Regulator of Social Housing

Quarterly survey for Q4

January to March 2018

Contents

Introduction

This quarterly survey report is based on regulatory returns from 229 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 2018 to 31 March 2018. The March survey includes additional annual data, relating to private finance, non-registered entities and impairment. 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 £2.3 billion was agreed in the quarter from banks and capital markets.
- In the year to March 2018, total new finance was £10.1 billion. This included an element of refinancing existing loans. Loan repayments were £4.0 billion over the 12 months.
- The sector remains financially strong with access to sufficient finance: £17.2 billion of undrawn facilities are in place.
- £3.4 billion (4.8%) of drawn debt is repayable within two years (2017: £4.4 billion, (6.3%)).
- 73% of drawn debt is at interest rates fixed for over 12 months (2017: 71%).
- Cash balances total £5.9 billion; this is forecast to reduce in the next 12 months to £4.1 billion as cash is used to fund planned capital expenditure.
- Cash interest cover excluding current asset sales was 150% for the quarter. Net operating cashflows of £6.6 billion are forecast for the 12 months ending March 2019.
- Including both current and fixed asset sales, total sale receipts of £1.5 billion in the quarter were in line with the forecasts made in December.
- In the 12 months to March 2019 the sector is forecasting £5.7 billion of sales receipts. By comparison, in the 12 months to March 2018 total sales were £4.8 billion.
- Investment in housing supply was £2.6 billion in the quarter to 31 March 2018; in December 2017 the forecast contractually committed spend for the quarter was £2.9 billion.
- Over the 12 month forecast period expected investment in new housing supply is £14.3 billion of which £9.5 billion is contractually committed. In the 12 months to March 2018 total investment in new supply was £10.0 billion.
- Around 3,800 first tranche units were developed in the quarter and 3,200 sold; unsold units increased by 19%. The level of development reported in the quarter to March 2018 was a 16% increase on the previous quarter but consistent both with the same quarter a year ago.

- A total of 1,340 market sake units were developed in the quarter. This was a 21% increase on the previous quarter and a 15% increase on the same quarter a year ago. In the quarter to March 2018 1,071 units were sold and unsold units increased by 13%.

- The pipeline of expected affordable home ownership (AHO) completions in the next 18 months, including committed and uncommitted development, indicates delivery of an average of 4,778 homes per quarter (December 4,763); market sales completions are expected to average 2,177 per quarter (December 1,905).

- Providers making use of free-standing derivatives reported mark-to-market (MTM) exposure of £2.2 billion, a slight decrease on the previous quarter reflecting a small increase in swap rates at the quarter end. In aggregate providers continue to have headroom on available collateral on MTM exposures.

- Income collection data continues to show a stable performance.

Operating environment

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

- A headline decrease of 0.3% in average house prices in England for the month of March. In the year to March, there was an increase of 4.0%.[1]

- In the quarter ending March 2018, output in the construction industry contracted, decreasing by 2.7% compared with the previous quarter ending December 2017[2]. This was the biggest fall in the quarter on quarter time series since August 2012. The adverse weather conditions could have potentially contributed to the decline in construction output, although it is difficult to quantify the exact impact on the industry.

- The Consumer Prices Index (CPI) rose by 2.5% in the year to March 2018, below the 3.0% growth for the year to December 2017[3]. Forecasters currently predict that inflation will remain steady at 2.4% for the year ending December 2018 and 2.2% for the year ending December 2019.[4]

- Latest estimates show that average weekly wages increased by 2.9% (not adjusted for price inflation) in the year to March[5].

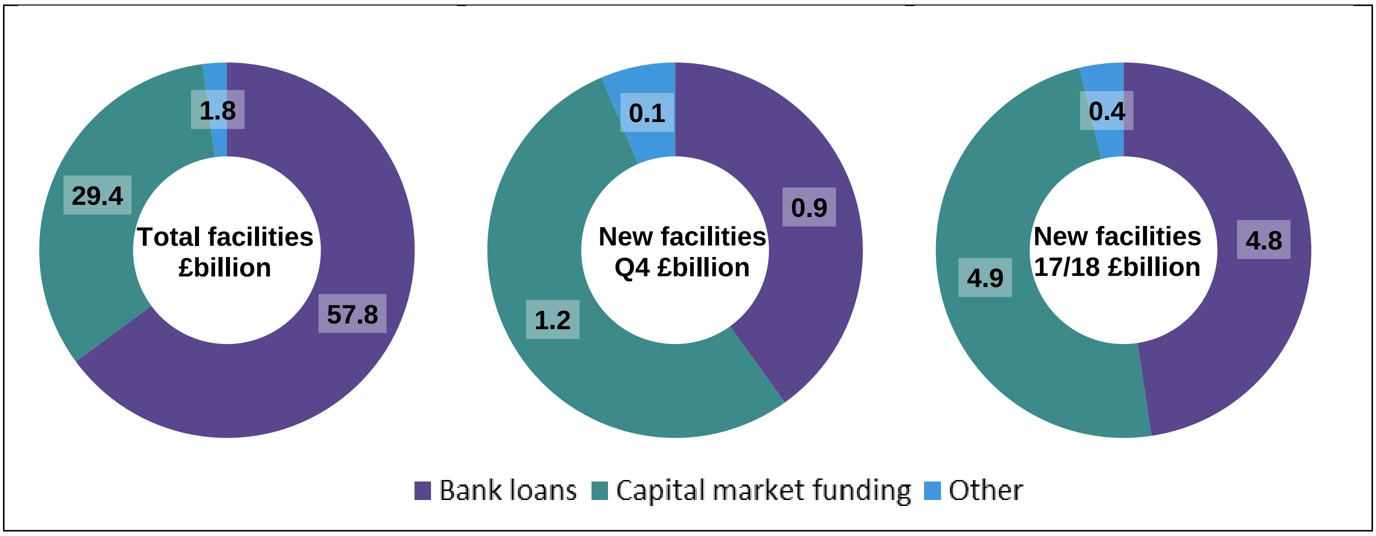
- Interim Construction Output Index (OPI) figures for all construction showed that costs increased by 3.0% in the year to March 2018.[6]

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[7] published annually by the regulator. The regulator will continue to monitor key market trends and to seek assurance that boards of PRPs are actively engaged in responding to emerging risks.

[1] UK House Price Index – March 2018, HM Land Registry
[2] Construction output in Great Britain - Office for National Statistics
[3] ONS Statistical Bulletin; UK consumer price inflation
[4] HM Treasury; Forecasts for the UK economy: a comparison of independent forecasts
[5] UK labour market - Office for National Statistics
[6] Construction output price indices (OPIs) - Office for National Statistics
[7] www.gov.uk/government/collections/sector-risk-profiles

Private finance

- The sector's total agreed borrowing facilities are £89.1 billion, £57.8 billion (65%) of which are bank loans.
- New facilities, including refinancing, agreed in the quarter totalled £2.3 billion.
- Bank lending accounted for 40% (£0.9 billion). Capital markets funding, including private placements and aggregated bond finance, contributed 54% (£1.2 billion) of the new funding in the quarter; other sources, including local authority lending, contributed 6%.
- New facilities agreed in the year, including refinancing, totalled £10.1 billion. This was an increase on the £7.6 billion new facilities agreed in the year to March 2017.



- Of the £89.1 billion agreed facilities, £82.7 billion has been secured and £3.7 billion of facilities do not require security. There are further agreed facilities of £2.7 billion where security is not yet in place.
- £71.9 billion is currently drawn, leaving undrawn facilities of £17.2 billion.
- 95% (December, 95%) of providers forecast that current debt facilities are sufficient for more than 12 months.
- In the 12 months to March 2019 the sector is forecasting loan drawdowns of £6.8 billion (December 12 month forecast £6.4 billion).
- Of the 12 month forecast drawdown, £1.3 billion is from facilities not yet agreed (December £1.7 billion).
- Providers estimate that, aggregated across the sector, additional security is available to support an additional £48 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. The regulator engages with PRPs that have low liquidity indicators or are forecasting drawdowns from facilities not yet agreed or secured.

Summary cashflow forecast[8]

Figures in £ billions	3 months to 31 Mar 2018 (forecast)	3 months to 31 Mar 2018 (actual)	12 months to 31 Mar 2019 (forecast)
Operating cashflows excluding sales	1.0	1.2	4.5
Interest cashflows	(0.8)	(0.8)	(3.2)
Payments to acquire and develop housing	(3.9)	(2.6)	(14.3)
Current assets sales receipts	0.9	0.9	4.0
Disposals of housing fixed assets	0.6	0.6	1.8
Other cashflows	(0.2)	(0.2)	(0.6)
Cashflows before resources and funding	**(2.4)**	**(0.9)**	**(7.9)**
Financed by:			
Net grants received	0.7	0.6	1.0
Net increase in debt	0.9	0.2	4.9
Use of cash reserves	0.8	0.1	1.9
Total funding cashflows[9]	**2.4**	**0.9**	**7.9**

- Interest cover, based on operating cash flows excluding sales, was 150% for the 12 months to 31 March 2018; the sector continues to forecast strong operating cashflows. Interest cover over the 12 months to 31 March 2019 is projected to be 140%

- In the 12 months to March 2019 the sector is forecasting £4.0 billion of current asset sales, of which £3.7 billion relates to properties for which development is contractually committed. In the 12 months to March 2018 current asset sales of £2.8 billion were achieved

- In the 12 months to March 2019 the sector is forecasting £1.8 billion of fixed asset sales. In the 12 months to March 2018 fixed asset sales were £2.0 billion

- As in previous quarters, expenditure on new supply was below the forecast level from the previous quarter. Over the 12 months to March 2018, actual investment has broadly been consistent with contractually committed forecast expenditure

- Capitalised repair and maintenance expenditure[10] for the year ending March 2018 was £1.7 billion, a 4% increase on the year ending March 2017. In the 12 months to March 2019 the sector is forecasting capitalised repairs and maintenance expenditure of £2.1 billion

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[8] Operating cash flow excludes current asset sales receipts and costs of sales. ‘Payments to acquire and develop housing properties’ include payments in respect of both current and fixed assets.

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

[10] Expensed repair and maintenance expenditure is not separately identified in quarterly survey submissions and is not included in this figure.

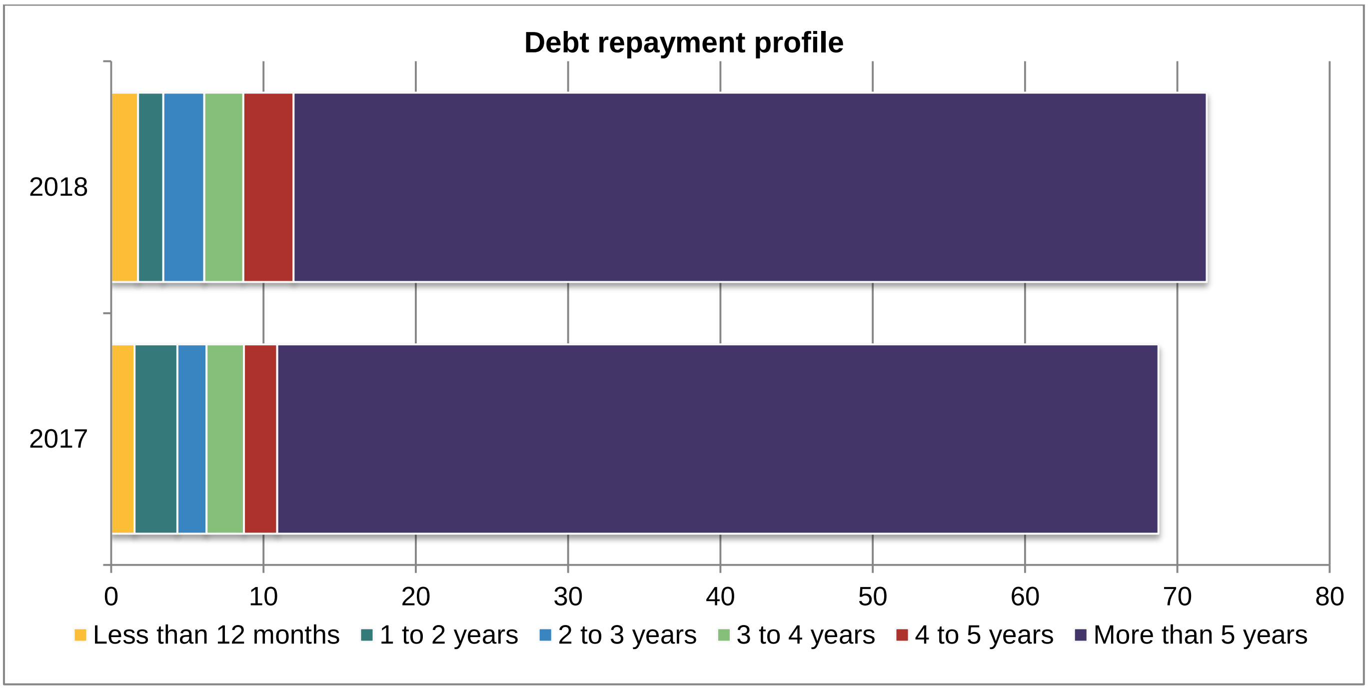
- Cash reserves decreased by £99 million in the quarter, compared to a decrease of £833 million forecast in December. Cash available at March 2018 was £5.9 billion; this is forecast to reduce to £4.1 billion over the next 12 months as cash reserves are used to fund capital investment

- In addition to the £5.9 billion available, cash held in secured accounts was £0.9 billion (December £0.9 billion).

Debt repayment profile

The value of debt repayable over the next two years is £3.4 billion, representing 4.8% of the sector debt (2017: £4.4 billion, 6.3%). The sector's immediate refinancing risk is low, with 2.5% of loans reported to be due for repayment within 12 months (2017: 2.2%).

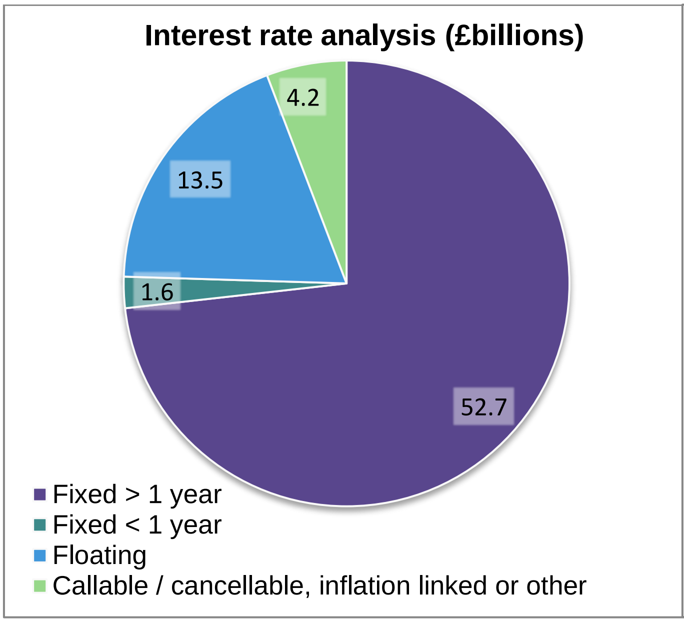
Long-term debt continues to account for the majority of the sector's borrowing with 83% of debt being due for repayment in over five years. £12.0 billion (2017: £10.9 billion) will become repayable over the next five years as profiled in the chart below.

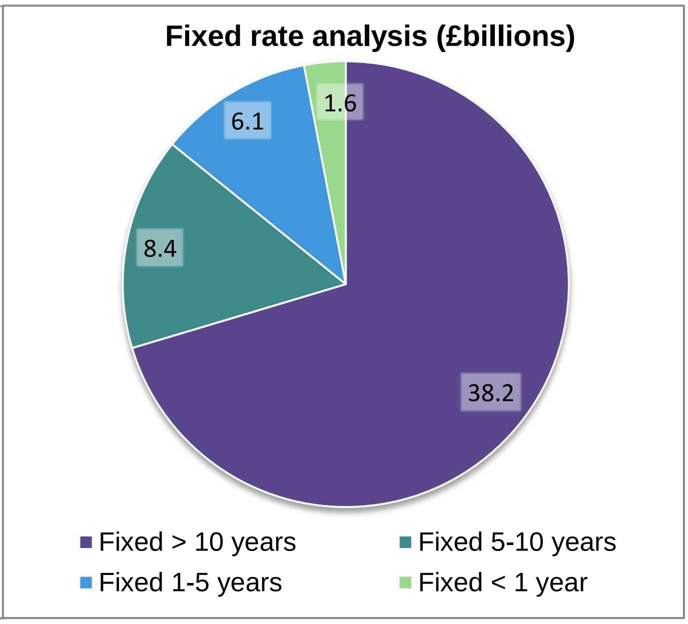


The exposure of individual providers to refinancing risk is covered by routine regulatory engagement. Seven providers have 10% or more of total debt due for repayment within 12 months; for more than 95% of providers, more than half of total debt is due for repayment in more than five years. It is the 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.



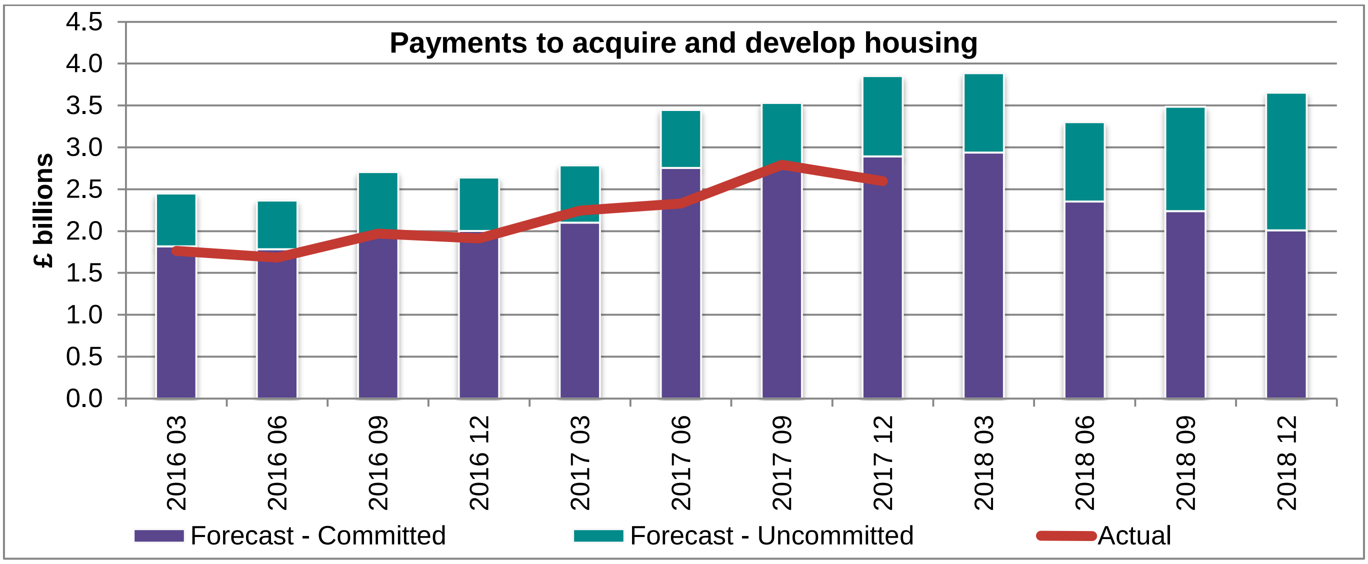


- Fixed rate debt (greater than one year) comprises 73% of the sector's drawn borrowings (2017: 71%).
- 53% of total drawn debt is at rates fixed for over 10 years providing the sector with a degree of certainty in forecasting the costs of borrowing.
- The total amount of debt reported as floating, fixed for less than a year or otherwise exposed to fluctuation through inflation linking or callable/cancellable options, amounts to £19 billion. This represents 27% of drawn debt (2017: £19.6 billion, 29%).
- £2.0 billion, 3% (2017: £2.6 billion, 4%) of drawn debt is callable or cancellable.
- 62 providers (2017: 70) report that they hold callable or cancellable debt. Of these providers, 19 (2017: 42) report that this comprises less than 10% of drawn debt.
- 35% (2017: 35%) of callable/cancellable debt may be called or cancelled within one year; for 23% (2017: 27%) the earliest date is over 10 years.
- £1.5 billion, 2% (2017: £1.3 billion, 2%) of drawn debt is inflation linked.
- 47 providers (2017: 65) report that they hold inflation linked debt or hedging. Of these providers, 37(2017: 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

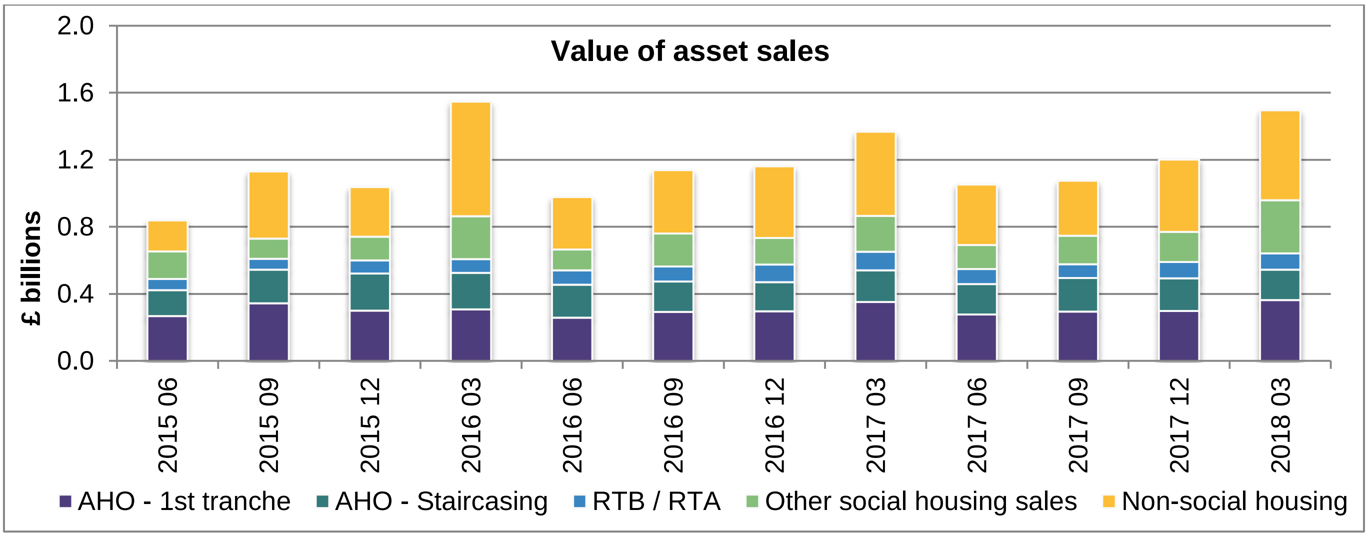
In total, £10.0billion was invested in the acquisition and development of housing in the 12 months to March 2018. In the next 12 months £9.5 billion expenditure is committed to acquire and develop housing properties; a further £4.8 billion, not contractually committed is included in the forecasts.



Actual expenditure in the quarter ending March 2018 was £2.6 billion. This was below both the total forecast expenditure of £3.9 billion and £2.9 billion forecast on contractually committed schemes. Development programmes are subject to change and the variances are largely a result of timing differences and slippage, exacerbated by the adverse weather conditions in this quarter.

Housing market

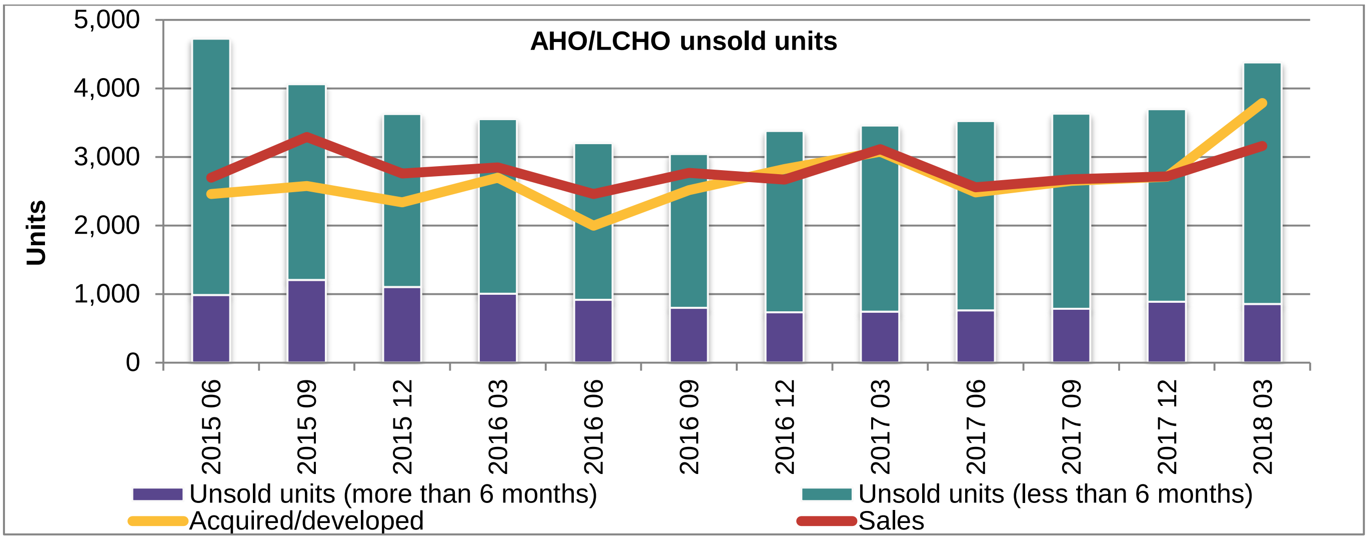
Asset sales revenues of £1.5 billion increased relative to the previous quarter (quarter to December 2017 £1.2 billion) and were greater than the £1.4 billion reported the same quarter a year ago. Surpluses from asset sales were £474m, an increase on £434 million for the previous quarter and in line with the surplus from the same quarter a year ago. Both asset sales reported and the surplus achieved in the 12 months to March 2018 were above the year to March 2017.



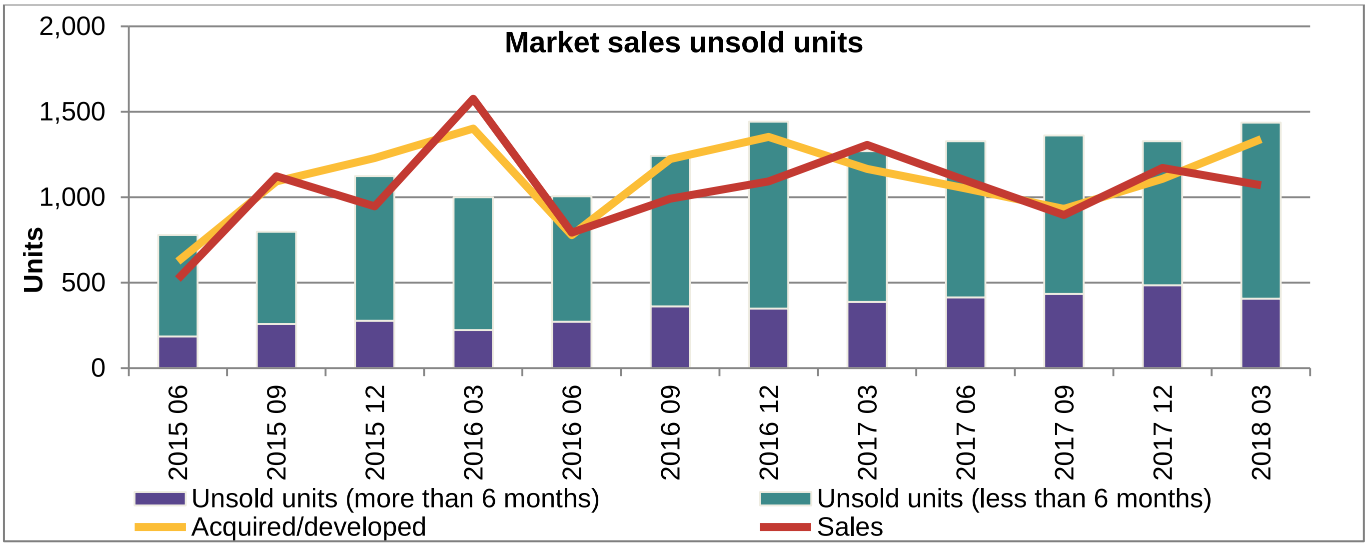
Total cash asset sales in the March 2018 quarter were £1.5 billion, in line with the forecasts received in the previous quarter. Fixed asset sales for the quarter were £595 million, above the forecast of £552 million. Current asset sales in the quarter (market sales and first tranche AHO sales) were £877 million; this was less than the forecast £921 million.

AHO unit sales were of 3,160 (December 2,718), significantly below 3,787 completions reported in the quarter (December 2,712). Taking into account transfers between tenures, there was a 19% increase in total unsold units to 4,378. Despite the overall increase in unsold units, the number unsold for more than 6 months decreased by 3%. Half of the unsold AHO stock at the end of the quarter was held by 21 providers.

The pipeline of AHO completions expected in the next 18 months is 28,670 (December, 28,577) of which 22,659 are contractually committed. Over the 18 months to March 2018, there were 17,532 AHO completions.



Development for outright market sale is concentrated in relatively few providers. There were 1,071 sales in the quarter (December, 1,171) and 1,340 homes were developed for market sale (December, 1,108). Taking into account transfers between tenures, the number of unsold market sale units at March 2018 increased to 1,437 (December 1,328), of which 407 had been unsold for over six months (December, 485). For market sales, half of the total unsold stock at the end of the quarter was held by seven providers.



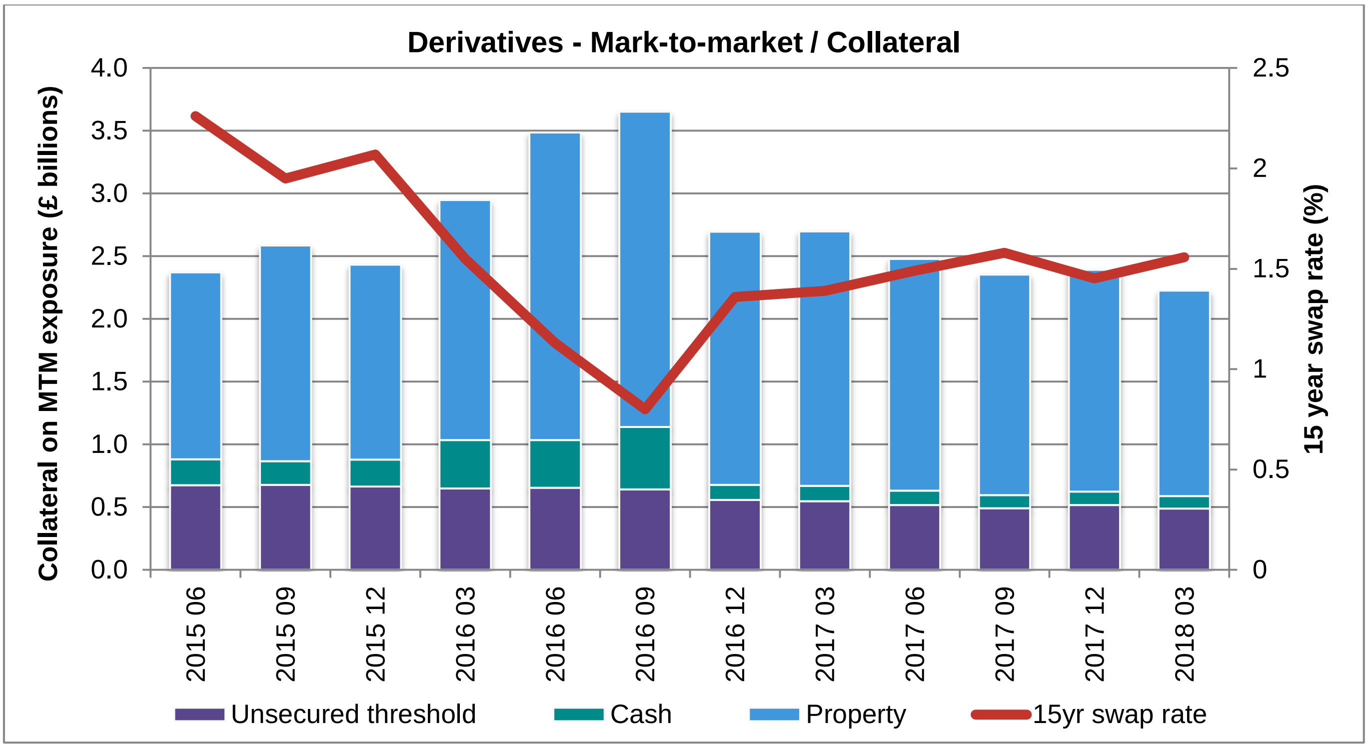
The pipeline for market sale completions expected in the next 18 months is 13,064 (December, 11,429) of which 11,735 are contractually committed. Over the 18 months to March 2018, there were 6,953 market sales completions.

Whilst there are likely to be quarterly fluctuations in the levels of for-sale development activity and sales achieved, the pipeline numbers continue to demonstrate an overall strategy of increased activity.

The difference between forecast and current asset housing sales achieved and the increase in unsold units is concentrated in a small number of providers. Variances have been attributed to slower sales and to delays in development programmes. 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.

Derivatives

- 45 providers (December, 46) currently make use of free-standing derivatives.
- The notional value of standalone derivatives was £8.4 billion (December, £8.1 billion).
- The current gross MTM exposure decreased by 7% from December to £2.2 billion.
- Unsecured thresholds and available security pledged to swap counterparties was £3.5 billion; of this total collateral, £1.9 billion (December, £2.1 billion) has been employed in the form of property or cash, together with unsecured thresholds of £0.5 billion.
- The additional excess collateral available consists primarily of property pledged but not employed.



The graph on the preceding page shows MTM exposures excluding excess collateral. Sterling swap rates at the end of March were higher than at the end of the previous quarter. This resulted in a decrease in MTM exposure.

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 to engage with providers where there are significant levels of exposure.

Non-registered entities

- 142 providers (2017: 141) have investment in, or lending to, non-registered subsidiaries, special purpose vehicles or joint venture entities. The total value of the investment or indebtedness is reported to be £6.4 billion (2017: £5.4 billion). Half of the total investment is within four providers; almost one third is within one provider.

- 35 providers (2017: 38) have given guarantees of £3.3 billion (2017: £2.3 billion) on the obligations or liabilities of other parties. Of these, 8 (2017: 8) have given security.

- 64 providers (2017: 48) report that a joint venture or non-registered subsidiary is forecasting a loss in their 2018 accounts.

Where providers engage in activities through 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

- 54 providers (2017: 56) anticipate an impairment charge in their 2018 accounts.

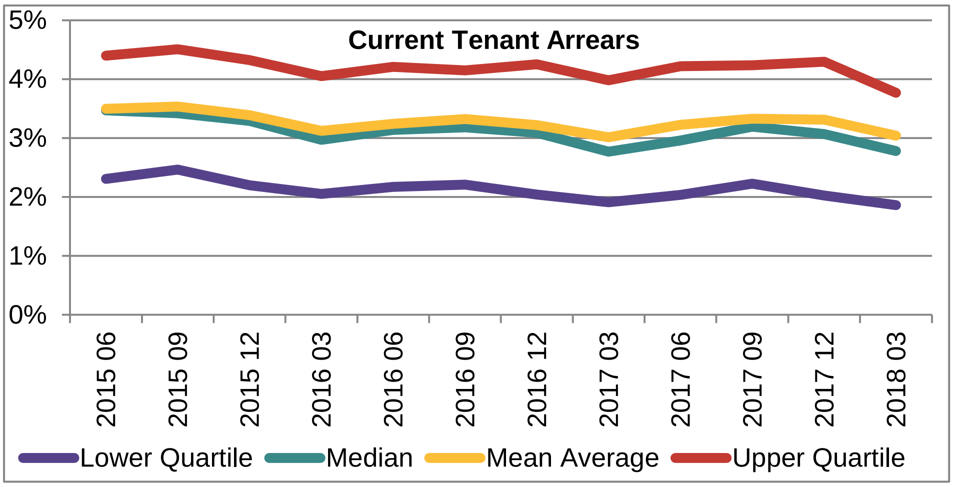
- The total anticipated charge is £106 million of which £46 million relates to social housing assets (2017: £74 million, £35 million).

- 28 providers (2017: 36) forecast an impairment charge of less than £1 million. More than half of the total impairment is forecast by seven providers; one provider anticipates a total impairment charge of greater than £10 million.

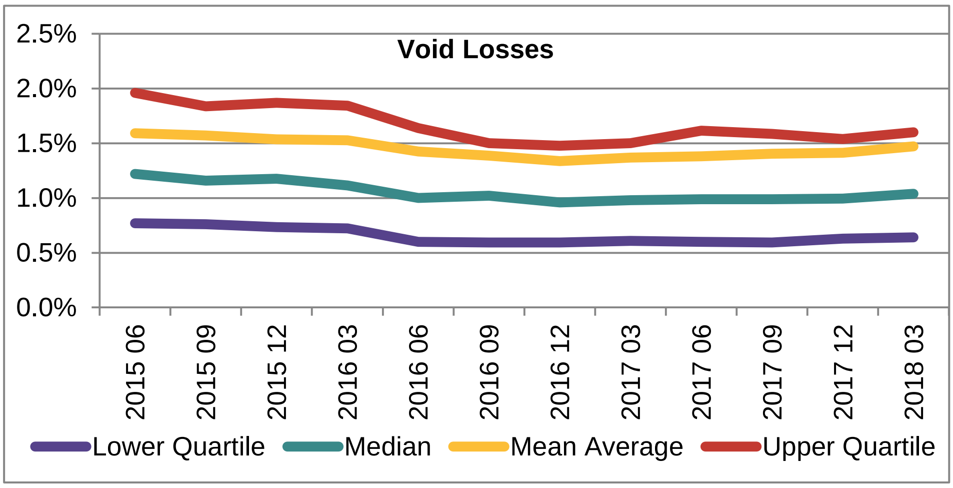
All the providers anticipating impairment in their 2018 accounts have reported that the charge will not affect the meeting covenants in the next three years.

Income collection

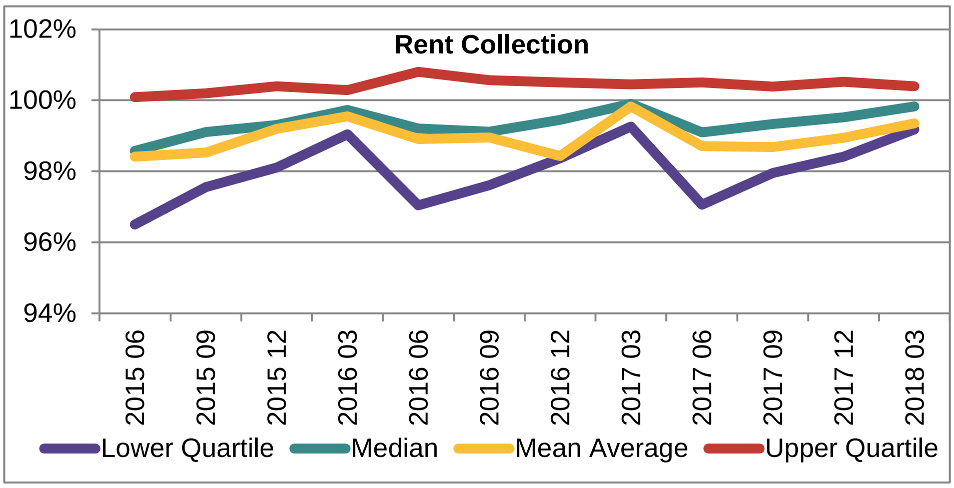
Most providers (88%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plan assumptions. The responses for each quarter remain reasonably stable, suggesting that providers are managing income collection risks and maintaining cashflows within business plan parameters. Fluctuations in income collection and arrears are broadly consistent with seasonal trends. Housing benefit cycles remain likely to have an impact on rent collection data.



Mean average and median current tenant arrears decreased on the previous quarter to 3.0% and 2.8% respectively (December 3.3% and 3.1%). The results are consistent with the seasonal trend and the figures reported in March 2017.



Mean average and median void losses were consistent with the previous quarter at 1.5% and 1.0% respectively (December 1.4% and 1.0%)



Mean average and median rent collection were 99.4% and 99.8%. Rent collection figures in the quarter are consistent with seasonal trends and housing benefit cycles. Two providers reported rent collection rates of less than 95% (December 8).

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