Social Housing Finance - May 2019

Mitigating Market Risk

savills

Supporting delivery through cycles

The affordable housing sector has never been more vulnerable to housing market fluctuations. Exposure to sales risk is greatest where the market is currently weakest. To mitigate sales risk and ensure the number of homes being built continues to increase requires grant and flexibility over how it can be used.

Housing associations are building a record number of new homes for market sale and Affordable Home Ownership (AHO). The most recent data[1] shows that 37,000 homes are contractually committed for completion over the 18 months from December 2018. Most of this activity is concentrated in London and the South East with the G15 forecasting sales tenures to account for 63% of starts and 53% of completions in 2019.[2]

Increasing market exposure

To give an accurate picture of how the sector's exposure to the market has continued to grow, we have analysed the turnover derived from sales activity for 192 of the largest housing associations over the last three years.[3] Often turnover from 'non-social housing activities' is used to indicate exposure to the housing market but this understates reality by including other activities in the total.

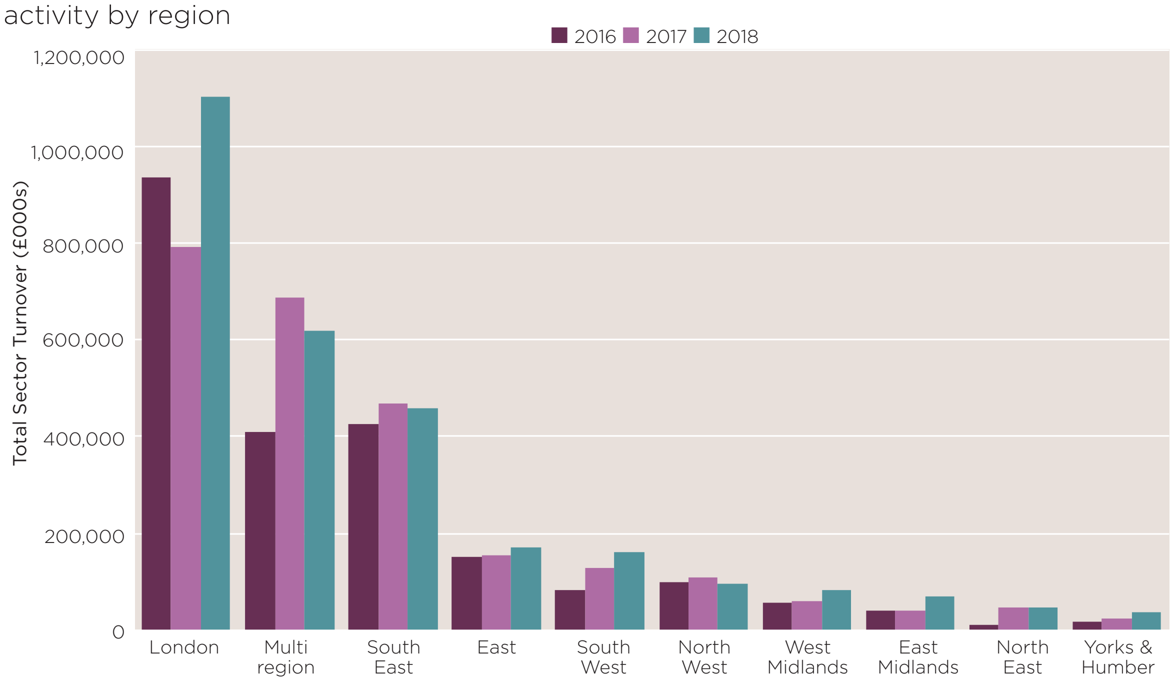
Our analysis shows that turnover from market sales increased by 16% (£221m) between 2016/17 and 2017/18, while non-social housing activities turnover increased by only 6.5%. Shared Ownership sales also carry market risk and sector turnover from this activity increased by 10% (£110m) over the same period. The combined increase in turnover from sales across the sector was 13% (£334m). This increase came at a time when overall turnover increased by 1.8%.

The majority of the increase in turnover from sales took place in London focused housing associations, accounting for £305m (91%) of the increase. This highlights that market exposure is greatest where the housing market is currently weakest. Average house prices in London fell by 0.6% over 2018 and annual transactions numbers in London were down 26% over the four years to February 2019.

The number of unsold homes, of both market sale and AHO, has increased over the last three years, according to data from the Regulator of Social Housing. But it has closely tracked the increase in completions, so the sector as a whole is continuing to sell stock successfully.

However, several high-profile stories in the media indicate that issues have arisen for some associations with particular focus on the London market, which has seen the biggest falls in both prices and transaction numbers. Many housing associations are focused on increasing housebuilding volumes in line with Government objectives, and volumes of committed development continue to increase.

Figure 1 Total combined turnover from development for sale and First Tranche sale activity by region



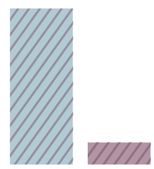
Source Savills Research, using published housing association accounts

[1] Regulator of Social Housing Q3 2018/19, Quarterly Survey
[2] G15
[3] This sample controls 2,077,049 General Needs homes

Key stats

37,000
Homes are contractually committed for completion over the 18 months from Dec 2018

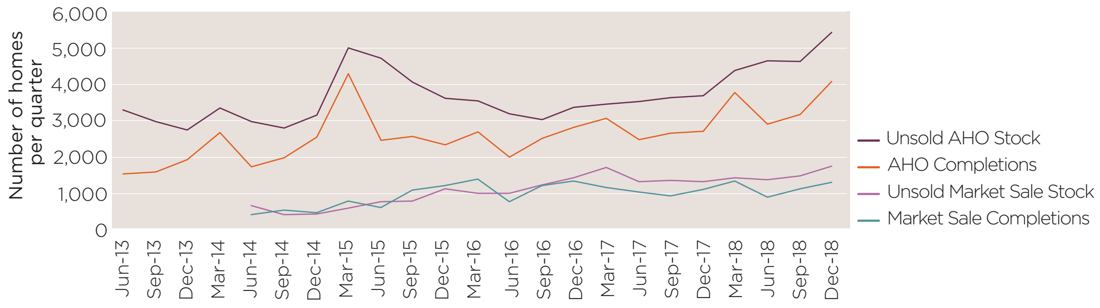
£221m
Turnover from market sales increased by 16% (£221m) between 2016/17 and 2017/18



13%
The combined increase in turnover from sales across the sector was 13% (£334m). This increase came at a time when overall turnover increased by 1.8%

91%
The majority of the increase in turnover from sales took place in London-focused housing associations, accounting for £305m (91%)

Figure 2 Relationship between completions and unsold stock



Source Regulator of Social Housing Quarterly Risk Reports

But the slowdown in house price growth is spreading [4] suggesting that more sales programmes will come under pressure. The sector will need options for de-risking development programmes that are reliant on sales.

Open market new homes sales and First Tranche Shared Ownership sales volumes declined in the last downturn (Fig. 3). Whilst we are not predicting a repeat scenario, we have performed stress tests on a hypothetical housing association to indicate the impact of two downturn scenarios.

Scenario testing

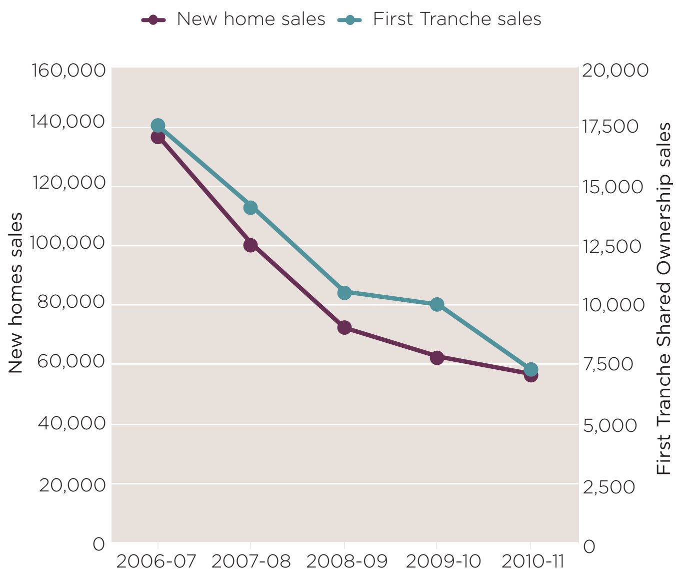
We applied scenarios for a 10% and 35% fall in sales prices to a hypothetical London/South East based association owning 32,000 homes, with a development plan of 5,600 homes over 10 years. In both scenarios cashflow is reduced (Fig. 4). We have assumed that our housing association can draw on additional debt finance (£39m or £221m) to ensure the programme continues. Without this, under the two scenarios, 279 or 1,572 homes of their planned development programme could not be financed.

The Negative Impact on 10 Year Cashflow shows the impact in cash terms over ten years and so the reduction in funds available to finance future development. Equivalent Homes Lost is an estimate of the impact on future development capacity, based on build cost per home (minus grant). Under the more severe scenario, future capacity is reduced by 3,392 homes, equivalent of 60% of the current 10 year development programme.

The impact of these scenarios shows the importance of having robust mitigation options to cope with market fluctuations. Housing associations are well placed to flip homes for sale into affordable rented tenures but need compensating for the loss of return on capital.

Making grant funding available to facilitate this activity would bring several benefits. Housing associations would be less vulnerable to market fluctuations, making their business models more robust. They would be able to carry on increasing the number of much needed affordable homes being built, even when the rest of the housing market is slowing. This activity would be wholly additional to that being undertaken by the private sector [5].

Figure 3 First Tranche sales and new build sales following the Global Financial Crisis



Source HM Land Registry, HCA SDR

Figure 4 Stress testing different downturn scenarios

	Original	10% Fall	35% Fall
Metrics			
10 Year Average: EBITDA MRI (£m)	185	172	139
Operating Margin	43%	41%	35%
Gearing	38%	40%	45%
Cumulative 10 Year Cash Flow	647	511	170
Drawdowns Required	-258	-297	-479
Negative Impact on 10 Year Cashflow	-	136	476
Equivalent Homes Lost	-	967	3,392

Source Savills Financial Consultants

Savills team

Please contact us for further information

Chris Buckle
Residential Research
020 7016 3881
cbuckle@savills.com

Josh Rose-Nokes
Residential Research
020 7409 5907
josh.rosenokes@savills.com

Robert Grundy
Head of Housing
020 7409 5995
rgrundy@savills.com

Helen Collins
Head of Housing Consultancy
020 7409 8154
hcollins@savills.com

Mike Roche
Financial Consultancy
01565 880 172
mroche@savills.com

[4] Savills UK Housing Market Update May 2019
[5] Savills 2019, Additionality of Affordable Housing