Quarterly survey of private registered providers

September 2011

TSA

THE SOCIAL HOUSING REGULATOR

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Introduction

Each quarter the TSA undertakes a survey of Private Registered Providers (PRPs) to establish the levels of exposure to the risks faced by the sector. The TSA carried out its latest survey in October 2011 for the quarter ended 30 September 2011, receiving responses from 272 PRPs owning and/or managing more than 1,000 homes.

Key findings for Quarter 2, 2011:

- The total reported borrowing facility for the sector is £63.7 billion. £51.3 billion is currently drawn, leaving £12.4 billion undrawn
- This includes new facilities of £693 million arranged in quarter (June £931 million)
- Of the sector's total agreed facilities 89% are attributable to bank loans and 10% to capital market funding
- The sector forecasts a total draw-down of £4.8 billion (June £4.9 billion) over the next 12 months
- For PRPs using standalone derivatives to hedge their debt, the current reported mark-to-market (MTM) exposure net of unsecured thresholds is £1.1 billion, (June £0.5bn). The change was due to movements in the swap rates, but the sector has managed the risk well with total collateral posted in excess of the MTM exposure
- The sectors overall position on Affordable Home Ownership (AHO) remained relatively flat. 1,870 first tranche sales were achieved in quarter. 3,077 remain unsold (June 3,985), of which 1,200 were reported as being unsold for over six months (June 1,194)
- An additional 1,699 AHO units were reported in the quarter
- The pipeline of AHO is consistent with previous quarters remaining at just over 13,000 completions expected in the next 18 months
- Total asset sales were £426 million (June £301 million) generating £117million of surplus. Most of this surplus (£88 million) is attributable to sales of other social housing and non-social housing assets

Summary and Conclusions

General findings from the Quarter 2 Survey suggest the sector has reduced its risk appetite. This position is an understandable response to the current uncertain environment. The sector is potentially exposed to external shocks which are beyond its control including emerging domestic policy and the national, European and global economy. All these present risks will require careful management.

Forecast debt draw-downs and new financing are the lowest reported since the quarterly survey began (January 2009). This is unsurprising given conventional lending is limited to a small number of banks, who are mainly lending to their existing customers, and on shorter terms. However, there are some promising signs, with the sector showing continuing interest in bond financing and demonstrating proactive treasury management, with the average mark-to-market exposure appearing to be under control.

Overall, funding for the next 18-24 months' business plan commitments appear to be generally in place, however, from 2013/14 there are planned substantial increases in development expenditure due to both the 2011-15 Affordable Housing Programme (AHP) and expected shared ownership developments. This will require additional facilities and at the same point an increase in demand and personal mortgage availability.

This survey also included questions on the AHP. These have been used to establish a baseline for the programme and as it matures it will be reported on in future surveys.

Financing Market and Derivatives

Financing Market

The sector faces particular exposures in terms of the availability of financing for capital investment, and the cost of both existing and future debt. In addition, the fall in swap rates continues to create the risk of calls for collateral for those with freestanding derivatives.

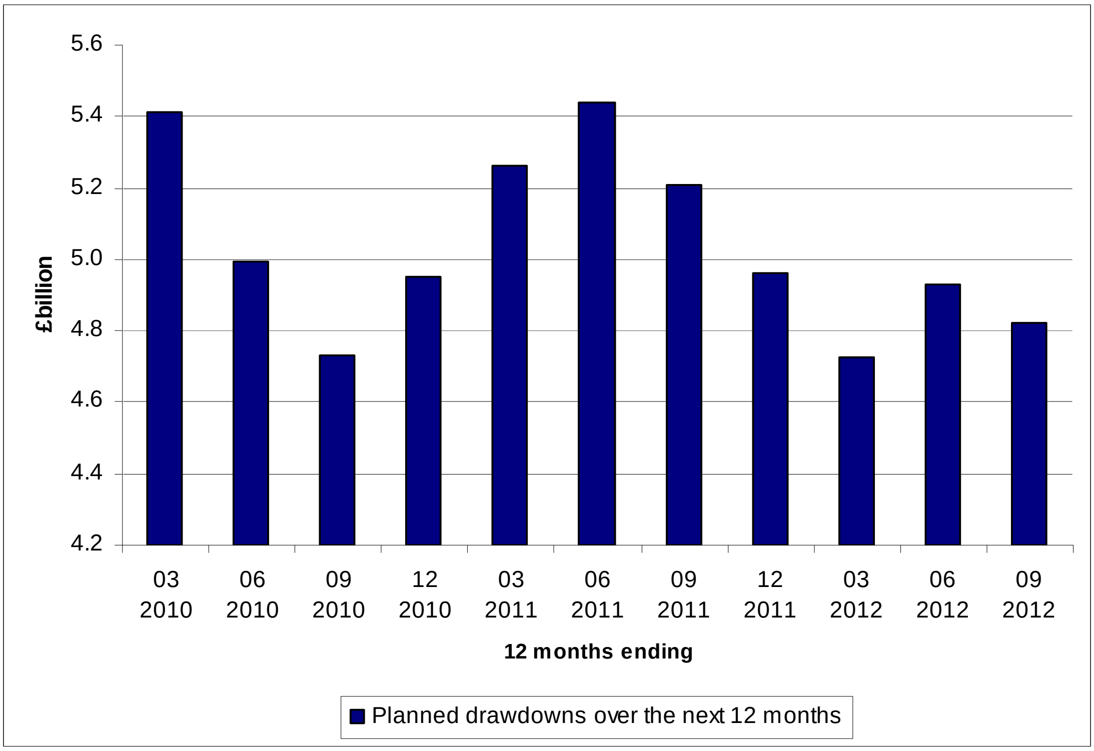
The key economic, financial indictors and other influencing factors prevalent for the quarter were:

- BoE base rate remained 0.5% throughout
- 3-month sterling LIBOR 30 June 0.76%, 30 September 0.95%
- September 2011 RPI 5.6% and CPI 5.2%
- 15 year swap rate 30 June 3.94%, 30 September 3.00%
- Nationwide HPI -0.1% over Q3, -0.5% annual to end September
- Low interest rates, with significant fall in swap rates resulting in mark-to-market exposure on derivatives
- Eurozone instability, with associated pressure on lenders with sovereign debt holdings
- Restricted availability of bank financing, both to providers and individuals with lenders focusing on repricing existing debt

Activity in the financing market has fallen in quarter, which saw the lowest level of reported new funding agreed since the survey began. In part this is due to significant levels of finance the sector has raised in the bond markets during the last 18 months, reducing the demand for conventional finance and leaving issuers holding cash in advance of investment. Further, it is reassuring that there is an ongoing market appetite for financing the sector, with an additional £693million agreed in Quarter 2. This consists of £220 million raised through a new issue and bond tap with a further £473 million through conventional bank financing. As in the first quarter, very few lenders were active, most only lending to their existing clients. New lending has generally been for less than 10 years and/or includes re-pricing clauses. In addition there is some evidence of PRPs cancelling unused facilities.

Forecasts from the sector suggest future drawdowns for the next 12 months will be £4.8billion, down by £100 million compared to June. Graph 1 shows how this position has changed over time. In part this reflects the increase in bond financing, where funding is drawn in advance of need. It can also be explained by the recent reduction in development activity as the 2008-11 National Affordable Housing Programme winds down before the 2011-15 AHP begins.

Graph 1 Planned drawdowns over the next 12 months



The average period covered by current facilities was 10 years five months. However when providers with over 10 years' facilities (typically stock transfers) were excluded the average falls to 28 months. It therefore appears that sufficient funding for the large majority of providers is in place for the next two years. There are a minority of providers surveyed reporting facilities of 12 months or less. Most of these have since indicated they had either agreed additional funding after the survey date or were in advanced stages of negotiations.

Overall, the reduced level of financing activity is in line with the slow-down in the wider economy. Lenders have reduced availability and increased the cost of finance, and providers have reduced their funding requirements. However, a key risk for the sector, particularly those providers who lack the size or expertise to access the capital markets, is that reasonably priced financing is not available in sufficient quantity when it is required.

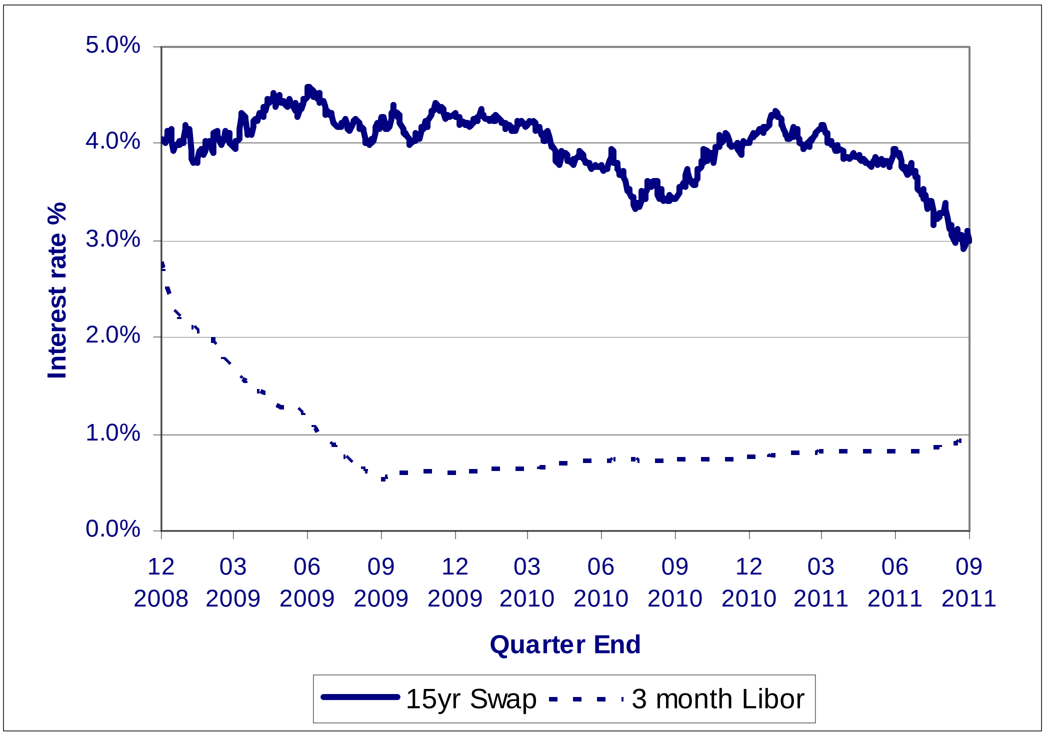
The TSA has made an assessment of required borrowing by the sector to deliver the 2011-15 AHP. Finance requirements for the programme are expected to be concentrated in the last two years of the spending review period, and we anticipate this to require up to £7.5billion. To achieve this level of contribution we would expect at least 40 providers to have arranged additional financing in the next 12-24 months in order to meet their forward development commitments. As more contracts with the HCA are signed, we would also expect to see an increase in financing activity reported in future quarterly surveys.

Derivatives

There were 46 PRPs reporting standalone derivatives (45, June 2011). Most of these instruments are long-dated swaps, with an average maturity of 15 years. Collateral calls have increased from £0.5bn to £1.1bn as swap rates having reduced by almost one percentage point in the quarter. Given the movement of the swap rate over the last three years, as shown in Graph 2, it is likely MTM exposure will continue to be a risk for some time.

However, PRPs have managed the recent collateral requirements, with all providers confirming they are able to meet future calls, and overall the sector has posted collateral in excess of its MTM exposure.

Graph 2 15 year swap rate since December 2008



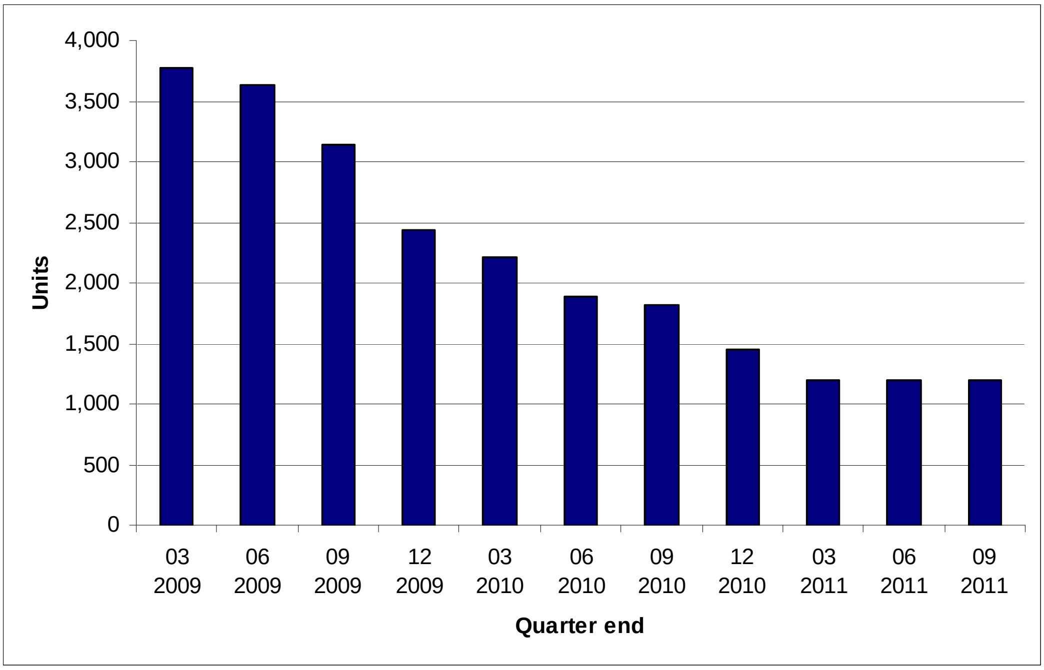
Housing market

This section concentrates on the risks associated with the PRPs development programmes. The key risks considered here are the demand for shared ownership, the management of assets mainly through market sale properties, and changes in the funding regime for new development. When asked to give an indication of forecast impairments, 12 providers reported write downs totalling £4.7 million. This number is small as most providers have already written holdings down in previous years. Further analysis will be undertaken in the Quarter 4 survey as this is normally a consideration at year-end.

Some providers may be in the process of considering the potential implications of Government policy changes including welfare reform and Right-to-Buy on their future development plans and a significant number of providers have been negotiating Affordable Rent contracts with the HCA.

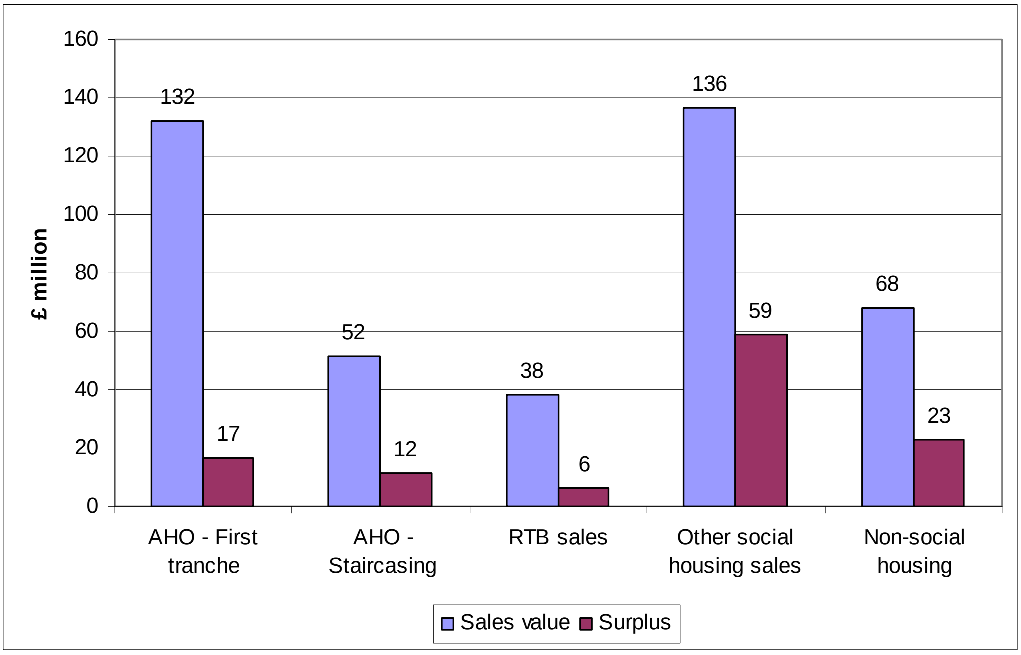
In Quarter 2, 3,077 shared ownership units (now known as Affordable Home Ownership or AHO) had not achieved first tranche sales. Of these 39% have been unsold for six months or more. This is an increase of 10 percentage points since Quarter 1. Graph 3 below shows in absolute terms the stock of shared ownership units unsold for six months or more. This figure has remained stable over the past three quarters at around 1,200 homes.

Graph 3 Shared ownership units unsold for more than 6 months



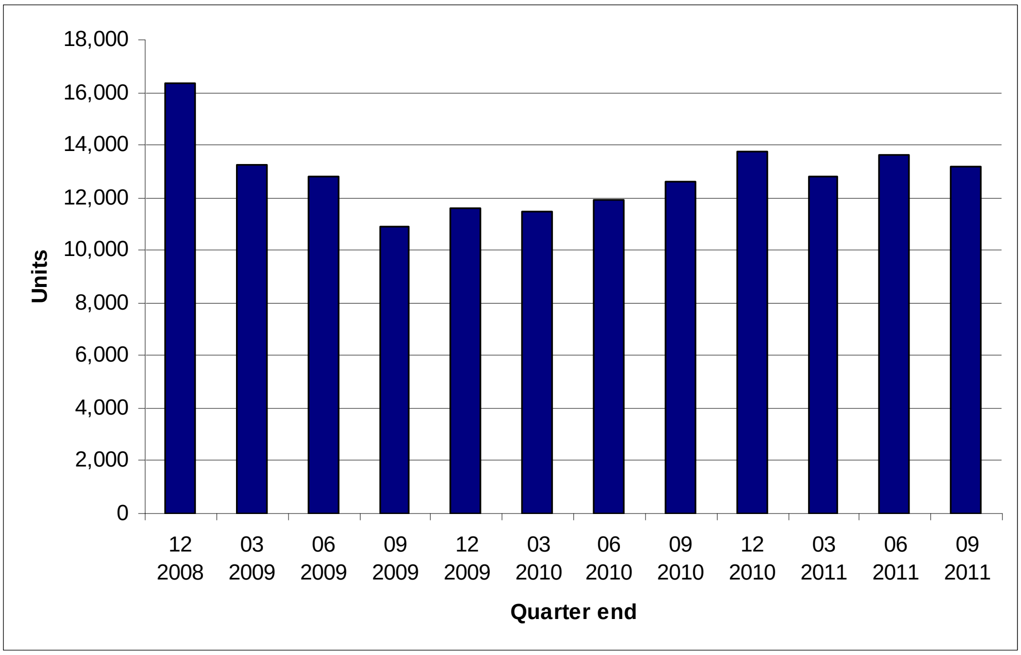
On a positive note, 1,870 units did achieve first tranche sales, this raised £132million and realised a surplus of £17million. As can be seen in Graph 4, this is a comparatively low level of margin (13%) compared to those generated on Right to Buy (16%), and on staircasing of AHO properties (22%). The level of surplus on sales of other social and non-social housing is considerably higher, at over 35%. Overall total sales have generated revenues of £426million in quarter and surpluses of £117million.

Graph 4 Asset sales and surpluses



In Quarter 2, 1,699 new AHO units were either developed or purchased by the sector. The anticipated level of shared ownership developments in the pipeline, remains unchanged at around 13,000 for the next 18 months, or 8,600 pa (Graph 5 below).

Graph 5 Forecast shared ownership completions in the next 18 months



Joint ventures

As providers have responded to the changing environment, joint ventures and other off-balance sheet vehicles have begun to increase. In some cases these take providers into areas of activity where their experience may be limited and/ or require additional lending which increases overall gearing. This in turn potentially creates risks to the social housing stock if not properly managed through cross-guarantees, accounting and financial losses.

Providers were asked to supply details of joint ventures (JV) where their potential exposure (either in equity or loan) was greater than £500,000. Forty such JVs were reported covering activities such as, market sale and mixed use development, shared service provision, regeneration schemes and PFI deals. Other parties included private contractors and developers, funders, other registered providers, and the HCA.

Providers were also asked to give details of any JV losses forecast for the year. Nine were reported, none sufficiently large to cause concern at this stage. We will repeat the question on JVs in Quarter 4, to obtain a more accurate picture of risk exposures in this area.

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This report outlines the results of the September 2011 survey of private registered providerss. It comments on the financial trends identified by the quarterly surveys carried out by the TSA and on the key challenges facing social housing providers.