Homes & Communities Agency

The social housing regulator

2012 GLOBAL ACCOUNTS OF HOUSING PROVIDERS

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Contents

Introduction

The primary purpose of the 2012 Global Accounts is to provide a financial overview of the regulated social housing sector based on 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 400 providers which own or manage at least 1,000 social homes, relating to more than 95% of the sector's stock.

There are two clear sub-sectors within the total - traditional and stock transfer providers. The latter providers are comparatively young, introduced since 1990 to take transfer of stock from local authorities. Stock transfers have financial characteristics, particularly in their early years, which are very distinct from existing traditional providers and are therefore analysed separately within this publication.

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 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 of providers 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 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 Operating and Financial Review section examines the sector's objectives in the context of the operating environment in which providers work. It analyses the operating and financial performance of the sector, the position at the end of the year, and factors that are likely to affect it in the future.

The 2012 Global Accounts section introduces the aggregate financial statements, providing a commentary on key movements and trends in the overall financial position of the sector.

The Thematic Analyses section provides commentary on three areas of interest. Firstly, analysis of providers' financial forecast returns focuses on the future five year trends in financial performance and examines some of the underlying assumptions on which financial plans are based. The diversification commentary analyses the degree of diversification in the sector and the activity undertaken through associated unregistered companies. Finally, the pensions and accounting commentary provides an update on the current pension issues in the sector and future changes in accounting requirements.

Part A – Executive summary

The 2012 Global Accounts demonstrate that the sector remains financially robust and is in general responding well to the current economic climate. The sector continued to grow its asset base and recorded an aggregate surplus of £1.8bn, some £0.7bn ahead of that recorded in 2011. However, there remains continued uncertainty in housing and financial markets on which the sector relies for its future growth and continuing financial strength.

The sector achieved the increase in surplus through the combination of increased turnover attributable to inflation linked rent increases, continued effective management of its cost base, and improved financial performance in housing sales activity.

The entire surplus is taken to reserves, which increased to £20.7bn. However, reserves are not held as cash but are in the main reinvested in the business. At March 2012, the sector in aggregate had reinvested some 88% of its total reserves in the acquisition and development of new supply and improvements to the existing stock base.

Providers continue to raise the significant levels of debt required to deliver their planned growth as they represent a good credit risk for investors. The sector in aggregate raised an additional £3.4bn of debt. As the availability of traditional bank finance remains constrained to shorter terms and comparatively high margins, new debt is increasingly sourced on the bond market (£1.8bn in year to March 2012), representing half of all new debt.

Whilst the financial results indicate the sector is responding well to the current economic environment, it is vital boards remain alive to associated risks and continue to manage them effectively. The Social Housing Regulator has set out in its Sector Risk Profile publication what it views as key risks in the sector including housing and financial markets, development risk, welfare reform, pensions and accounting changes and diversification into other activities – all areas covered within this publication.

The analysis of financial forecasts in Part D of the report demonstrates the sector will be increasingly reliant on sales and new debt to deliver new development in an environment of low grant rates. In the year to 2012, housing sales, including shared ownership, social and open market developments recorded encouraging financial results. Increased sales and profitability of shared ownership reverses a declining trend over the previous three years. It indicates the sector in aggregate is effectively managing sales risk whilst the housing market remains subdued in much of the country.

It is vital the sector continues to manage its operational risks to its income and cost base. Changes resulting from the implementation of welfare reform may affect the certainty of income flows. As reforms are implemented, it is vital that the sector ensures it maintains its current operational performance.

Financial highlights include turnover rising by 9% to £13.8bn, while total operating costs increased at a lower rate of 6% to £10.5bn. Management costs per unit increased by 4%, following two consecutive years of decreases and total major repair costs per unit increased by 14.8%, also reversing a trend of decreased per unit spending in the previous two years. For the second year running, routine and planned maintenance per unit costs fell by 3%.

The figures contained within the Global Accounts are affected by the implementation of accounting changes to the approach to asset capitalisation. These accounting changes affect comparison with previous years in some areas of costs, adjustments to reserves and fixed assets. Whilst the detail of the impact of the changes is described within this report, they do not reflect a change in the underlying dynamics of cashflows and financial performance of providers.

Overall, the sector is financially viable, although performance of individual providers varies significantly and is masked by the aggregation of data. The continued financial performance of the sector is reliant upon providers meeting the challenges associated with the key uncertainties and risks they face. The Regulator will continue to seek assurance that providers are managing these challenges effectively.

Part B – Operating and financial review

Overview of the sector

The sector is comprised of 1,500 providers, which are diverse organisations in terms of their constitutions, focus and drivers. Whilst, for most, the landlord function represents the majority of their activity and turnover, providers do undertake a wide range of activities. They use their role, often as the major landlord in specific geographical areas, to further facilitate the sustainability of neighbourhoods and communities. This can involve, but is not limited to: leading on or contributing to regeneration activities; provision of community centres; training facilities and other services in the community; and the provision of a range of housing tenures including market rent and housing for sale.

Providers own or manage around 2.6m homes. However, stock holding in the sector is skewed with the significant majority, 1,100 providers, owning less than 1,000 homes each, whilst 79 (just 5% of providers) own or manage more than 10,000 homes each and around 60% of the sector total. The category of stock transfer providers own just under 1.1m homes, which is 41% of the total.

The majority (75%) of the homes in the sector are those for general needs tenants offered at sub-market rent levels. Around 12% of homes are made available as housing for older people and a further 4% for supported housing tenants. The remaining stock in the sector comprises care homes, temporary social housing, key worker accommodation and increasingly leasehold and shared ownership properties. In addition, the sector owns approximately 77,000 non-social housing dwellings including student accommodation, key worker homes, homes for rent in the open market and (non-social housing) residential care homes.

The sector's objectives

Whilst providers individually undertake a range of activities, there are consistent themes in the objectives of many providers, which refer to:

- Developing quality housing; providing affordable homes to those in need
- Asset management; maintaining and maximising the value of existing assets
- Improving customer services; offering choice and high quality services
- Expanding client groups; delivering products to meet diverse customer needs and aspirations
- Promoting inclusion; investment in communities to support successful neighbourhoods
- Being a good employer; investing in staff to be a well-run organisation
- Commitment to equality and diversity
- Delivering value for money; operating efficient businesses to unlock value
- Improving financial performance and capacity

Dynamics of the housing sector

The sector has, in general, responded well to the challenging economic environment. However, it is not immune to factors affecting the rest of the economy and with on-going uncertainty in the macroeconomic environment, the next few years will continue to be difficult and demanding.

The reduced grant rate available to support the delivery of new affordable homes has placed a greater reliance on debt to fund development programmes. Bank lenders continue to offer loans to the sector, however, the number and capacity of lenders is limited. New loans tend to be at higher margins than the sector has historically enjoyed and for shorter terms. To meet long term financing needs, providers have looked to the bond market and other sources of funding to meet these needs. Increasingly providers will look to innovative funding sources to support growth aspirations, posing a challenge for the sector to manage.

The sector is benefitting from the continuation of historically low interest rates. It manages interest rate risk through fixing on average around 70% of debt at any one time. Whilst it is uncertain when rates are likely to increase, providers need to ensure that business plans can cope with variability in rates and to continue to effectively manage interest rate risk. The low interest rate environment has impacted on the mark-to-market position of free standing interest rate derivatives, with a fall in the reference swap rate over the last few years. Providers exposed to mark- to- market calls, of which there are just under 50 in the sector, have continued to manage the exposure. However, this has required both cash and fixed asset collateral to be tied up and, with continuing uncertainty, remains a risk.

The sector continues to have a significant sales programme including shared ownership, social housing sales and market sales. In spite of the continuation of depressed housing markets in many areas, providers have continued in general to deliver planned sales performance. However, future sales are forecast to provide required cross subsidy for investment in new housing supply and a number of providers are reliant on sales to support their business plans and meet interest costs. Therefore, exposure to the housing market remains a key risk for the sector to manage.

In addition to new sources of long term debt finance and cash flows from sales to contribute to the new housing supply, many providers have considered greater diversification into other activities to fill the funding gap. This includes market rent, commercial housing and the provision of services to other housing providers via the use of subsidiaries, Special Purpose Vehicles (SPVs) and Joint Ventures (JVs), with partners in the private sector. Although this type of activity is undertaken to generate greater rewards, there is a higher level of risk involved and providers need to ensure that they understand these risks and that structures are in place to ensure social housing assets remain protected.

The new Affordable Rent product that was introduced by the Affordable Homes Programme 2011/15, links rents to market levels. By using market linked tenures, this presents a different risk profile that the sector needs to understand and effectively manage.

The variety of changes brought in by welfare reform over the period 2013 - 2017 pose a particular risk to income collection. It may create greater volatility in the sector's income cashflow. Additionally, uncertainty remains over the future of rent setting policy beyond 2015. Providers must manage income collection effectively on implementation of welfare reforms and ensure financial plans can withstand variability in rental cashflow.

Operating performance

Table 1
Indicators of operational performance

Indicator	2012	2011	2010
Stock failing Decent Homes Standard at year end	1.9%	2.4%	5.4%
Voids for the year	1.75%	1.78%	2.15%
Bad debts for the year	0.8%	0.7%	0.8%
Current tenant arrears at year end	4.8%	5.1%	5.1%

The sector has successfully met the challenge to bring its stock to the Decent Homes Standard, with only a small proportion of stock remaining below standard as those providers with extensions to the deadline for compliance complete the required works.

In summary, at a national level, average performance in both voids and arrears has improved compared to the 2011 results, whilst bad debts have remained broadly stable over the past three years. Bad debts, voids and tenant arrears will be key performance indicators in assessing the impact of welfare reform over the coming years.

Financial performance

The sector recorded a strong financial result in the year to March 2012 having benefitted from the permitted, inflation linked rental uplift of 5.1% and continuing low interest rates. Turnover increased by 9% to £13.8bn, whilst total operating costs (including cost of sales and exceptional items) increased by 6% to £10.5bn. The operating surplus of the sector increased by 19%, or £516m, over the previous year to £3.2bn. Management costs per unit increased by 4% with corresponding falls in routine and planned maintenance costs per unit of 3%.

Growth in rental income was largely attributable to the inflation linked guideline rent increase of 5.1%. The majority of general needs units had average rents at no more than 5% above target rents at 31 March 2012. A number of providers have extensions to meeting rent restructuring requirements agreed with the Regulator. These extensions vary and are time limited.

The surplus from the sale of properties increased significantly compared to 2011 and 2010 with an increase of 61% to £516m. There was also an increase in first tranche shared ownership sales where the surplus rose by 69% to £83m.

Overall, the net result of these changes has led to an improved financial performance of the sector in 2012, with increases in the surplus after tax for both the traditional and stock transfer sub-sectors. The surplus after tax for the sector totalled £1.8bn compared with £1.1bn in 2011. EBITDA MRI[1]interest cover increased to 115.7% with significant improvements in the traditional sub-sector (up from 114.8% to 128%). There was a slight decrease in interest cover in the stock transfer sub-sector from 89.3% to 87.9%. This

[1] The interest cover calculation is based on earnings before interest, taxation, depreciation and amortisation with all major repairs spending included.

decrease was mainly attributable to increased major repairs activity and a one-off pension adjustment that bolstered the 2011 result.

Table 2
Three year financial highlights and key financial ratios

Indicator	2012	2011	2010
£ million			
Turnover	13,751	12,647	12,280
Total operating costs	10,530	9,944	10,056
Operating surplus	3,220	2,704	2,224
Surplus on social housing lettings	3,057	2,605	2,242
Net interest payable	2,184	1,959	1,895
Profit on sales of assets	516	321	347
Surplus for the year	1,778	1,116	609
Operating margin	23.4%	21.4%	18.1%
EBITDA interest cover	197.0%	162.6%	138.6%
EBITDA MRI interest cover	115.7%	106.4%	81.1%
Growth in turnover	8.7%	3.0%	6.2%
Growth in total assets	5.6%	7.4%	6.2%
Debt per home (£)	18,372	17,226	17,034
Management cost per unit (£)	908	873	884
Routine and planned maintenance cost per unit (£)	979	1,009	1,011

The financial performance of the sector in 2012 was influenced by the adoption of component accounting, introduced in the Statement of Recommended Practice (SORP) 2010. For the majority of the sector, the adoption of component accounting resulted in the capitalisation of major repair costs (components of housing properties) that had been expensed in prior years. This meant writing off the residual values of old components that had been replaced/restored (to avoid double counting) and expensing the additional amount of depreciation that has been recognised as a result of the shorter useful lives of components.

In 2012, total major repair costs increased by 16% from £2.3bn to £2.6bn. However, with the application of component accounting, expensed major repair costs reduced by 41% to £593 million and capitalised major repair costs increased by 62% to £2bn. This reflects an increase in the average capitalisation rate for major repair costs from 55% to 77%. With a higher level of capitalisation, depreciation on housing properties also experienced a significant increase of 90% from £652 million to £1.2bn.

For many providers, the impact of component accounting was a fundamental change in accounting policy. Therefore, prior period adjustments against opening reserves were undertaken to reflect the change. The prior period adjustment reported in 2012 was £2.4bn. A number of providers also changed their accounting policy to report housing properties at cost, rather than at valuation, due to the adoption of component accounting. This contributed to the fall in revaluation reserves of 14% from £9.2bn to £8bn.

Investment for the future

In 2012 the total grants, SHG and other capital grants, reported on balance sheet increased by £641 million (1.5%) to £43.8bn, contributing to the increase in the Gross Book Value of housing properties of £9.1bn (8%) to £118.6bn. With loan funding of £48.5bn, other long term creditors of £3.6bn and revaluation reserves of £8bn, at 31 March 2012 the sector had re-invested £11.1bn, or 88%, of its revenue reserves in the acquisition and development of fixed assets.

The new Affordable Rent product was introduced in 2011 under the HCA Affordable Homes Programme 2011/15. Affordable Rent tenancies will be shorter and for fixed terms, with rents at levels above social rent up to a maximum of 80% of market rent. The Statistical Data Return (SDR) reported that 188 providers owned over 7,000 Affordable Rent homes as at 31 March 2012; 94% of which were general needs with the remainder made up of supported housing and housing for older people. This includes homes newly built and conversions from existing social rented homes to Affordable Rent homes.

Capital structure and treasury policy

During 2012, the external debt of the sector increased by £3.4bn (7.6%) to £48.5bn. With pressure on grant rates, the main source of capital finance for future growth in the housing market is expected to be debt. Debt per home increased by 6.7% from £17,226 to £18,372 and gearing levels are expected to continue to rise as further investment is required to develop housing.

The use of bond finance increased during 2011/12 and £1.8bn (2010/11: £940 million) was raised on the bond market at rates between 4% and 6.025% (2011: 4.87% to 5.4%). The bond market has continued to be a favourable source of long term finance throughout 2012/13. As at February 2013, over £3bn had been raised on the bond market for the year to date. This included the first bond issue in February 2013 made by aggregating vehicle, GB Social Housing, which will be on lent to three providers.

The Bank of England base rate has remained at 0.5% throughout this period, as it had the previous year. Providers with a higher proportion of variable rate debt have been able to take advantage of the lower cost of finance. However, the average effective interest rate for the sector increased from 5% to 5.2%. Although bank base rates remained low, new bank finance arranged in year will be priced with relatively high margins compared to older debt. The sector has traditionally maintained a high proportion of fixed rate debt with approximately 70% of total debt being held at fixed rates at March 2012 (2011: 65%).

Going concern and regulatory compliance

In overall terms, the sector is financially viable, although performance is variable between providers. The position of individual providers is assessed from the review of statutory and regulatory returns submitted. Where a material change to the assessment occurs, the published regulatory judgements are amended to reflect the current regulatory review.

The financial viability of individual providers is assessed at group level and is graded as set out below:

- V1 – The provider meets the requirements on viability set out in the Governance and Financial Viability standard and has the capacity to mitigate its exposures effectively.
- V2 – The provider meets the requirements on viability set out in the Governance and Financial Viability standard but needs to manage material financial exposures to support continued compliance.
- V3 – The provider's financial viability is of concern and in agreement with the Regulator it is working to improve its position.
- V4 – The provider's financial viability is of serious concern and it is subject to regulatory intervention or enforcement action.

As at March 2013, the Regulator has assessed 82.6% of providers as V1 and 17% as V2. Both of these gradings indicate compliance with the Regulator's standards in respect of financial viability. There is one provider graded as V4. In accordance with its intervention and enforcement powers, the Regulator is working with the provider and other stakeholders to seek a resolution to the serious financial issues.

Part C - 2012 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 2012. Comparative figures for 2010/11 and 2009/10 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 groups 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.

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 2011 to 31 March 2012.

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 2011 and 31 March 2012.

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.

Effect of implementation of SORP changes in accounting for fixed assets

The financial results for this year are affected in a number of areas as a result of the adoption of component accounting, a change required by the SORP. The change, whereby providers now capitalise and depreciate components of fixed assets, has resulted in a significant prior period adjustment. That adjustment has the effect of increasing the accumulated surplus and accumulated depreciation, changing the capitalisation basis for some elements of expenditure and increasing the in-year depreciation charge. Where figures in the analysis are affected by this change in accounting, the effect is described.

Table 3
Balance sheet

All figures in £ million	Traditional 2012	Stock transfer 2012	Total 2012	Total 2011	Total 2010
Fixed assets					
Housing properties at cost	80,571	17,504	98,075	84,750	79,461
Housing properties at valuation	6,727	13,761	20,488	24,672	21,465
Gross book value of housing properties	**87,298**	**31,265**	**118,563**	**109,423**	**100,926**
SHG/HAG	37,779	3,837	41,616	41,118	38,478
Other capital grants	1,593	621	2,214	2,072	1,968
Depreciation	4,967	1,816	6,783	3,549	2,944
Net book value of housing properties	**42,960**	**24,990**	**67,950**	**62,684**	**57,536**
Other fixed assets	2,619	581	3,200	2,720	2,888
Total fixed assets	**45,579**	**25,571**	**71,150**	**65,404**	**60,424**
Current assets					
Property for sale	1,114	171	1,285	1,351	1,077
Non liquid current assets	938	843	1,780	2,054	1,521
Cash and short term investments	1,985	685	2,670	2,427	2,676
Other current assets	2,333	1,051	3,384	3,080	3,245
Total current assets	**6,369**	**2,750**	**9,119**	**8,913**	**8,519**
Current liabilities					
Short term loans	414	198	612	680	601
Bank overdrafts	18	9	27	43	31
Other current liabilities	3,912	1,837	5,749	5,568	5,581
Total current liabilities	**4,344**	**2,043**	**6,388**	**6,291**	**6,214**
Net current assets (excluding pensions)	**2,025**	**707**	**2,731**	**2,621**	**2,305**
Pension liabilities	(263)	(425)	(688)	(438)	(883)
Net current assets (including pensions)	**1,761**	**282**	**2,043**	**2,184**	**1,423**
Total assets less current liabilities	**47,340**	**25,853**	**73,193**	**67,587**	**61,847**
Financing and reserves					
Long term loans	32,103	15,766	47,869	44,373	42,216
Other long term creditors	2,783	779	3,562	3,551	3,249
Provisions	249	854	1,103	1,306	897
Accumulated surplus	9,340	2,405	11,745	7,526	5,524
Designated reserves	314	119	433	1,091	1,030
Restricted reserves	42	407	449	500	515
Revaluation reserves	2,475	5,497	7,972	9,214	8,302
Pension reserves	35	24	59	28	114
Total reserves	12,205	8,453	20,659	18,358	15,485
Total financing and reserves	**47,340**	**25,853**	**73,193**	**67,587**	**61,847**

Fixed assets

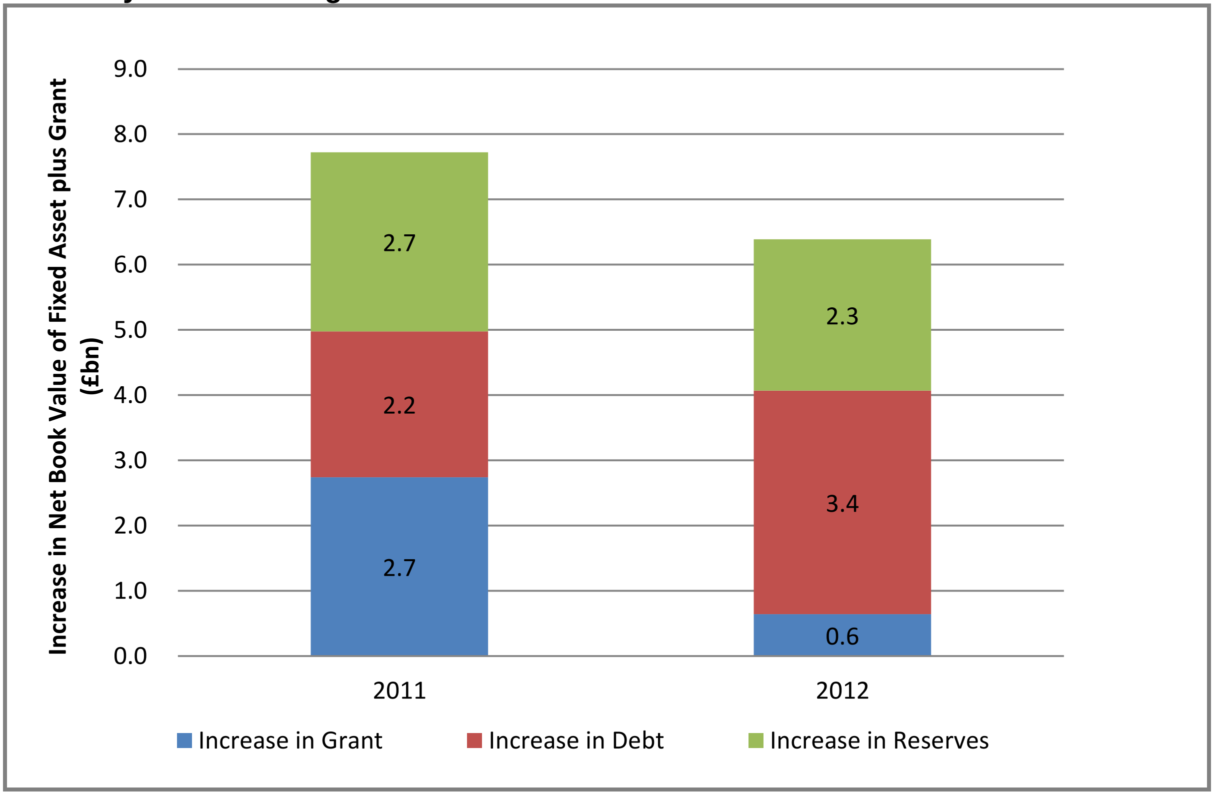
Providers are free to report properties in the balance sheet at either historic cost or valuation. At March 2012, 55 providers reported housing properties at valuation (2011: 69 providers). This equates to 83% of the value of the sector's housing properties being shown in the balance sheet at historic cost (2011: 77%). Providers changed their accounting policy to report housing properties at cost rather than valuation due to the adoption of component accounting.

The Gross Book Value (GBV) of the sector's assets (total housing properties at cost and valuation) has increased by £9.1bn (8%) to £118.6bn. The increase in GBV has been partly funded by an increase in capital grants of £0.6bn to £43.8bn, and a £3.4bn increase in external debt to £48.5bn.

The growth in GBV was consistent with the previous year at 8%. The number of stock transfers from local authorities has continued to decrease significantly over the past four years. There were two new stock transfers included in the 2012 figures, compared to four new stock transfers in 2011. The two new stock transfers were Bolton at Home and Red Kite Community Housing. In 2012, 70% of the growth in GBV was attributable to traditional providers (2011: 71%).

The net book value of total fixed assets increased by £5.7bn to £71.2bn. This was primarily funded by increased debt, internally generated reserves and a net increase in values as a result of the adoption of component accounting[2]

Figure 1
Summary of the funding of the increase in the value of fixed assets



[2] As described in Reserves section on page 14

Current assets

Current assets have increased by £207 million (2%) to £9.1bn. The value of properties for re-sale decreased slightly to £1.3bn (2011: 1.4bn). The number of unsold Affordable Home Ownership (AHO) homes is monitored by the Regulator through its Quarterly Survey of providers. The survey results show that sales are completing and that most unsold AHO homes have been available for less than six months. Where responses to the survey indicate material levels of unsold stock, the Regulator engages closely with providers to monitor the impact of the unsold stock on the provider's cashflow position.

The total cash and short term investments reported in 2012 were £2.7bn (2011: £2.4bn). It is vital that providers have sufficient access to liquid funds at all times.

Non-liquid and other current assets increased by £30m to £5.2bn. Approximately 43% of non-liquid and other current assets are attributable to inter-group balances. There has been an increase in the amounts due from group members for traditional providers and this is reflected in the rise in non-liquid and other current assets of £294 million (10%) in this sub-sector.

Around 23% of non-liquid and other current assets are for future works, reflecting the contractual arrangements between councils and stock transfer providers to complete refurbishment programmes. This amount is reported under current assets with a corresponding entry in current and/or long term liabilities. Stock transfer providers had a reduction in non-liquid and other current assets of £264 million (12%). Fewer homes have been transferred into the sector via stock transfer providers in recent years. Together with continued progress on existing improvement programmes by stock transfer providers, this has contributed to a decline in the future works balances reported in the balance sheet. Other items included within non-liquid and other current assets are prepayments, accrued income, grant receivable, development partner debtors and rent and service charge debtors.

Current liabilities

Current liabilities have increased by £97m (2%) to £6.4bn. This comprises a decrease in short term loans of £67m, a decrease in bank overdrafts of £16m whilst other current liabilities rose by £181m.

Approximately 55% of other current liabilities were amounts due to other group undertakings in respect of monies borrowed from treasury vehicles. 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 balances as due to group undertakings rather than as housing loans.

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

Net current assets

Net current assets were £2.7bn at March 2012 (2011: £2.6bn) showing a positive position for the sector's short-term solvency. However, not all current assets are readily convertible to cash, and the sector aggregate masks different provider characteristics. This means that continued effective cash flow management in the sector is essential.

Long term liabilities

External debt (long term loans) has increased by £3.5bn (8%) to £47.9bn in 2012 (2011: £44.4bn). The external debt drawn by the traditional sub-sector has increased by £3.1bn to £32.1bn and this represents 67% of the total debt of the sector (2011: 65%). Those providers managing in excess of 10,000 homes accounted for 57% of the total drawn debt of the sector (2011: 52%).

The increase in total debt (long and short term loans) was 53% higher than in 2011 and 22% higher than in 2010. This reflects an increasing proportion of debt drawn to support future investment in fixed assets. A limited stock transfer programme will, conversely, exert a downward pressure on the rate of increase in debt in this sub-sector.

During 2011/12, providers have increasingly accessed the bond market for financing. Fourteen bond issues were completed during the year, totalling around £1.8bn, compared to six issues totalling £940 million in 2011 and five issues totalling £988 million in 2010. The issuers were: Catalyst (two), Places for People (three), Notting Hill, Moat, Circle Anglia, Radian, AmicusHorizon, Hastoe, London & Quadrant and The Housing Finance Corporation (two). The Housing Finance Corporation is an aggregating financial intermediary that enables smaller providers to access finance via the capital markets.

Re-financing risk can be expressed in terms of the percentage of loans that are due to be repaid in less than one year. Short term loans have decreased by 10% to £612m. This represents 1.3% of all outstanding loans (2011: 1.5%) and it demonstrates that re-financing risk is low for the sector as a whole. For four providers within the sector, over 50% of loans are due to be repaid within one year. This represents a high re-financing risk for these providers. The financial position of providers is monitored closely by the Regulator and it will continue to engage with the sector to gain assurance that providers have the facilities they need.

Reserves

Reserves are not ‘cash backed’ as most of the surplus transferred to balance sheet reserves is reinvested in the provider’s business, including major repairs of existing stock and the development of new homes. To date, 88% of total reserves have been re-invested into total fixed assets (2011: 83%).Total reserves have increased by £2.3bn (13%) to around £21bn. In 2011, total reserves increased by £2.9bn which was a 19% increase.

The accumulated surplus increased by 56% (£4.2bn) to £11.7bn. Of this increase, £2.4bn is attributable to prior period adjustments in respect of the adoption of component accounting. This accounting change has had a considerable impact on the financial statements in this year and is a one-off change in accounting policy. Prior period adjustments in stock transfer providers accounted for 91% of the total. The effect of the adoption of component accounting has been to increase the amount of major repairs expenditure that was accounted for on the balance sheet. This is depreciated over the estimated useful life of the component. In previous years, a higher proportion of this expenditure was fully expensed through the income and expenditure account in the year in which it was incurred. In 2012, the average capitalisation rate for major repairs was 77% compared to 55% in 2011.

The revaluation reserve reduced by £1.2 million (14%) to £8.0bn and this represents 39% of total reserves. This is largely attributable to five providers that changed accounting policy for housing properties from valuation to historic cost. Valuations of properties on an existing use basis are likely to be higher than historic cost net of grant.

Transfers to reserves totalled £377 million (2011: £400 million). An actuarial loss on pension schemes totalled £350 million. This follows an actuarial gain on pension schemes of £328 million in 2011 due to a change in the valuation of pensions using the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). The loss on pension schemes in 2012 led to an increase in the pension liability reported in the balance sheet of 57% to £688m (2011: £438m).

Table 4

Summary income and expenditure account

All figures in £ million	Traditional 2012	Stock transfer 2012	Total 2012	Total 2011	Total 2010
Turnover	8,674	5,077	13,751	12,647	12,280
Operating costs	(6,113)	(3,733)	(9,846)	(9,569)	(9,480)
Cost of sales	(570)	(101)	(672)	(491)	(563)
Exceptional items	(12)	(1)	(12)	116	(13)
Operating surplus	**1,978**	**1,242**	**3,220**	**2,704**	**2,224**
Surplus on sale of fixed assets	450	67	516	321	347
Gift aid	28	(11)	17	27	8
Other items	215	8	223	35	(55)
Interest receivable and other income	147	24	171	135	126
Interest payable and similar charges	(1,609)	(747)	(2,355)	(2,094)	(2,021)
Exceptional items relating to early redemption of loans	(6)	(12)	(18)	(10)	(7)
Surplus before tax	**1,204**	**571**	**1,775**	**1,117**	**622**
Corporation tax	(2)	5	3	(1)	(13)
Surplus after tax	**1,203**	**575**	**1,778**	**1,116**	**609**
Transfer (to)/from reserves	302	76	377	400	(371)
Accumulated surplus/(deficit) b/f	7,710	(184)	7,526	5,523	5,420
Actuarial surplus (loss) on pension scheme liability	(103)	(246)	(350)	328	
Prior period adjustments	229	2,185	2,414	159	(135)
Accumulated surplus /(deficit) c/f	**9,340**	**2,405**	**11,745**	**7,526**	**5,523**

Turnover and operating costs

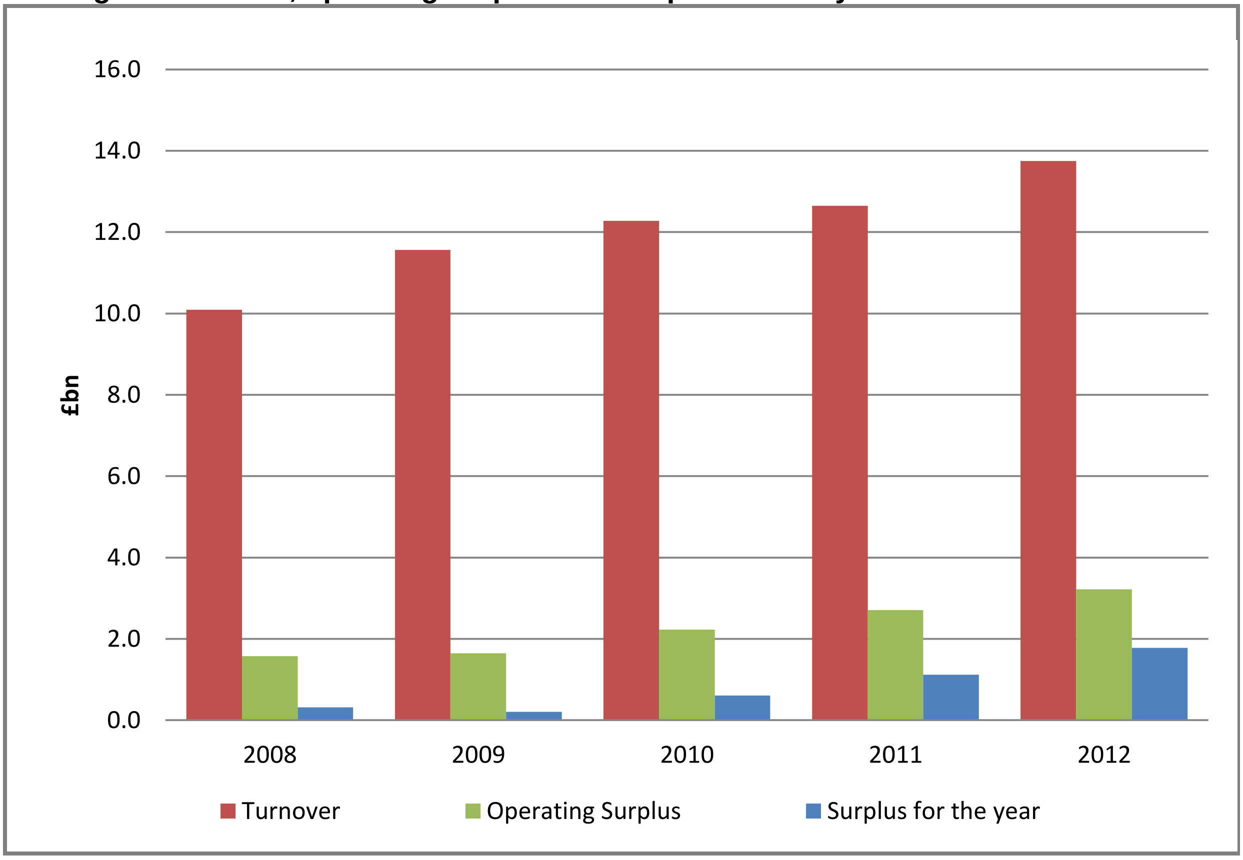
Turnover has increased by £1.1bn (9%) to £13.8bn. This was the highest year-on-year increase since 2009 when first tranche shared ownership sales were included in turnover for the first time, contributing to a 15% increase. Of the 9% increase in 2012, £761m (69%) was attributable to traditional providers (2011: 63%) and £342m (31%) was attributable to stock transfer providers (2011: 37%).

Total operating costs increased by £277m (3%) to £9.8bn. The increase in operating costs was below the level of inflation throughout the period. RPI was 5.2% in April 2011 and this rose to 5.6% in September 2011 before falling to 3.6% in March 2012. This includes an increase of £39m (1%) for stock transfer providers and £238m (4%) for traditional providers. In 2011, operating costs decreased by 1% for the stock transfer sub-sector and increased by 2% for the traditional sub-sector. Exceptional items of £12m are mainly attributed to impairment charges on non-social housing activities within two large traditional providers.

The overall operating surplus has increased by £516m (19%) to £3.2bn. This led to an improvement in the operating margin with an increase from 21% in 2011 to 23% in 2012. However, the operating margin, when adjusted for capitalised major repairs, fell from 12% to 9% in 2012. Investment in capitalised major repairs was £2bn; 62% higher than 2011 and 2010 which had capitalised major repairs of £1.3bn in both years.

Figure 2

Change in turnover, operating surplus and surplus for the year 2008-2012



Surpluses from property sales

The surplus from sales of fixed assets increased by £196m (61%) to £516m. This is significantly higher than the level of sales experienced in the last few years and is more consistent with the surplus recorded in 2008 of £577m. Of the surplus from the sale of fixed assets, £171m (33%) was attributable to five traditional providers. Three of these providers reported relatively high surpluses from the sale of fixed assets in both 2011 and 2012. Just under £200m of the surplus from the sale of fixed assets was generated through sales to other registered providers (2011: £60m).

Interest

Interest payable has risen by £261 million (13%) to £2.4bn. Of the increase, 86% was attributable to traditional providers (2011: 85%). This led to a marginal increase in the aggregate effective interest rate from 5.0% in 2011 to 5.2% in 2012. The aggregate effective interest rate for traditional providers was 5.3% (2011: 5.1%) and for stock transfer providers was 4.8% (2011: 4.7%). Although three month LIBOR increased from around 0.8% to 1% during the year, the historic low interest rate environment has kept the effective interest rate low. The sector fixes the interest rate on approximately 70% of its debt on average (2011: 65%).

Exceptional items relating to early redemption of loans increased by £8m (77%) to £18m. 74% of this was attributable to breakage costs of fixed rate loans for two providers.

Interest capitalised increased by £4m (3%) to £142m. This follows a decrease of 21% in 2011 and 34% in 2010 which was linked to a slowdown in improvement programmes to meet the Decent Homes Standard (DHS). In 2012, 84% of capitalised interest was attributable to traditional providers. Traditional providers capitalised 7% of total interest costs and the stock transfer sub-sector capitalised 3% (2011: 8% and 3% respectively). Capitalised interest for traditional providers increased by 6% in 2012 to £119m and this can be linked to increased development activity.

Interest receivable for the sector increased by £36m (27%) to £171m. This can be attributed to the increase in cash and short term investments held by the sector in 2012.

Net surplus

The performance of the sector has improved between 2011 and 2012 with an increase in net surplus of £662m (59%) to £1.8bn. The net surplus includes £220m under other items. This was due to the collapse of a group structure in a large provider whereby an adjustment was made to reflect the value of the net assets transferring into the recipient provider.

Other contributions to the remaining two thirds of the increase in net surplus include additional rental income of £851m from social housing lettings, over £230m increase in the surplus from sales and a £165m reduction in planned maintenance expenditure. This was offset by an increase of £261m in interest payable and an increase of £583m in depreciation on housing properties. 84% of the increase in the net surplus was attributable to traditional providers. The net surplus of the stock transfer sub-sector increased by 22%, to £575m.

Table 5
Income and expenditure from social housing lettings

All figures in £ million	Traditional 2012	Stock transfer 2012	Total 2012	Total 2011	Total 2010
Income					
Rents	5,805	4,295	10,100	9,249	8,922
Service income	710	231	941	870	801
Charges for support services	145	46	192	209	202
Net rental income	**6,660**	**4,573**	**11,233**	**10,328**	**9,925**
Revenue grants	93	44	138	202	185
Other	135	49	183	167	140
Total turnover from social housing lettings	**6,888**	**4,666**	**11,553**	**10,697**	**10,250**
Expenditure					
Management	1,353	964	2,317	2,206	2,149
Service costs	889	286	1,175	1,129	1,073
Care/support costs	191	51	242	198	193
Routine maintenance	991	791	1,782	1,671	1,638
Planned maintenance	363	352	715	880	820
Major repairs	179	414	593	1,011	1,133
Bad debts	50	31	81	68	75
Lease charges	120	18	139	220	163
Depreciation of housing properties	728	507	1,235	652	551
Impairment of housing properties	13	3	16	1	44
Other	136	65	201	57	169
Total expenditure on social housing lettings	**5,013**	**3,483**	**8,497**	**8,093**	**8,008**
Surplus on social housing lettings	**1,875**	**1,182**	**3,057**	**2,605**	**2,242**

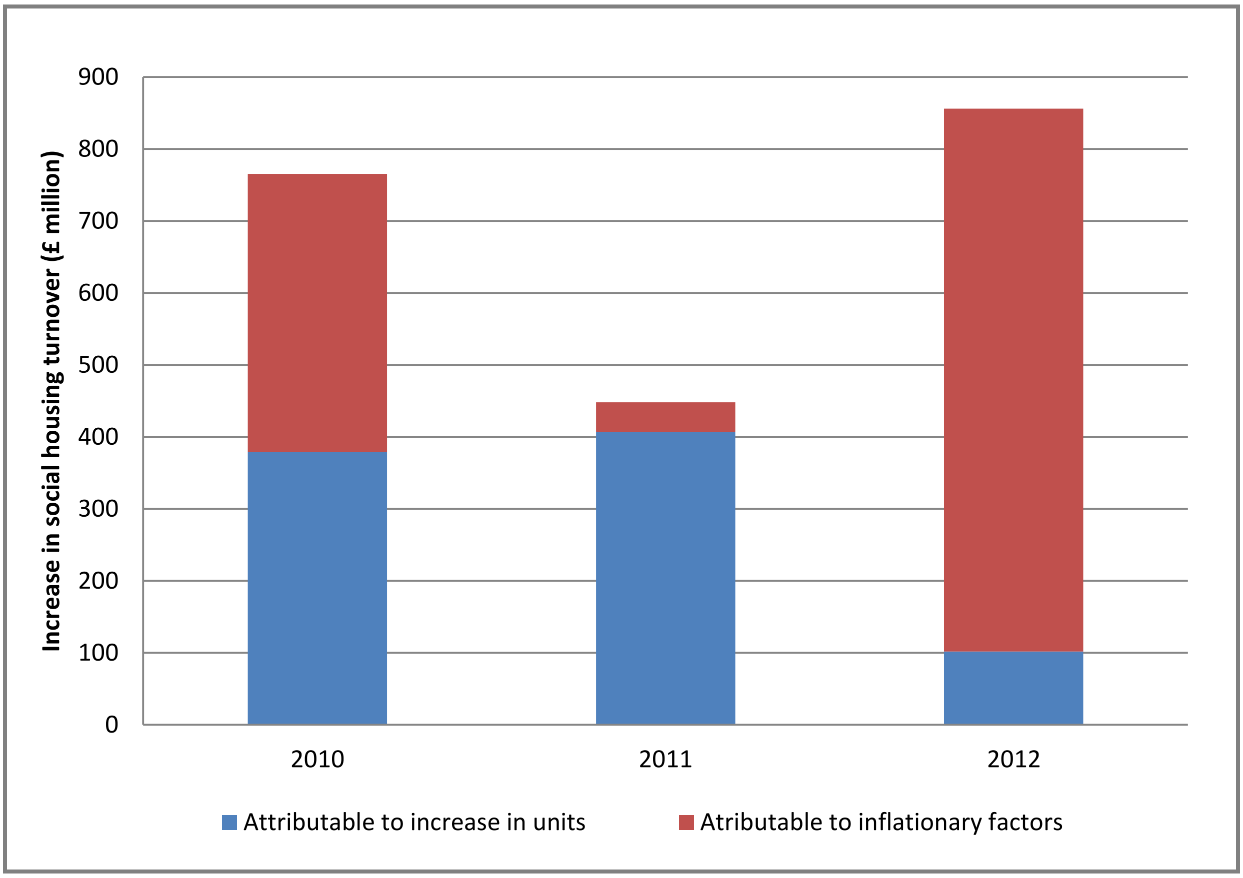
Rents and service income

Turnover from social housing lettings increased by £856m (8%) to £11.6bn. Rental income increased by £851m (9%) and service charge income increased by £71m (8%). These increases were caused by inflationary factors and, to a lesser extent, the increase in the number of homes in management (Figure 3).

The rent per social housing unit increased in 2012 by 8% to £76 per week (2011: £70 per week). There was a 7% increase in service charges per social housing unit and therefore the combined rent and service charges per social housing unit increased to £83 per week (2011: £77 per week). Average rent and service charge per unit was £88 per week for the traditional sub-sector (2011: £81 per week) and £78 per week for the stock transfer sub-sector (2011: £72 per week).

The increase in rent per unit is higher than the guideline limit for rent increases in 2011/12 which was 5.1% (RPI September 2010 4.6% plus 0.5%). The difference between the guideline limit and the change in average rents will be attributable to some rents converging upwards by £2 per week in excess of the guideline limit to target rent levels. Also, new units developed and re-lets are likely to be let at higher rents than those units that are sold.

Figure 3
Increase in turnover from social housing lettings

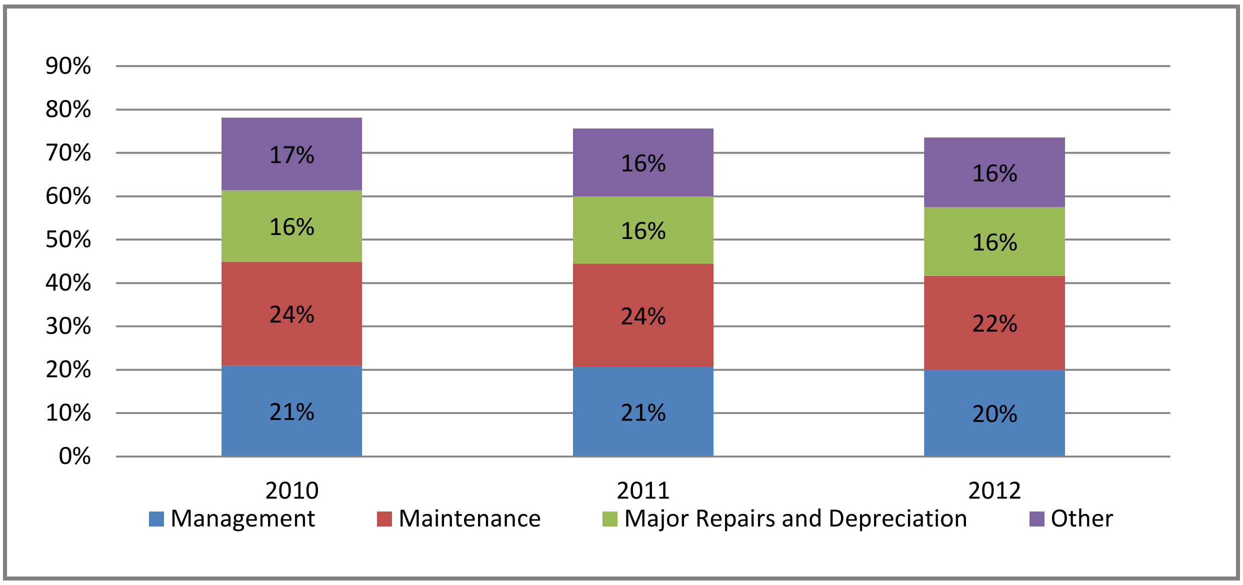


Service charge recovery rates have shown an improving trend over the last few years. Service income represented 72% of service costs in 2009, 75% in 2010 and 77% in 2011. This increased to 80% in 2012.

Social housing costs

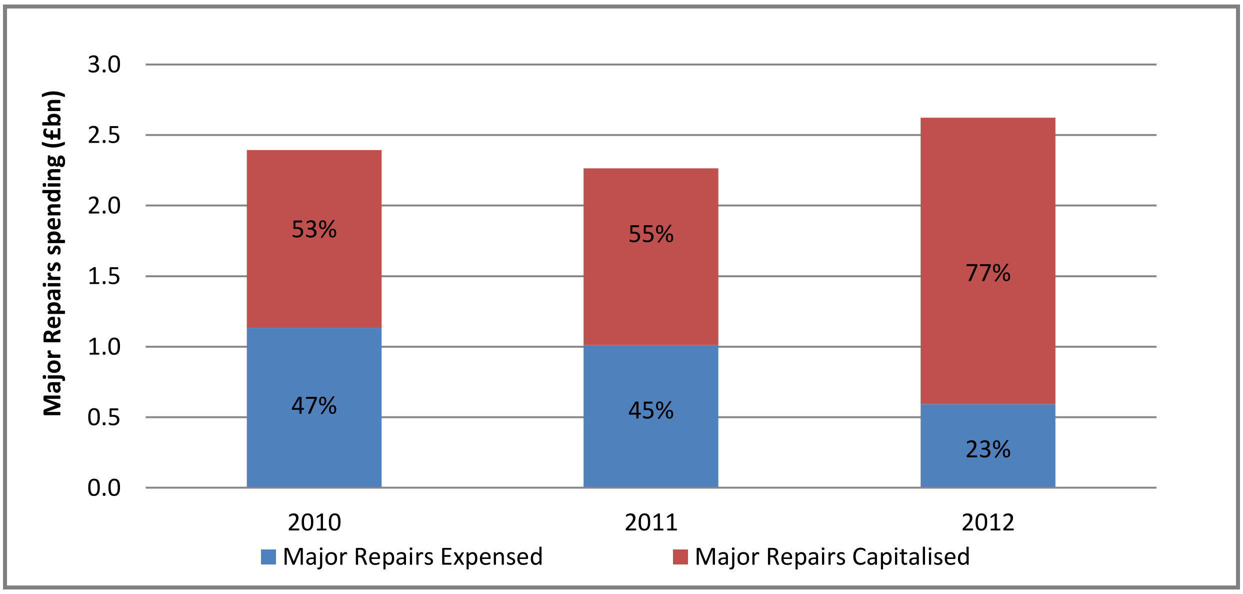
Total expenditure on social housing lettings increased, by £404m (5%), to £8.5bn. This resulted in an improved margin on social housing lettings, as costs as a percentage of turnover fell from 76% in 2011 to 74% in 2012. The key drivers of the increase in margin were reductions in management and maintenance costs as a percentage of turnover. The adoption of component accounting changed the look of the income and expenditure account with a lower proportion of major repairs spending being expensed and an increased depreciation charge. Taking these two cost lines in total, the overall expense was 16% of turnover in 2012, which was unchanged from 2011 (Figure 4).

Figure 4
Operating costs as a percentage of turnover from social housing lettings



Overall, the total major repairs costs (including capitalised major repairs) increased by £359 million (16%). Over the last few years, the average capitalisation rate for major repairs has increased. In 2012, the average capitalisation rate for major repairs was 74% for stock transfers (2011: 53%) and 83% for traditional providers (2011: 60%). The step change in capitalisation rates between 2011 and 2012, as demonstrated in the graph below is due to the adoption of component accounting.

Figure 5
Change in capitalisation rates of major repairs spending



Total repair costs per unit increased by 5% to £2,007 (2011: £1,905). Planned and routine maintenance costs per unit declined by 3%, whilst total major repairs costs per unit (including capitalised) had a significant increase of 15%. This was particularly marked in traditional providers with an increase of 23%, twice the increase experienced by stock transfer providers of 11%.

Management costs increased by £111m (5%). This increase is higher than the 1% increase in social housing homes managed in 2012, resulting in a higher average management cost per unit of £908 compared to £873 in 2011. Stock transfer providers had a higher increase in management costs per unit due to the small reduction in social housing homes in management in 2012.

Due to the adoption of component accounting in 2012, there was a 90% increase in the depreciation of housing properties to £1.2bn (2011: £652m). Depreciation now accounts for 15% of the expenditure on social housing lettings, compared to 8% in 2011. The increase in depreciation of housing properties of £583m charged in 2012 was largely offset by the reduction in major repairs expenditure totalling £418 million.

Impairment of housing properties for social housing lettings was £16m, compared to £1m reported in 2011. The total impairment charge reported by the sector was £31m in 2012 (2011: £58m) and this amount was net of a £13m impairment release in the same period (2011: £9m). 80% of the total impairment reported was attributable to traditional providers (2011: 89%).

Table 6

Costs per unit

Indicator	Traditional	Stock transfers	Total
Management costs per unit £			
2012	946	860	908
2011	925	809	873
2010	947	808	884
% increase			
2011-12	2.4%	6.3%	4.0%
2010-11	-2.4%	0.1%	-1.2%
2009-10	-0.7%	-2.1%	-1.0%
Routine and planned maintenance costs per unit £			
2012	947	1,019	979
2011	987	1,038	1,009
2010	984	1,044	1,011
% increase			
2011-12	-4.0%	-1.8%	-3.0%
2010-11	0.2%	-0.6%	-0.2%
2009-10	3.1%	1.9%	2.4%
Total major repair costs per unit £			
2012	732	1,406	1,028
2011	598	1,269	896
2010	637	1,404	985
% increase			
2011-12	22.5%	10.8%	14.8%
2010-11	-6.2%	-9.6%	-9.0%
2009-10	2.7%	-3.0%	-2.4%
Major repair costs per unit (expensed) £			
2012	125	369	232
2011	241	598	400
2010	266	707	466
% increase			
2011-12	-48.2%	-38.3%	-41.9%
2010-11	-9.2%	-15.4%	-14.2%
2009-10	-4.0%	-11.1%	-10.5%
Major repair costs per unit (capitalised) £			
2012	607	1,037	796
2011	356	671	496
2010	371	696	519
% increase			
2011-12	70.4%	54.6%	60.5%
2010-11	-4.1%	-3.6%	-4.4%
2009-10	8.3%	6.8%	6.2%

Other activities

Table 7
Income and expenditure on other activities

All figures in £ million	Traditional 2012	Stock transfer 2012	Total 2012	Total 2011	Total 2010
First tranche shared ownership sales					
Income	455	145	600	553	698
Expenditure	391	126	517	504	676
Result	**64**	**19**	**83**	**49**	**23**
Other social housing activities					
Income	714	99	814	744	757
Expenditure	740	102	842	780	817
Result	**(26)**	**(2)**	**(28)**	**(36)**	**(60)**
Non-social housing lettings					
Income	184	66	250	213	202
Expenditure	129	30	159	141	137
Result	**55**	**36**	**91**	**73**	**66**
Non-social housing – other activities					
Income	433	102	534	440	372
Expenditure	422	94	516	426	419
Result	**10**	**8**	**18**	**14**	**(47)**
Total other activities					
Income	1,786	411	2,197	1,950	2,030
Expenditure	1,682	351	2,034	1,851	2,048
Result	**103**	**60**	**164**	**99**	**(18)**

The sector reported a surplus on its other activities of £164m (2011: £99m). Traditional providers generated 63% of this surplus compared to 18% in 2011 showing an improving trend. The surplus generated by the stock transfer sub-sector fell by 27% to £60m.

Turnover from first tranche sales increased by £47m (9%) to £600m reflecting an increase in sales compared to 2011. This improvement breaks the trend of a decline in turnover since 2009 when data on first tranche sales was first reported in the Global Accounts. Margins also improved from 9% to 14% and therefore the surplus on first tranche sales increased by 69% to £83m.

A deficit of £28m was reported on other social housing activities - an improvement on the deficit of £36m in 2011. Activities typically reported in other social housing activities include Supporting People contract income, expenditure on regeneration community based activities and development overheads.

The sector reported a surplus on non-social housing lettings of £91m (2011: £73m). The operating margin achieved on non-social housing lettings was 36% (2011: 34%).

Other non-social housing activities (including properties developed for outright sale) saw a 21% increase in revenues to £534m. This can be linked to a rise in non-social housing sales mainly within three large providers. Margins remained low at around 3%.

Homes in management

Table 8
Number of homes managed

	2012	2011	2010
Social housing			
Traditional	1,429,549	1,404,464	1,327,870
Stock transfer	1,121,577	1,122,618	1,102,749
Total	**2,551,126**	**2,527,082**	**2,430,619**
Non-social housing			
Traditional	71,426	71,343	65,302
Stock transfer	16,334	16,948	17,671
Total	**87,760**	**88,291**	**82,973**
All homes			
Traditional	1,500,975	1,475,807	1,393,172
Stock transfer	1,137,911	1,139,566	1,120,420
Total	**2,638,886**	**2,615,373**	**2,513,592**

The total homes managed by providers increased by 23,513 homes (1%). The number of social housing homes managed increased by 24,044 (1%), with the number of non-social homes decreasing by 531 (0.6%). During 2011/12, there were a number of homes that were reclassified for reporting purposes from non-social housing to other social housing and this contributed to the reduction in non-social housing homes in 2012. Overall the proportion of non-social homes remained steady, representing 3% of the total homes in management (2011: 3%).

Social housing homes managed by stock transfer providers had a small decrease of 1,041 homes (0.1%). This small decline follows growth of 2% in 2011, with the increase of 19,869 homes. The number of homes transferring into the sector through stock transfer providers in 2012 was 23,840 from two providers. During 2011/12, seven stock transfer providers were transferred into other traditional providers as part of group restructuring within the sector. These stock transfer providers represented around 52,000 social housing homes. Overall, the number of social housing homes managed by traditional providers increased by 25,085 (2011: 76,594).

The number of homes managed in the stock transfer sub-sector as a proportion of total homes was slightly lower than the prior year at 43% and continues the declining trend since 2008 (2011: 44%, 2010: 45%, 2009 and 2008: 46%).

In both stock transfer and traditional sub-sectors, the increase reported is net of any sales or demolitions. Also, there are a small number of providers that move in and out of the dataset each year. This is due to changes in accounting periods or changes in the number of homes in management above or below the 1,000 homes threshold for the requirement to submit the FVA return.

Approximately 50,000 new homes were developed during 2011/12. This reflects a 12% increase on the number of homes developed during 2010/11 of around 45,000. The growth achieved through this development was offset by a number of sales/demolitions during the period totalling 23,989 (2011: 14,548).

Key ratios

Key financial ratios in Table 9 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.

The ratios show that the sector has continued to grow with an increase in total assets of 5.6%. This signals the lowest level of growth in the sector over the last few years and is significantly below peak growth levels of 11.5% and 11.7% achieved in 2008 and 2009.

The operating margin showed an improved performance for the sector at 23.4% (2011: 21.4%). This is mainly due to improved margins on the core social housing lettings business. Other social housing and non-social housing activities also achieved higher margins with a higher level of activity in first tranche shared ownership sales and outright sales. The traditional sub-sector had a higher operating margin on social housing lettings than the stock transfer sub-sector caused by lower major repairs expenditure overall. However, the stock transfer sub-sector demonstrated slightly higher profitability with an overall operating margin of 24.5%. This is due to the stock transfer sub-sector generating a significantly higher margin on non-social housing lettings (54.8%) compared to the traditional sub-sector (29.9%).

The effective interest rate increased by 0.2% to 5.2% in 2012. The movement in rates reflects the changes in reference rates during the year (most typically 3 month LIBOR). The 3 month LIBOR rate increased from 0.82% to 1.01% over the 12 months to March 2012. The effective interest rate for both sub-sectors is the same as those experienced in 2010. Total interest costs (including capitalised) as a percentage of turnover have remained at around 18% for 2011 and 2012.For the traditional sub-sector this was 20% and for the stock transfer sub-sector this was 15%.

Despite an increase in the effective interest rate, the improved operating margin led to a stronger interest cover ratio for the sector which is measured by the EBITDA MRI interest cover ratio. Interest cover increased from 106.4% to 115.7%, demonstrating that the sector as a whole generated enough surplus to meet its interest payments with no reliance on the sale of fixed assets. However, it should be noted that this interest cover measure includes less certain cash flows generated from first tranche sales and the sale of non-social housing properties. Total other activities contributed to 5% of the total operating surplus (2011: 4%). There was a stronger performance in the traditional sub-sector, as is to be expected, with interest cover rising to 128%. 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. Underlying the overall position, is a range of performances where 103 out of 347 providers (2011: 118 out of 366 providers) had an EBITDA MRI interest cover ratio below 100% of which 70 were stock transfer providers.

Table 9
Key financial ratios by sub-sector

	2012	2011	2010
Growth ratios			
Growth in turnover			
Sector	8.7%	3.0%	6.2%
Traditional providers	9.6%	3.0%	7.4%
Stock transfers	7.2%	3.0%	4.2%
Growth in total assets			
Sector	5.6%	7.4%	6.2%
Traditional providers	5.7%	7.0%	7.2%
Stock transfers	5.3%	8.6%	3.5%
Growth in total debt			
Sector	7.6%	5.2%	7.0%
Traditional providers	10.2%	6.3%	8.1%
Stock transfers	2.7%	3.2%	5.1%
Profitability ratios			
Operating margin			
Sector	23.4%	21.4%	18.1%
Traditional providers	22.8%	20.6%	18.9%
Stock transfers	24.5%	22.7%	16.7%
Effective interest rate			
Sector	5.2%	5.0%	5.1%
Traditional providers	5.3%	5.1%	5.3%
Stock transfers	4.8%	4.7%	4.8%
Debt servicing ability			
EBITDA MRI interest cover			
Sector	115.7%	106.4%	81.1%
Traditional providers	128.0%	114.8%	101.5%
Stock transfers	87.9%	89.3%	40.1%
Adjusted net leverage			
Sector	41.5%	40.9%	41.8%
Traditional providers	37.2%	35.6%	35.7%
Stock transfers	54.1%	56.5%	60.5%
Debt per unit (£)			
Sector	18,372	17,226	17,034
Traditional providers	21,664	19,995	19,921
Stock transfers	14,029	13,640	13,445

Loan covenants related to gearing are common in the loan agreements of the traditional sub-sector. It is calculated in a number of ways, however, all calculations measure the proportion of debt to equity in a provider's financial structure. A common definition is to measure loans as a proportion of the sum of grant and reserves. Most loan agreements that use this definition set a maximum gearing level of between 60% and 80%. Sector level gearing measured using loans as a proportion of the sum of grant and reserves (excluding revaluation reserves) is 85.9% in 2012 (2011: 86.1%). The ratio is 66.3% for the traditional sub-sector (2011: 62.2%), and 216.0% for the stock transfer sub-sector (2011: 321%).

The Regulator uses the adjusted net leverage ratio as the key measure of indebtedness. This is not widely used in loan agreements and produces a lower result than the traditional definition of gearing. It takes into consideration cash reserves, and allows more useful comparison between providers that value properties on different bases. Despite external debt funding continuing to increase, the level of leverage for the sector remained relatively low. The adjusted net leverage ratio has increased by 0.6% to 41.5%. This increase is mainly due to the growth in total debt in the traditional sub-sector of 10.2%. The reason for the small increase in adjusted net leverage, in contrast with the small reduction in gearing noted above, is that the decrease in the revaluation reserve is included in the adjusted net leverage calculation. Gearing levels are expected to rise as the Affordable Homes Programme continues due to the reduction in grant rates which has created a need for greater levels of debt to fund development.

There is a considerable variation between the traditional sub-sector with a reported adjusted net leverage of 37.2% and 54.1% for the stock transfer sub-sector. Higher levels of indebtedness are characteristic within the stock transfer sub-sector. This is because new stock transfer providers typically complete significant major repairs and improvement works in the first five years of transfer. As a consequence, newer stock transfer providers tend to record deficits in the first five years and these deficits are funded with debt. With only two new stock transfer providers in 2012, the adjusted net leverage for the stock transfer sub-sector decreased by 2.4% to 54.1%.

The 8% increase in external debt was not matched by the increase in homes which only increased by 1%. Therefore, the debt per home has risen by 7% to £18,372 (2011: £17,226). This increase in mostly attributable to the traditional sub-sector where the debt per home increased by 8% to £21,664 (2011: £19,995). Stock transfers reported a relatively smaller increase of 3% to £14,029 (2011: £13,640).

Part D – Thematic analyses

D1 – Analysis of financial forecast returns 2012/13

Dataset

The Social Housing 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 organisations' business plans. Consequently they are returned at the level at which organisations complete business plans, be that at group or subsidiary level. The majority of providers submit a 30 year FFR, although traditional providers undertaking very little development can submit a five year FFR.

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

Headline figures

This analysis focuses on the first five forecast years. Providers' business plans include a mix of development plans including contractually committed development, programmes agreed with HCA Investment, non-grant funded development and uncommitted, aspirational development. The Affordable Homes Programme runs until 2015 and we therefore see more development in the first three years of the plans than in later years. This has the effect of increasing cashflow in the later years of the plan as projected investment in new supply falls.

The Affordable Homes Programme is characterised by lower levels of grant funding and higher levels of debt funding compared to previous grant-funded development programmes. This is reflected in the forecasts as gearing[3] is expected to increase to 91.4% in 2014 with debt increasing by £9bn, and grant by £2bn, in the first two forecast years.

Operating margins are projected to improve throughout the period, from 23% to 28%, as cost increases are expected to be lower than the rate of rental increases.

Sales of current assets (first tranche affordable home ownership and properties developed for outright sale) are forecast to increase from £1.2bn in 2013 to £2.2bn in 2015 and 2016. This meansincreasing exposure to the housing market in those years, contributing to the increased operating margins.

[3] Gearing defined as debt as a percentage of grant plus reserves. This represents a different basis to the gearing calculation in the main Global Accounts section of this report, as revaluation reserve is not separately identified in FFRs

Financial statements

Table 10
Summary income and expenditure account

£million	2013	2014	2015	2016	2017
Turnover	15,009	16,111	17,443	18,005	18,146
Operating expenditure	(11,507)	(12,042)	(12,909)	(13,002)	(12,987)
Operating surplus	3,502	4,068	4,534	5,004	5,159
Profit/(loss) on the sale of fixed assets	261	227	221	209	197
Surplus before interest and tax (SBIT)	3,763	4,295	4,755	5,212	5,356
Interest and other finance costs	(2,540)	(2,775)	(3,117)	(3,358)	(3,493)
Surplus for the year before tax	1,223	1,521	1,637	1,854	1,863
Tax	(9)	(10)	(13)	(15)	(15)
Surplus for the year	1,214	1,511	1,624	1,839	1,848

The income and expenditure account shows strong projected results for the first five forecast years, with a retained surplus of between 8% and 10% of turnover in each year. Operating margins are projected to increase steadily over this period from 23% in year 1 to 28% in year 5. Projected interest cover (on a revenue basis) is very strong at around 150% in each year. Increases in operating margins offset the impact of increased interest costs as a result of an anticipated increase in effective interest rates and additional borrowings.

A steadily increasing trend in operating margins is in keeping with the pattern that is usually exhibited in provider forecasts. This is illustrated on Figure 6 below. The graph also shows the trend in historical performance which supports the reasonableness of future projections.

Figure 6
Operating margins

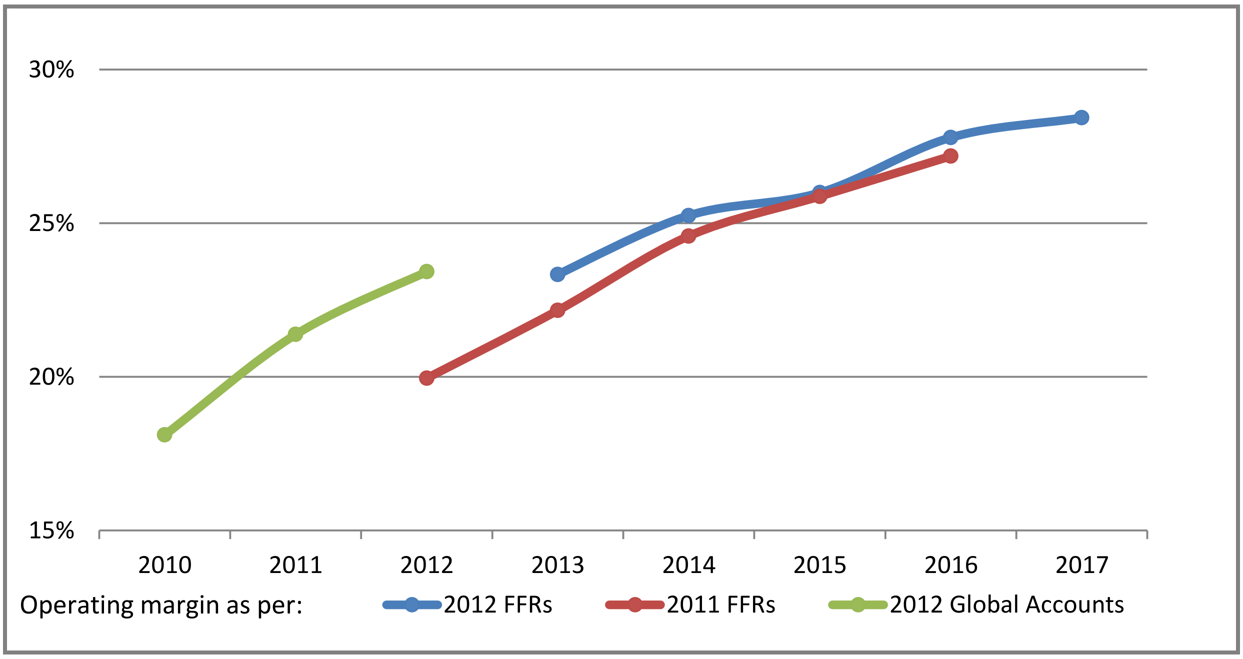


Table 11
Summary balance sheet

£million	2013	2014	2015	2016	2017
Total fixed assets	75,635	81,865	86,365	89,185	91,575
Net current assets incl. pension assets	4,726	4,080	3,460	3,066	2,735
Total assets less current liabilities	**80,362**	**85,945**	**89,825**	**92,252**	**94,309**
Long term loans and provisions	59,249	62,991	64,901	65,037	64,730
Reserves	21,113	22,954	24,923	27,215	29,580
Total loans provisions and reserves	**80,362**	**85,945**	**89,825**	**92,252**	**94,309**

The balance sheet is projected to grow with significant investment in new supply and the existing asset base. Loans peak in year 4 at £64.2bn. However, gearing peaks in year 2 at 91.4%, falling back to 84.5% in year 5. Debt as a percentage of turnover peaks in year 1 at 3.9 times falling to 3.5 times in year 5.

Table 12
Summary cashflow statement

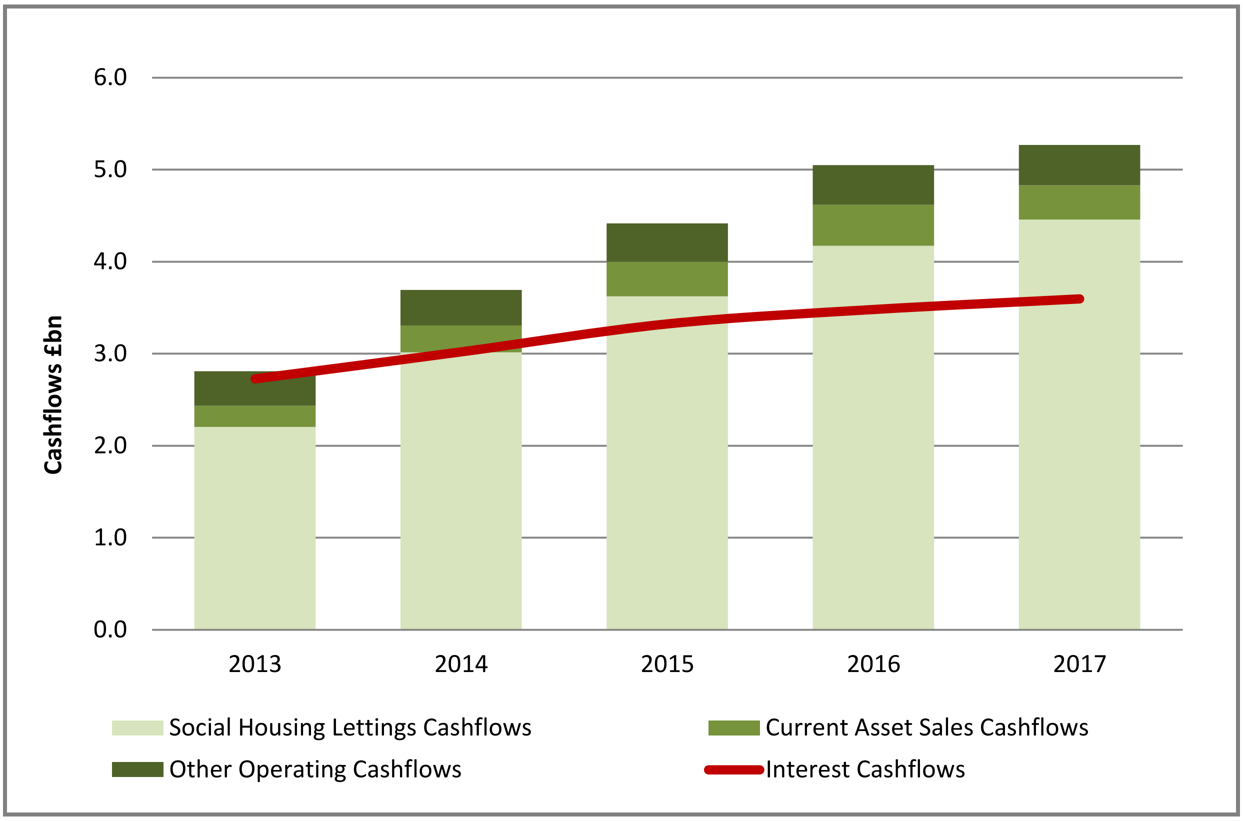
£million	2013	2014	2015	2016	2017
Operating cashflows	2,811	3,693	4,414	5,048	5,269
Interest cashflows	(2,726)	(3,019)	(3,323)	(3,480)	(3,595)
Payments to acquire or develop properties	(6,654)	(6,377)	(4,343)	(2,319)	(2,119)
Fixed asset sales	760	594	558	550	534
Grant	1,062	832	825	258	217
Other cashflows	(390)	(369)	(250)	(107)	(18)
Cashflow before resources & funding	**(5,138)**	**(4,646)**	**(2,119)**	**(51)**	**288**
Increase in medium & long term debt	6,840	4,454	2,984	1,820	1,707
Loan repayments	(1,469)[4]	(825)	(883)	(1,552)	(2,011)
Other financing cashflows	(79)	39	49	(19)	(17)
Financing cashflows	**5,292**	**3,668**	**2,150**	**248**	**(321)**
Cash increase / (decrease)	154	(978)	31	198	(33)

Operating cashflows take into account capitalised major repairs spending and depreciation and therefore differ from operating surplus. Interest cover on this cash basis increases from 103% in year 1 to 147% in year 5. This equates to a total free cashflow from operations of £5.1bn over the period with an increase from £0.1bn in year 1 to £1.7bn in year 5. This free cashflow is projected to support a total of £21.8bn investment in new supply over the same period.

Figure 7 shows that social housing lettings cashflows are expected to fully meet interest cashflows from 2015 onwards.

[4] The figure for loan repayments differs from short term loans in the Global Accounts balance sheet due to the differing treatment of revolving loan facilities in statutory accounts and business planning tools in a number of providers.

Figure 7
Breakdown of operating and interest cashflows (£bn)



Development activity is concentrated in the three years to 2015, the period of the Affordable Housing Programme, with around £17.4bn of expenditure projected. Grant funding (net of repaid grant) is £2.7bn to 2015. Medium and long term debt is expected to increase by £14.3bn with loan repayments of £3.2bn. Cashflows in years 4 and 5 show that a lower level of development is supported at the macro level by operating cashflows, with increases in debt funding offset by loan repayments. The next section, 'Cashflow Dynamics', will take a closer look at some of the drivers behind these cashflows.

Table 13
Units

Units (000s)	2013	2014	2015	2016	2017
Opening units	2,554	2,587	2,629	2,674	2,695
New units	46	51	53	28	20
Units sold	13	9	8	7	6
Closing units	**2,587**	**2,629**	**2,674**	**2,695**	**2,709**
First tranche unit sales	9	10	11	8	5
Outright sale unit sales	3	4	6	6	5

Unit numbers illustrate the development profile noted above. Total units sold peak in 2015 at 25,000. A proportion of the units sold are planned as part of stock rationalisation programmes and are likely to be transferred to other registered providers.

Cashflow dynamics

Table 14
Social housing lettings analysis

£million	2013	2014	2015	2016	2017
Rents receivable	10,939	11,550	12,193	12,805	13,283
Service charges	1,025	1,064	1,102	1,139	1,174
Rent losses from voids	(201)	(220)	(232)	(246)	(254)
Other Income	503	492	471	481	493
Income from social housing lettings	**12,267**	**12,886**	**13,534**	**14,179**	**14,696**
Management costs	(2,918)	(2,963)	(3,013)	(3,082)	(3,156)
Service costs	(1,054)	(1,096)	(1,139)	(1,172)	(1,210)
Routine maintenance costs	(2,260)	(2,299)	(2,368)	(2,420)	(2,493)
Major repairs	(3,028)	(2,684)	(2,537)	(2,443)	(2,463)
Rent losses from bad debts	(121)	(163)	(179)	(196)	(201)
Other costs	(681)	(665)	(674)	(695)	(714)
Total social housing lettings costs	**(10,062)**	**(9,870)**	**(9,910)**	**(10,007)**	**(10,238)**
Operating cashflow	**2,204**	**3,015**	**3,624**	**4,172**	**4,459**

The forecasts show an average annual growth in rents of 5% per year. Additional social housing units account for around 22% of this increase, with 78% explained by inflationary factors. Inflationary factors include the headline RPI rate of inflation assumed, additional increases allowable under the rent formula and the effects of higher rents on new properties including the impact of Affordable Rent.

Service charge recovery rates are 97% over the five year period. Historic performance shows an improving trend but further improvement will be necessary as the 2012 recovery rate was 80%. There is a small increase in projected rent losses from void properties as the void loss rate increases from 1.68% in year 1 to 1.76% in year 5. Rent losses from bad debts show a more pronounced increase from 1.01% to 1.39%, an increase of 66% in cash terms. This increase is likely to be as a result of some providers anticipating the impact of welfare reform on rent collection. More providers are expected to factor in these changes in 2013 as the implementation of elements of welfare reform near.

The forecasts show that the cash operating margin on social housing lettings increases from 18% in year 1 to 30% in year 5. The greatest contributory factor to this forecast improvement is reduced spending on major repairs. In year 1, major repairs spending is equivalent to 24.7% of revenue. This falls to 17.0% in year 5. This is likely to be due to a reduced volume of works as catch up works to meet the DHS are substantially complete.

Providers are forecasting that they will hold management cost increases below the expected headline rate of inflation. Overall, the forecasts show average annual growth in management costs of 2% per year. Management costs on a per unit basis increase by just 3.5% over the five year period and are flat in years 2 and 3. As a percentage of income from social housing lettings, management costs fall from 23.8% in year 1 to 21.5% in year 5. A similar pattern is observable for routine maintenance costs, as they fall from 18.4% of revenue to 17.0% in year 5. This projected reduction in these cost lines, as a percentage of social housing lettings income, represents a continuation of a trend that has seen both cost categories reduce as a percentage of income by 2.3 percentage points in the last five years.

Table 15
Current asset sales

£million	2013	2014	2015	2016	2017
Shared ownership first tranche sales					
Sales receipts	610	725	906	654	440
Cost of sales	(513)	(609)	(764)	(544)	(361)
Net cashflow - first tranche sales	**97**	**116**	**142**	**110**	**79**
Sale of properties developed for sale					
Sales receipts	684	1,026	1,437	1,592	1,399
Cost of sales	(550)	(851)	(1,204)	(1,259)	(1,107)
Net cashflow - properties developed for sale	**134**	**175**	**233**	**333**	**292**
Net cashflow for all current asset sales	**231**	**292**	**375**	**444**	**371**

Increased current asset sales activity is forecast under both shared ownership and outright sales programmes. First tranche activity peaks in 2015, being the final year of the current Affordable Homes Programme, with increases in sales revenues of 19% in 2014 and 25% in 2015. The margins anticipated on first tranche sales also increase, from around 16% in the first three years, with higher forecast margins in the final two forecast years as activity declines. The margin on first tranche sales has shown an increasing trend in recent years. It was 14% in 2012. Outright sales activity peaks in 2016, with annual sales more than double the year 1 projection in years 3, 4 and 5. Margins are expected to increase to 21% in years 4 and 5.

The pattern for forecast increased sales activity in the medium term will require careful monitoring at a provider level. At a macro level, strong operating surpluses from the core social housing lettings income stream reduces the risk from increased exposure to the housing market.

Table 16
Fixed asset sales

Fixed asset sales income (£ million)	2013	2014	2015	2016	2017
General needs	496	388	313	270	232
Shared ownership (non 1st tranche)	128	148	174	198	195
Other	136	59	71	82	107
Total	**760**	**594**	**558**	**550**	**534**

In total, fixed asset sales are forecast to be £3bn across the five year period. The most significant category of receipts is that of the general needs housing stock, including Right to Buy sales and the sales of properties to other providers, for example, as part of a stock rationalisation programme. Shared ownership sales are predominantly staircasing sales.

Table 17
Interest cashflows

£million (unless otherwise stated)	2013	2014	2015	2016	2017
Interest paid	2,782	3,076	3,387	3,557	3,676
Opening debt	52,355	58,096	61,767	63,914	64,182
Closing debt	58,096	61,767	63,914	64,182	63,867
Average debt	55,226	59,932	62,841	64,048	64,025
Effective interest rate (%)	5.0%	5.1%	5.4%	5.6%	5.7%
Sum of fixed rate debt	42,701	43,587	43,962	42,830	41,199
Sum of variable rate debt	15,395	18,181	19,951	21,352	22,668
Debt at fixed rates (%)	74%	71%	69%	67%	65%

Effective interest rates are projected to steadily increase from 5.0% in year 1 to 5.7% in year 5. The majority of debt is at fixed rates of interest, which increases the certainty around future interest cost projections. However, the amount of debt held at variable interest rates is projected to be over £20bn by year 4. The risk inherent in the business plans from variable rate debt will vary according to the LIBOR assumption. At the provider level, the Regulator monitors further treasury risks including re-pricing risk and mark-to- market derivative exposure. Providers often forecast based on debt reverting to variable rate interest when current hedging arrangements expire - although in reality, they will look to arrange additional hedging as part of an active treasury management strategy.

Table 18
Development – summary

	2013	2014	2015	2016	2017
Payments to acquire or develop properties (£m)	6,654	6,377	4,343	2,319	2,119
Shared ownership cost of sales (£m)	513	609	764	544	361
Grant (£m)	1,062	832	825	258	217
New units (000s)	46	51	53	28	20
Cost per unit (£000s)	157	138	96	102	123
Grant per unit (£000s)	23	16	16	9	11
Grant rate (%)	15%	12%	16%	9%	9%

Timing differences between expenditures on developing new properties and the properties being available for rent cause variations in the cost and grant per unit calculations above. However, it is possible to see the low grant rate assumed during the Affordable Homes Programme period and very little grant funded development is assumed thereafter.

Table 19
Development – expenditure and financing

£ million	2013	2014	2015	2016	2017
Development expenditure					
Payments to acquire or develop properties	6,654	6,377	4,343	2,319	2,119
Cost of sales: shared ownership first tranche sales	513	609	764	544	361
Cost of sales: properties developed for sale	550	851	1,204	1,259	1,107
Total spend on new properties	**7,717**	**7,836**	**6,312**	**4,122**	**3,587**
Financed by					
Movement in debt	5,371	3,629	2,101	268	(304)
Movement in grant	1,062	832	825	258	217
Current asset sales	1,294	1,751	2,343	2,246	1,839
Other resources	(10)	1,624	1,043	1,350	1,835
Total	**7,717**	**7,836**	**6,312**	**4,122**	**3,587**

In year 1, 83% of spending on new properties is expected to be funded by debt and grant, with some cross subsidy from current asset sales. In years 2 and 3, a greater proportion of internally generated resources are expected to fund development to supplement the external funding. In 2016 and 2017, there is a very low level of external funding and much less new development is forecast in these years. In forecasts to be received in 2013 and 2014, it is expected that, as plans for new development programmes become clearer, providers will include a greater level of development in these years.

Assumptions

The following tables illustrate the range of different macroeconomic assumptions that underpin the forecasts.

Table 20
RPI assumptions

%	2013	2014	2015	2016	2017
Minimum	1.5	1.5	1.5	1.5	1.5
Quartile 1	2.5	2.5	2.5	2.5	2.5
Median	3.0	2.5	2.5	2.5	2.5
Quartile 3	5.6	2.6	2.5	2.5	2.5
Maximum	5.6	5.6	3.7	3.9	3.7
Mean	3.7	2.6	2.5	2.5	2.5

The sector norm is for a long term RPI assumption of 2.5% and there are very few exceptions to this. In general, the forecasts show rental income from social housing lettings increasing at a higher rate than inflation and the major cost lines increasing at a lower rate.

Table 21
LIBOR assumptions

%	2013	2014	2015	2016	2017
Minimum	0.3	0.5	0.8	1.0	1.0
Quartile 1	1.3	2.0	3.0	3.5	4.3
Median	1.8	3.0	4.0	5.0	5.5
Quartile 3	3.0	4.0	5.0	5.8	6.0
Maximum	7.1	7.1	7.1	7.1	7.1
Mean	2.3	3.3	4.1	4.6	5.0

There is more divergence of opinion on this assumption than RPI. The general pattern is for a steady increase in LIBOR to around 5.5% to 6% by year 5. This is then used as a long term assumption. This assumption is more important where a high proportion of debt is held at variable rates of interest. For example, the provider estimating LIBOR at 1% in 2017 has also forecast 100% debt at fixed rates.

The following tables illustrate the differences in the cost profiles in the sector and show the future cost trends that underpin the increased margins projected.

Table 22
Management cost per unit

£	2013	2014	2015	2016	2017
Quartile 1	800	820	824	847	859
Median	1,102	1,104	1,116	1,109	1,137
Quartile 3	1,440	1,438	1,429	1,448	1,493
Mean	1,227	1,221	1,229	1,248	1,273

A below inflation level of cost increases shows the benefit of development as the fixed element of management costs can be spread across a greater number of units. However, there may be upward pressure on management costs in future years if the introduction of welfare reforms increase rent collection costs.

Table 23
Major repairs cost per unit

£	2013	2014	2015	2016	2017
Quartile 1	642	617	596	614	621
Median	963	887	868	861	895
Quartile 3	1,442	1,316	1,249	1,207	1,244
Mean	1,296	1,130	998	955	963

Projected decreases in major repairs per unit are likely to be driven by a reduced volume of works as catch up repairs complete as stock transfer providers mature.

Table 24
Routine maintenance cost per unit

£	2013	2014	2015	2016	2017
Quartile 1	700	687	700	700	713
Median	871	867	879	900	923
Quartile 3	1,048	1,035	1,050	1,098	1,123
Mean	894	894	904	918	944

Below inflation increases are likely to be as a consequence of planned efficiency savings. It is important that, where efficiency savings are embedded within financial forecasts, there is an action plan to ensure that they are delivered in practice. This is particularly important in providers with limited headroom to the financial performance required to comply with loan covenants.

D2 – Diversification of the sector

For many years, providers have undertaken a diverse range of non-social housing activities in order to meet their objectives and growth aspirations. Providers undertake these activities through a range of delivery vehicles. Some non-social housing activity is delivered within registered providers. Other activity is undertaken within the non-registered subsidiaries of a controlling registered group parent and others delivered through joint ventures or special purpose vehicles set up with third parties.

Where the activity is undertaken within the registered provider, some data is collected through the annual accounts returns and reported in the Global Accounts. Table 25 identifies that non-social housing activity generated an income of £784m in 2012, which equates to 5.7% of the sector's total turnover. The resulting surplus on this activity was £109m, representing an operating margin of 13.9%. Comparative figures for 2011 indicate non-social housing comprised 5.2% of turnover and generated a surplus of £86m, an operating margin of 13.2%. The margin on non-social housing achieved in 2011 and 2012 is significantly above that achieved in the two years prior to that of 3.1% margin in 2010 (on non-social housing income of 4.7% of total turnover) and 4.3% in 2009 (on income of 5.1% of total turnover).

The majority of providers do not undertake a significant volume of non-social housing activity within the registered body. The analysis below demonstrates that 76% of all providers report less than 5% of their turnover as attributable to non-social housing, whilst only 1% of providers report non-social housing turnover in excess of 35% of their total turnover.

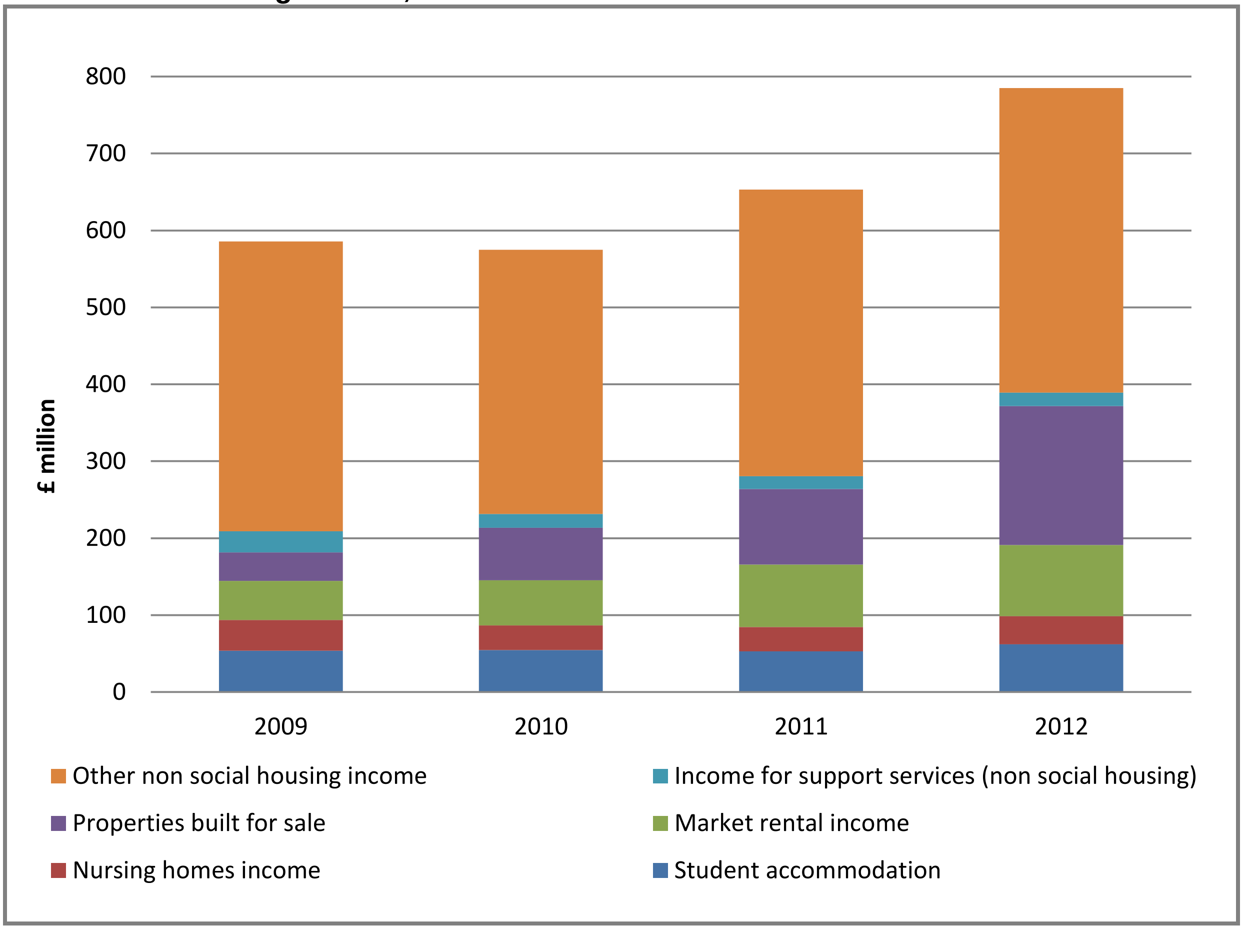
Proportion of turnover related to non- social housing activities	Percentage of providers
0-5%	76%
5-10%	12%
10-15%	6%
15-20%	3%
20-25%	1%
25-35%	1%
35-45%	1%

Non-social housing activity is often a natural extension of social housing activity delivered by the provider. It may relate to specific additional services or community based projects or an extension of the housing tenure offered by providers in an area, to include market rental properties and homes for outright sale.

Increasingly, common non-social housing rental activities include temporary housing, student accommodation, market rent and PFI, and care and support housing and services. In addition, a number of providers undertake a wide range of regeneration, community based and training and employment initiatives. These activities also form a significant element of the overall non- social housing business reported by registered providers.

Figure 8 below sets out the trend for the most significant elements of non- social housing activity through the period 2009 – 2012.

Figure 8
Non-social housing income, 2009 – 2012



Half of the non-social housing activity reported in the data reflects a mixture of activity grouped together as 'other'. The graph shows the key significant elements of non-social housing activity and demonstrates the growth in the significance of housing built for sale over the previous four year period. Whilst activity is increasing, it remains concentrated within a small number of providers. The table below shows the proportion of major categories of non-social housing income reported by the top five and top ten providers reporting income in each category.

Table 25
Non-social housing income, 2012 accounts

	Total income	Proportion of income generated by:	
Type of activity	£m	Top 5 providers	Top 10 providers
Housing for sale	180,486	86%	97%
Market rental	92,482	41%	60%
Student housing	61,046	80%	93%
Nursing and care homes	36,860	75%	94%
Support housing and services	17,410	66%	82%
Other non-social activities	395,817	35%	46%
Total	784,101	39%	50%

Increasingly, providers are delivering their diverse activity through associated companies and other vehicles not registered with the Social Housing Regulator. Providers completing the detailed statistical data return in 2012 reported they had over 350 subsidiary bodies. There are a number of drivers for providers to deliver activities in this way: some providers are constrained in their activity by their charitable rules and therefore need alternative vehicles to deliver more commercial activity; joint ventures (JVs) and special purpose vehicles (SPVs) may better facilitate partnership working; a methodology for management of risk and protecting the social housing activity from adverse financial impact; to limit balance sheet impact on the registered provider; to deliver tax efficiencies; and to deliver in general improvements in efficiency and effectiveness.

Through their subsidiaries, JVs and SPVs providers deliver a range of activity including:

- Property development and property investment project specific development
- Housing management services, property management and maintenance and telecommunication services
- Market and sub market rental residential lettings
- Employment and training services
- Financial services including treasury vehicles and bond issues
- Commercial property lettings such as shops and garages, furniture rental, recycling services, solar panel related work
- Community services including youth and family related work, environmental services, estate regeneration and social enterprise initiatives ;
- Homes for sale
- Procurement services
- Private Finance Initiative social housing schemes
- Specialist housing activities including provision of accommodation including ex-offender homes, homeless people, key worker, sheltered and student housing
- Supported housing and care services, nursing homes and residential care homes

There are potentially many benefits for the sector in diversifying. These opportunities can be an important way in which providers cross subsidise their social housing purposes. Also, diversification is a rational response to a range of the risks facing the sector outlined elsewhere in this document. Diversification has the potential to facilitate innovation and development of new homes and to contribute to wider economic and social benefits.

However, managing a diverse portfolio of activities, finance sources and business structures requires high quality risk management. Where diversification is not effectively managed, regardless of how it is delivered, there is potential to put social housing assets at greater risk. Therefore, the Regulator will increasingly look for assurance that boards understand the extent of risk arising from diverse activity and ensure that providers are effectively managing financial and non-financial relationships between their registered and non-registered bodies to ensure social housing assets are effectively protected.

D3 – Accounting and pension matters – commentary

Pensions: the present position

Pension costs continue to be large and long term influences upon financial results. Substantial numbers of providers still offer their staff defined benefit (DB) pension schemes, although these are gradually being reviewed as their cost continues to mount. Less than 10% of private companies now offer such pensions, and it is arguable that the social housing sector will continue to cut back on such benefits. The major pension providers to registered providers continue to be the Social Housing Pension Scheme (SHPS) and the Local Government Pension Scheme (LGPS).

SHPS is a multi-employer scheme managed by The Pensions Trust. It covers over 59,000 members in over 700 housing related organisations (though not all of these are registered providers). LGPS has around 1.4million members – mainly employed in local authorities – in 99 separately run pensions schemes, but all offer a standard set of benefits. Both have historically been DB final salary schemes. However, due to economic and demographic factors, such pensions are expensive, and becoming increasingly so.

SHPS currently has an average combined employer and employee cost of 17.8% of salaries for their 60^{th} of final salary pension and 13.5% for 80^{th} schemes[5]. There is freedom for individual employers to agree the exact split of contribution between staff and employer, but the employee cost tends to be around 6% with employers paying typically 8 to 12%.

There is an additional charge which is part of the 'recovery plan' for past deficits. This amounts to 7.5% of pensionable salary roll (growing each year by assumed salary inflation).

LGPS charges employees an average of 6.5% of salaries and employers around 15%, although this will very as each scheme is run by a different administering authority which will have different investment performance.

The overall level of cost depends upon take-up of pensions by staff as well as the type of scheme on offer. LGPS based schemes tend to have higher levels of membership than those offering just SHPS. This reflects the higher membership that exists in local authorities which feeds through into stock transfer providers and only diminishes as staff turnover occurs over time. Consolidation of the sector has tended to cause many providers to have staff on a variety of pension schemes. Completely pulling out of a scheme creates potential cessation costs. So it is less expensive to continue with inherited schemes rather than close them completely, but the options offered to new staff are normally limited.

It can be seen that costs may vary according to scheme type. An examination of a sample of annual accounts shows a range of pension costs, from 0.7% to 4.7% of turnover. The lower figure is from a large provider who has closed all DB options and the higher is a stock transfer provider with active LGPS membership. In general, however, costs tend to fall within the range of 1 to 2% of turnover.

[5] 60^{th} and 80^{th} relate to the accrual rates. The accrual rate is the percentage of salary that is received for each year of service.

Pensions: future changes

All major pension schemes are currently under review and, in view of their costs and on-going business requirements, providers continue to review what is offered to their staff, balancing attractiveness to staff against cost of provision.

SHPS disclosed a deficit in excess of £1bn in their last triennial valuation as at September 2011. This will lead to higher costs for their membership. They are further revising the range of schemes offered and more employers are expected to move to career average rather than final salary DB schemes and make use of the variety of accrual rates from 60ths to 120ths. SHPS are also changing pension updating from RPI indexation to CPI. The range of options includes a lower cost DB and lower risk defined contribution (DC) scheme.

This gives SHPS good positioning as auto-enrolment into pension schemes is rolled out, having started in October 2012 and going on to 2016. The variety of schemes they offer are all compliant with auto-enrolment requirements. However, costs of the DB schemes will rise - 60th final salary scheme will in future cost 19.4% (combined employees and employers contribution rate) and 80th Career Average Revalued Earnings will cost 14%. In most cases, taking an average of earnings for a pension is cheaper than the final, normally higher paid, years of employment.

LGPS are also revising their scheme (LGPS 2014) in response to rising costs. It is to become a 49th CARE (as opposed to 60th final salary) scheme with CPI rather than RPI uprating. The cost is to remain the same on average for staff at 6.5%, although higher contributions will apply to those on higher earnings. The average employer cost is planned to drop (based on Government Actuary Department estimates) from 15.2% to 13%. The LGPS is relatively limited compared to the range of schemes offered by SHPS, but does allow staff to adopt a 50/50 option whereby they pay half the cost for half the benefits.

A further factor that might affect current pension schemes is the proposed new flat rate state pension scheme, planned to start in April 2017. Members of employer pension schemes are currently ‘contracted-out’, paying a reduced National Insurance (NI) rate, for a reduced state pension. Current proposals will remove this, meaning that an extra 1.4% NI will have to be paid. At a time of low pay rises, this may lead to higher numbers of staff opting out of their employer pension scheme.

Accounting: recent changes

The Statement of Recommended Practice (SORP) 2010 introduced mandatory component accounting for the sector with effect for accounting periods commencing 1 April 2011. 2011-12 is the first year for which the SORP 2010 took effect. Component accounting had been used sporadically by some providers for a number of years, being introduced in FRS15, and therefore applicable even before the SORP update.

Component accounting requires the various elements of a fixed asset to be depreciated over the life of that component. This may be for a relatively short period of 15 to 20 years for bathrooms and kitchens and up to 100 years for the main building structure. It replaces depreciating the entire asset for typically 50 to 100 years. The intention of component accounting is to introduce more consistent accounting for fixed asset replacement. This avoids the previous situation where the treatment of items capitalised or expensed to revenue was often chosen to influence short term financial results.

It may be argued that inconsistencies will still exist with component accounting, although the extremes outlined above should no longer happen. The introduction of component accounting tends to have an initial positive effect on results – as more cost is capitalised – but over time it is expected to balance out as depreciation increases, as a result of the capitalisation of new components.

Accounting: forthcoming changes

The big change looming over the horizon is the next Statement of Recommended Practice (SORP) for providers. This, presumably being SORP 2014, will be designed to accommodate changes proposed by the Financial Reporting Council (FRC) to incorporate International Financial Reporting Standards (IFRS) into UK accounting requirements for medium sized entities. This is detailed within the new Financial Reporting Standard 102.

There has been considerable debate over the last couple of years with the sector, advisors and FRC, led by the SORP Working Party as to how this will affect providers. This has resulted in changes to the initial proposals, which would have led to considerable difficulties.

Many providers will find that accounting for financial instruments will introduce volatility into income and expenditure statements as their value is recognised on an annual basis. Accounting for pension deficits will also be changed which will affect those in the multi-employer SHPS scheme. In future, they will be treated in a similar way to employers using LGPS, with Income and Expenditure statements being hit by debits and credits following varying performance of the pension schemes. At present, SHPS deficits are not recognised within provider accounts.

The above will affect a large number of providers, but virtually all will have to change their balance sheets to cope with changes in accounting for government grant. This may require recognition within the income and expenditure account, over the lifetime of the properties funded, rather than being netted off cost for those showing assets at cost, or being ignored altogether by those using valuation.

This significant change is currently being evaluated to see what this may mean for providers and what options may be suitable in accounting terms.

All of the above will be subject to consultation and discussion over the course of the next year. Though cashflows will not be affected, it is inevitable that financial results and ratios will change and it will be essential that providers start to consider the likely changes and possible consequences as soon as possible.

Although the SORP 2014 will only impact on accounts for years ended 31 December 2015 and onwards, providers should plan effectively to ensure boards, auditors and funders are engaged at the appropriate time.

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