Regulator of Social Housing

Quarterly Survey for Q1

March to June 2018

Contents

Introduction

This quarterly survey report is based on regulatory returns from 230 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 April 2018 to 30 June 2018. 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 £3.2 billion was agreed in the quarter; £1.0 billion from banks and £2.2 billion from capital markets. The latter included several large bond issues.

- This included an element of refinancing existing loans. Loan repayments were £1.0 billion in the quarter.

- The sector remains financially strong with access to sufficient finance: £18.3 billion of undrawn facilities are in place. Debt facilities now total over £90 billion.

- Cash balances total £6.1 billion; this is forecast to reduce in the next 12 months to £4.3 billion as cash is used to fund planned capital expenditure.

- Operational financial performance was in line with expectations. Cash interest cover excluding current asset sales was 144% for the quarter.

- Total sale receipts of £1.3 billion in the quarter were below the forecast of £1.6 billion made in March.

- In the 12 months to June 2019 the sector is forecasting £6.2 billion of sales receipts. By comparison, in the 12 months to June 2018 total sales were £5.1 billion.

- Investment in housing supply was £2.8 billion in the quarter to 30 June 2018; in March 2018 the forecasted contractually committed spend for the quarter was £2.9 billion.

- Over the 12 month forecast period expected investment in new housing supply is £14.9 billion of which £10.1 billion is contractually committed. In the 12 months to June 2018 total investment in new supply was £10.5 billion.

- Around 2,900 Affordable Home ownership (AHO) units were developed in the quarter and 2,800 were sold; unsold units increased by 6%. The level of development reported in the quarter to June 2018 was an 18% increase on the same quarter a year ago.

- Around 900 market sale units were developed and sold in the quarter. This was a decrease on the number developed in the previous quarter and the same quarter a year ago. Unsold units decreased by 4%.

- Relative to current activity levels, the sector intends to increase development of for-sale properties (both AHO and market sale). In the next 18 months, including committed and uncommitted development, plans include the completion of 28,000 AHO units and 13,000 market sale properties. This compares to 18,000 AHO units and 6,500 market sale properties developed in the last 18 months.

- Providers making use of free standing derivatives reported mark-to-market (MTM) exposure of £2.0 billion, a decrease on the previous quarter reflecting an 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 consistent with seasonal trends.

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 increase of 0.3% in average house prices in England for the month of June. In the year to June, there was an increase of 2.7%.[1]

- In the quarter ending June 2018, output in the construction industry grew by 0.9% compared to March 2018, recovering from a 0.8% fall in the previous quarter. The increase in construction output was driven by a 2.7% increase in repair and maintenance work, with all new work remaining flat.[2]

- The Consumer Prices Index (CPI) rose by 2.4% in the year to June 2018, below the 2.5% growth for the year to March 2018.[3] Forecasters currently predict that inflation will be at 2.2% for the year ending December 2018 and 2.1% for the year ending December 2019.[4]

- Latest estimates show that average weekly earnings (not adjusted for price inflation) increased by 2.7% excluding bonuses, and by 2.4% including bonuses, compared with a year earlier.[5]

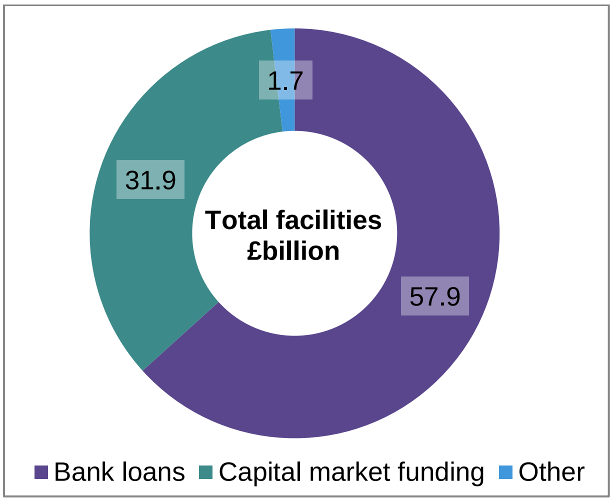
- Interim Construction Output Index (OPI) figures for all construction showed that costs increased by 3.4% in the year to June 2018.[6]

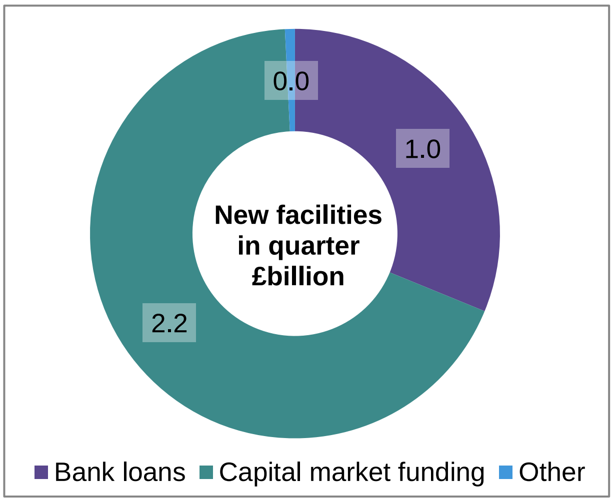
The survey results suggest that the sector is in a robust position to respond to any uncertainty and changes in the wider economic environment. The key risks faced by the sector are considered in the Sector Risk Profile[7] published annually by the regulator. The regulator will continue to monitor key market trends and to seek assurance that boards of PRPs are actively engaged in responding to emerging risks.

[1] UK House Price Index – June 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] https://www.gov.uk/government/collections/sector-risk-profiles

Private finance

- The sector's total agreed borrowing facilities are £91.5 billion, £57.9 billion (63%) of which are bank loans.
- New facilities, including refinancing, agreed in the quarter totalled £3.2 billion.
- Bank lending accounted for 32% (£1.0 billion). Capital markets funding, including private placements and aggregated bond finance, contributed 67% (£2.2 billion) of the new funding in the quarter; other sources, including local authority lending, contributed 1%.





- Of the £91.5 billion agreed facilities, £84.7 billion has been secured and £3.8 billion of facilities do not require security. There are further agreed facilities of £3.0 billion where security is not yet in place.
- £73.2 billion is currently drawn, leaving undrawn facilities of £18.3 billion.
- 93% (March, 95%) of providers forecast that current debt facilities are sufficient for more than 12 months.
- In the 12 months to June 2019 the sector is forecasting loan drawdowns of £6.6 billion (March 12 month forecast £6.8 billion).
- Of the 12 month forecast drawdown, £1.4 billion is from facilities not yet agreed (March £1.3 billion).

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 30 June 2018 (forecast)	3 months to 30 June 2018 (actual)	12 months to 30 June 2019 (forecast)
Operating cashflows excluding sales	1.1	1.1	4.7
Interest cashflows	(0.8)	(0.8)	(3.2)
Payments to acquire and develop housing	(3.9)	(2.8)	(14.9)
Current assets sales receipts	0.9	0.7	4.7
Disposals of housing fixed assets	0.6	0.6	1.5
Other cashflows	(0.2)	(0.3)	(0.4)
Cashflows before resources and funding	**(2.2)**	**(1.4)**	**(7.6)**
Financed by:			
Net grants received	0.4	0.4	1.0
Net increase in debt	1.1	1.2	4.6
Use of cash reserves	0.7	(0.2)	2.0
Total funding cashflows[9]	**2.2**	**1.4**	**7.6**

- Interest cover, based on operating cash flows excluding sales, was 144% in the quarter to June 2018. The sector continues to forecast strong operating cashflows; Interest cover over the 12 months to 31 June 2019 is projected to be 145%.

- In the 12 months to June 2019 the sector is forecasting £4.7 billion of current asset sales, of which £4.3 billion relates to properties for which development is contractually committed. In the 12 months to June 2018 current asset sales of £2.8 billion were achieved.

- In the 12 months to June 2019 the sector is forecasting £1.5 billion of fixed asset sales. In the 12 months to June 2018 fixed asset sales were £2.2 billion.

- Expenditure on new properties in the quarter was £2.8 billion. This was below the total forecast of £3.9 billion and marginally less than the forecast spending of £2.9 billion on contractually committed schemes.

- Capitalised repair and maintenance expenditure in the quarter was £385 million. This was below the forecast of £501 million. Variances have been attributed to delays in repair programmes and re-profiling of planned works.

[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

- In the 12 months to June 2018, capitalised expenditure on repairs and maintenance was £1.8 billion. In the 12 months to June 2019 the sector is forecasting capitalised repairs and maintenance expenditure of £2.2 billion.

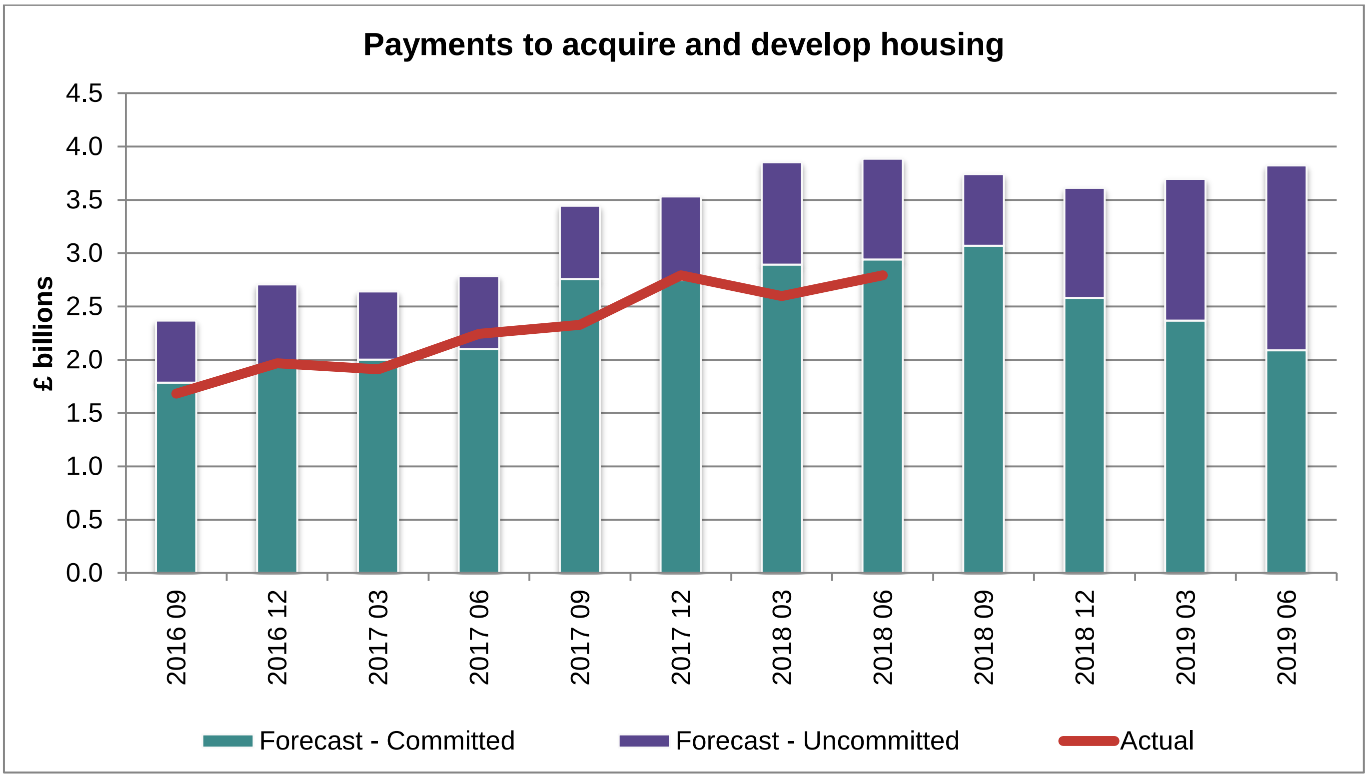
- Cash balances increased £229 million in the quarter, compared to a decrease of £659 million forecast in March. The increase in cash balances is linked to the high value of new capital market funding agreed in the quarter.

- Cash available at June 2018 was £6.1 billion; this is forecast to reduce to £4.3 billion over the next 12 months as cash reserves are used to fund capital investment.

- In addition to the £6.1 billion available, cash held in secured accounts (and therefore not accessible to providers) totalled £986 million at June 2018 (March, £902 million).

Development

In total, £10.5 billion was invested in the acquisition and development of housing in the 12 months to June 2018. In the next 12 months £10.1 billion expenditure is committed to acquire and develop housing properties; a further £4.8 billion, not contractually committed is included in the forecasts.

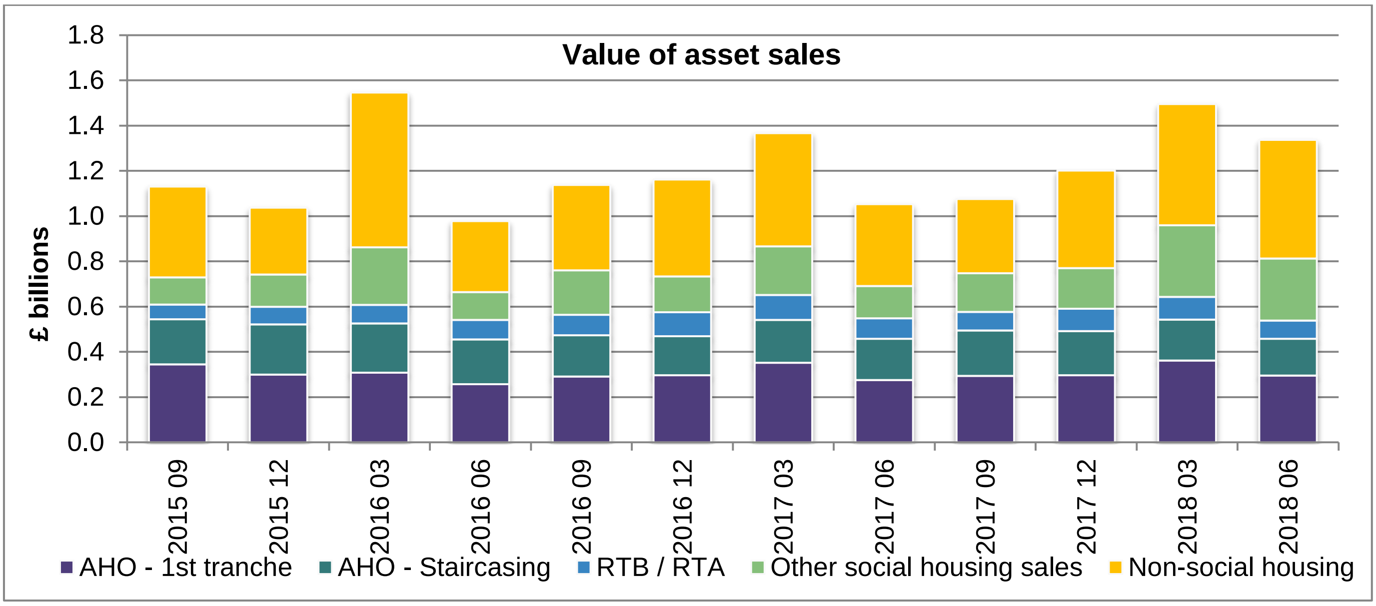


Actual expenditure in the quarter ending June 2018 was £2.8 billion. This was below both the total forecast expenditure of £3.9 billion and £2.9 billion forecast on contractually committed schemes. Development programmes are subject to change and the variances are largely a result of timing differences and slippage.

Providers consistently exercise prudence in the forecasting of development cash flows by over estimating expenditures.

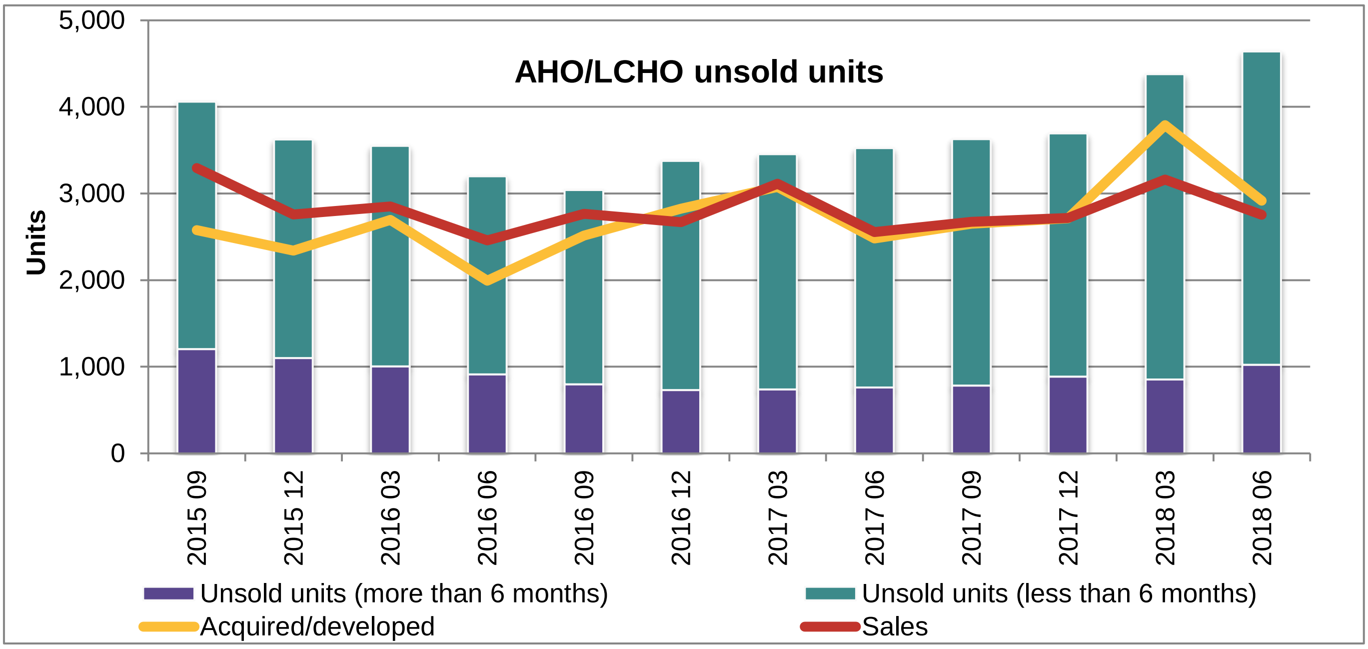
Housing market

Total sales of £1.3 billion represented a 27% increase compared to the corresponding quarter a year ago. Surpluses from asset sales were £407m, a margin on sales of 31%.



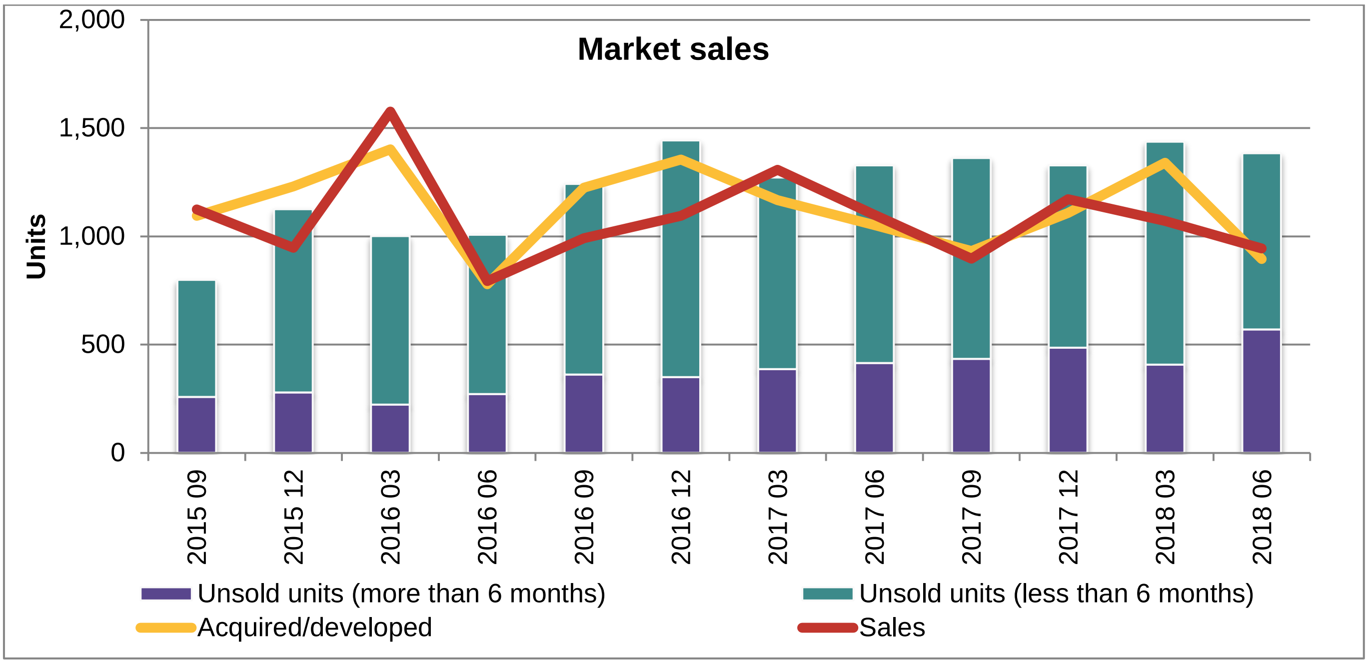
However, sales were £0.3 billion below the forecast of £1.6 billion received in the previous quarter. Fixed asset sales for the quarter were in line with the forecast at £650 million. Current asset sales in the quarter (market sales and first tranche AHO sales) were £665 million; this was less than the forecast £937 million. This 30% variance mirrors the underspend on development compared to forecast, meaning that the lower sales have not caused a weakening of liquidity.

AHO unit sales were 2,755 (March 3,160), slightly below 2,917 completions reported in the quarter (March 3,787). Taking into account transfers between tenures, there was a 6% increase in total unsold units to 4,641. The number unsold for more than 6 months increased by 20% to 1,022. Half of the unsold AHO stock at the end of the quarter was held by 22 RPs.



The pipeline of AHO completions expected in the next 18 months is 28,187 (March, 28,670) of which 22,256 are contractually committed. Over the 18 months to June 2018, there were 17,624 AHO completions.

Development for outright market sale is concentrated in relatively few providers. There were 944 sales in the quarter (March, 1,071) and 895 homes were developed for market sale (March, 1,340). Taking into account transfers between tenures, the number of unsold market sale units at March 2018 decreased to 1,384 (March 1,437). Of this number 569 had been unsold for over six months (March, 407). For market sales, half of the total unsold stock at the end of the quarter was held by seven providers.



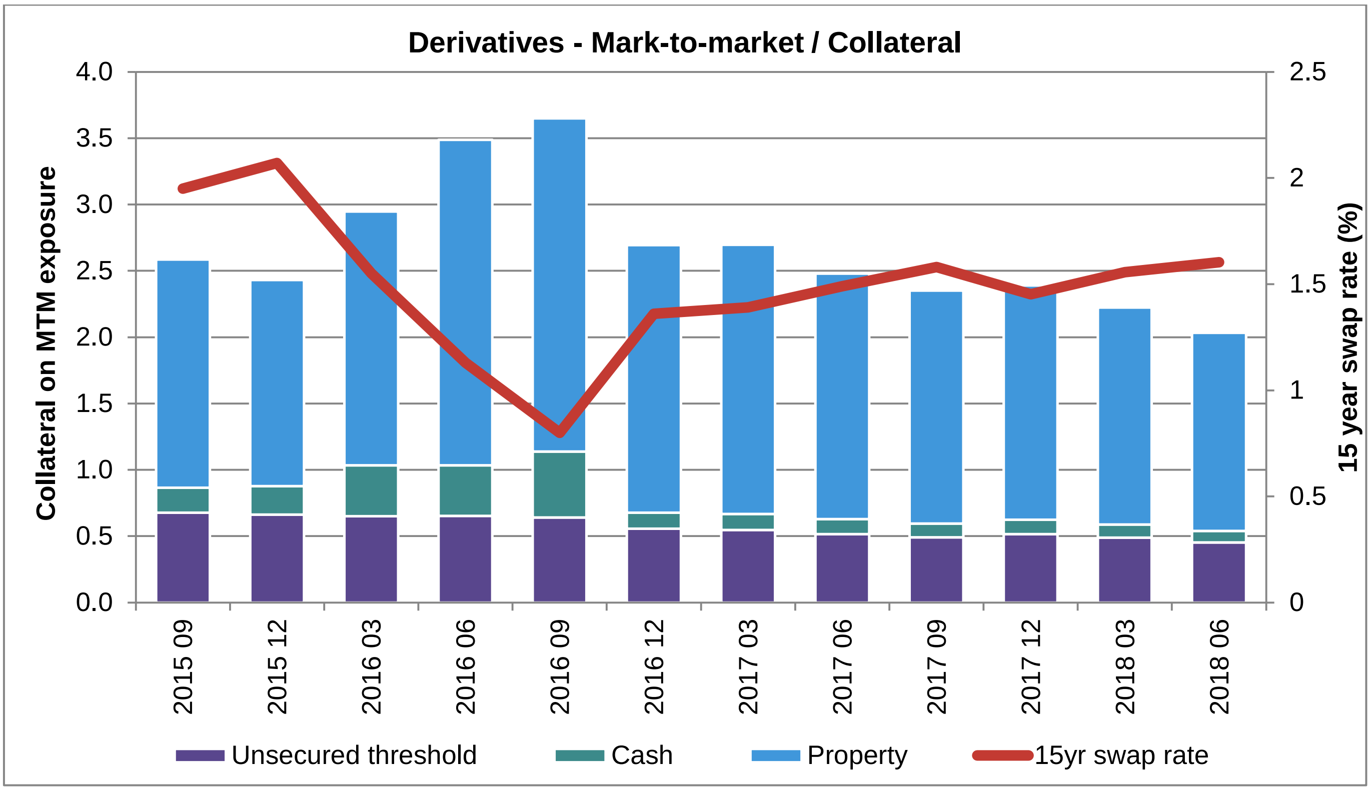
The pipeline for market sale completions expected in the next 18 months is 13,260 (March, 13,064) of which 11,384 are contractually committed. Over the 18 months to June 2018, there were 6,494 market sales completions.

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 actual 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

- 43 providers (March, 45) currently make use of free-standing derivatives.
- The notional value of standalone derivatives was £8.4 billion (March, £8.4 billion).
- The current gross MTM exposure decreased by 9% from March to £2.0 billion.
- Unsecured thresholds and available security pledged to swap counterparties was £3.5 billion; of this total collateral, £1.7 billion (March, £1.9 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.



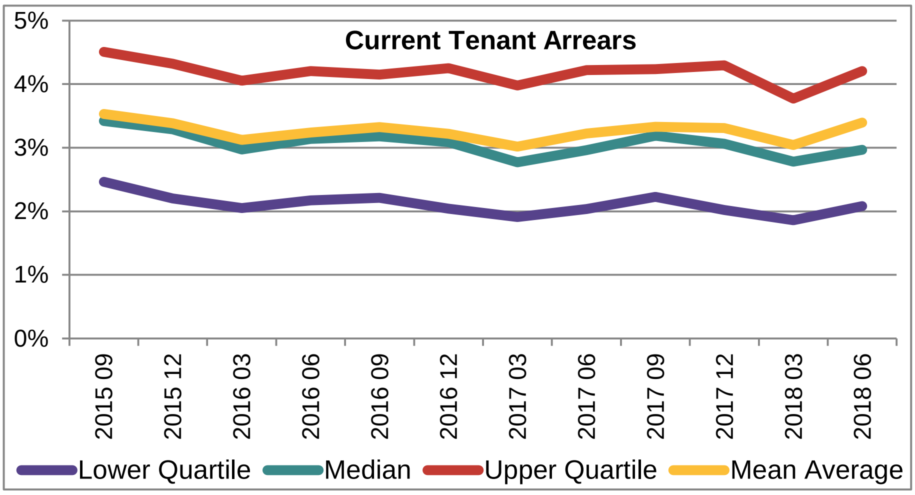
The above graph shows MTM exposures excluding excess collateral. Sterling swap rates at the end of June were higher than at the end of the previous quarter. This resulted in a decrease in MTM exposure.

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, the headroom of collateral available over current exposure was £1.4 billion.

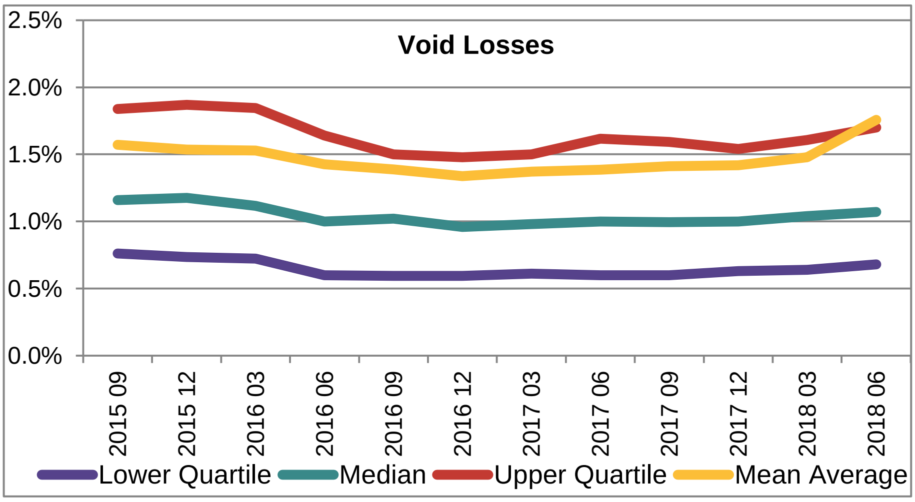
Interest rate volatility means that collateral requirements will remain a long-term exposure. Individual providers must ensure that they have sufficient available security as a fall in swap rates has the potential to increase MTM exposure. The regulator will continue to monitor on-going movements in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

Income collection

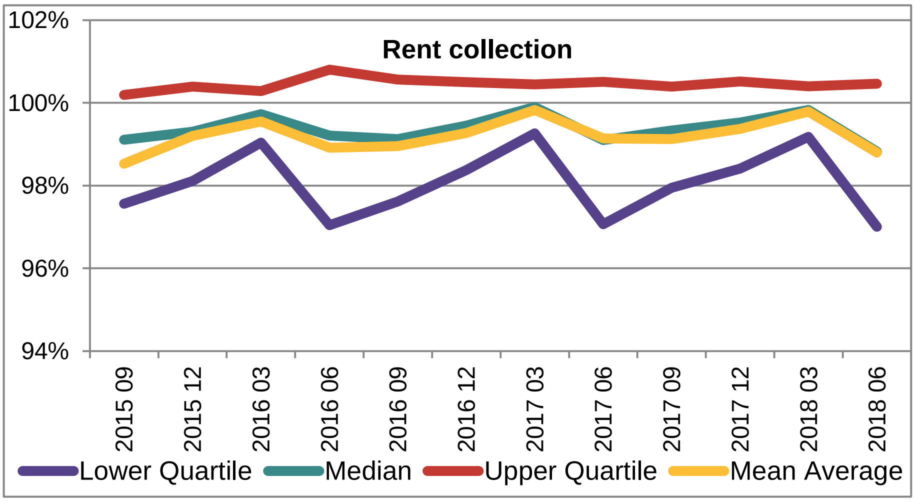
Most providers (87%) continue to report that the current levels of arrears, rent collection and voids are within, or outperforming, their business plan assumptions. The responses for each quarter remain reasonably stable, suggesting that providers are managing income collection risks and maintaining 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 increased on the previous quarter to 3.4% and 3.0% respectively (March 3.0% and 2.8%). The results are consistent with the seasonal trend and the figures reported in June 2017.



The median and quartile void losses were consistent with the previous quarter. Mean average void losses have increased from 1.5% in December to 1.8% in June. This is attributable to additional providers added to the QS dataset (managing more than 1,000 units for the first time). The additional providers supply temporary supported housing and report relatively high levels of voids.



Mean average and median rent collection were both 98.8%. Rent collection figures are also affected by the additional providers added to the dataset. Despite this results in the quarter are generally consistent with seasonal trends and housing benefit cycles. 29 providers reported rent collection rates of less than 95% (March 2018, 6 and June 2017, 22)

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