 3% below the forecasts received in the previous quarter. Current asset sales for the year (market sales and first tranche AHO sales) were £2.6 billion; this was in line with committed forecasts, but below the total forecast of £2.8 billion. Fixed asset sales for the year were £2.0 billion, compared to a forecast of £1.4 billion.

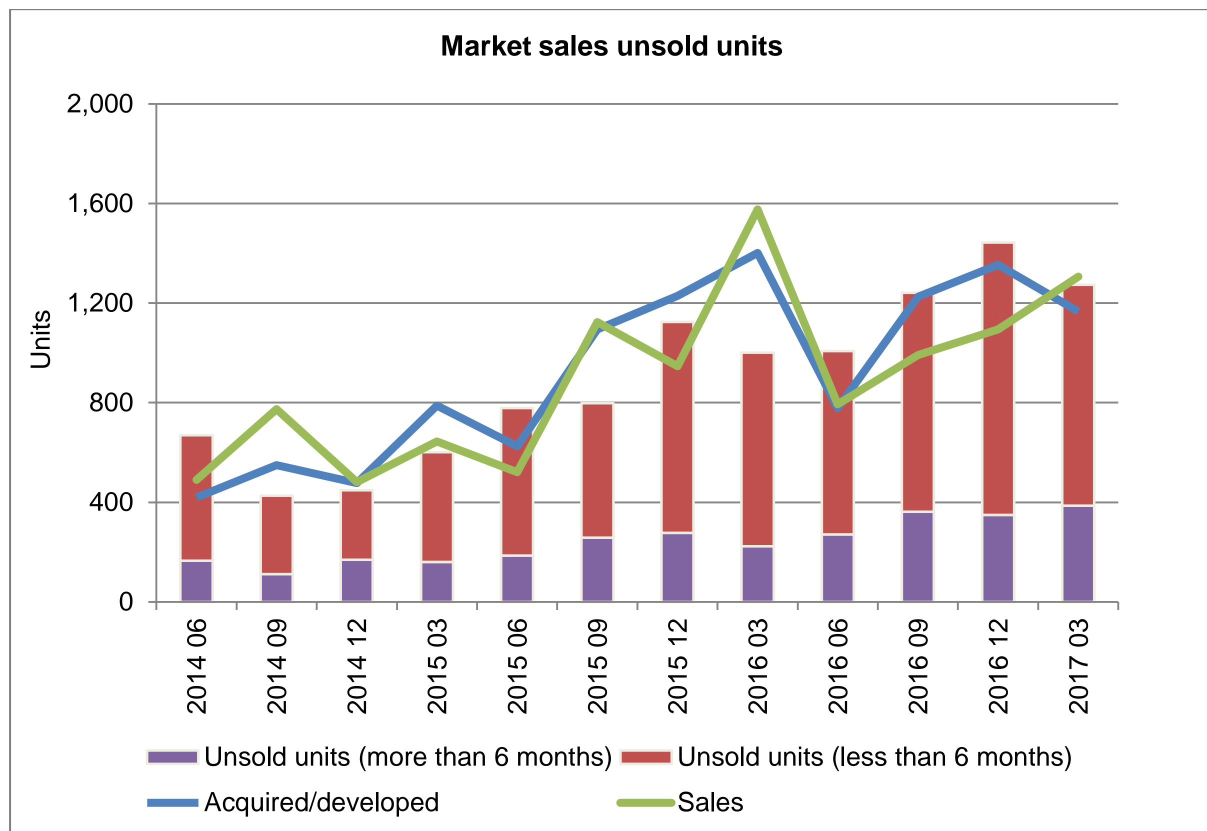
The difference between forecasts and current asset housing sales achieved is concentrated in a small number of providers. Development programmes are subject to change and the variances are largely a result of delays in handovers of properties from developers. Where sales revenues are lower than forecast, 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 exceeded completions; there were 3,111 first tranche sales (December, 2,671) compared to 3,074 AHO completions and acquisitions (December, 2,825). However, taking into account transfers between tenures, there was a 2% increase in total unsold units in the quarter; this included a 1% increase in units unsold for over six months. At the end of March 3,454 homes were unsold (December, 3,378) of which 741 had been unsold for over six months (December, 733). 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 24,199 (December, 22,871) of which 19,109 are contractually committed. Over the 18 months to March 2017, there were 15,445 AHO completions.

Development for sale is concentrated in relatively few providers. There were 1,307 sales in the quarter (December, 1,094) and 1,167 homes were developed for market sale (December, 1,354). The number of unsold market sale units at March 2017 was 1,271 (December, 1,443), of which 387 had been unsold for over six months (December, 349). For market sales, half of the total unsold stock at the end of the quarter was held by eight providers.

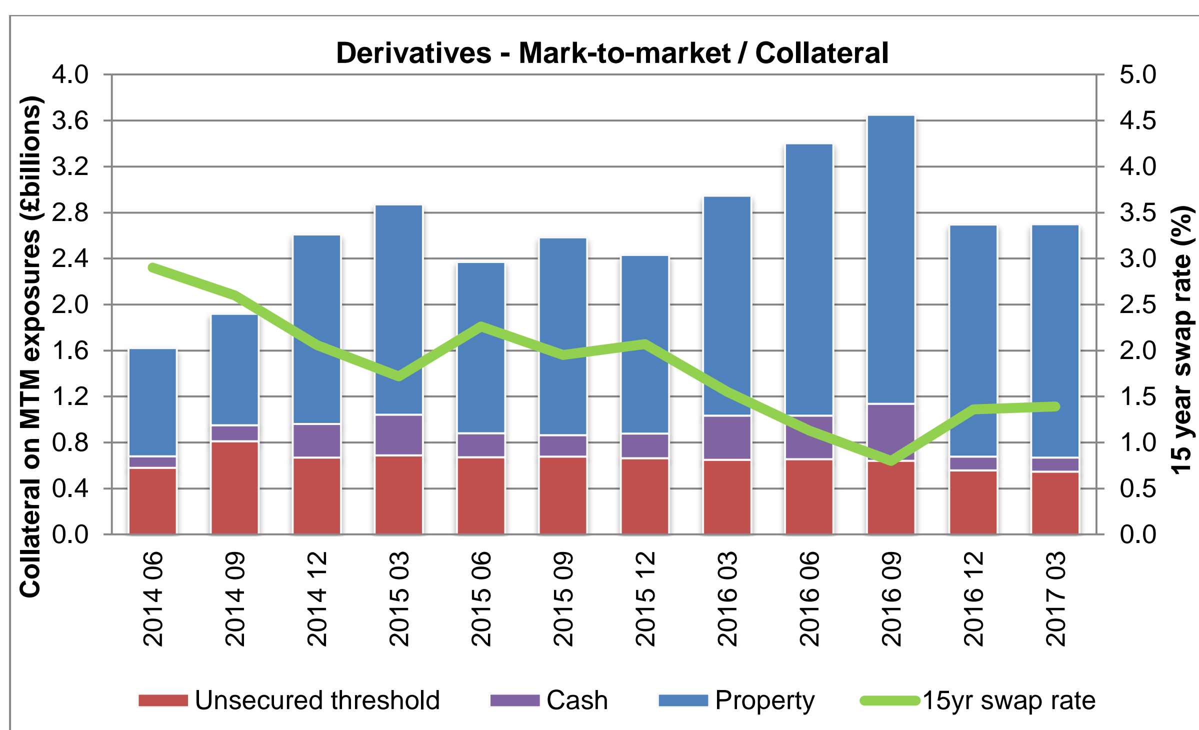



The pipeline for market sale completions expected in the next 18 months is 10,343 (December, 9,445) of which 8,603 are contractually committed. Over the 18 months to March 2017, there were 7,156 market sales completions.

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 March 2018 the sector has forecast current asset sales of £3.1 billion. This compares to actual sales achieved in the year to March 2017 of £2.6 billion.

# Derivatives

- 48 providers (December, 47) currently make use of free standing derivatives.
- The notional value of standalone derivatives was £9.1 billion (December, £9.0 billion).
- The current gross MTM exposure was £2.7 billion (December, £2.7 billion).
- Unsecured thresholds and available security pledged to swap counterparties was £4.1 billion; of this total collateral, £2.3 billion (December, £2.3 billion) has been employed in the form of property or cash, together with unsecured thresholds of £547 million.
- The additional excess collateral available consists primarily of property pledged but not employed.




The graph above shows MTM exposures excluding excess collateral. Sterling swap rates remained stable over the quarter, leading to little change in MTM exposures.

Collateral given in terms of security and cash continues to exceed the sector's current exposure levels; this provides some mitigation against the risk of further adverse movements in the swap rate. At sector level, headroom of collateral available over current exposure was £1.4 billion.

Interest rate volatility means that collateral requirements will remain a long-term exposure. Individual providers must ensure they have sufficient available security as a 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.

## Non-registered entities

- 141 providers (2016: 135) have investment in, or lending to, non-registered subsidiaries, special purpose vehicles or joint venture companies. The total value of the investment or indebtedness is reported to be £5.4 billion (2016: £3.2 billion). Half of the exposure is within three providers; almost one third of the exposure is within one provider.

- 38 providers (2016: 40) have given guarantees of £2.3 billion (2016: £2.0 billion) on the obligations or liabilities of other parties. Of these, eight (2016: 10) have given security.

- 48 providers (2016: 52) report that a joint venture or non-registered subsidiary is forecasting a loss in their 2017 accounts. Total losses are forecast at £85 million (2016: £61 million).

Where providers engage in activities with non-registered entities, the regulator seeks assurance that boards understand the associated risks and that social housing assets are not exposed to undue risk.

## Impairment

- 56 providers (2016: 63) anticipate an impairment charge in their 2017 accounts.

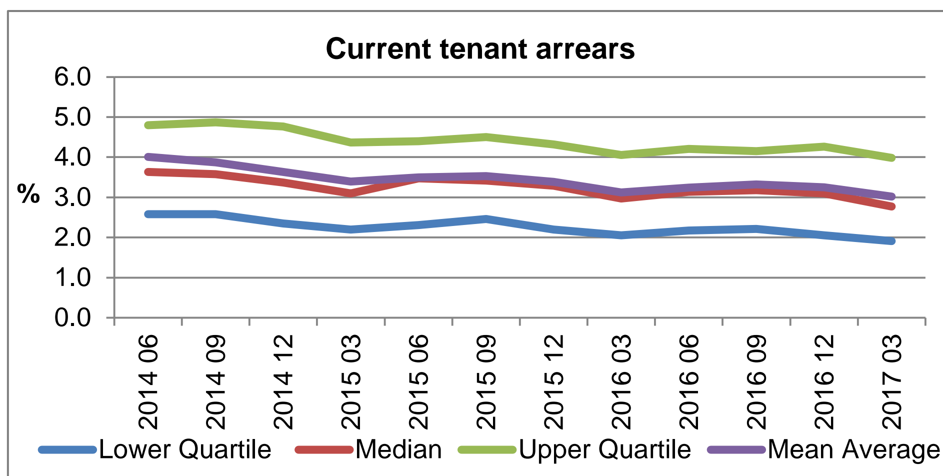
- The total anticipated charge is £74 million of which £35 million relates to social housing assets (2016: £89 million, £55 million).

- 36 providers (2016: 34) forecast an impairment charge of less than £1 million. One third of the total impairment is forecast by three providers; one provider anticipates a total impairment charge of greater than £10 million.

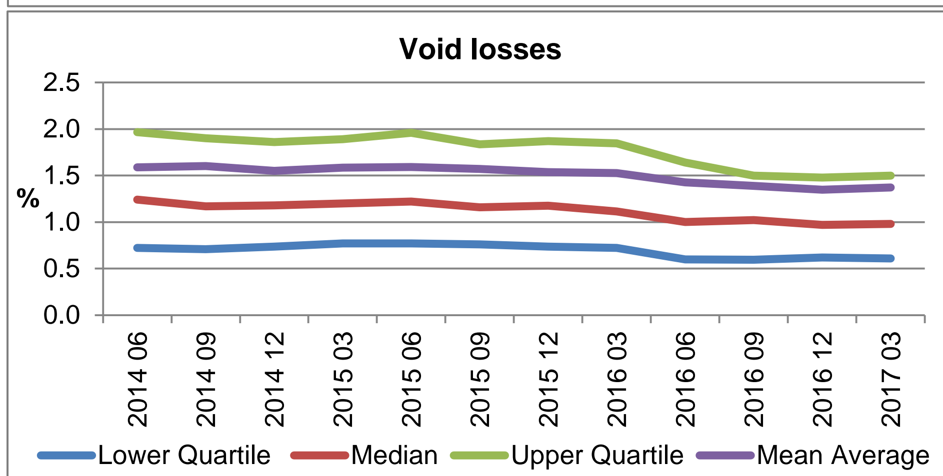
There is no evidence from the quarterly survey data that any forecast impairment charges will have an impact on providers meeting the performance requirements of their loan covenants.

# Income collection

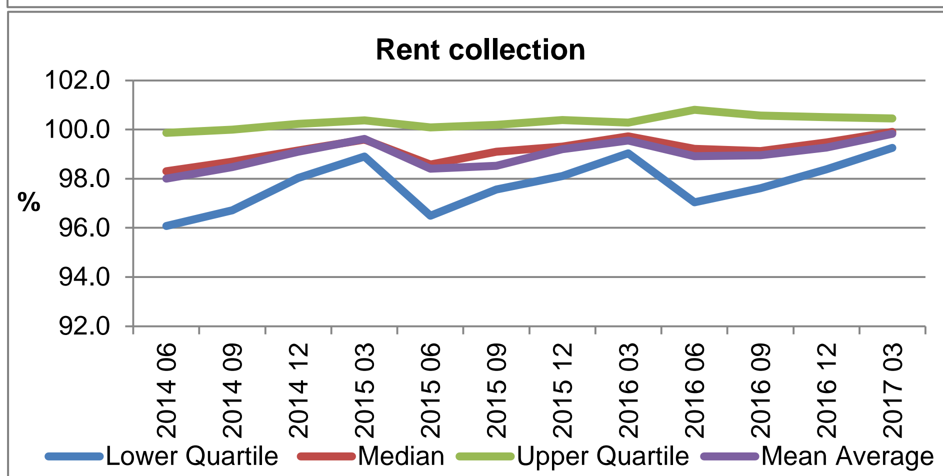
Most providers (92%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plan assumptions. The responses for each quarter remain reasonably stable, suggesting that providers are managing income collection risks and maintaining cashflows within business plan parameters. Housing benefit cycles are likely to have an impact on rent collection data.




Current tenant arrears were marginally improved in the March quarter: the mean average and median were 3.0% and 2.8% respectively (December, 3.2% and 3.1% respectively).




Mean average and median void losses marginally increased from the previous quarter at 1.4% and 1.0% respectively (December, 1.3% and 1.0%).




Mean average and median rent collection were 99.8% and 99.9% (December, 99.3% and 99.5%).
Two providers reported rent collection rates of less than 95% (December, eight; March 2016, five).