Business and financial journalist – Pete Apps

English associations' sales income breaks £2bn

In the social housing sector, finance directors have the third month in February marked in their calendars. This is when government regulator the Homes and Communities Agency publishes its Global Accounts – the combined accounts for all housing associations. These are used to benchmark performance and are the best indication of the financial strength of the sector.

In 2015 Pete, a long-standing finance reporter at *Inside Housing*, decided he could get the headlines out quicker. This year's story marks the second successive year he has done so. The special report involved two weeks of collating and inputting data from 75 of the largest housing associations' accounts.

It demonstrates his ability to understand the needs of readers, pull together a huge data-led piece of journalism and create a compelling narrative from bland data. The research is now a fixture of *Inside Housing*'s calendar and is always well received by readers.

PRS scheme set to issue £265m bond

In this exclusive finance scoop, Pete once again demonstrated his ability to get important stories ahead of his rivals. *Inside Housing* revealed the long-awaited government-backed bond issuance for new rented housing was on its way on 11 November. The Financial Times did not have the story until 17 November, while readers of Property Week did not find out until 21 November.

Pete's scoop came from a trusted industry contact who he has spent years getting to know and building trust with. It is a classic piece of old school financial journalism – breaking a market-moving story about an important deal well ahead of the competition by making and cultivating the right contacts. Scoops such as this are what mark *Inside Housing* out as a leader in its sector and make a subscription so essential for housing professionals who want to stay ahead of the game.

The rise of the medium merger

Consolidation has been the word on the lips of housing associations over the past two years, as multiple financial pressures and a desire to build more homes forces social landlords into merger deals.

Pete's analysis is a top quality piece of analysis of a market trend – featuring interviews with the key players and a clear-eyed view of the wider context. It demonstrates the knowledge Pete has built up over many years as an industry journalist, as well as his skill as an interviewer and writer. The piece was well received and praised by *Inside Housing*'s key targets – decision-makers and leaders in the social housing sector.

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Four most commented
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Accounts analysis special

English associations' sales income breaks £2bn

Revenue derived from properties developed for sale reaches £2bn

Pete Apps

English housing associations generated more than £2bn through properties developed for sale last year, with the vast majority of the activity in London.

Inside Housing's annual round-up of the Top 75 largest associations' accounts reveals £2.14bn of turnover came from sales in 2015/16 – with £1.25bn from open market sales and £882m from initial shared ownership sales. This is a rise from £1.58bn in 2014/15 and represents 14.7% of overall turnover – up three percentage points – demonstrating the scale of the sector's drive into more for-sale products. It came as the percentage of turnover from core social housing lettings dropped from 74.4% to 72.1% on average.

Housing associations have stepped up sales activity since 2011, seeking to generate profit to compensate for the loss of government grants and fund affordable housing.

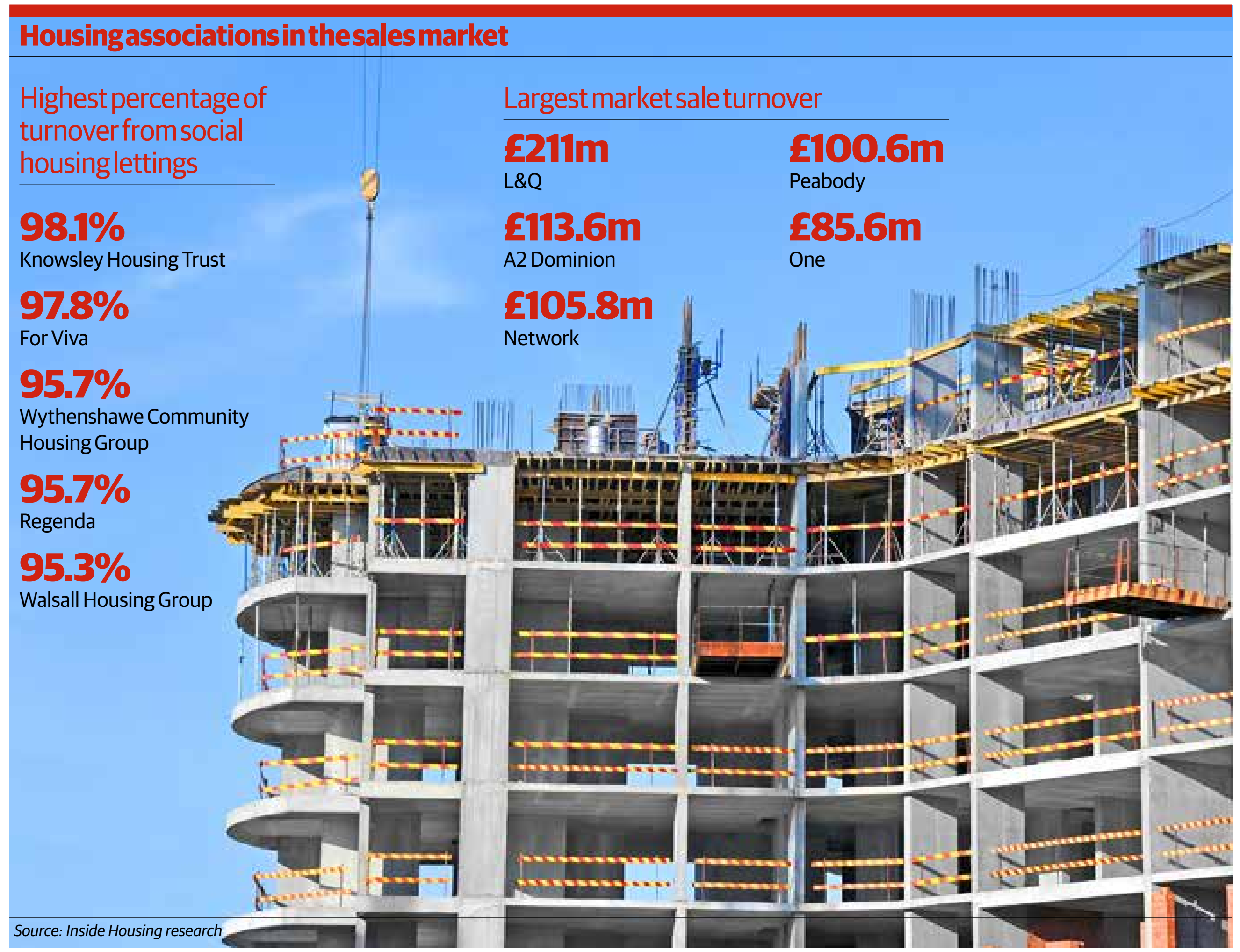
But credit agencies have repeatedly warned against over-exposure this year, with a clutch of landlords downgraded over their future reliance on the riskier sales market.

The sales activity was heavily concentrated on the capital with 17 landlords based wholly or partly in London, accounting for £1.1bn (85%) of the outright sale turnover.

London associations also delivered £526.1m of the shared ownership sales (60%), with sales accounting for 24% of all turnover among landlords in the capital. L&Q was the largest developer of housing for outright sale – raising £211m alongside £58m from first tranche sales. Peabody saw the largest increase, with turnover from sales growing from £24.9m to £148.2m, with £101m coming from outright sales. Seven London landlords raised more than £100m from sales.

However, outside London sales activity accounted for just 5.4% of overall turnover, with Places for People and Orbit alone accounting for more than a quarter of the turnover.

Many non-London landlords limited their sales activity to a small but growing volume of shared ownership deals – with £355.8m raised from first tranche sales.



Source: Inside Housing research

The figures showed 19 providers generated more than 90% of income from core social housing lettings, with all but Croydon-based Amicus Horizon outside the capital.

Charlotte Harrison, executive director of policy at the Northern Housing Consortium, said: "If you are a provider in an area where you cannot generate income from sales, you have to look at other ways to generate the income to build."

Terrie Alafat, chief executive of the Chartered Institute of Housing, said: "Housing associations deliver profit for a purpose. Their surpluses are reinvested."

Different strokes: a case study

WM Housing recorded open market sales a shade under £4m in 2015/16, and shared ownership first tranche deals of £3.3m.

While this was a substantial rise from the total of £3.4m recorded the year before, it pales into insignificance compared with housing associations at the other end of the M40.

The Birmingham-based landlord WM has 27,000 homes, putting it on a level with London landlords such as Peabody and Notting Hill.

However, these two each made a shade under £150m through sales in the same financial year, with Peabody breaking the £100m barrier from open market sales alone.

Higher values and a stronger sales market in the capital are the obvious causes of this discrepancy.

Kevin Rodgers, chief executive of WM, told *Inside Housing*: "When we started looking at new forms of development, we knew we were entering unchartered territory."

Average margins rise to 28.3%

Operating margins of the biggest housing associations rise by 1%

Pete Apps

The average operating margin of the largest housing associations rose by one percentage point in the past year before rent cuts came into effect.

Inside Housing's combined accounts for the largest 75 housing associations in the sector show margins rose from 27.2% to 28.3% in 2015/16.

The figure was a result of turnover rising more than a billion to £14.5bn as rents increased, while costs rose by less, to £10.5bn from £9.8bn.

The 2015/16 financial year was the last year when rents rose by consumer price index inflation plus 1%, before the flat 1% rent cut kicked in this year.

London landlord L&Q topped the list with a huge operating margin of 44.6%, followed by 26,000-home Midlands landlord Waterloo, which had a margin of 42.7%.

Operating margin shows the percentage of turnover left after running costs, and is an important measure of an organisation's efficiency.

Anchor, which provides retirement housing, was bottom with an operating margin of 7.1% due to the higher costs of providing retirement homes.

Sarah Jones, finance director at Anchor, said: "The accounts reflect all Anchor activity, not only social housing, and so are not comparable with other providers. Underlying margin for our social housing for rent has improved from 20.1% to 21.4%."

Sunderland housing association Gentoo came second bottom, with an operating margin of 8.8%. This was largely due to payments it made during the year to 330 departing staff.

Mervyn Jones, head of Savills Housing Consultancy, said it believes organisations need to aim for a margin of 30% to continue to fund development plans as cuts start to bite. Of the largest 75 associations, only 30 had an operating margin of above 30%.

"If you are going much below that, there isn't a great risk barrier if things go wrong," Mr Jones added.

HCA warns on sales risk

The English social housing regulator has repeated calls for landlords to ensure they understand the risks of more market activity, following *Inside Housing*'s findings of increased sales.

Jonathan Walters, deputy director for strategy and performance, said: "The regulator has been clear with providers for some time about the need to stress test their business plan when taking on greater market-facing activity to ensure they understand and can mitigate any downside risk." The Homes and Communities Agency last month highlighted sales activity in its Sector Risk Profile document. It comes as Standard & Poor's lowered the credit rating for Places for People due to the landlord's diversification into non-social housing activity.

➔ See page 10 for more

PRS scheme set to issue £265m bond

PRS Housing Guarantee Scheme prepares to launch 10-year bonds

Pete Apps

The long-awaited private rented sector (PRS) government-guaranteed bond is currently being roadshowed to investors ahead of a launch next week.

Inside Housing can reveal investors are being approached to buy £265m of 10-year bonds, with £90m set to be retained. HSBC and the Royal Bank of Scotland are understood to be acting as bookrunners on the deal.

Roadshowing to investors took place at the end of last week, with the bond set to be issued as *Inside Housing* went to press.

The PRS Housing Guarantee Scheme was first announced by the government in 2012, with a management contract awarded to Venn Partners in 2014. The issuance is handled by the company's wholly owned subsidiaries PRS Finance plc and PRS Operations Limited. Individual developers must take at least £10m from the programme. Many large housing associations, including Notting Hill and Genesis, are known to have considered applying.

In May last year, the programme secured an Aa1 rating from credit agency Moody's, but this will be the first time it has raised cash. This rating was affirmed by Moody's this week. It is likely to secure a similar price to the parallel Affordable Housing Finance (AHF) programme, which has raised more than £2bn for affordable homes development.

The most recent AHF bond priced at 0.36% over gilts (government borrowing rates). The current 10-year gilt rate is around 1.35%, meaning the finance could be raised at a rate as low as 1.7% if it secures a similar price to AHF.

The government has promised to guarantee up to £3.5bn of debt under the programme, which reduces risk for investors and therefore allows them to charge a lower rate.

In its affirmation of the bond's rating, Moody's noted that "a potential risk" is the guarantee breaching European Union rules on state aid. However, it noted the bond has been "structured to comply" with state aid rules.

Moody's said: "The Aa1 rating to the updated programme reflects Moody's belief that the terms of the guarantee to be provided by the Department for Communities and Local Government will be sufficient for credit substitution with credit worthiness of the UK government."

PRS Finance will make 30-year loans to developers using the cash. It had previously issued 'letters of comfort', assuring finance would be issued, to help them raise development finance.

Development of the week Highwood Mill, Horsham, West Sussex

Local authority: Horsham District Council
Housing association: Saxon Weald
Developer: Berkeley Homes
Architect: PRP
Contractor: Berkeley Homes
Number of homes: 105
Cost: £20.6m
Completion date: December 2016
The scheme: Highwood Mill is an extra care retirement development for over-55s. Sixty homes are available for affordable rent, while 45 are for outright sale. The scheme has been built without grant and has a 'New England'-inspired interior. It includes a restaurant and bar, library, activity studio, hair salon, landscaped gardens and woodland walkway. An on-site care team will also offer support 24 hours a day.

Social housing REIT raises £350m

Civitas Social Housing Real Estate Investment Trust (REIT) has raised £100m more than its planned fundraising of £250m, as it prepares to float on the London Stock Exchange today (Friday).

The company, which is the UK's first social housing REIT (a tax-efficient structure that holds income-producing assets) to float, has raised £350m for its initial public offering, under plans to pump the proceeds into social housing stock in England and Wales under sale-and-leaseback-style arrangements.

Civitas aims to provide investors with dividend yields of 5%, expected to increase in line with inflation, and was oversubscribed by potential investors. Through buying existing stock from associations, the vehicle will look to cash in on demand for liquidity in the face of reduced grant.

> "Civitas looks forward to working in partnership with social housing providers to enable new investments."
> *Paul Bridge, chief executive, Civitas Housing Advisors*

Its creation has prompted a lukewarm reaction: experts warned earlier this month that, unless properly regulated, providers could be drawn into binding 10 to 40-year agreements, as wider economic conditions - such as the falling pound and the 1% rent reduction - deteriorate.

Civitas insists the plan will provide associations with a new source of funding, through one-off capital receipts, and remove debt from balance sheets as the fees paid would not be counted as debt. The company reportedly has a pipeline of nine transactions. A company announcement to the stock exchange on Wednesday stated that applications had been made for 350 million ordinary shares ahead of today's listing.

Paul Bridge, chief executive of Civitas Housing Advisors, which will run the listed company, said: "Civitas looks forward to working in partnership with social housing providers to enable significant new investments."

While mega-mergers have stumbled, there is growing consolidation among medium-sized associations. *Pete Apps* investigates

The rise of the medium merger

"This time next year, there will be plans in place for eight organisations of 100,000 homes or more." So said an unnamed housing expert, almost a year ago in the opening lines of an analysis piece in these pages about the rise in mega-mergers. It seemed a reasonable prediction back then. The idea of already giant housing associations joining forces to create behemoths, with FTSE 100-style balance sheets and Barratt Homes-size development pipelines had political backing and economic drivers aplenty.

As is often the case though, reality has proved a little more humdrum. While Affinity Sutton and Circle led the way, joining their organisations to create 125,000-home Clarion Group in November, other deals have faltered, fallen or never made it off the starting line.

What has happened instead is consolidation slightly lower down the food chain. In the past four weeks alone, 11 regional or local providers have announced plans to join forces with similar-sized associations in their nearby area.

Many other conversations are understood to be under way up and down the country among various social landlords.

Resilient structure

The drivers for these mergers are varied and unique at the micro level, but the same macro concerns run through them all: the need for resilience in an increasingly uncertain economy and the financial strength to meet the political challenges over growth and efficiency.

It is tempting to draw the conclusion that this is all about surviving the rent cut - the four-year forced 1% reduction in income that wiped around 16% out of housing association business plans. But this may be a lazy assumption.

Rob Beiley, a partner at Trowers & Hamlins solicitors, says: "I genuinely don't think it's about rent cuts. Most associations we are seeing going in to these deals are completely sustainable in their own right and can keep a development programme in their own right."

This chimes with the merging associations *Inside Housing* speaks to. They are keen to stress this was not a decision driven by concerns about viability.

But while it may not be about survival, the rent cut has played its part. Speaking to Tony Bramley, chief executive of 7,900-home Lincolnshire-based Shoreline which is merging with 4,800-home Boston Mayflower, it is clear that the two are not entirely unconnected. Lincolnshire is a comparatively low rent area, and Shoreline is a former stock-transfer landlord - two factors which mean it was at the extreme end of the impact of rent-cutting.

"I think there is no question that certainly for us the rent reduction has been a catalyst for looking seriously at it [merger]," he says. "It led to us

> **"For us, it is more about protecting community-based services."**

extracting £4m out of our operating expenditure, which is about 18% of our turnover - that's massive for us."

In practice, this meant the death of a lot of community activities the organisation has previously prided itself on. It has axed its training and support services, reduced self-funded adaptations for disabled tenants and closed self-funded supported housing. It wants to get back into these activities, which it believes are important for its local area.

"Perhaps in contrast to what has driven the mega-mergers, which is increasing capacity, for us, it is more about protecting community-based services," says Mr Bramley.

Where once this desire might have led a landlord such as Shoreline to partner up with a big player, perhaps as part of a federated group structure, this has changed.

"We have seen the death of the federal group structure in recent years," says Mr Beiley. "Where previously an association had the option to go into Circle or one of the other big national players, a lot of those federal structures have been unwound. So if the local providers want to retain a local identity, they are more likely to look for a local partner." ▶

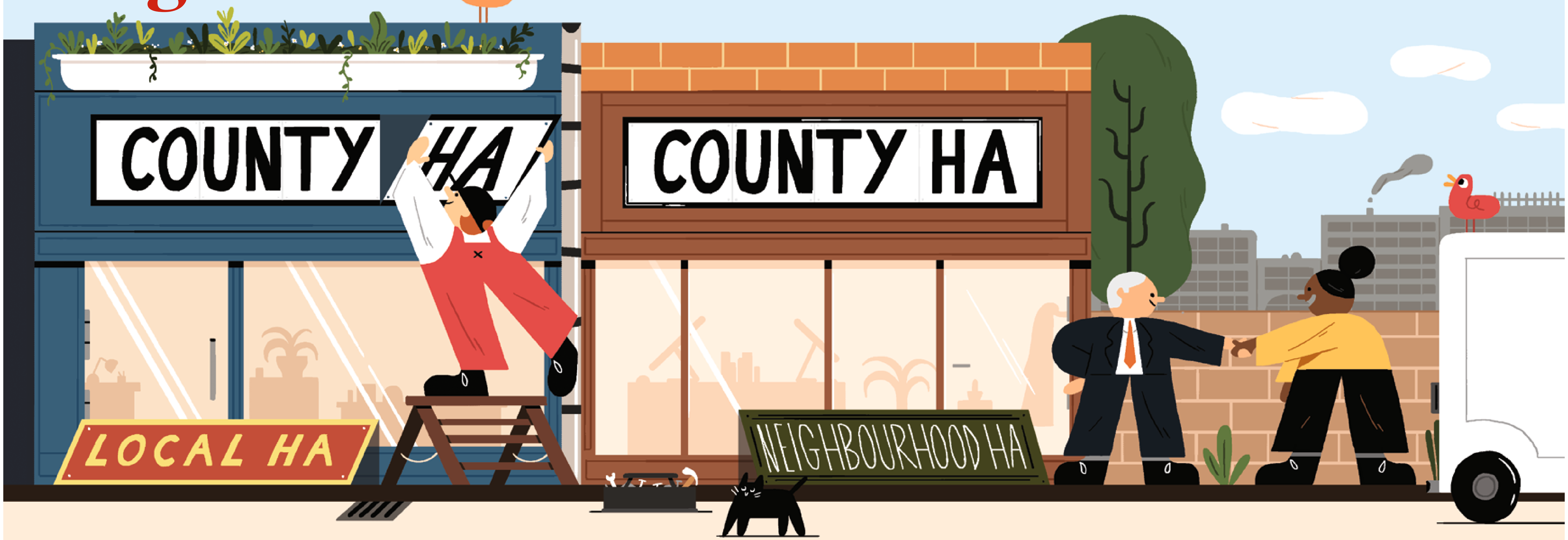


ILLUSTRATION: ELLIOT KRUSZYNSKI

This reflects the comments of Orla Gallagher, chief executive of 7,500-home Housing Solutions, which is merging with 7,000-home Bracknell Forest Homes.

"We have always stayed within an hour's drive from Maidenhead, and we are still a very locally-based housing association. There was no appetite to look at an organisation that was going to take us away from that area," she says.

The organisation has an operating margin - the percentage of turnover left after day-to-day costs are deducted - of 44.6%.

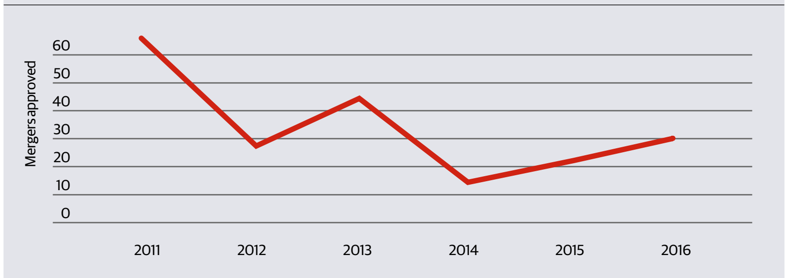
This is equivalent to giant London landlord L&Q and better than everyone else in the top tier of large landlords, meaning Ms Gallagher's organisation is already extremely efficient. So why merge?

"Both organisations have got development ambitions, and the local authority is very, very keen that Housing Solutions continues to provide homes in the borough," she says. "In merging with Bracknell, we are able to do more."

Government pressure

There is also a reputational issue driving associations to merge. Commentators on the sector, including those in government, have long expressed frustration that similar associations operate in similar areas, but duplicate services thereby adding to their costs.

Mergers approved each year



Source: HCA (includes group restructures)

Amid increasing pressure from the government to think about expenditure, regulator the Homes and Communities Agency (HCA) has been stepping up its Value for Money (VfM) regulation through in-depth assessments, and the White Paper made a clear call for housing associations to improve their efficiency.

"The organisation has been running really well - there has been great service delivery but at a cost," says Paul Fiddaman, chief executive of 12,500-home Isos, which is merging with Cestria and Derwentside Homes to create a 23,500-home landlord.

"We were asking how we could maintain those standards and bring down costs. The conclusion was inevitable. We can look at taking out any duplication in services. By doing that, we can deliver efficiencies."

"We were asking how we could maintain those standards and bring down costs. The conclusion was inevitable."

He is clear that the housing association sector needs to align with the government's efficiency agenda going forward if it wants to retain credibility with ministers.

"If, in a year's time, in response to that VfM challenge, all we have done is not build as many houses, that would destroy the positive relationship we have been building up with government over the last few years," he says.

He says that the projections suggest the merger will strip out £3m a year in expenditure, which means more than doubling its pipeline of 4,500 new homes to 11,000 over the course of its business plan.

Local suitability

There are also local factors at play. Derwentside Homes encompasses Prince Bishops, a subsidiary that carries out private rented sector development and management. Isos has no experience in this area but wants to expand, and a merger is a quicker and more efficient way of doing so compared with building up its own capacity to do the same work.

Similar factors to those described above are driving associations up and down the country to the negotiating table. Lawyers and consultants talk of a huge uptick in work on mergers at a local level.

However, we are still some way from a frenzy of completed deals. Some negotiations will never leave the confidential discussions stage and others may stumble as the details are thrashed out.

Figures provided by the HCA show 30 deals were approved in 2016 - higher than the 22 in 2015 and 13 in 2014, but well below the peak of 66 approvals in 2011 (see graph: Mergers approved each year).

While these figures need to be viewed with some caution (they include the collapsing of group structures which mean several approvals can be contained in one deal), they demonstrate that merger frenzy is yet to completely catch on, despite the bold predictions of many of those watching the sector.

What is certain, though, is that many locally-based organisations are talking to their neighbours about joining up. Should these talks continue to progress, 2017 is set to be the year of the medium-merger. ■