Homes &
Communities
Agency

2014 GLOBAL ACCOUNTS OF HOUSING PROVIDERS

2014 Global Accounts of Housing Providers

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Introduction

The primary purpose of the 2014 Global Accounts is to provide a financial overview of the regulated social housing sector based on an analysis of the regulatory financial returns of private registered providers. Within this publication, private registered providers of social housing (primarily housing associations) are referred to as ‘providers’.

The social housing sector is diverse in both the size of providers that operate within it and the range of activities each undertakes. In total there are around 1,500 active providers, of which the majority have fewer than 250 homes. This publication is concerned with the financial analysis of the 336 providers which own or manage at least 1,000 social homes, representing more than 95% of the sector’s stock.

There are 2 sub-sectors within the total – traditional and stock transfer providers. The latter were introduced in 1990 to take transfer of stock from local authorities. In their early years, they have distinctive characteristics, which are very different from existing traditional providers and are therefore analysed separately within this publication. However, approximately two thirds of stock transfers occurred 10 or more years ago. The distinction between the traditional and an increasingly mature stock transfer sub-sector is diminishing.

The provision of homes for rent is the major activity for the majority of providers. However, many also provide homes for ownership, thereby generating income from the sale of homes. This type of activity exposes providers to a different risk profile to that for traditional renting and has changed the financial profile of a number of providers within the sector.

Further differences exist between providers in their degree of specialism. The majority have some specialist supported, care or housing for older people homes. There is, however, a small but significant number of primarily specialist providers, who are largely contract service rather than property based organisations. These providers face particular challenges in competition from other service providers for local authority commissioned support contracts. Additionally, a small number of providers undertake a significant amount of activity that is not social housing. They increasingly deliver a range of community regeneration and housing solutions through subsidiary or associated companies not registered with the social housing regulator.

The 2014 Global Accounts are presented in Part B. It introduces the aggregate financial statements, with specific sections relating to the income and expenditure statement, balance sheet and key financial ratios. The narrative provides a commentary on key movements and trends in the overall financial position of the sector in the context of the operating environment in which providers work. This includes examining historic trends as well as factors likely to affect the sector in the future.

The thematic analysis section provides commentary on 4 specific areas of interest. The first, section C1, examines the increasing variety of sources of private funding accessed by providers. Section C2 analyses providers’ financial forecast returns including a comparison of this year’s forecasts against those submitted in the previous year. Section C3 further analyses the drivers behind the recent increase in reported surpluses and the future implications for the sector. Finally, section C4 evaluates varying performance across the sector against the regulator’s Value for Money Standard.

Part A – Executive summary

The 2014 Global Accounts demonstrate that the sector, in aggregate, remains financially robust. The sector recorded a strong financial result in the year ending March 2014, turnover increased by 5% to £15.6 billion and the operating margin also increased from 25.9% in 2013 to 26.5% in 2014. Surpluses for the sector have continued to rise and total £2.4 billion for 2014, an increase of 22% compared to 2013.

Historically, the surplus generated by registered providers remained relatively constant between 2003 and 2009. The increase in surplus recorded by the sector since 2009 is in part attributable to favourable macroeconomic conditions. The sharp increase in surplus post 2009 corresponds with a period of historically low interest rates and permitted rent increases linked to retail price index (RPI) significantly outstripping wage inflation.

The increase in surplus in recent years is also partly attributable to the growing maturity of the stock transfer sub-sector. In their early years, typically over a 5 to 12 year period, stock transfer providers undertake high levels of improvement works. This is reflected in high deficits and low levels of interest cover. Over 75% of stock transfers took place before 2006. Prior to 2010, the surplus from the sector as a whole was reduced by deficits in the stock transfer sub-sector. In 2014 the stock transfer sub-sector contributed £818 million (35%) to the total surplus.

The entire surplus generated is taken to reserves, which are not held as cash but are reinvested in providers' businesses. At March 2014, the sector had reinvested £12.7 billion of its reserves in the acquisition and development of new supply and improvements to the existing stock base and the balance is retained within the balance sheet as working capital. The gross book value (GBV) of the sector's assets (total housing properties at cost and valuation) has increased by £6.8 billion to £132.7 billion.

The sector has forecast that it will generate a surplus of approximately £2 billion per year for the next 5 years and that it will continue to reinvest its reserves in the acquisition and development of new stock. The sector is forecasting that it will increase the level of development activity. It is expecting to develop 285,000 units between 2014/15 and 2018/19. The sector developed 34,500 units during 2013/14.

The sector's exposure to the housing market is likely to increase in the next 5 years when sales income is projected to be £17.9 billion which equates to 18% of the sector's forecast turnover. There are a number of additional risk factors that could affect the volatility of the sector's cashflow:

- from April 2015, providers will be required to ensure that all rent increases are linked to consumer price index (CPI) inflation + 1% rather than RPI +0.5%; providers will no longer be permitted to increase rents in excess of this where rent levels are below target rents
- the variety of changes brought in by welfare reform pose a risk to income collection
- the Bank of England base rate has remained at 0.5% throughout the current year, as it has the previous 3 years. Providers are susceptible to increases in the base rate which could significantly increase interest costs. As at March 2014, the sector's fixed rate debt is approximately 67% of its total debt (2013: 65%, 2012: 70%)

Total debt raised in the year was £5.6 billion (up from £5.5 billion in 2013). This was split between approximately £2.3 billion of incremental growth in debt, and £3.3 billion of refinancing or restructuring existing facilities. During 2013/14, providers issued £2.9 billion of bonds in the debt capital markets, similar to the amount raised in the previous year. The market for bond financing has continued to expand, with an increased range of institutions buying provider paper and a variety of structures being established.

The sector remains an appealing lending prospect for both the banks and capital markets, with the strong asset base, predictable income streams and government support through Housing Benefit and regulation combining to produce favourable pricing. The ready availability of debt capital market finance has continued into 2014/15, with the fall in the gilt rate further decreasing the cost of capital.

The HCA's Value for Money (VfM) Standard has been part of the regulatory framework since April 2012. For the majority of providers, 2014 was the second year in which they were required to publish VfM self-assessments. The sector has increasingly got to grips with the requirements of the standard. In general, self-assessments were more detailed, with a greater number of providers transparently setting out their evidence of how they meet the specific requirements set out in the VfM Standard.

On 30 January 2015, the regulator published its decision statement on the adoption of a new Governance and Financial Viability Standard. This new standard comes into effect from 1 April 2015, and will strengthen the expectations on providers to actively manage risk in a more complex and risky operating environment. The 2 standards complement each other, with the revised Governance and Financial Viability Standard setting out the requirements to understand and manage the risks to the social housing assets, and the Value for Money Standard setting the expectation that providers should understand the return on those assets and seek to optimise them.

Part B – Global Accounts

This analysis is based on a database of information derived from housing providers' audited financial statements. The database contains data from the annual account regulatory returns (FVAs) which must be submitted by providers that manage 1,000 or more homes.

These regulatory returns are aggregated to produce the balance sheet and income and expenditure account for the sector as at 31 March 2014. Comparative figures for 2012/13 and 2011/12 are also provided.

The Global Accounts do not include the consolidated accounts of registered provider group structures, because they would include financial information from unregistered bodies. The accounts of non-asset holding parents of the group are also excluded to avoid double counting of income and costs, where the parent provides centralised corporate services which are recharged to group subsidiaries. However, since individual group member accounts are included, there remains a degree of grossing-up of income and expenditure, and of current assets and liabilities, reflecting intra-company charges and balances at year end.

Providers' FVA returns are reported in £ thousands and the aggregate data is reported in £ millions, therefore sub totals may contain rounding differences.

Aggregate income and expenditure account

The aggregate income and expenditure account reflects the sum of private registered provider activity for all accounting periods ending between 1 April 2013 and 31 March 2014.

Aggregate balance sheet

The aggregate balance sheet is the sum of individual private registered provider balance sheets whose financial year ends fall within the period from 1 April 2013 to 31 March 2014.

Additional information

Additional information is provided on the aggregate income and expenditure on social housing lettings, income and expenditure on other activities, and the number of homes in management.

Additional disclosure - financing and reserves

The FVA was updated in 2014 to allow for additional disclosure. In addition to long term loans and other long term creditors previously disclosed, providers have been required to disclose amounts due to group undertakings and details of any finance lease obligations. This affects a number of areas within the analysis and has resulted in key ratios referred to in previous versions of the Global Accounts being restated. Where figures in the analysis are affected, the effect is described.

Table 1

Summary income and expenditure account

	Traditional	Stock transfer	Total	Total	Total
All figures in £m	2014	2014	2014	2013	2012
Turnover	9,914	5,720	15,634	14,860	13,751
Operating costs	(6,602)	(4,004)	(10,606)	(10,147)	(9,846)
Cost of sales	(698)	(150)	(848)	(852)	(672)
Exceptional items	(28)	(13)	(41)	(12)	(12)
Operating surplus	**2,586**	**1,553**	**4,139**	**3,849**	**3,220**
Surplus on the sale of fixed assets	485	146	630	466	516
Gift aid	97	(25)	72	47	17
Other items	(21)	(3)	(25)	(13)	223
Interest receivable and other income	182	35	217	182	171
Interest payable and similar charges	(1,776)	(862)	(2,638)	(2,522)	(2,355)
Exceptional items relating to early redemption of loans	(9)	(24)	(34)	(64)	(18)
Surplus before tax	**1,543**	**819**	**2,362**	**1,946**	**1,775**
Corporation tax	(10)	(1)	(12)	(15)	3
Surplus after tax	**1,533**	**818**	**2,350**	**1,930**	**1,778**
Transfer (to)/from reserves	66	64	130	158	377
Accumulated surplus / (deficit) bf	**10,453**	**3,073**	**13,526**	**11,745**	**7,526**
Actuarial surplus (loss) on pension scheme liability	3	162	166	(196)	(350)
Prior period adjustments	114	(30)	84	(112)	2,414
Accumulated surplus / (deficit) cf	**12,170**	**4,087**	**16,256**	**13,526**	**11,745**

Table 2

Balance sheet

All figures in £m	Traditional 2014	Stock transfer 2014	Total 2014	Total 2013	Total 2012
Fixed assets					
Housing properties at cost	87,942	21,053	108,995	105,090	98,075
Housing properties at valuation	7,308	16,439	23,747	20,886	20,488
Gross book value of housing properties	**95,250**	**37,492**	**132,741**	**125,976**	**118,563**
SHG/HAG	39,086	4,431	43,517	43,059	41,616
Other capital grants	1,592	817	2,409	2,348	2,214
Depreciation	6,195	2,465	8,660	7,781	6,783
Net book value of housing properties	**48,376**	**29,778**	**78,155**	**72,788**	**67,950**
Other fixed assets	3,089	715	3,803	3,569	3,200
Total fixed assets	**51,465**	**30,493**	**81,958**	**76,357**	**71,150**
Current assets					
Properties for sale	907	194	1,101	1,031	1,285
Non liquid current assets	1,103	1,206	2,310	2,178	1,780
Cash and short term investments	2,861	1,661	4,523	3,914	2,670
Other current assets	2,148	981	3,129	3,060	3,384
Total current assets	**7,020**	**4,043**	**11,063**	**10,184**	**9,119**
Current liabilities					
Short term loans	459	235	694	823	612
Bank overdrafts	6	7	13	27	27
Other current liabilities	3,072	1,258	4,329	5,638	5,749
Total current liabilities	**3,537**	**1,500**	**5,037**	**6,488**	**6,388**
Net current assets (excluding pensions)	**3,484**	**2,543**	**6,027**	**3,696**	**2,731**
Pension liabilities	(322)	(402)	(724)	(963)	(688)
Net current assets (including pensions)	**3,162**	**2,140**	**5,302**	**2,733**	**2,043**
Total assets less current liabilities	**54,627**	**32,634**	**87,261**	**79,090**	**73,193**
Financing and reserves					
Long term loans	33,055	17,652	50,706	51,215	47,869
Amounts owed to group undertakings	4,386	1,734	6,119		
Finance lease obligations	130	0	130		
Other long term creditors	1,377	258	1,635	3,659	3,562
Provisions	127	1,105	1,232	897	1,103
Accumulated surplus	12,170	4,087	16,256	13,526	11,745
Designated reserves	331	141	473	456	433
Restricted reserves	202	357	560	585	449
Revaluation reserves	2,806	7,213	10,019	8,731	7,972
Pension reserves	43	86	129	21	59
Total financing & reserves	**54,627**	**32,634**	**87,261**	**79,090**	**73,193**

Income and expenditure

Turnover and operating costs

Turnover has increased by £0.8 billion (5%) to £15.6 billion (2013: £1.1 billion and 8%). Of the increase 30% was attributable to stock transfer providers (2013: 37%) and 70% to traditional providers (2013: 63%).

Turnover from social housing lettings has increased by £646 million (5%) to £13.1 billion (2013: £919 million and 8%). Income from first tranche shared ownership sales decreased by £20 million (3%) to £775 million. Total turnover from non-social housing activities has increased by £113 million (13%) to £983 million. In aggregate, the turnover from activities other than social housing lettings has increased by £129 million (5%).

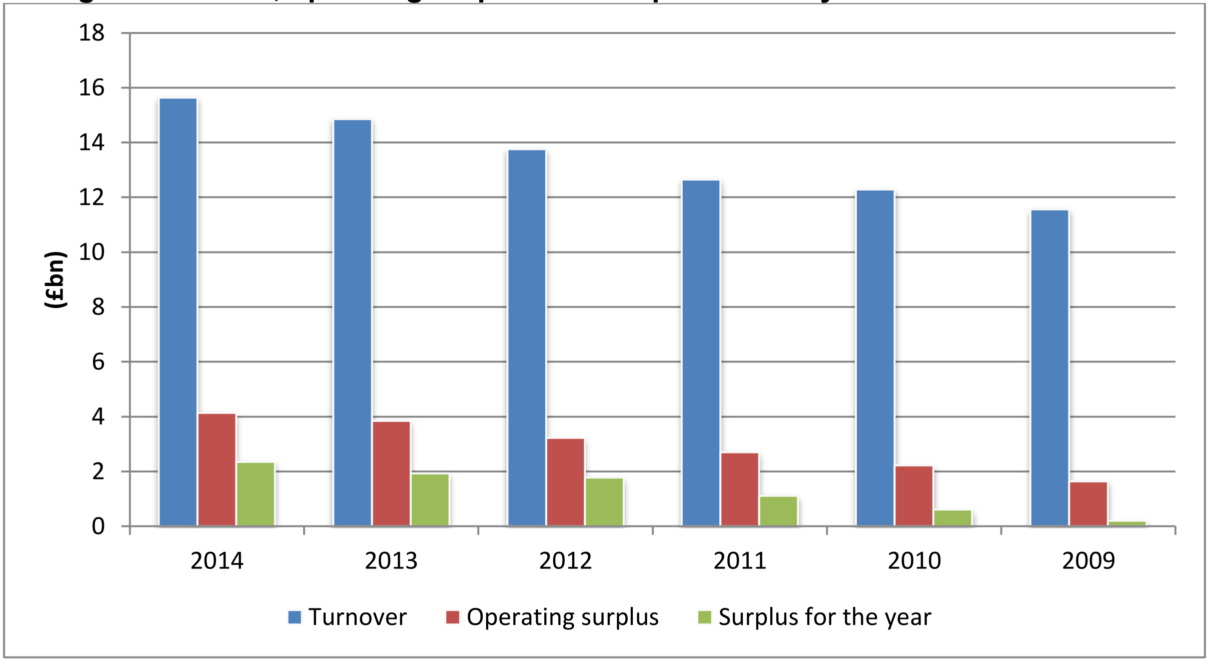
Total operating costs increased by £459 million (4.5%) to £10.6 billion. The increase in operating costs was marginally greater than inflation throughout the period RPI was 2.9% in April 2013 and this rose to 3.3% in August before falling back to 2.5% in March 2014.

Operating costs for stock transfer providers increased by £124 million (3%), the operating costs for the traditional sub-sector increased by £336 million (5%). Operating costs per unit for the stock transfer sub-sector increased by 4% to £3,472 per annum and increased by 3% to £4,447 for the traditional sub-sector.

The overall operating surplus has increased by £290 million (8%) to £4.1 billion, £2.6 billion is attributable the traditional sub-sector. As a result, there has been an improved operating margin from 25.9% in 2013 to 26.5% in 2014. The operating margin in the traditional sub-sector has improved from 25.5% to 26.1% and for the stock transfer providers the operating margin has also improved from 26.7% to 27.2%. The EBITDA MRI[1] operating margin, which includes capitalised major repairs increased from 24.6% to 27.3% in 2014.

Figure 1

Change in turnover, operating surplus and surplus for the year 2009-2014



[1] Earnings before interest, tax, depreciation and amortisation including major repairs divided by turnover

Surplus from fixed asset sales

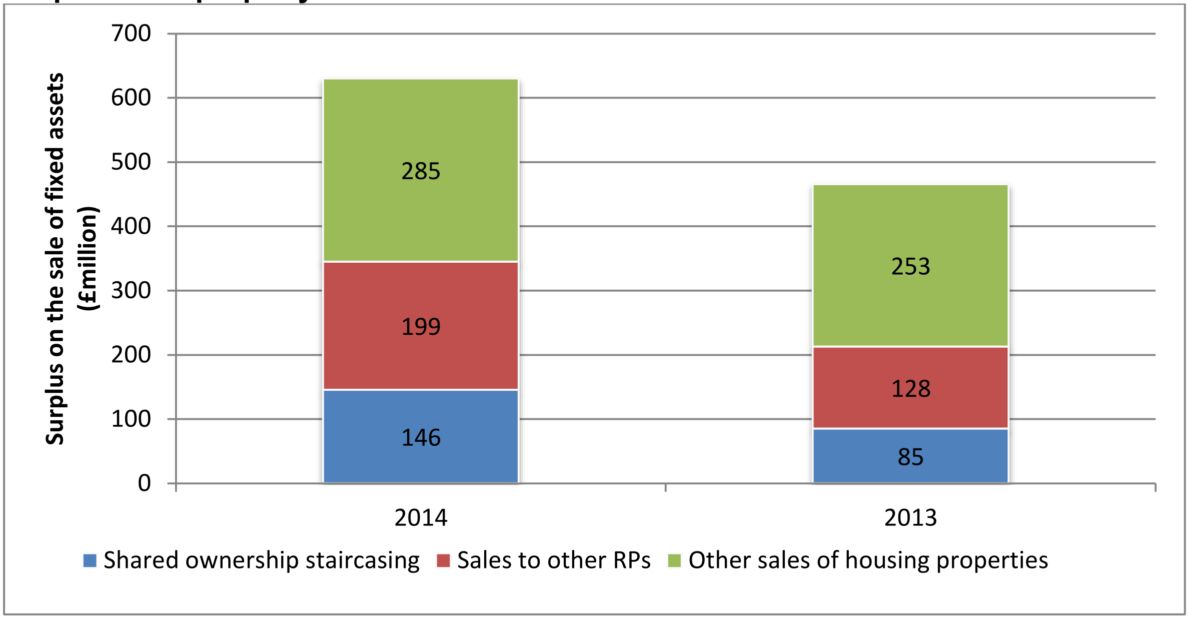
The surplus from the sale of fixed assets has increased by £165 million (35%) to £630 million. Of this total surplus, 77% is attributable to traditional providers (2013: 81%).

The increase was driven by an increase in surplus from sales to other RPs of £72 million to £199 million. Of the surpluses realised on properties sold to other RPs, 87% is attributable to the traditional sub-sector and over 80% is attributable to the top 10 providers reporting surpluses under this classification.

The surplus attributable to other sales of housing properties and other assets increased by £32 million to £285 million from £253 million in 2013. Analysis of this surplus indicates that 61% of the total surplus was within the traditional sub-sector, with roughly 50% of the total being attributable to the top 16 providers reporting these surpluses.

The surplus attributable to shared ownership staircasing also increased significantly by £61 million to £146 million. Traditional providers account for 95% of the surplus generated with 25 traditional providers accounting for 80% of the total surplus attributable to shared ownership staircasing.

Figure 2
Surplus from property sales



Interest

Interest payable has risen by £116 million (5%) to £2.6 billion, 67% was attributable to traditional providers (2013: 54%). Between April 2013 and March 2014 LIBOR[2] has remained stable at 0.5%. In comparison, between April 2012 and March 2013 LIBOR fell from 1.1% to 0.5%. There has been a marginal decrease in the effective interest rate[3] from 4.8% in 2013 to 4.7% in 2014.

[2] London Interbank Offered Rate

[3] Effective Interest rate: Interest payable plus capitalised interest divided by long term loans plus short term loans plus amounts due to group undertakings plus finance lease obligations plus other long term creditors. Restated from Global Accounts 2013.

The effective interest rate for the traditional sub-sector fell by 0.1% to 4.8% and the comparable rate for the stock transfer sub-sector remained at 4.5%. Total interest costs (including capitalised interest) as a percentage of turnover have remained at around 18% from 2010 through to 2013. For the traditional sub-sector this was 19% and for the stock transfer sub-sector this was 16%.

Interest cost (interest payable plus capitalised interest) increased by £123 million (5%). The movement in interest cost can be disaggregated by movement in the sector's effective interest rate and increase in total debt. The reduction in effective interest rate would have caused total interest payment to decrease by £47 million. This was counteracted by a 6.4% increase in debt[4] which caused interest costs to increase by £171 million.

As at March 2014, the sector fixed the interest rate on approximately 67% of its debt on average (2013: 65%, 2012: 70%). Fixing debt gives providers a degree of certainty on forecasting the cost of borrowing. The remaining 33% of debt is subject to less certain rates, either because it is a floating rate, is cancellable by the lender, or is inflation linked. Providers have benefited from low floating rates in recent years. The regulator continues to monitor the potential impact of interest rate movements and engage with providers on treasury management where risk is identified.

Exceptional items relating to the early redemption of loans decreased by £31 million to £34 million (2013: increase of £46m). In 2014 the entire balance is attributable to breakage costs of fixed rate loans or hedging agreements within 5 providers.

Interest receivable for the sector increased by £34 million (19%) to £217 million. This can be attributed to the increase in cash and short term investments held by the sector in 2014.

Net surplus

The reported net surplus has increased by £420 million (22%) between 2013 and 2014 to £2.4 billion, in comparison the increase between 2012 and 2013 was £153m[5] (9%).

Table 3

Increase in surplus

All figures in £m	Traditional	LSVT	Total
Increase in revenues from social housing lettings	139	50	188
Increase in margin on social housing lettings	58	29	89
Increase in net interest costs	(51)	(30)	(81)
Profit/(loss) on fixed & current asset sales	122	54	176
Other items[6]	6	43	49
Aggregate increase in surplus	**274**	**146**	**420**

Additional net rental income of £668 million from social housing lettings (2013: £860 million) has driven an increase in surplus on social housing lettings of £277 million (8%). The figure attributable to the increase in revenues is derived by applying the operating margin from 2013 to the increase in social housing revenues. The margin on social housing lettings

[4] Debt: long term loans plus short term loans plus amounts due to group undertakings plus finance lease obligations plus other long term creditors. Restated from Global Accounts 2013.

[5] The £153m increase included a £220m adjustment attributable to the collapse of a group structure in a large provider. Excluding the effect of this adjustment the increase was £373m.

[6] Other items include other non-social housing activities, other social housing activities, gift aid, exceptional items relating to early redemption of loans, corporation tax and other sundry items.

increased from 29% to 30%, further increasing the operating surplus by £89million. This was partially offset by an increase in net interest costs of £81m which was caused by the increase in debt in the year.

The surplus generated from fixed asset sales has increased by £165 million (35%) from 2013. Of this increase, £110 million is attributable to traditional providers and £55 million to the stock transfer sub-sector.

The net surplus for traditional providers increased by £274 million (22%) to £1.5 billion and the net surplus for the stock transfer sub-sector increased by £146 million (22%) to £818 million. The stock transfer sub-sector continues to mature with the number of new stock transfers declining over the past 3 years.

Part C3 of this report focuses on the net surplus reported by the sector. The section analyses reported surpluses over a 10 year period, examining in more detail the drivers for recent improvement in the performance of the sector in aggregate.

Detailed income and expenditure

Table 4

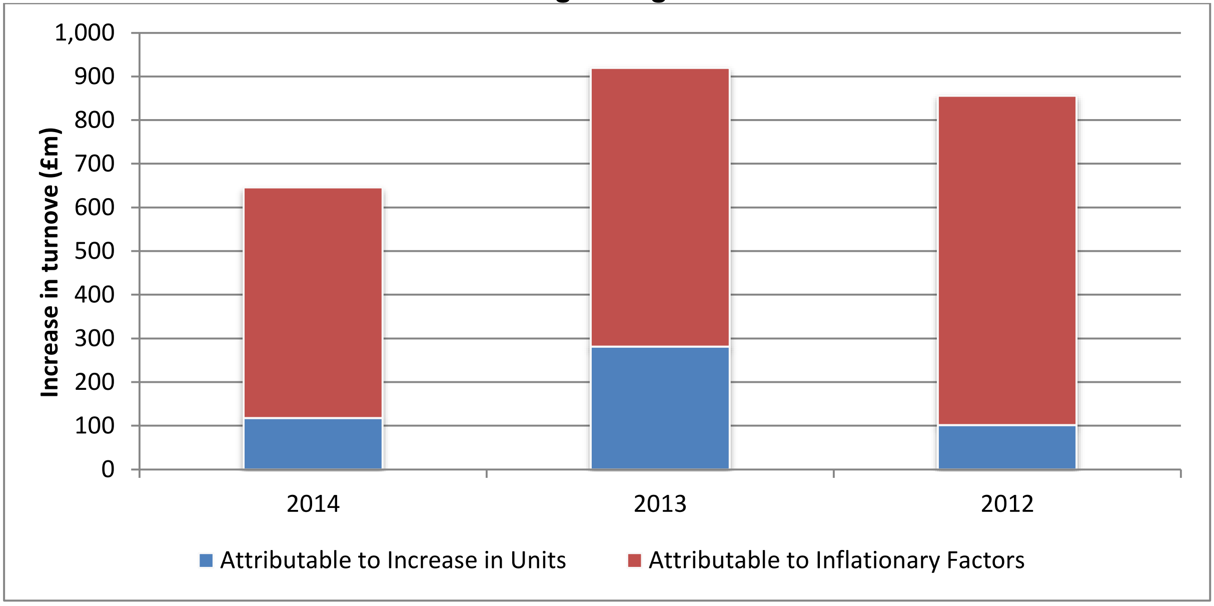
Income and expenditure from social housing lettings (SHL)

All figures in £m	Traditional 2014	Stock transfer 2014	Total 2014	Total 2013	Total 2012
Income					
Rents	6,762	4,884	11,645	11,030	10,100
Service Income	853	263	1,116	1,063	941
Charges for support services	0	0	0	0	192
Net rental income	**7,615**	**5,147**	**12,761**	**12,093**	**11,233**
Other & revenue grants	271	87	357	380	321
Total turnover from SHL	**7,886**	**5,233**	**13,119**	**12,473**	**11,553**
Expenditure					
Management costs	1,533	1,079	2,612	2,488	2,317
Service costs	1,040	325	1,365	1,302	1,175
Care/support costs	0	0	0	0	242
Routine maintenance	1,047	831	1,877	1,826	1,782
Planned maintenance	438	364	801	767	715
Major repairs	182	394	576	572	593
Bad debts	67	51	118	96	81
Lease charges	0	0	0	0	139
Depreciation of housing properties	846	606	1,452	1,347	1,235
Impairment of housing properties	27	7	34	50	16
Other	288	89	377	397	201
Total expenditure on social housing lettings	**5,467**	**3,746**	**9,212**	**8,844**	**8,497**
Surplus on SHL	**2,419**	**1,487**	**3,906**	**3,629**	**3,057**

Rents and service income

Turnover from social housing lettings has increased by £646 million (5%) to £13.1 billion. Rental income increased by £615 million (6%) and service charge income by £53 million (5%) to £1.1 billion. Revenue grants have increased by £18 million (12%) and other social housing revenue income has decreased by £41 million (17%).

Figure 3
Increase in turnover from social housing lettings



The combined rent and service charge per unit increased by 4.5% to £93 per week. Average rent and service charge per unit was £99 per week for the traditional sector (2013: £95 per week) and £86 per week for the stock transfer sub-sector (2013: £82 per week).

The rent per social housing unit increased in 2014 by 4.6% to £85 per week (2013: £81 per week). The increase in rent per unit is partially attributable to the guideline limit for rent increase in 2013/14 which was 3.1% (based on RPI at September 2012 2.6% + 0.5%). The difference between the guideline limit and the change in average rents is partly attributable to some rents converging upwards by £2 a week in excess of the guideline limit to target rent levels. Also, new units developed and re-lets are likely to be at higher rents, including units let at Affordable Rent, than units that are sold.

The Statistical Data Return (SDR)[7] indicates that the number of Affordable Rented units owned by the sector has increased from just under 40,000 in March 2013 to 80,000 in March 2014. As a percentage of total social housing units in management, this represents an increase from 1.5% in 2013 to 3.0% in 2014.

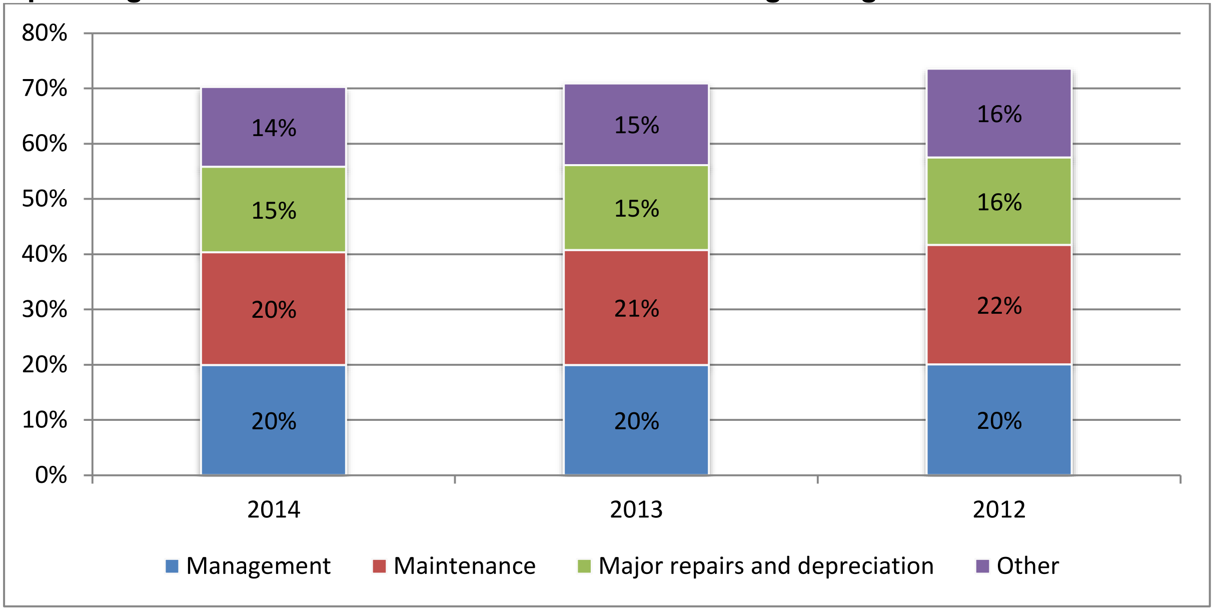
Social housing costs

Total expenditure on social housing lettings has increased by £369 million (4%), to £9.2 billion. This resulted in an improved margin on social housing lettings, as costs as a percentage of turnover fell from 71% in 2013 to 70% in 2014. The key drivers in the increased margin were reductions in major repairs costs and maintenance costs as a percentage of turnover.

[7] Private Registered Provider Social Housing Stock in England. Statistical Data Return 2013/14.

Figure 4

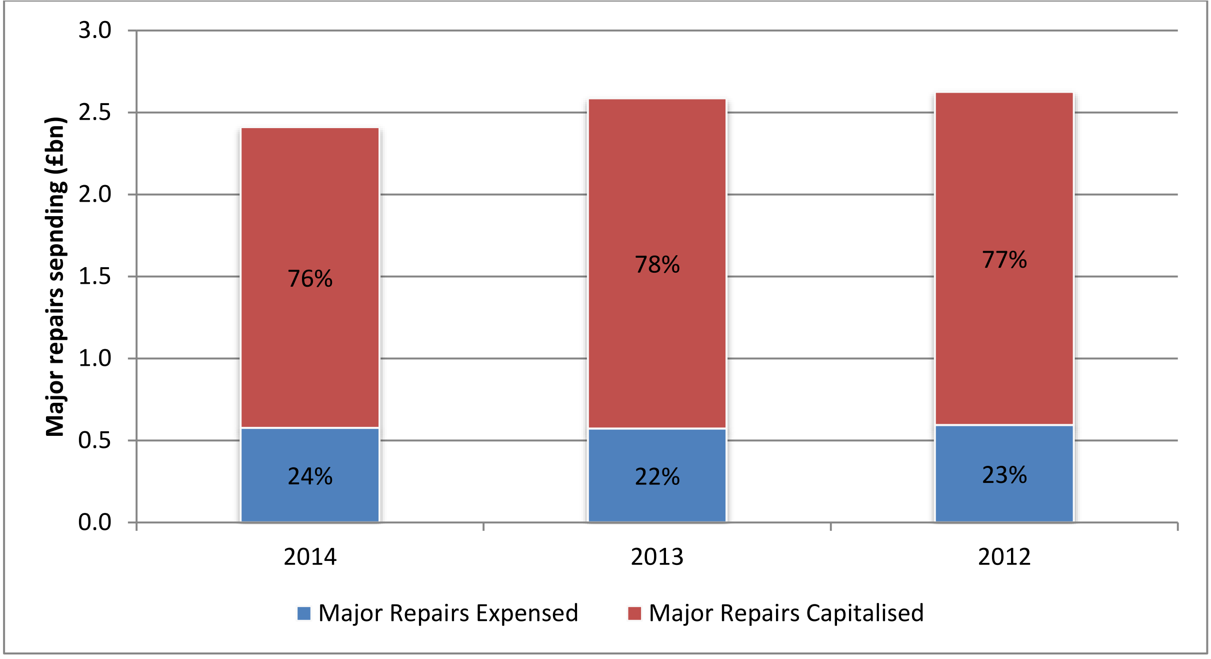
Operating Costs as a % of turnover from social housing lettings



Overall, total major repairs costs (including capitalised major repairs) have decreased by £176 million (7%) from £2.6 billion in 2013 to £2.4 billion in 2014. In 2014 capitalisation rates decreased marginally by 2% to 76%, the aggregate capitalisation rate was 71% (2013: 74%) for stock transfers and 83% (2013: 83%) for traditional providers.

Figure 5

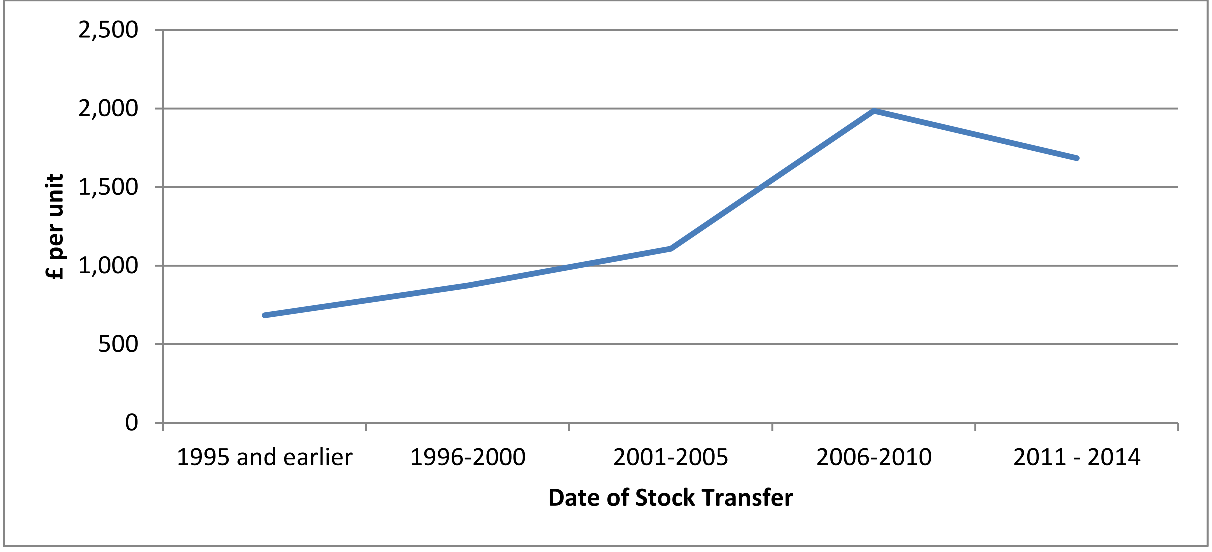
Major repairs spend



Total repair costs per unit decreased by 3% to £1,929 (2013: £1,981). Planned and routine maintenance costs per unit increased by 2% to £1,015, whilst total major repairs costs per unit (including capitalised major repairs) decreased by 8%. Major repairs cost per unit has decreased by 8% to £913; the movement is largely due to the decrease in major repairs costs per unit within the stock transfer sub-sector. Stock transfer providers typically have high major repairs costs linked to initial stock improvement programmes.

Table 5 below shows how, on average, major repairs costs decrease with the maturity of the stock transfer provider.

Table 5
Stock transfer major repair costs per unit



The 6 new stock transfers which have taken place since 2011 have not reached peak levels of activity in respect of their stock improvement programmes. This is reflected in the decreasing major repairs costs for the latest stock transfers. The 6 post 2011 stock transfer providers account for less than 5% of units in the sub-sector. No new providers reported their first results in 2014 (3 stock transfers reported their first results in 2013).

Management costs per social housing unit increased by 4% to £990. The increase in the stock transfer sub-sector is 7% and the comparable increase in the traditional sub-sector is 2%.

In 2014 the depreciation of housing properties increased by 8% to £1.5 billion. The depreciation of housing properties now accounts for 15.8% of the expenditure on social housing lettings (2013: 15.2%). Depreciation as percentage of turnover has been consistent over the last 3 years at 11%.

Impairment of housing properties for social housing lettings was £34 million, compared to £50 million reported in 2013. The total impairment charge reported by the sector was £55 million in 2014 (2013: £56 million). This amount was net of a £14 million (2013: £10 million) release in the same period. Of the total impairment reported, 64% was attributable to traditional providers. The increase in impairment is largely attributable to land held for development and schemes under construction.

Table 6

Costs per unit

Indicator	Traditional	Stock transfer	Total
Management costs per unit £			
2014	1,033	936	990
2013	1,012	876	952
2012	946	860	908
% increase			
2013-14	2.0%	6.8%	4.0%
2012-13	7.0%	1.9%	4.8%
2011-12	2.4%	6.3%	4.0%
Routine and planned maintenance costs per unit £			
2014	1,000	1,035	1,015
2013	954	1,041	992
2012	947	1,019	979
% increase			
2013-14	4.8%	-0.5%	2.3%
2012-13	0.7%	2.1%	1.4%
2011-12	-4.0%	-1.8%	-3.0%
Total major repair costs per unit £			
2014	707	1,179	913
2013	744	1,297	989
2012	732	1,406	1,028
% increase			
2013-14	-4.9%	-9.1%	-7.7%
2012-13	1.6%	-7.7%	-3.8%
2011-12	22.5%	10.8%	14.8%
Major repair costs per unit (expensed) £			
2014	122	342	218
2013	124	338	219
2012	125	369	232
% increase			
2013-14	-1.5%	1.3%	-0.3%
2012-13	-0.7%	-8.5%	-5.8%
2011-12	-48.2%	-38.3%	-41.9%
Major repair costs per unit (capitalised)			
2014	585	837	695
2013	619	960	770
2012	607	1,037	796
% increase			
2013-14	-5.6%	-12.8%	-9.8%
2012-13	2.1%	-7.5%	-3.2%
2011-12	70.4%	54.6%	60.5%

Social homes in management

Table 7

Number of social homes managed

	2014	**2013**	**2012**
Social housing (no)			
Traditional	1,484,779	1,454,424	1,429,549
Stock transfer	1,153,226	1,158,851	1,121,577
Total	**2,638,005**	**2,613,275**	**2,551,126**
Social housing (% change)			
Traditional	2.1%	1.7%	1.8%
Stock transfer	-0.5%	3.3%	-0.1%
Total	**0.9%**	**2.4%**	**1.0%**

The number of social housing homes managed increased by 24,730 (0.9%). This is the lowest level of growth in social housing units managed in recent years. This is partly attributable to there being no new stock transfers in 2014. In 2013, the increase of 2.4% (62,149) included 3 new stock transfer providers reporting their results for the first time with a total additional 18,656 social housing units in management. In 2012, the increase of 1.0% (24,044) included 2 new stock transfer providers reporting their results for the first time with a total additional 23,840 units in management.

In aggregate, the percentage of homes managed in the stock transfer sub sector remains at 44% as in 2013, 2012 and 2011. In both stock transfer and traditional sub-sectors, the increase reported is net of any sales or demolitions.

Approximately 34,500 units were developed during 2013/14. This represents a slight decrease (5%) on the number of homes developed during 2012/13 of around 36,000. The growth achieved through this development was offset by a number of sales / demolitions during the period totalling 17,183 (2013: 16,822).

Transfers between providers and other movements were accountable for a net increase of approximately 4,500 units. There are a small number of providers which move in and out of the dataset each year. This is due to changes in the number of homes in management above or below the 1,000 homes threshold requirement to submit the FVA return.

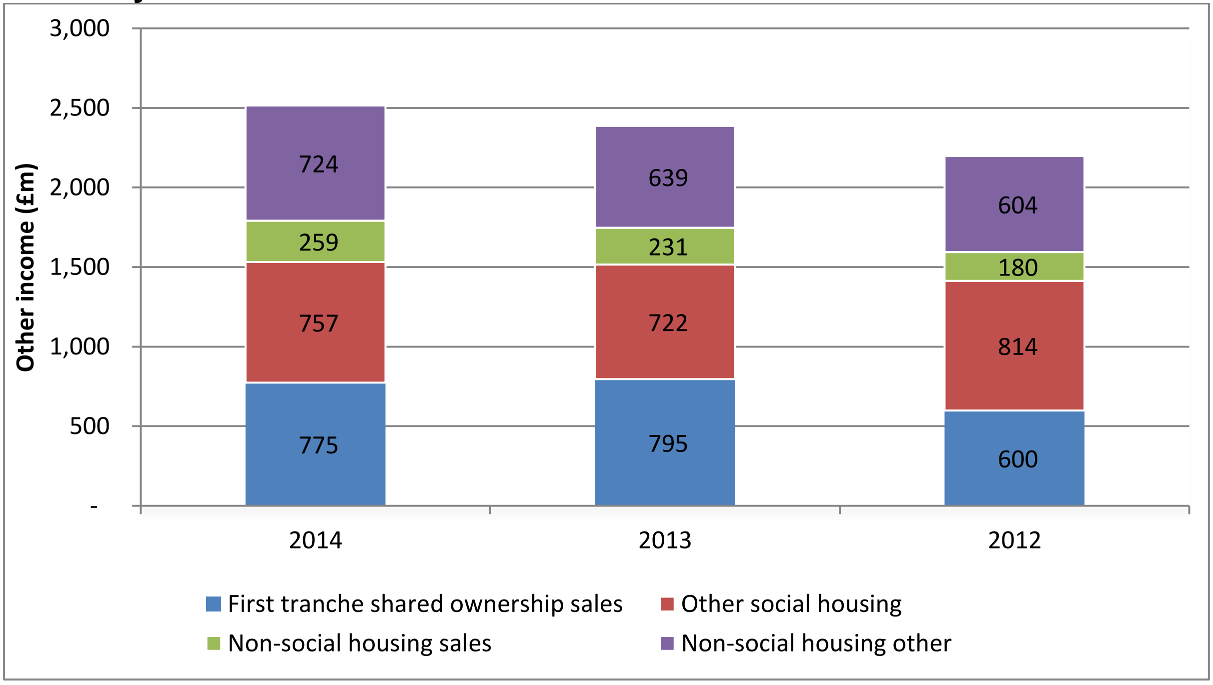
Other activities

Table 8
Income and expenditure on other activities

All figures in £m	Traditional 2014	Stock Transfer 2014	Total 2014	Total 2013	Total 2012
First tranche shared ownership sales					
Income	611	164	775	795	600
Expenditure	486	133	619	669	517
Result	**125**	**31**	**155**	**126**	**83**
Other social housing activities					
Income	640	117	757	722	814
Expenditure	669	129	797	808	842
Result	**(28)**	**(12)**	**(40)**	**(87)**	**(28)**
Non-social housing activities					
Income	778	206	983	870	784
Expenditure	707	159	866	689	675
Result	**70**	**47**	**117**	**181**	**109**
Total other activities					
Income	2,029	487	2,515	2,387	2,197
Expenditure	1,862	421	2,283	2,167	2,034
Result	**167**	**66**	**233**	**220**	**164**

The sector reported a surplus on its other activities of £233 million (2013: £220 million). Traditional providers generated 72% of this surplus compared to 76% in 2013. The surplus generated by the stock transfer sub-sector increased by £12 million (23%) to £66 million.

Figure 6
Income by other activities



Turnover from first tranche sales has decreased by 3% to £775 million. However, the surplus on first tranche shared home ownership sales increased by 23% (£29.3 million) from £126 million in 2013 to £155 million in 2014. Of this increase, £20.6 million (70%) is attributable to the traditional sub-sector. This represents an improvement in the margin from 16% in 2013 to 20% in 2014. First tranche sales activity remains concentrated with 50% of receipts attributable to just 13 providers.

Table 9

Other social housing activities

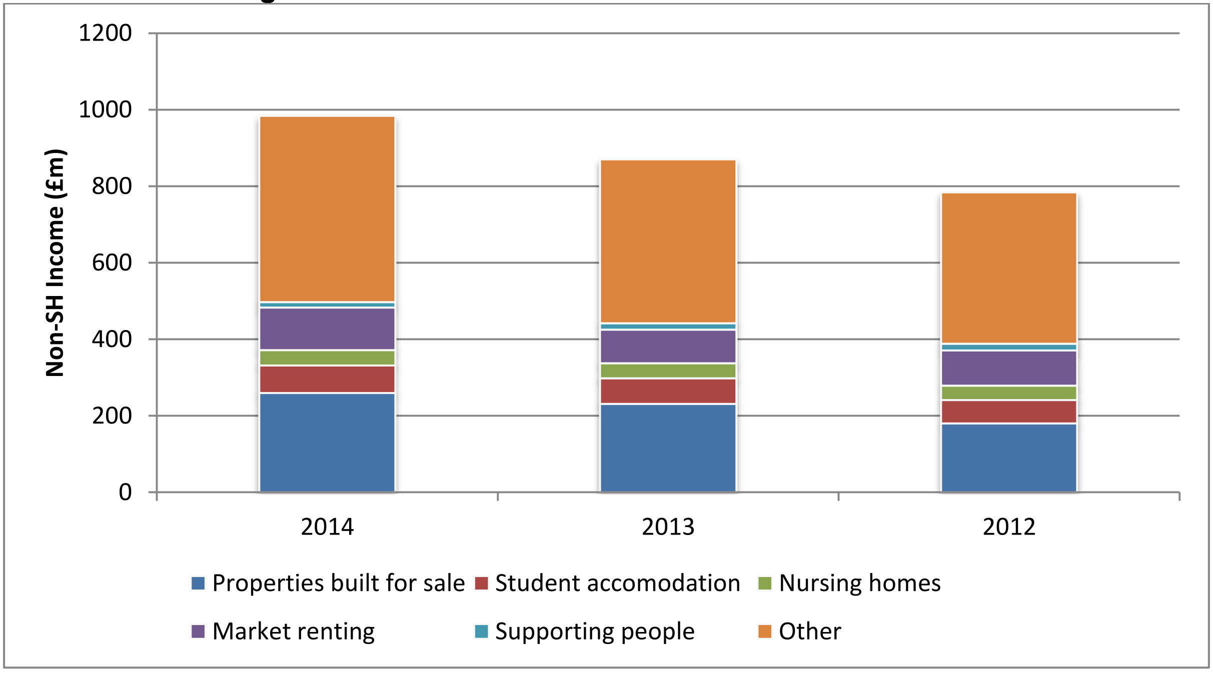
All figures in £m	2014	2013	2012
Charges for support services			
Income	239	199	NA
Expenditure	280	230	NA
Surplus / (loss)	**(40)**	**(31)**	**NA**
Other			
Income	518	523	814
Expenditure	518	579	842
Surplus / (loss)	**0**	**(56)**	**(28)**

The total income from other social housing activities (including both charges for support services and other) has increased by £36 million (5%) to £757 million. The total deficit on other social housing activities was £40 million, an improvement of £47 million on the deficit in 2013. Activities typically reported in other social housing include expenditure on regeneration, community based activities and development overheads.

Turnover from non-social housing activity has increased by £113 million (13%) to £983 million. However, the surplus from non-social housing activities has decreased by £63 million (35%) to £117 million. Overall the margin on non-social housing activities decreased from 21% to 12%. The figure below breaks down non-social housing income by source over the past 3 years.

Figure 7

Non-social housing income



In 2014, 26% of non-social housing income (£259 million) was generated through properties built for sale (2013: 27%). In total, 24% of non-social housing income is attributable to student accommodation, nursing homes, market renting and supporting people. The balance of £486 million of non-social housing income reflects a mixture of activity grouped together as other. Activities represented under 'other' include but are not limited to management services, commercial property lettings, community services and employment and training services.

The type of non-social housing activity varies by sub-sector. The majority (94%) of non-social housing activity delivered by stock transfer providers is categorised as other activity.

Non-social housing activity is concentrated in the traditional sub-sector which generated 79% of all income. Traditional providers more typically develop properties for sale, with the sub-sector being responsible for 95% of all income from this activity. This activity is concentrated within a small number of providers, with 9 traditional providers being responsible for 80% of all income from properties built for sale. In addition, the sub-sector reported 88% of all income from student accommodation and nursing homes.

Balance sheet

Fixed assets

The gross book value (GBV) of the sector's assets (total housing properties at cost and valuation) has increased by £6.8 billion to £132.7 billion. The net book value of total fixed assets has also increased by £5.6 billion to £82.0 billion. The increase in value was primarily funded by increased debt and internally generated reserves. Grant reported on the balance sheet increased by 1% (£519 million) to £45.9 billion. In 2014, 6 providers switched the basis for valuing housing properties from historic cost to valuation resulting in a circa £80 million decrease in grant reported in 2014 for these providers.

The growth in GBV (5%) is slightly less than the previous year (6%). There were no new stock transfers preparing financial statements as registered providers in 2014 (3 stock transfers reported their first results in 2013). The growth attributable to the stock transfer sub-sector decreased from 49% in 2013 to 39% in 2014.

Providers report properties in the balance sheet at either historic cost or valuation. At March 2014, 80% of the value of the sector's housing properties are shown in the balance sheet at historic cost (2013: 83%, 2012: 83%).

Current assets

Current assets have increased by £880m (9%) to £11.1bn. The most significant contributing factor is an increase in cash and short term investments. The total cash and short term investments reported in 2014 were £4.5 billion, an increase of £608 million (16%) from 2013.

It is vital that providers have sufficient access to liquid funds at all times. In 2014, there were 27 bond or private placement issues. Bonds and private placements typically involve a single large drawdown on issue. The number of issues has increased the level of cash and short term investment held by providers. Other contributory factors include timing differences between loan drawdown and development spend, stock improvement programmes and increased cashflow from sales activity.

The value of properties for sale increased by 7% (£71 million) to £1.1 billion (2013: £1 billion). This is partly due to an increase in the number of unsold Affordable Home Ownership (AHO) homes. Levels of unsold AHO are monitored through the regulator's quarterly survey of providers. The number of unsold AHO homes at 31 March 2014 was 10% higher than that at 31 March 2013. Where responses to the quarterly survey indicate material levels of unsold stock, the regulator will continue to engage closely with providers to monitor the impact of the unsold stock on their cashflow position.

Non-liquid and other current assets have increased by 4% to £5.4 billion. As a proportion of total non-liquid and other current assets, amounts attributable to intra-group balances have increased from 39% in 2013 to 48% in 2014. Approximately 89% of intra-group balances are attributable to traditional providers.

Around 25% of non-liquid and current assets are for future works, reflecting contractual arrangements between councils and stock transfer providers to complete refurbishment programmes. The amount is reported under current assets with a corresponding entry in current and/or long term liabilities.

Current liabilities

Current liabilities have decreased by £1.5 billion (22%) to £5.0 billion. This comprises a decrease in short term loans of £129 million, a decrease in bank overdrafts of £13 million and a decrease in other current liabilities of £1.3 billion.

A number of large groups provide financing for subsidiaries via treasury vehicles that borrow funds on behalf of the group to on-lend to group members. Some providers report the resulting balances in other current liabilities rather than as housing loans. The significant decrease in 2014 in other current liabilities is attributable to 1 large group reanalysing loans to more appropriately represent the element of inter-company on-lending between the treasury vehicle and the guarantor provider due after 1 year. On reanalysing inter-company loans the group has reclassified the £1.3 billion balance in 2014 as a long term creditor under amounts due to group undertakings.

Other current liabilities also include a range of items such as trade creditors, accruals, deferred income tax, Recycled Capital Grant Find (RCGF), Disposals Proceeds Fund (DPF) and rent and service charges received in advance.

Net current assets

Net current assets at March 2014 were £6.0 billion. This is an increase of £2.3 billion (63%) on 2013. This is mainly due to the significant decrease in current liabilities noted above, in conjunction with the increase in cash and short term investments. This indicates a positive position for the sector's short term solvency. However, the sector aggregate masks different provider characteristics and continued cashflow management remains essential.

Long term liabilities

In 2014 providers have been required to provide a further breakdown of long term liabilities. In addition to long term loans and other long term creditors, providers are required to disclose amounts due to group undertakings and finance lease obligations.

Total long term liabilities[8] have increased by £3.7 billion (6.8%) to £58.6 billion (2013: £3.4 billion increase to £54.9 billion). Of this increase, £2.6 billion is attributable to the traditional sub-sector, an increase of 7% on 2013. Total long term liabilities have increased by £1.2 billion (6.2%) for the stock transfer sub-sector.

In aggregate, the sector reported £6.1 billion as amounts due to group undertakings. Of this balance, £4.4 billion is attributable to the traditional sub-sector and £1.7 billion to the stock transfer sub-sector. The balances reported as amounts due to group undertakings in 2014 were reported in 2013 as long term loans (£3.4 billion), other long term creditors (£1.3 billion) and other current liabilities (£1.3 billion).

The sector reported £130 million as finance lease obligations, almost all is attributable to the traditional sub-sector. Approximately 94% of the figure is attributable to sale and leaseback agreements within 4 providers. The balances reported as finance lease obligations in 2014 were previously reported as other long term creditors.

[8] Calculated in 2013 as long term loans plus other long term creditors. Calculated in 2014 as long term loans plus amounts due to group undertakings plus finance lease obligations plus other long term creditors.

Additional disclosure - financing and reserves

In previous versions of the Global Accounts, sector debt has been calculated as long term loans plus short term debt. In 2014, the basis for calculating debt has been amended to include amounts due to group undertakings and finance lease obligations. The additional disclosures have been added to provide additional information of the types of finance held by providers. Providers should understand the implications, obligations and risks associated with the new debt arrangements they enter into.

As identified above, the additional disclosure includes balances (approximately £1.3 billion) previously disclosed as other long term creditors. In order to ensure comparability with previous year's Global Accounts, it is necessary to include other long term creditors in the calculation of debt. The table below summarises the impact of the additional disclosure on reported loans and other long term creditors.

Table 10
Financing

	2014 (£m)	2013 (£m)	2012 (£m)	2014 % change	2013 % change	2012 % change
Short term loans	694	823	612	-15.7%	34.5%	-9.9%
Long term loans	50,706	51,215	47,869	-1.0%	7.0%	7.9%
Amounts owed to group undertakings	6,119	NA	NA	NA	NA	NA
Finance lease obligations	130	NA	NA	NA	NA	NA
Other long term creditors	1,635	3,659	3,562	-55.3%	2.7%	0.3%
Total	**59,285**	**55,698**	**52,043**	**6.4%**	**7.0%**	**7.1%**

Including other long term creditors, total debt has increased by £3.6 billion (6.4%) to £59.3 billion. This increase is partly attributable to the decision by one group to reclassify £1.3 billion of inter-group lending as a long term creditor from other current liabilities. Of the overall increase in debt, £2.4 billion is attributable to the traditional sub-sector (an increase of 6.6% on 2013) and £1.2 billion to the stock transfer sub-sector (6.2%).

Refinancing risk can be expressed in terms of the percentage of loans that are due to be repaid within 1 year. The sector's immediate refinancing risk remains low; short term loans have decreased by (£129 million) to £694 million. This represents 1.2% of all outstanding debt (2013: 1.5%, 2012: 1.2%). The percentage of facilities due for repayment in the next 2 years is slightly lower than that reported in the previous 3 years.

Refinancing risk for the sector as a whole remains low, 2 providers have over 50% of their loans due to be repaid within one year (2013: 1 provider, 2012: 4 providers). In one case, the short term debt disclosed by the provider is actually the revolver element of a long term facility. In the second case, the provider in question is a relatively small subsidiary within a large group. Treasury arrangements are managed at group level and the overall percentage of short term debt within the group structure is not a concern.

The financial arrangements of all providers are monitored closely by the regulator through the quarterly survey of providers and it will continue to engage with the sector to gain assurance that providers have access to the liquidity they require.

Reserves

Reserves are not ‘cash backed’ as the surpluses transferred to balance sheet reserves are reinvested in the providers’ businesses, including the major repairs of existing stock and the development of new homes.

At March 2014, the sector had reinvested £12.7 billion (73%) of its reserves, excluding the revaluation reserve, into existing stock and new supply (2013: 82%, 2012: 88%). The significant decrease in the reinvestment ratio is as a result of 1 large group reclassifying inter-company lending. The reclassification has increased long term creditors by £1.3 billion in the current year. If the reclassification had not been undertaken, the sector would have reinvested 80% of its reserves into existing stock and new supply. Section C3 provides further analysis and narrative on how reported surpluses and reserves have been utilised by the sector.

The balance of the sector’s reserves of £4.8 billion (27%) is retained within the balance sheet to be re-invested in the future. The amount of the reserves not reinvested has increased by £2.1 billion in 2014 improving the net current assets position of the sector. Providers must have sufficient net current assets including cash to meet all financial liabilities as they fall due. The majority of reserves not reinvested have been identified as being a reclassification of inter-company lending of £1.3 billion as a long term liability in one provider and an increase in cash balances of £570 million.

Total reserves increased by £4.1 billion (13%) to £27.4 billion. The accumulated surplus increased by 20% (£2.7 billion) to £16.3 billion. In 2013, the accumulated surplus increased by £1.8 billion (15%). In 2014, prior period adjustments accounted for a £84 million increase in the accumulated surplus carried forward (2013: £112 million decrease).

The revaluation reserve has increased by £1.3 billion (15%) to £10.0 billion and this represents 37% of total reserves (2013: 37%). Six providers have changed accounting policy for housing properties from cost to valuation. As valuation of properties on an existing use basis is generally higher than historic cost, the revaluation reserve reported by these 6 providers has increased by £370 million.

The majority of the increase in revaluation reserves is attributable to the stock transfer sub-sector with revaluation reserves increased by £963 million to £7.2 billion. The increase is largely attributable to stock improvement programmes and the revaluation of properties at EUV-SH in the year which has resulted in the properties having increased in value.

The actuarial gain on pension schemes totalled £166 million (2013: loss of £196 million). The gain on pension schemes in 2014 contributed to a decrease in the pension liability in the balance sheet of 25% to £724 million. The loss on pension schemes in 2013 contributed to a 40% increase in the pension liability.

Key financial ratios

A number of the ratios included in previous Global Accounts publications have been restated. As mentioned earlier in the document, 2 additional disclosures have been added to the long term liabilities section of the balance sheet to provide further information on the types of finance held by providers. To ensure comparability with the 2 previous years, we have recalculated sector debt to include long term loans, short term loans, amounts due to group undertakings, finance lease obligations and other long term creditors. The ratios where this restatement is applicable are highlighted in the Tables 12, 13 and 14 below.

Table 11

Indicators of operational performance

% of gross rent	2014	2013	2012
Voids for the year			
Sector	1.8%	1.7%	1.8%
Traditional providers	2.0%	1.9%	2.0%
Stock transfers	1.7%	1.5%	1.5%
Bad debts for the year			
Sector	1.0%	0.9%	0.8%
Traditional providers	1.0%	0.9%	0.8%
Stock transfers	1.0%	0.8%	0.7%
Current tenant arrears at the end of the year			
Sector	4.7%	4.8%	4.8%
Traditional providers	5.1%	5.3%	5.4%
Stock transfers	4.1%	4.0%	3.9%

The introduction of significant welfare reforms, such as reductions in Housing Benefit to under occupying households, partially came into force from April 2013. The roll out of a programme of reforms, including Universal Credit, will continue up to 2020. Bad debts, voids and current tenant arrears are used by the regulator as key performance indicators in assessing the impact of welfare reform.

In 2014, the proportion of bad debts reported as a percentage of gross rent increased by 16%. Voids as a percentage of gross rent have also increased by 6.3% from 2013. Current tenant arrears have remained relatively stable in comparison with 2013 levels.

It is not possible to directly attribute movement in voids, bad debts and arrears to the changes brought in by welfare reform. The regulator continues to monitor performance against welfare reform indicators through the quarterly survey and SDR.

The key financial ratios, identified in Tables 11 to 14, summarise the overall performance trends in the period and assist in understanding the main drivers of financial performance and balance sheet strength in the sector.

Table 12

Growth ratios by sub-sector

	2014	2013	2012
Growth in turnover			
Sector	5.2%	8.1%	8.7%
Traditional providers	5.7%	8.1%	9.6%
Stock transfers	4.3%	8.0%	7.2%
Growth in total assets			
Sector	5.3%	6.3%	5.6%
Traditional providers	4.4%	4.0%	5.7%
Stock transfers	7.7%	12.7%	5.3%
Growth in total debt[9]			
Sector	6.4%	7.0%	7.1%
Traditional providers	6.6%	4.7%	10.4%
Stock transfers	6.2%	11.8%	0.7%

The ratios show that the sector has continued to grow with an increase in total assets of 5.3%. This is a lower rate of growth compared to 2013 (6.3% growth) and it remains significantly below peak growth levels of 12% achieved in 2008 and 2009. There have been no new stock transfers in 2014.

Table 13

Profitability ratios

	2014	2013	2012
Operating margin			
Sector	26.5%	25.9%	23.4%
Traditional providers	26.1%	25.5%	22.8%
Stock transfers	27.2%	26.7%	24.5%
Effective interest rate[9]			
Sector	4.7%	4.8%	4.8%
Traditional providers	4.8%	4.9%	4.9%
Stock transfers	4.5%	4.5%	4.6%

The traditional sub-sector had a higher operating margin on social housing lettings (31%) than the stock transfer sub-sector (28%) caused primarily by lower major repairs and maintenance expenditure overall. However, the stock transfer sub-sector demonstrated higher profitability with an overall operating margin of 27.2%. This is a result of the stock transfer sub-sector generating significantly higher margins on non-social housing activity (23%) compared to the traditional sub-sector (9%).

[9] Ratio restated as set out in narrative on page 25.

Table 14

Debt servicing ability

	2014	2013	2012
EBITDA MRI interest cover			
Sector	153.7%	138.0%	115.7%
Traditional providers	157.8%	147.3%	128.0%
Stock transfers	145.1%	118.3%	87.9%
EBITDA MRI interest cover social housing lettings			
Sector	145.3%	129.7%	109.1%
Traditional providers	148.9%	138.0%	122.0%
Stock transfers	137.7%	111.9%	80.1%
EBITDA MRI margin			
Sector	27.3%	24.6%	21.0%
Traditional providers	30.0%	28.4%	25.5%
Stock transfers	22.6%	18.2%	13.3%
Adjusted net leverage[10]			
Sector	42.8%	43.0%	43.4%
Traditional providers	39.4%	39.0%	39.3%
Stock transfers	51.6%	53.8%	55.4%
Gearing[10]			
Sector	93.8%	92.9%	92.2%
Traditional providers	73.8%	72.1%	71.9%
Stock transfers	202.2%	215.0%	226.6%
Debt to turnover			
Sector	379.2%	374.8%	378.5%
Traditional providers	397.5%	394.3%	407.0%
Stock transfers	347.6%	341.5%	329.8%
Debt per unit (£)[10]			
Sector	22,474	21,313	20,400
Traditional providers	26,540	25,421	24,693
Stock transfers	17,238	16,159	14,928

The regulator measures interest cover for the sector using the EBITDA MRI interest cover ratio. Interest cover increased from 138.0% to 153.7% demonstrating that the sector as a whole has generated enough surplus to meet its interest payments with no reliance on the sale of fixed assets.

The key driver for the increase in EBITDA MRI interest cover is improved margin. EBITDA MRI margin increased by 17% in 2013 and 11% in 2014. The effective interest rate and debt to turnover have remained relatively stable over the two year period.

The biggest improvement in interest cover in recent years is in the stock-transfer sub-sector with interest cover increasing to 145.1% in 2014 from 87.9% in 2012. This has been driven by an increase in EBITDA MRI margin of 37% in 2013 and 24% in 2014. In their early years, stock transfer providers are usually undertaking high levels of improvement works resulting in high deficits and low levels of interest cover.

[10] Ratio restated as set out in narrative on page 25.

Underlying the overall position, is a range of performance where 57 out of 336 providers (2013: 80 out of 339 providers) had an EBITDA MRI interest cover ratio below 100% of which 38 were stock transfer providers.

It should be noted that this interest cover measure includes less certain cash flows generated from first tranche sales and properties developed for sale. Total other activities contributed to 6% of the total operating surplus (2013: 6%, 2012: 5%). The performance of the traditional sub-sector continued to improve with a growth in interest cover from 147% in 2013 to 158% in 2014.

The EBITDA MRI interest cover social housing lettings has increased from 109.1% in 2012 to 145.3% in 2014. The biggest improvement in interest cover is within the stock-transfer sub-sector with interest cover increasing from 80.1% in 2012 to 137.7% in 2014 and is attributable to the growing maturity of the sector.

Gearing for the traditional sub-sector has increased by 1% to 93.8% in 2014. However, the growing maturity of stock transfer providers continues to provide downward pressure on gearing across the sector as whole. Gearing for the sub-sector has fallen from 575% in 2008 to 202% in 2014 (2013: 215%). Downward pressure on gearing also comes from an increase in reserves largely driven by accumulated surpluses.

The 6.4% increase in external debt was not matched by the increase in homes which only increased by 0.9%. Therefore, the debt per social housing unit has risen by 5.4% to £22,474 (2013: £21,313). Debt per social housing unit has increased by 4.4% for the traditional sub-sector to £26,540 per unit and by 6.7% in the stock transfer sub-sector to £17,238.

Part C – Thematic analyses

C1 – Private funding market

Introduction

The 2013/14 year saw registered providers access an unprecedented variety of sources of funding. Though the growth of debt capital market funding to over half of new debt raised was the largest development in numerical terms, some new funding sources opened up and others became more established. The launch of the Affordable Homes Guarantee Programme in January 2014 provided a new departure for government-linked financing to the sector, while a small number of local authorities have on-lent from their public works loan board facilities.

Total debt-raising in the year was £100 million higher than in 2012/13, at £5.6 billion. This was split between around £2.3 billion of incremental growth in debt, and £3.3 billion of refinancing or restructuring existing facilities. The year-on-year stability in debt raising reflects progress through the 2011-15 Affordable Housing Programme, with many providers having previously secured facilities to take them through to the end of the programme and a lack of recent stock transfers. Forecasts from the HCA quarterly survey indicate that debt raising and net indebtedness will both increase substantially over the next 3 years.

Bank market

The bank market has seen considerable consolidation since 2008, with mergers and withdrawals from the market bringing the number of large active lenders down to 5 – Barclays, Lloyds, Nationwide, Santander and RBS – with around 10 further lenders currently active, mainly at the smaller end of the market. During the 2013/14 year, the Co-operative Bank and Newcastle Building Society announced plans to manage down their exposure to the sector, while more recent entrants to the sector such as Triodos and MetroBank expanded their operations. In addition, the European Investment Bank and HSBC made a small number of loans. In total, providers reported borrowings from 28 bank and building society lenders at 31 March 2014.

New bank lending over the year totalled £2.5 billion, just under half of which was raised in the last quarter of the year. The increase in new funding raised reflects both a greater demand for new funding, particularly for AHP commitments, and increasing competition in the market bringing the cost of new lending down.

Lenders report increasing interest from providers in restructuring and refinancing existing lending, which in part reflects the availability of capital market alternatives to bank facilities but also a greater willingness on the part of borrowers to accept changes to the terms of their current loans. Many bank loans from the late 2000s were made at rates which are no longer profitable for lenders, leading them to re-price lending when the opportunity arose – for example, when a borrower was looking for increased facilities, or when lender consent to a corporate restructure was required. This led to some reluctance on the part of borrowers to approach their lenders for fear of losing beneficial rates. A combination of changing approaches to repricing (e.g. a smaller increase in margin with a decrease in term, rather than a large increase) and borrowers' need for funds appear to have opened up these discussions.

Over the year new term loans were available for most medium and large providers for periods up to 10 years, with pricing around 130-200 basis points (bps) over LIBOR.

Increasingly, providers are using revolving credit facilities for short-term needs, combined with capital market funding for the longer term. These facilities add extra flexibility in terms of cost and security use to the relationship benefits of bank funding. However, the bank market is not in most cases meeting larger providers' need for longer term funding. As a result, the basic treasury model of the sector is changing, introducing new tiers of short- (overdraft and revolving) and medium-term facilities to long-dated debt from existing bank facilities and the capital markets. This will in turn increase the refinancing needs of the sector in the next 10 years as both new and existing loans expire together.

Capital markets

Over 2013/14, providers issued £2.9 billion of bonds in the debt capital markets, similar to the amount raised in the previous year. The market for bond financing has continued to expand, with an increased range of institutions buying provider paper and a variety of structures being established. Typical institutional interest is from pension and life funds looking to match long-dated liabilities with an index-related income stream.

Around £500 million was raised through private placements, where the provider strikes a bilateral deal with a single investor. The size of these issues has continued to reduce, the smallest in the year being £25 million with an all-in cost only slightly higher than larger issues. At the other end of the market, there were 2 benchmark (£250 million or more) issues and a further ten of over £100 million. Pricing of these issues was between 95bps and 140bps over gilts with tenors mainly between 30 and 35 years. This relatively narrow range is also reflected in provider credit ratings, which are all between A and Aa3.

Some smaller providers that did not have the scale or the need for an own-name issue were able to access the debt capital markets through aggregated issues by The Housing Finance Corporation (THFC). Its £161m of issuance was priced below most own-name issues at 105bps over gilts.

During the year, the second retail bond in the sector was issued, unsecured and in denominations available to private individual investors. While this could open up new sources of capital to providers, most of the issue was bought by similar funds to other issues. Other new structures for the sector in the year included varied tenors under the same issue and a forward fix of a large retained element.

Debt capital market funding has increasingly offered a source of long-dated funding for providers in the space previously occupied by the banks. Demand for provider bonds is currently high, partly reflecting the fit of the sector with funds' needs, and also a relatively limited range of alternative long-dated sterling opportunities. The development of the private placement market has offered these opportunities to smaller providers. However, bond financing has its disadvantages in its relative lack of flexibility, more complex and expensive arrangement processes and higher exit costs.

Innovations

2013/14 saw the first government guaranteed debt made available to providers under the Affordable Homes Guarantee Programme through THFC's subsidiary, Affordable Housing Finance. The guarantee backed a £500 million loan from the EIB for on-lending to providers: AHF has subsequently issued its own bonds. The combination of the government guarantee and EIB's AAA rating resulted in very low on-lending rates to providers, at around 40bps over gilts. This funding source is only available for new development.

Providers raised around £65 million in leaseback funding, on both social and non-social housing properties, with 2 more substantial transactions (£300 million) completing shortly after the year end. There has been limited interest in leaseback structures from the sector, perhaps reflecting a perception of complexity or inflexibility, and the ready availability of other sources of funding at favourable rates.

Conclusion

The sector remains an appealing lending prospect for both the banks and capital markets, with the strong asset base, predictable income streams and government support through Housing Benefit and regulation combining to produce favourable pricing. The ready availability of debt capital market finance has continued into 2014/15, with the fall in the gilt rate further decreasing the cost of capital.

C2 – Financial forecasts and development

Dataset

The regulator collects financial forecast returns (FFRs) from all providers owning and/or managing 1,000 units or more. The returns represent the financial basis of the organisation's business plans. Consequently, they are completed at the level at which providers plan their businesses, be that at group or subsidiary level. The majority of providers submit a 30 year FFR, although traditional providers undertaking very little development are permitted to submit a 5 year FFR.

The following analysis is taken from a dataset of FFRs, excluding returns received at subsidiary level where a group return is also received. Providers' business plans are commercially sensitive and as a consequence, this analysis focuses on trends in the aggregate data and the underlying data source will not be made publicly available.

The FFRs were submitted following two significant policy announcements. Firstly, the new rent settlement post March 2015, linking rents to CPI +1% and removing upward convergence where rent levels are below target rents, was announced in 2014. Secondly, the bidding round for the Affordable Homes Programme (AHP) 2015-18 and The Mayor's Housing Covenant (TMHC) 2015-18 were completed in 2014. The impacts of both policy developments on provider business plans are reflected in the financial forecasts submitted.

It is important to note that this information is from forecast business plans and as such reflects the providers' assumptions about interest rates, house prices, inflation etc. which are only indicative of what might happen. As we demonstrate below, changes in the key assumptions can have a significant impact on the forecast outcomes, so these results should be considered to be a guide to what might happen rather than the guaranteed performance of the sector.

Headlines

The analysis focuses on the first 5 financial years, the period from 2014/15 to 2018/19. In aggregate, the sector continues to show strong financial performance with EBITDA MRI interest cover of 157% over the 5 year period. In comparison, the forecasts submitted in the previous year showed an aggregate EBITDA MRI interest cover of 146% over the first 5 forecast years.

This aggregate masks variable performance within individual providers. Twenty one providers (8% of the sector) have an aggregate 5 year interest cover below 100%. Of this group, over 80% are stock transfer providers.

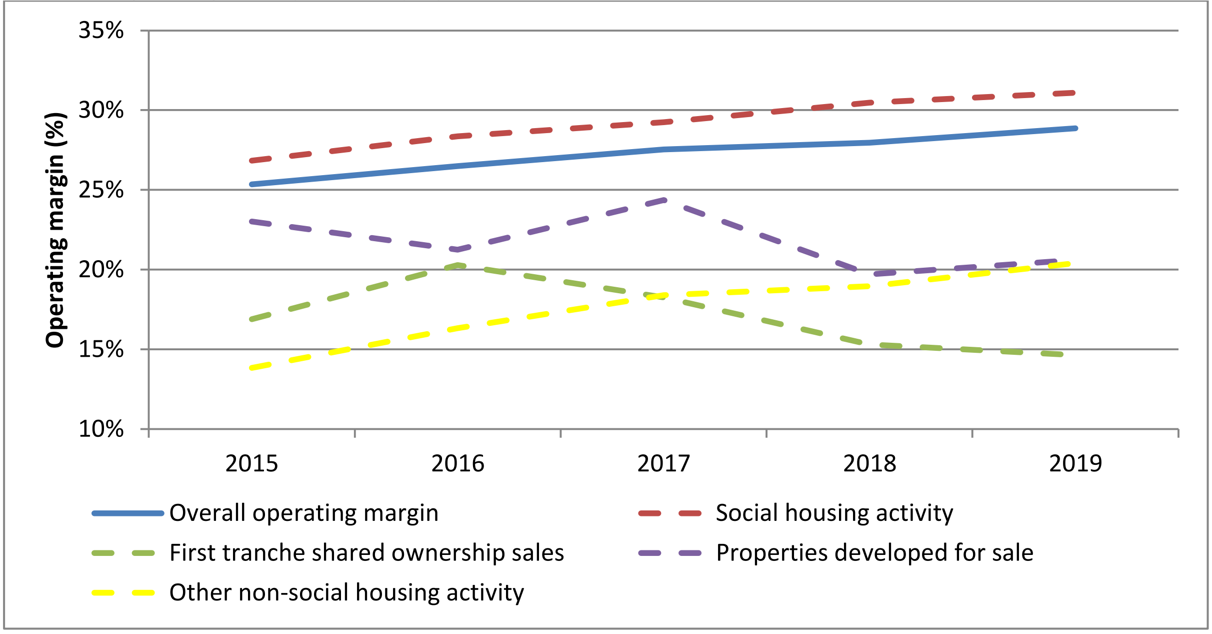
In the year ending 2015, development is dominated by the back loading of the AHP 2011-15. In aggregate, the sector is forecasting to develop 73,000 units in the year. This level of development is broadly comparable with the forecasts submitted in the previous year. However, between 2015/16 and 2018/19 the sector is forecasting development of 212,000 units. The forecasts submitted in the previous year included the development of only 135,000 units over the same time period. This forecast increase is partly attributable to the inclusion of development under the AHP and TMHC 2015-18.

The exposure to the housing market increases throughout the first 5 forecast years. The sales income forecast from first tranche shared ownership and properties for outright sale increases from just under £2 billion in the year ending 2015 to over £3 billion in each of 2017, 2018 and 2019.

Over the first 5 forecast years, 76% of turnover is attributable to social housing lettings. This is a slight decrease from the comparable figure derived from forecasts submitted in the previous year of 78%. However, at an aggregate level, the sector is not reliant on diverse activities. The forecasts show that diverse activities have a lower margin than social housing activities, raising questions as to the extent to which such activities cross subsidise traditional social housing lettings.

Figure 8

Operating margins by activity type



The margin on social housing lettings increases from 27% to 31% over the forecast period. The delivery of this margin will be challenged by risks to income from welfare reform. Controlling costs remains equally important. Forecasts show that the sector will spend over £2.5 billion a year on major repairs to maintain the value of existing stock.

Financial statements

As outlined elsewhere in this report, the sector has demonstrated a strong financial performance in recent years. This is projected to continue in the future, with a forecast retained surplus rising from 11% in 2015 to 13% in 2019. The sector is forecast to continue to grow its surpluses with revenues rising at a faster rate than operating costs. This offsets the impact of increased interest costs as a result of an anticipated increase in effective interest rates and additional borrowings.

Table 15
Summary income and expenditure account

All figures £m	2015	2016	2017	2018	2019
Turnover	17,692	19,617	20,680	21,401	21,872
Operating Expenditure	(13,209)	(14,419)	(14,984)	(15,418)	(15,561)
Operating surplus	**4,483**	**5,198**	**5,696**	**5,983**	**6,311**
Profit/(loss) on the sale of fixed assets	293	290	265	269	277
Surplus before interest and Tax (SBIT)	**4,777**	**5,487**	**5,962**	**6,252**	**6,588**
Interest and Other finance costs	(2,775)	(3,041)	(3,274)	(3,513)	(3,756)
Surplus for the year before tax	**2,002**	**2,446**	**2,687**	**2,739**	**2,832**
Tax	(13)	(16)	(18)	(19)	(24)
Surplus for the year	**1,989**	**2,430**	**2,669**	**2,719**	**2,808**

The aggregate operating margin is expected to increase from 25% in year 2015 to 29% in year 2019. Projected interest cover, on a revenue basis, is very strong being above 170% in each year.

The majority of providers submit a 30 year FFR at group level. Therefore, forecasts include activities within unregistered subsidiaries and joint ventures. The Global Accounts is based on the audited annual accounts of registered providers which does not include consolidated group structures. As a result, the headline figures identified in Table 15 vary from those reported in Section B of this document.

The forecast surplus generated in 2015 is lower than the surplus reported in 2014. However, this is largely attributable to the following 2 factors.

- forecast sales of fixed assets tend to be lower than actuals as providers only include sales for which they are at an advanced stage of negotiation. In 2015, the sector is forecasting a surplus on fixed asset sales of £293 million - some £337 million less than the surplus achieved in 2014
- in the stock transfer sub-sector, covenants are often cashflow based and therefore the distinction between capitalised and expensed major repairs in forecasts is not so relevant. In 2014, the sector capitalised 76.1% of major repairs expenditure compared to a forecast capitalisation rate of 72.6% in 2015. Adjusting the capitalisation rate to the reported level of 2014 would increase the surplus forecast in 2015 by £102m

Adjusting for fixed asset sales and capitalisation rate, the forecast surplus for 2015 would be circa £2.4 billion, broadly comparable with that reported in 2014. The difference between forecast and reported surplus is also partially attributable to providers adopting more conservative and prudent assumptions in their forecasts.

Table 16

Summary balance sheet

All figures £m	**2015**	**2016**	**2017**	**2018**	**2019**
Total fixed assets	91,326	97,993	103,898	109,245	113,289
Net current assets including pension assets	4,620	3,760	3,815	3,368	3,479
Total assets less current liabilities	**95,946**	**101,754**	**107,713**	**112,613**	**116,769**
Long term loans & provisions	66,555	69,590	72,415	74,167	74,963
Reserves	29,391	32,163	35,299	38,446	41,806
Total loans provisions and reserves	**95,946**	**101,754**	**107,713**	**112,613**	**116,769**

The projected aggregated balance sheet of the sector shows that there is an expected significant increase in the asset base driven by investment in new supply and existing stock. This is being financed by debt, internally generated reserves and, to a lesser extent, grant funding. Loans increase from £65.1 billion in 2015, peaking at 74.3 billion in 2019. As indicated elsewhere in the report, this is partially attributable to increased development activity and the inclusion of AHP 2015-18 and TMHC 2015-18 in this year's forecasts.

Retained surpluses are expected to total £12.6 billion across the first 5 forecast years, with reserves further bolstered by £2.0 billion of anticipated upward revaluations of the fixed asset base.

Capital grants recorded on the balance sheet increase from £47.2 billion in 2015 to £49.2 billion in 2019. At an aggregate sector level, gearing peaks in 2016 at 88%[11]. For the stock transfer sub-sector, gearing levels decrease from 145% in 2015 to 121% in 2019 as reserves increase. In the traditional sub-sector, gearing peaks in 2016 at 79%, reflecting projected investment in new supply. Net debt as a percentage of turnover[12] peaks in 2015 at 363%, falling to 336% in 2019.

[11] Forecast gearing is not directly comparable with actual levels of indebtedness reported in 2014 in Section B. Revaluation reserves are excluded from the gearing calculation referenced in section B. The forecasts submitted by providers do not isolate revaluation reserves from other reserves.

[12] Net debt to turnover: Long term loans plus short term debt plus other long term creditors less cash and short term investments.

Table 17
Summary cashflow statement

All figures £m	2015	2016	2017	2018	2019
Operating cashflows	4,121	5,192	5,860	6,192	6,582
Interest cashflows	(3,007)	(3,298)	(3,546)	(3,802)	(4,000)
Payments to acquire or develop properties	(9,333)	(7,159)	(6,172)	(5,033)	(3,813)
Fixed asset sales	898	696	645	566	588
Grant	992	658	567	436	221
Other cashflows	(475)	(287)	(172)	(225)	(238)
Cashflow before resources and funding	**(6,804)**	**(4,198)**	**(2,817)**	**(1,867)**	**(660)**
Increase in Med and LT Debt	6,770	5,432	4,949	4,198	3,627
Loan repayments	(1,547)	(1,566)	(2,583)	(2,740)	(2,586)
Other financing cashflows	(154)	48	160	274	93
Financing cashflows	**5,069**	**3,914**	**2,526**	**1,733**	**1,134**
Cash Increase / (Decrease)	(1,735)	(284)	(290)	(134)	473

Operating cashflows include capitalised major repairs spending, exclude depreciation and therefore differ from operating surplus. Interest cover on this cash basis is projected to increase from 137% in 2015 to 165% in 2019. This equates to a total free cashflow[13] from operations of £10.3 billion over the period with an increase from £1.1 billion in 2015 to £2.6 billion in 2019. This free cashflow is projected to support a total of £31.5 billion investment in new supply over the same period. Over the first 5 forecast years, medium and long term debt is expected to increase by £25.0 billion with loan repayments of £11.0 billion.

Development and new supply

In the previous year's forecasts, levels of development and new supply decreased after 2015 coinciding with the end of the AHP 2011-15. In July 2014, initial grant funding allocations of £1.3 billion were made for the Affordable Homes Programme 2015-18[14] and The Mayor's Housing Covenant 2015-18[15]. Additional allocations continue to be made through continuous market engagement with the sector.

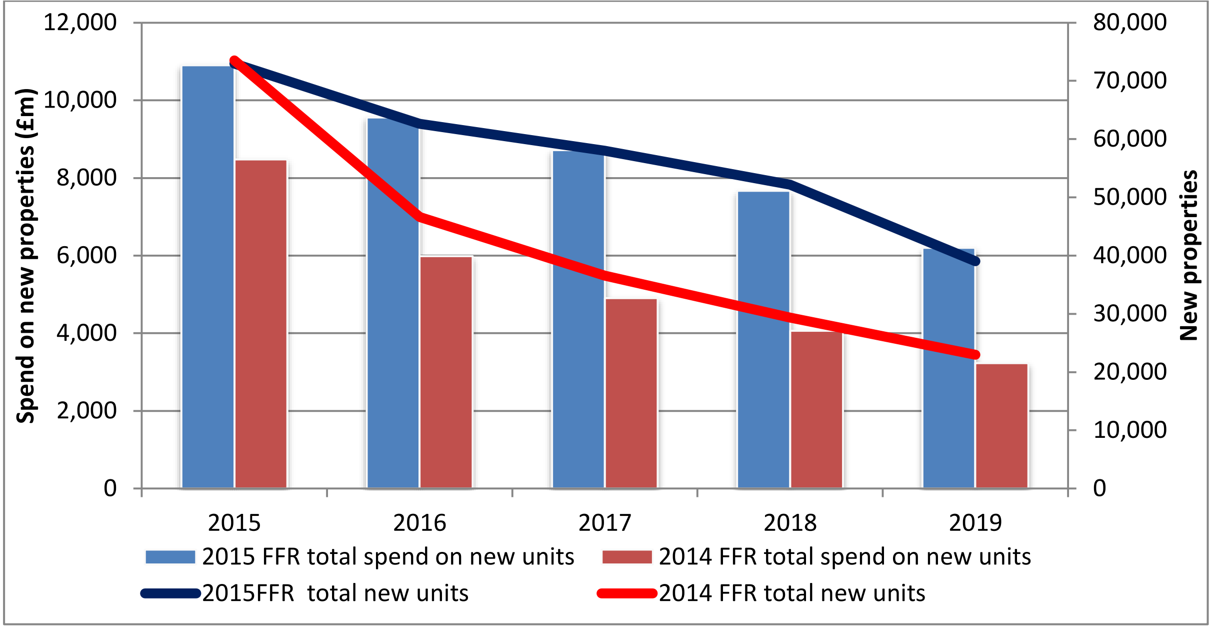
The inclusion of the new investment programmes has, in part, contributed to a significant aggregate increase in forecast development activity and investment in new supply. Throughout this section, a comparison is made between current FFR dataset (first forecast year ending 2015) based on forecasts submitted this year and last year's FFR dataset (first forecast year ending 2014) based on forecasts submitted in the previous year. The figure below demonstrates the movement in development activity between the 2 sets of forecasts.

[13] Free cash flow – Earnings before Interest, Tax, Depreciation and Amortisation less interest costs

[14] www.gov.uk/government/collections/affordable-homes-programme-2015-to-2018-guidance-and-allocations#allocations

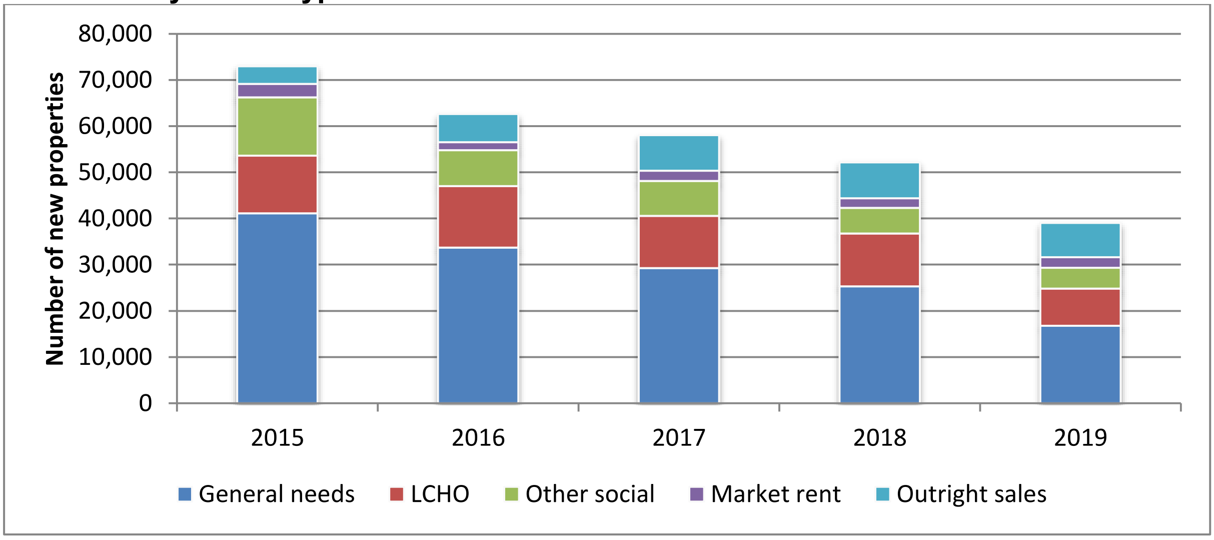
[15] www.london.gov.uk/priorities/housing-land/increasing-housing-supply/mayor-housing-covenant-2015-2018

Figure 9
Comparison of forecast spend on new properties and the number of new units[16]



Based on the latest forecast data, between 2015 and 2019, the sector will spend £43 billion on new properties and develop 285,000 new units. The comparable figures over the same time period in last year's forecasts were £29 billion spend and 209,000 new properties. This represents a 36% increase in the number of new units forecast to be developed over the 5 year period.

Figure 10
New units by tenure type



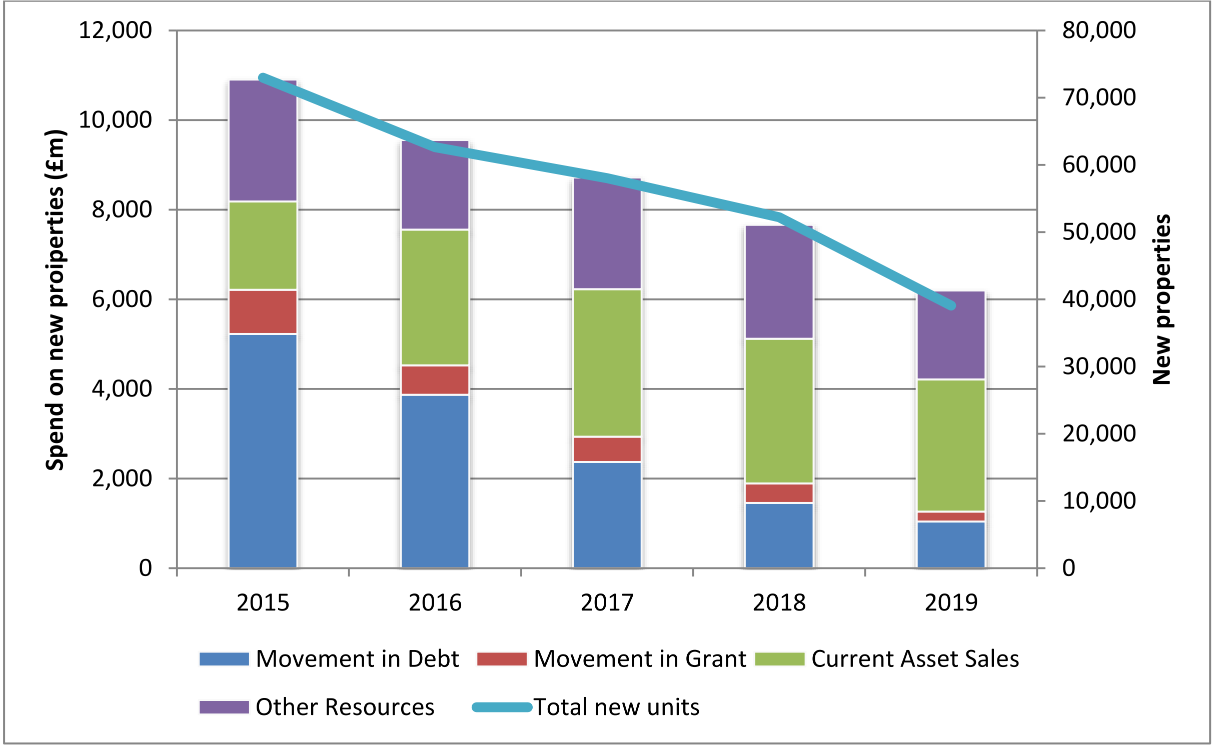
Over 50% of all new units developed over the 5 year forecast period will be general needs rented units. The number of units developed for outright sale as a percentage of all units developed increases from 5% in 2015 to 19% in 2019.

An increased scale of development in turn increases the reliance on debt and levels of exposure to finance market risk. Based on the latest forecasts, between 2015 and 2019 the

[16] Total spend on properties includes payments to acquire or develop properties, cost of sales: shared ownership first tranche and cost of sales: properties developed for sale.

sector will raise £25 billion in debt offset by repayments of £11 billion over the same period. Over the same time in the previous forecasts, the comparable figures were £15 billion raised and £11 billion repaid.

Figure 11
Spend on new properties & new units



Total spend on new properties decreases steadily over the first 5 forecast years. In 2015, 48% of the activity will be funded through borrowing. Over the initial 3 year development period, £11.5 billion of the total spend will be financed through debt.

Other resources become increasingly significant contributors to the financing of new development, moving from 25% of all funding required in 2015 to 32% in 2019. A high proportion of other resources relates to surpluses reinvested into development programmes.

Providers are increasingly reliant on sales activity to cross subsidise development of properties for rent. Current assets sales are an increasingly significant source of financing of new development, moving from 18% in 2015 to 48% in 2019.

The sector in aggregate is forecasting to develop 89,000 units for sale (either AHO or outright sale) over the first 5 years of the forecast. In comparison to last year's forecasts, this represents an increase of over 20,000 units. In total 31% of all new units developed over this 5 year period will be for sale rather than rent.

Figure 12

Comparison of forecast sales income

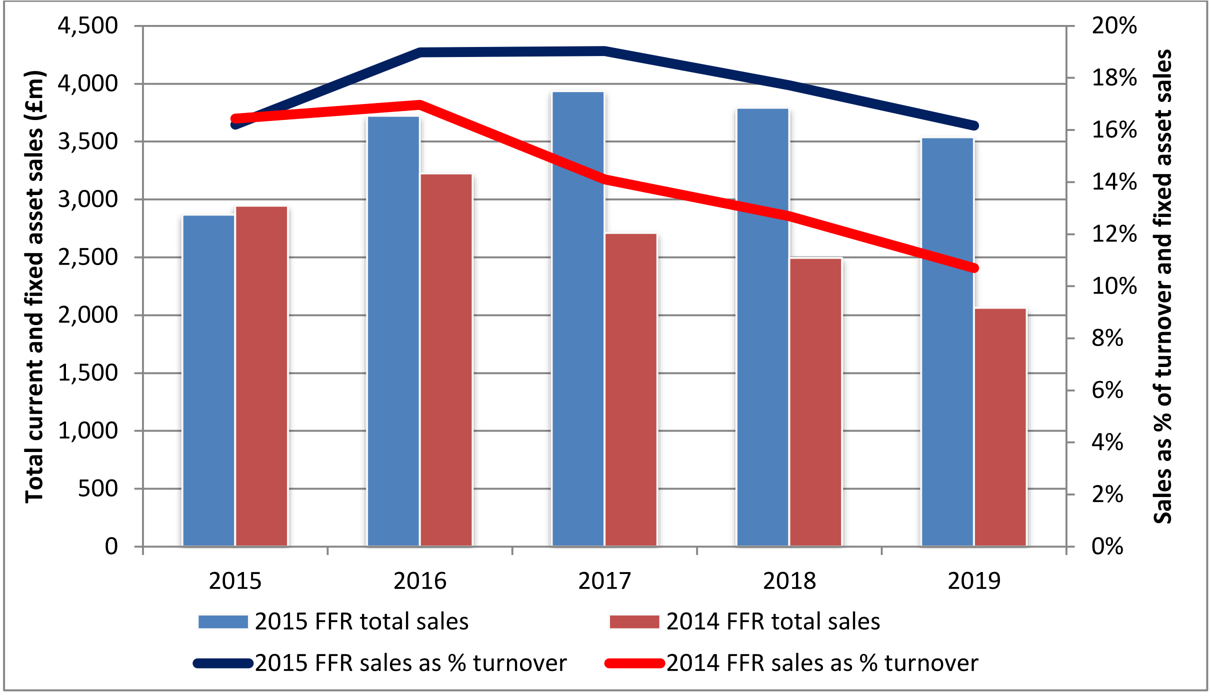
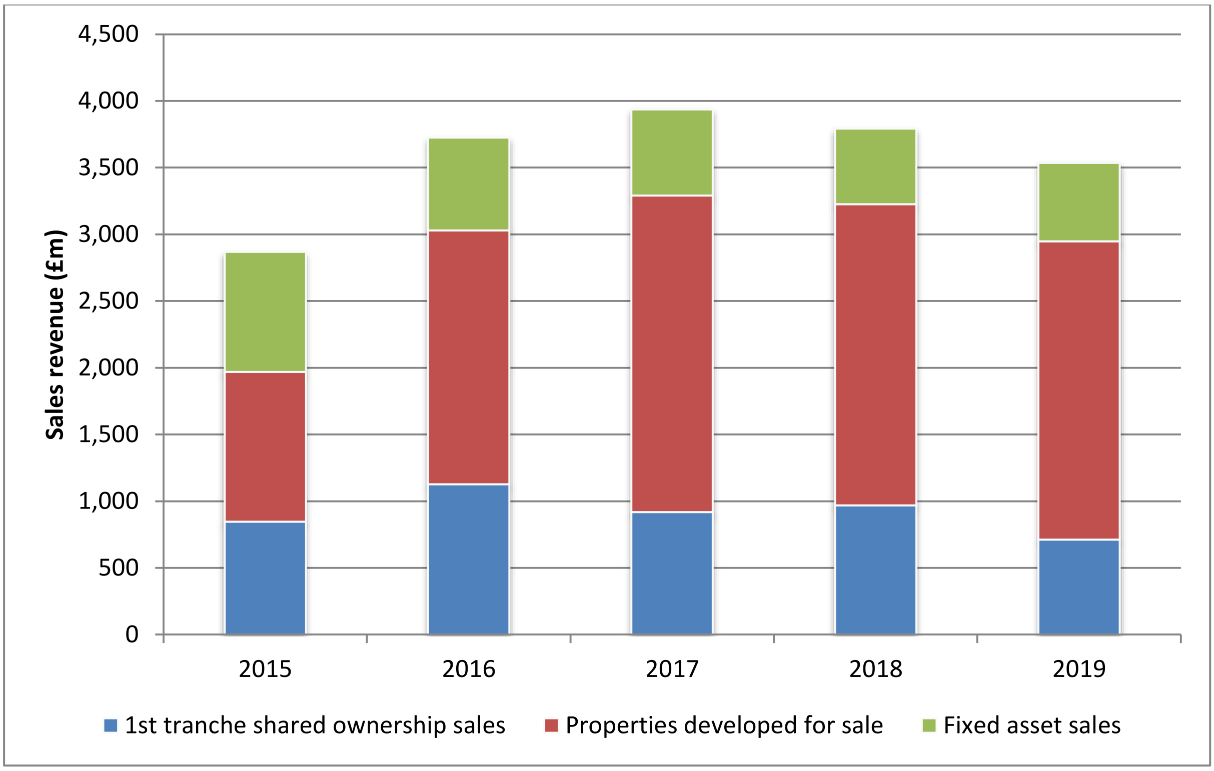


Figure 12 shows the increased reliance on sales revenue based on this year's forecasts. Sales income as a % of turnover peaks at 19% in 2016 and 2017. Over the first 5 years total sales income is £17.9 billion which equates to 18% of all sector turnover. The comparable figures from last year's forecast are £13.4 billion and 14% respectively. Figure 13 below shows sales income by type of property sold based on the latest forecasts.

Figure 13

Sales income



Shared ownership sales peak in 2016. However, shared ownership sales income remains at approximately £1 billion between 2016 and 2018. Although the sector is currently benefitting from an upturn in the housing market, the lessons from 2008 and 2009 should not be forgotten. A downturn in the housing market left some providers exposed with significant numbers of unsold shared ownership properties. Government intervention, through additional grant, was required to remedy the situation.

Figure 13 shows sales of fixed assets of £3.4 billion over the 5 year period. Sales of fixed assets include staircasing sales of shared ownership properties, Preserved Right to Buy / Right to Acquire sales, sales of tenanted stock to other registered providers, sales of void properties and sales of non-housing fixed assets. In 2015, fixed asset sales are significant at £900 million, 31% of all sales revenue for the year. In later years, sales values average £600 million at around 17% of total sales.

It is the increased activity in respect of properties developed for outright sale which is most significant. Properties developed for sale are expected to contribute 55% of all sales revenues to 2019. Providers are increasingly forecasting that sales activity will cross subsidise development of properties for rent.

Table 18
Properties developed for sale

Figures in £m & %	**2015**	**2016**	**2017**	**2018**	**2019**
Receipts from properties developed for sale	1,125	1,901	2,374	2,258	2,237
Year on year increase %	***36%***	***69%***	***25%***	***-5%***	***-1%***
Contribution from properties developed for sale	259	404	578	445	461
Year on year increase %	***40%***	***87%***	***35%***	***-9%***	***4%***
Margin on properties developed for sale	23%	21%	24%	20%	21%
Last year's forecasts	**2014**	**2015**	**2016**	**2017**	**2018**
Contribution from properties developed for sale	141	263	356	322	336
Margin on properties developed for sale	*19%*	*19%*	*20%*	*21%*	*23%*

Between 2015 and 2019, the forecast contribution from properties developed for sale is £2.1 billion. This equates to a 36% increase in comparison to last year's forecasts over the same time period. Between 2015 and 2019, the average margin is 22% in both sets of forecasts.

C3 – Providers' surpluses

Registered providers' surpluses are calculated as income generated less total expenditure incurred during the year. Table 19 shows that registered providers' surpluses have continued to rise over the previous 5 years and total £2.4 billion for 2014, this is an increase of £420 million (22%) compared to 2013. The sector continues to reinvest its surpluses and at March 2014 the sector had reinvested £12.7 billion (73%) of its reserves in the acquisition and development of new supply and improvements to the existing stock base (2013: 82%, 2012: 88%)[17]. This section identifies the main factors contributing to the increase in the sector's surplus position and reviews the forecasted surpluses over the next 5 years.

Table 19

Increase in surplus

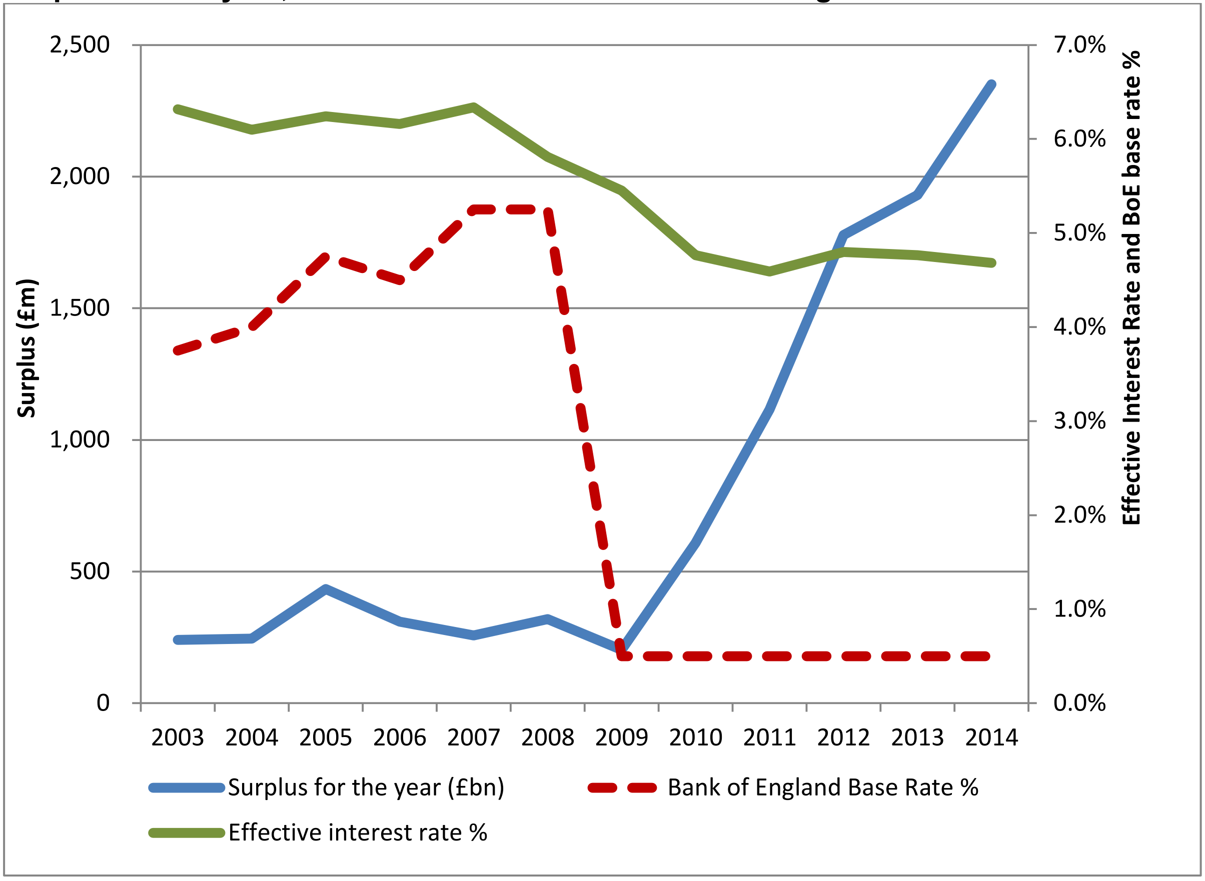
All figures £m	**2014**	**2013**	**2012**	**2011**	**2010**
Turnover	15,634	14,860	13,751	12,647	12,280
Total operating costs	11,495	11,010	10,530	9,943	10,056
Operating surplus	4,139	3,849	3,220	2,704	2,224
Surplus on social housing lettings	3,906	3,629	3,057	2,605	2,242
Net interest payable	2,421	2,339	2,184	1,960	1,894
Profit on sales of assets	630	466	516	321	347
Surplus for the year	**2,350**	**1,930**	**1,778**	**1,116**	**609**
Increase in revenues from social housing lettings	188	243	208	98	133
Increase in margin on social housing lettings	89	329	244	265	466
Increase in net interest costs	(81)	(155)	(225)	(65)	(3)
Profit/(Loss) on sale of fixed assets	165	(51)	196	(26)	11
Increase / (decrease) in 1st tranche sales surplus	29	43	34	26	(32)
Increase / (decrease) in other social surplus	47	(59)	8	23	20
Increase / (decrease) in non-social surplus	(63)	72	22	68	(6)
Fair value adjustment in Sanctuary	0	(220)	220	0	0
Other items	47	(50)	(46)	118	(182)
Aggregate increase in surplus	**420**	**153**	**662**	**507**	**406**

The sector recorded a strong financial result in the year to March 2014 having benefitted from the permitted, inflation linked rental uplift of 3.1% and continuing low interest rates. The Bank of England base rate has remained at 0.5% throughout the previous 5 years.

[17] The decrease in the reinvestment ratio is as a result of 1 large group reclassifying inter-company lending, as a long term creditor rather than a current liability as in previous years. The reclassification has increased long term creditors by £1.3bn in the current year. If the reclassification has not been undertaken our analysis indicated the sector would have reinvested 80% of its reserves into existing stock and new supply.

Figure 14

Surplus for the year, effective interest rate and Bank of England base rate[18]



Historically, as illustrated in Figure 14, the surplus generated each year remained relatively constant between 2003 and 2009. The increase in surplus recorded by the sector since 2009 is in part attributable to favourable macroeconomic conditions. The sharp increase in surplus post 2009 corresponds with a period of historically low interest rates.

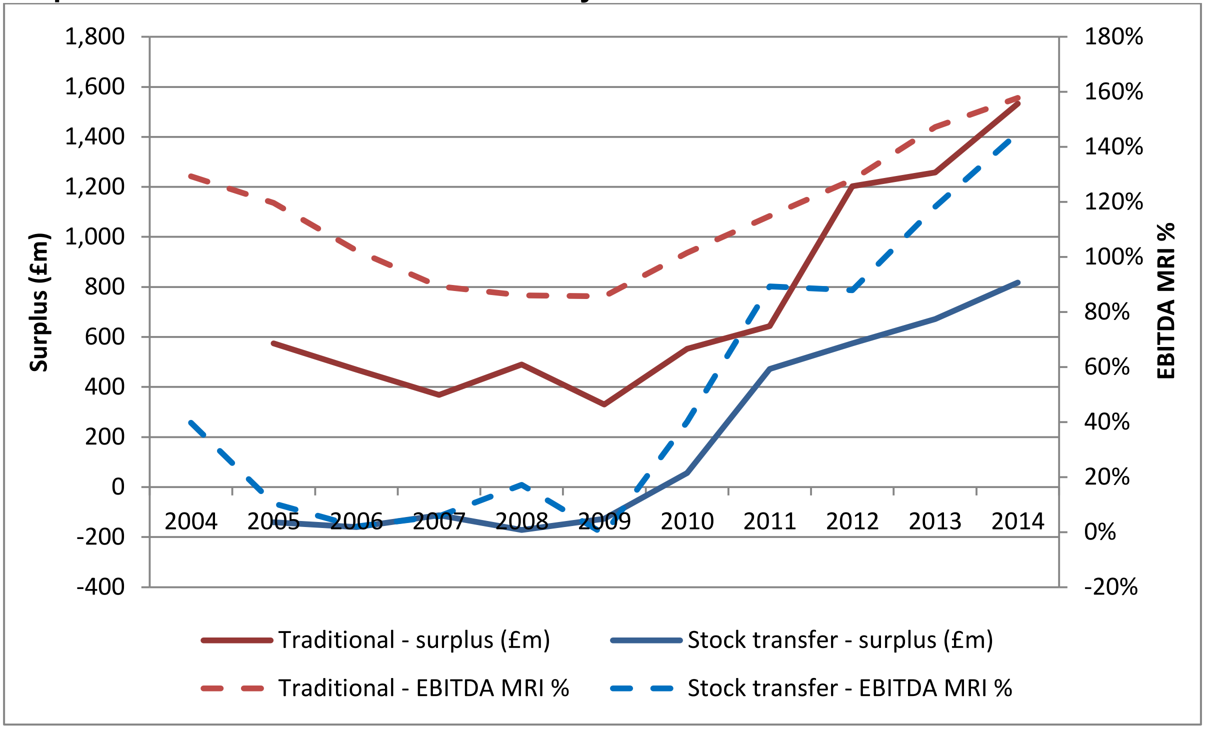
The sale of fixed assets has generated a surplus of £630 million in 2014 - an increase of £164 million (35%) from 2013. The average surplus generated on sale of fixed assets over the last 5 years was £436 million, 81% related to traditional providers.

Diversification has also contributed to the surplus position of the sector; turnover generated from other and non-social housing activities has continually increased over the last 5 years and totals £2.5 billion in 2014. Total surpluses generated from non-social housing activities has increased by 6% to £233 million in 2014 - 10% of total surplus generated by the sector.

The increase in surplus in recent years is also partly attributable to the growing maturity of the stock transfer sub-sector. The figure below demonstrates the movement in the sub-sector from deficit to surplus over a 10 year period.

[18] Ratio restated as set out in narrative page 25

Figure 15
Surplus and EBITDA MRI interest cover by sub-sector



In their early years, typically over a 5 to 12 year period, stock transfer providers undertake high levels of improvement works. This is reflected in high deficits and low levels of interest cover. Over 75% of stock transfers took place before 2006. Prior to 2010, the surplus from the sector as a whole was reduced by deficits in the stock transfer sub-sector.

It is essential that the sector records annual surpluses. The sector must invest in its existing stock and also play a key role in the development of new housing. This requires surpluses to be generated to re-invest directly and also to support significant increases in debt financing.

Table 20

Summary financial forecast

All figures £m	**2016**	**2017**	**2018**	**2019**
Turnover	19,617	20,680	21,401	21,872
Operating expenditure	(14,419)	(14,984)	(15,418)	(15,561)
Operating surplus	**5,198**	**5,696**	**5,983**	**6,311**
Profit/(loss) on the sale of fixed assets	290	265	269	277
Surplus before interest and tax (SBIT)	**5,487**	**5,962**	**6,252**	**6,588**
Interest and other finance costs	(3,041)	(3,274)	(3,513)	(3,756)
Surplus for the year before tax	**2,446**	**2,687**	**2,739**	**2,832**
Tax	(16)	(18)	(19)	(24)
Surplus for the year	**2,430**	**2,669**	**2,719**	**2,808**
Aggregate increase in surplus	441	239	50	89
Free cashflow	1,894	2,314	2,390	2,582

The sector has forecast that it will generate a surplus of approximately £2 billion per year for the next 5 years with the average increase in surpluses over the next 5 years being approximately £200 million.

There are a number of risk factors impacting on the volatility of the sector's cashflow that could significantly affect the ability of providers to generate the forecast surpluses. These include:

- from April 2015, providers will be required to ensure that all rent increases are linked to consumer price index (CPI) inflation + 1% rather than RPI +0.5%. Providers will no longer be permitted to increase rents in excess of this where rent levels are below target rents
- providers' costs are not linked to CPI (wage increases are a significant proportion of costs, and development and capital improvement costs are more closely linked to construction cost inflation). An increase in providers' costs may significantly affect providers' profitability
- the Bank of England base rate has remained at 0.5% since 2009. Providers are susceptible to increases in the base rate which could significantly increase interest costs. As at March 2014, the sector's fixed rate debt is approximately 67% of its total debt (2013: 65%, 2012: 70%)
- the variety of changes brought in by welfare reform pose a risk to income collection
- the sector's exposure to the housing market is likely to increase in the next 5 years. Sales income over the next 5 years is projected to be £17.9 billion which equates to 18% of the sector's forecast turnover. This makes providers susceptible to a housing market downturn

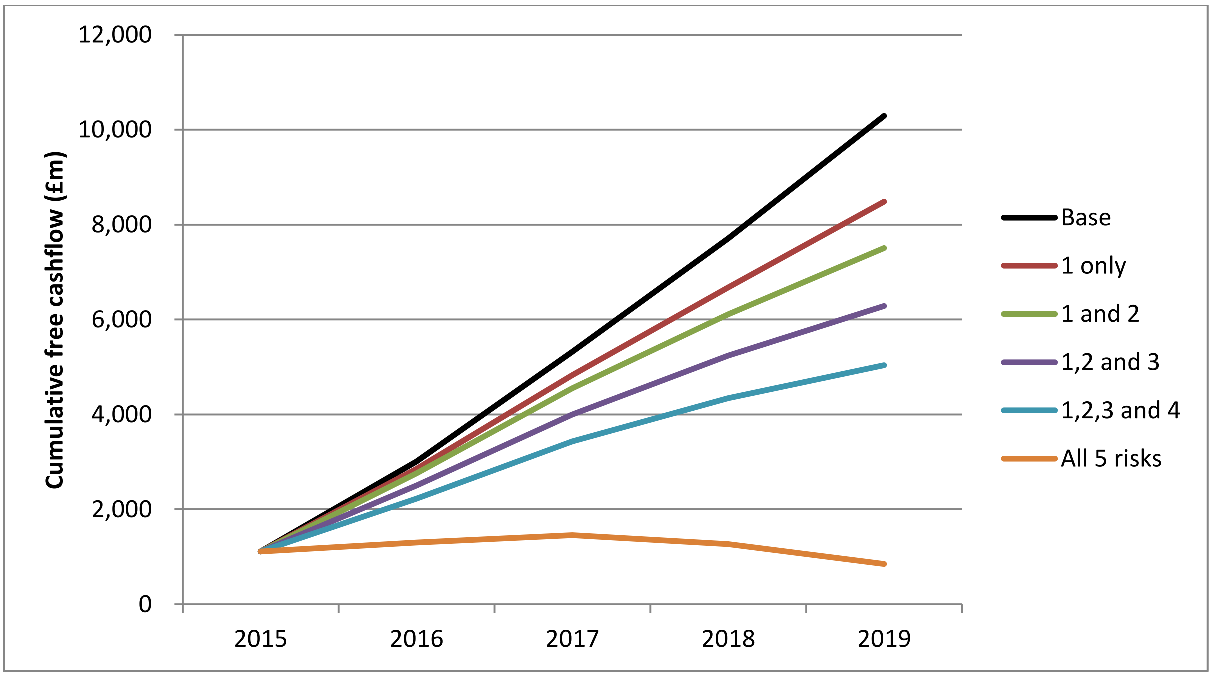
The sector's financial robustness can be examined by considering the effect the above risks would have on the cumulative free cash flow that providers can generate. The assessment does not constitute all the risks that the regulator believes should be tested for when evaluating the robustness of providers' business plans.

Figure 16 shows the cumulative free cash when the following risks are considered:

1. rental inflation, CPI inflation is at 1% for the 5 year period
2. cost inflation increases by 1% per annum
3. interest rate increase of 1% to providers' forecasted LIBOR rate
4. welfare reform increases the level of non-collectable rent by 2% over the forecasted period
5. current asset sales are reduced by 30% over the period

Figure 16

Risk factors



The scenario analysis above shows the potential vulnerability of providers' forecast surpluses. The sector's surpluses would be significantly reduced over the 5 years when the scenarios are applied. The combined risks would reduce the cumulative free cashflow over the 5 year period from £10.3 billion to £0.9 billion

C4 – Value for money

The Value for Money Standard and self- assessment

The HCA's Value for Money (VfM) Standard has now been part of the regulatory framework since April 2012. The standard requires registered providers to articulate and deliver a comprehensive and strategic approach to achieving VfM in meeting their organisation's objectives. Boards are also expected to demonstrate to stakeholders how they are meeting the standard. As part of that process, on an annual basis, they should publish a robust self-assessment which sets out in a way that is transparent and accessible to stakeholders, how they are achieving VfM in delivering their purpose and objectives. The standard sets a specific expectation that the assessment shall:

- enable stakeholders to understand the return on assets measured against the organisation's objectives
- set out the absolute and comparative costs of delivering specific services
- evidence the value for money gains that have been and will be made and how these have and will be realised over time

The 2012 Accounts Direction stipulated that all providers should undertake and publish within either their board report or operating and financial review (OFR), a self- assessment of their performance against the VfM Standard. As the regulator has previously made clear, providers are free to publish more detailed material elsewhere, in addition to the coverage in their OFR. If this material is clearly sign-posted in the OFR, the regulator will take it into account in reaching its view on the degree of assurance it takes from the self- assessment.

Regulation of the Value for Money Standard to date

For the majority of providers, 2014 was the second year in which they were required to publish VfM self- assessments (a small number of providers, with September or December financial year end dates, published their first self- assessments). As set out in the 2013 Global Accounts, last year's (2013) self- assessments provided the regulator with varying degrees of assurance that the sector was meeting the requirements of the VfM Standard. Whilst some providers did publish robust self- assessments, demonstrating a focus on VfM, many others provided more limited assurance, and did not provide sufficient information to allow external stakeholders to reach an informed judgement about all aspects of a providers' performance against the expectations of the standard.

In particular, whilst many providers provided evidence of past VfM gains, and data on operating cost comparisons, the level of information provided on return on assets was generally much more limited. It was rare for providers to provide clear targets for future improvement. A small number of providers, where the regulator had least assurance against the requirements of the standard, had their governance gradings downgraded as a result. Subsequently, a number of these providers did publish self- assessments meeting the requirements of the standard, and provided the regulator with a greater degree of assurance over the internal control failures which had led to them failing to do so in a timely fashion. As a result, these providers have subsequently been upgraded once again.

Overall, the regulator took a proportionate approach to its regulation of the VfM Standard last year, recognising that this had been the first year in which providers had been required to produce such self- assessments, but made clear that expectations would be higher for the 2014 self- assessments.

Regulation of the Value for Money Standard in 2014

The majority of providers published their second self- assessments by September 2014. Overall, these suggested that the sector has increasingly got to grips with the requirements of the standard. In general, self- assessments were more detailed, with a greater number of providers transparently setting out their evidence of how they meet the specific requirements set out in the VfM Standard. Across the sector as a whole, the regulator took a greater degree of assurance from the self-assessments than it had the previous year. However, there was still a minority of providers where the regulator had insufficient assurance against the standard, and particularly against its transparency requirement.

As the regulator previously made clear, expectations were higher for 2014 now that providers have had another year to absorb the requirements of the standard. The level of assurance that was acceptable in the first year was not necessarily sufficient to demonstrate engagement with the requirements of the standard.

A focus on delivering value for money, and effective systems for doing so, should be a core part of everyday business for an effective organisation. The requirements of the VfM Standard simply capture what an effective board should be doing anyway. With this in mind, it was noticeable that a significant proportion of the providers that did not provide sufficient assurance on VfM in 2014 also had other on-going governance issues.

Considering the specific requirements of the self- assessment

There were several other key themes that emerged from the regulator's review of the second year of self- assessments.

Return on assets

Providers' evidence demonstrating an understanding of the return on their assets generally improved in comparison to last year. Many providers showed greater transparency in demonstrating an appreciation of the differing values of their properties according to location or type of stock and clear links to how this best enables delivery of the organisation's objectives.

In a greater number of self- assessments, consideration was also given to how this information was used to inform business decisions. For example, some providers showed how their understanding of criteria such as property demand, forecast returns (whether financial, social, economic, etc.) and consideration of alternative uses was used to inform decisions on retention, conversion or disposal of stock. The processes, criteria and information used to make these decisions were clearly articulated and demonstrated that the organisation was making decisions that enabled them to make best use of their asset base in delivering their objectives. Increasingly, providers have begun to estimate the social return on their assets, using a wide range of different methodologies to try and quantify the impact of their social activities and the benefits of providing subsidised housing to low income groups.

However, overall return on assets remained the element of the standard where the regulator took the lowest level of assurance. A number of self- assessments also continued to provide significantly less evidence of understanding variations in the performance of assets across their stock (for example by considering variations in the net present value of their stock holdings, differences in the social return to tenants or the variations in environmental performance of their assets). Consideration of how the value realised by their assets would

change under alternate uses, and whether this would better support the delivery of the organisation’s purpose, was also not considered by a number of providers.
In some instances, providers reiterated both this year and last that a stock condition survey or asset management strategy was underway, without demonstrating significant progress had been made in the interim. Other self-assessments provided a list of future actions that they would undertake but limited explanation of how these decisions had been made.

Absolute and comparative costs of delivering services

Overall the self-assessments were strongest on this element of the standard and the degree of assurance was generally higher, both in terms of the level of detail provided and the number of organisations who provided it.

The self-assessments providing the highest degree of assurance were those which included quantified absolute cost data for a wide range of specific, disaggregated named services, comparisons with the providers’ performance in previous years, and comparisons with the performance of a relevant, and identifiable, peer group.

These comparisons were systematic, allowing external stakeholders to identify areas of performance where the provider compared unfavourably with its peers as well as those where it compared well. Commentary was provided alongside the data which provided a balanced and reasonable interpretation of the results, along with discussion of what (if any) issues needed to be addressed and how this would be achieved. Quantified evidence on the cost of delivering services were clearly linked to outputs, allowing stakeholders to reach judgements on the efficiency of delivery of these services year on year.

The self-assessments which provided least assurance generally contained some of the above data, but usually at a lower level of detail or not at all in some cases. Although a degree of quantified cost data was normally included, this was not always given for specific services and was sometimes given at a very high level of aggregation e.g. as a single combined repairs, management and maintenance cost figure, which reduced the overall transparency of the information provided.

A number of self-assessments did not provide meaningful comparative data, either with the providers’ own past performance or with other providers. Whilst in some cases comparative data was given, this was often not quantified and relied on narrative descriptions of how costs were ’greater’ or ’less’ than peers which did not allow for an accurate assessment of how the scale of costs compared. In addition, comparative data was frequently not given for the relevant financial year, and for some providers it was not always clear with whom they were comparing themselves. Others did not provide context or discussion about the benchmarking results even when they showed the organisation compared unfavourably to its peers. Some continued to provide comparisons selectively, only showing data on services where they compared favourably with other providers.

As with previous years, not all specialist providers published peer comparator analysis, although a number did so, making use of qualitative as well as quantitative analysis. It was common for providers to cite the use of benchmarking tools (either third-party or in-house) to gain an understanding of the relative cost of delivering their services, but without providing much actual cost data to transparently demonstrate this understanding to stakeholders.

Evidence for past VfM gains and how these have and will be realised over time

In common with other elements of the standard, the sector's response on past and future VfM gains has improved from previous years. In general, however, responses were more detailed with regard to past gains than future targets.

The responses that gave greatest assurance provided clear evidence of past VfM gains, including details on the timescales in which improvements were realised and the resources required to achieve them. Evidence of past improvements demonstrated cost savings and/or improved service efficiencies, with specific examples of one-off or continuing savings and efficiencies placed in the context of the wider business performance and objectives. Where cost savings were identified, these were considered in relation to the service outcomes that were delivered, demonstrating a focus on efficiency and effectiveness and not solely immediate economic savings.

Supporting details on the performance management and scrutiny functions in place to deliver further progress were also provided, along with clearly laid out future improvements given in terms of clear, measurable targets (including both the efficiencies which would be made and the timescales in which they would be achieved). This will allow stakeholders to hold providers to account on the delivery of these ambitions, and judge whether continuous improvements are being made.

Providers for whom the regulator had less assurance generally only covered some of these areas. Examples remained of self-assessments citing specific examples of a cost saving generated by a past decision (e.g. a specific contract renegotiation or switch to e-learning for staff training), but as isolated examples which were not placed in the context of the providers' wider business or objectives. Further, there was not always clarity about how significant such savings were in the context of the providers' overall cost base, whether they were one-off or continuing savings, what impact was subsequently made on delivery of key outcomes, or how any savings had been utilised elsewhere to further the providers' objectives.

A lack of detail on future VfM targets was another common theme amongst some of the self-assessments, and often there were no measures (either explicit or implicit) given for how progress against these targets could be tracked and assessed by independent stakeholders. Common examples include references to 'improving' costs or services, or reviewing areas of the business. In several cases it was also not clear how the stated targets related to the efficiency of the organisation or how achieving them would improve overall VfM.

Regulation of the VfM standard in 2015 to 2016

On 30 January 2015, the regulator published its decision statement on the adoption of a new Governance and Financial Viability Standard. This new standard comes into effect from 1 April 2015, and will strengthen the expectations on providers to actively manage risk in a more complex and risky operating environment. The revised Governance and Financial Viability Standard sets out the requirements on how they should do this, including maintaining comprehensive asset and liability registers and undertaking stress testing. The Value for Money Standard will remain unchanged, and will remain a high priority for the regulator.

The 2 standards complement each other, with the revised Governance and Financial Viability Standard setting out the requirements to understand and manage the risks to the social housing assets, and the Value for Money Standard setting the expectation that providers should understand the return on those assets and seek to optimise them.

The sector has, in general, responded to the feedback from the regulator in 2014, and most providers have published more transparent self- assessments this year. However, the HCA will continue to expect further progress, in line with the VfM Standard's expectation that providers should plan for and deliver on-going improvements in value for money. The published self- assessment will therefore remain a key focus of our regulation. In particular, the regulator will increasingly focus on the extent to which the initiatives set out in providers' self- assessments bear fruit, and deliver the promised value for money improvements.

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