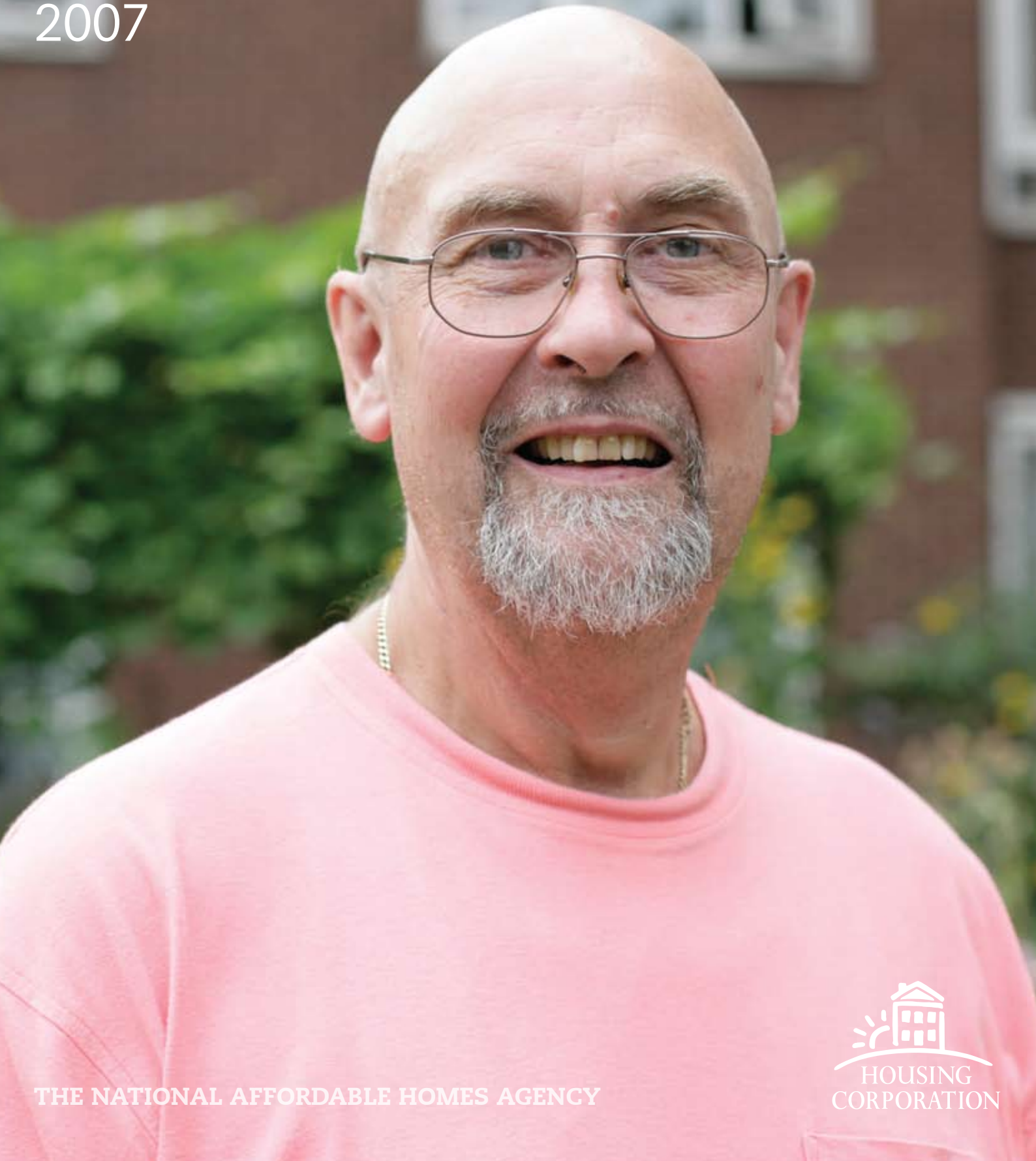


Global accounts of housing associations

2007



THE NATIONAL AFFORDABLE HOMES AGENCY



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Introduction

The primary purpose of the 2007 Global Accounts of Housing Associations is to provide a financial overview, based on published accounts data, of the housing association sector and some of its key segments. This annual update and analysis highlights key ratios and trends within the sector defined by English housing associations.

The term 'housing association' is used throughout as a generic term for all registered social landlords, including housing trusts, co-operatives and housing companies.

The housing association sector is diverse in both the size of associations that operate within it and the range of activities each undertakes. The sector comprises around 1,950 associations. Of these, around 400 have more than 1,000 properties, representing more than 97% of the current stock in the sector of 2.2 million homes.

Whilst some associations have been in operation for over a hundred years, the sector has grown rapidly since the Housing Act 1974 and since the introduction of stock transfers from local authorities, which began in 1990. These stock transfer associations have financial characteristics, particularly in their early years, which are very distinct from existing traditional associations.

This year's global accounts differ from their predecessors in that they are based on associations with more than 1,000 homes. In the past the cut-off point for inclusion has been 250 homes. The reason for this change is that as part

of the Housing Corporation's response to the Elton Review, we have raised the size limit for associations required to submit electronic returns from 250 to 1,000 homes.

Within the segment of larger associations (in excess of 1,000 homes) there is still a great diversity in the size of associations and the range of activities they undertake. We are seeing a small but increasing number of very large associations with over 10,000 homes. The largest 7% of associations in the sector manage 33% of the stock. In addition, the majority of the larger associations in the sector are organised in even larger group structures.

Typically, the larger associations are more aggressive in their approach to growth and new development, either with the support of grant, in partnership with the Corporation or in unsubsidised developments. A key challenge for these associations is to use their financial capacity to full effect to help deliver a step increase in provision of new social housing supply necessary to meet current and future demand. Increased competition for grant from non-registered organisations also features highly for these developing associations.

Whilst the provision of rental properties remains the major objective for the majority of associations, increasingly they provide home ownership products and rely to varying degrees on asset sale proceeds. This type of activity exposes associations to a different risk profile to traditional

renting and is changing the financial profile of some associations within the sector.

Further differences exist between associations in their degree of specialism. The majority of associations have some specialist supported care or housing for older people properties. There is, however, a small but significant number of primarily specialist associations, who are largely service rather than property based organisations. These face particular challenges in competition from other service providers for Supporting People contracts.

The sector does not, of course, operate in a vacuum and key economic variables affect the opportunities for associations to develop and extend their services. Rental incomes are constrained by reference to the retail prices index (RPI) each year as associations comply with rent influencing. Conversely maintenance, build cost and salary inflation rates typically outturn at levels above RPI. The market for housing is a key influence on associations' ability to maintain financial strength, particularly with increased involvement in home ownership products and reliance on the profit from sales of fixed assets. Associations, similarly, are vulnerable to changes to base rates, as approximately 35% of debt is held at unhedged variable rate.

Other key considerations include factors common to other sectors, for example the impact of pension liabilities, and the influence of Government policy

initiatives to improve the quality and supply of social housing.

The global accounts publication is an opportunity to see how some of these factors are reflected in the financial position of the sector as a whole, and key segments within it.

The 2007 global accounts are presented in five sections:

Part A Executive summary

Part B Operating and financial review

Part C Global accounts 2007

Part D Sector and sub-sector analysis

Part E Appendices

All analysis in this publication is derived from housing associations' audited financial statements and compiled by the Housing Corporation from returns submitted annually by housing associations to the Housing Corporation's field offices.



Executive
summary

The sector has continued to grow in a balanced fashion in 2007 and at a slightly faster rate than the previous year. Turnover is up 9.4% to £9,117 million, whilst the surplus before tax has grown by 8.4% to £270 million. The increase in turnover is largely driven by the increase in unit numbers, both from the transfer of stock from local authorities and the construction of new homes by existing associations. Both of these activities require associations to take on additional debt and in the year debt has risen by 9.2% to £30.9 billion, whilst the gross book value of associations' housing properties stands at £77.4 billion, up 10.1% on 2006. This has been done whilst constraining the growth in interest costs to 9.2% at £1,912 million.

However, there remain some significant challenges for the sector. Although the global operating margin has risen slightly from 15.2% to 15.5%, for traditional associations it has actually fallen from 19.2% to 18.4%. This reflects the ongoing inflationary pressures faced by housing associations as they deliver the Decent Home Standard (DHS). The sector has also continued to benefit from the recent buoyancy in the housing market and it seems unlikely the sector would have registered a surplus without the £542 million profit made on disposal of properties. This profit is up 8.6% on the previous year and emphasises how mainstream shared ownership activity has become and how important it is to the sector's business

model. Looking forward, this clearly means associations are more exposed to a downturn in the property market than they would have been ten years ago.

Despite these challenges, the sector continues to have significant capacity for more development. The capacity models submitted to the Housing Corporation show associations planning on drawing down £17,000 million over the next five years. In addition, the Housing Corporation thinks there is additional capacity within a number of associations that may be able to deliver even more.

The quartile analysis in Part D shows that there is a significant spread in financial strength amongst traditional associations, and even on those measures where the aggregate average has lowered, there remain a significant number of financially very strong associations in the median and upper quartiles.

Part D also highlights the importance of choosing the most appropriate measure for interest cover. The traditional sector's interest cover using the Housing Corporation's conventional measure (EBITDA Interest Cover¹) is 118%. However, when the figure is adjusted for capitalised items then it drops to 90% and when profits on sale are also added, it then increases to 119%.

¹ Earning Before Interest, Tax, Depreciation and Amortisation

This range of potential results highlights two key themes that run through this report in addition to the tightening of margins: the importance of sales discussed above and the increasing level of capitalisation seen within the sector.

Highlights from this year's global accounts:

- the growth in the sector has been weighted more to traditional associations than in the previous year. The split was 73% in the traditional sector and 27% in the LSVT sector, which compares to a 62%/38% split in 2005-06;
- the level of HomeBuy activity shown in the balance sheet of associations has passed the £1 billion mark for the first time, underlining its increasing importance to the sector;
- the global housing association balance sheet remains relatively lowly geared. Using the Housing Corporation's preferred measure (adjusted net leverage) gearing stands at 39.5%, down slightly from the previous year's figure of 39.8%;
- the sector's external debt passed the £30 billion mark for the first time this year and for the last two years associations have more debt than Social Housing Grant (SHG) showing on the face of the balance sheet. However, the increase in debt relative to SHG is largely driven by the transfer of stock from local authorities, which is solely debt funded. Within traditional associations, debt amounts to £19.8 billion compared to SHG at £28.0 billion;
- turnover has risen by 9.4% to £9,117 million, whilst operating costs have grown more slowly (by 7.8%) to £7,466 million. This means that the operating surplus has risen by 11.7% to £1,417 million;
- there is continuing growth in surplus on disposal (which has risen by 9% to £542 million). However, the rate of growth is slowing and the current year's position is down on the 19% increase between 2004-05 and 2005-06;
- the growth in interest costs has remained largely in line with the growth in debt. Income and expenditure interest has risen by 7.3% compared to a 9.2% increase in debt. However, the increase in total interest (including capitalised interest) is 9.3%, taking total interest paid to £1,912 million. This relatively restrained growth is despite the fact that during the 12 months under review, the base rate increased from 4.50% to 5.25%;
- overall rental income has increased by 7.7% and service charges are up 13.7% giving a combined income of £7,337 million. However, this level of increase has largely been driven by new homes coming into the sector (from both stock transfer and new build). The increase on a per unit basis for rent and service charge income is 2.3% for all organisations and 2.0% for stock held by traditional associations;
- the issue for associations is that parts of their cost base are growing at a faster rate than their rental income. For example, on a per unit basis management costs increased by 6.7% for all associations and 5.7% for traditional organisations. By contrast, routine

and planned repairs increased by 1.7% per unit for all associations, but 3.4% for traditional organisations;

- levels of voids and bad debts reported by associations remain at historic lows, suggesting continued strong demand for their properties, together with good performance on rent collection. Overall void levels were 2.3% (consistent with the previous year) and bad debts also stayed constant at 1.0%; and
- turnover on activities other than social housing lettings totals £1,278 million and represents 14.0% of total turnover. Both turnover and expenditure on non-social housing lettings activities have remained relatively constant at around 14% and 17% of total turnover and expenditure respectively since 2005.

B

Operating
and financial
review

Overview of the sector

There are around 1,800 housing associations owning or managing almost 2.2 million homes. The sector is characterised by a large number of associations that own fewer than 1,000 homes each, representing 6% of the total stock in the sector. Those associations that own more than 1,000 homes total less than 400.

Within the grouping of larger associations, there is great diversity in size, with a small but increasing number of very large associations (at March 2007, 49 associations either owned or managed more than 10,000 homes). As was the case during 2005-06, there continues to be significant merger and group structure development activity in the sector as associations seek growth and more efficient and effective structures. The largest 20 association groups account for around 28% of the stock in the sector, and around 80% of the larger associations are in group structures.

An increasing proportion of housing within the sector is owned by stock transfer associations. Currently stock transfer associations own around 45% of the total stock in the sector, which is an increase of 4% on last year.

The total stock of the sector comprises homes for general needs tenants, supported housing, care homes, temporary social housing, key workers and, increasingly, leasehold and shared ownership properties. In addition, the sector owns around 40,000 non-social housing dwellings including

student accommodation, some key worker homes, homes for rent in the open market and (non social housing) residential care homes.

At 31 March 2007, the Regulatory and Statistical Return, completed by all active associations recorded the following aggregate stock levels:

Housing stock owned ('000)

General needs	1,621
Supported housing	99
Housing for older people	306
Leasehold properties (<100% equity)	112
Total owned ('000)	2,138

Associations are involved in a wide range of activities, beyond providing homes. Associations increasingly use their role as the major landlord in areas to further ensure the sustainability of developments and communities. This can involve (but is not limited to) leading or involvement in regeneration activities, provision of community centres, training facilities and other services in the community.

The sector's objectives

The sector is comprised of a large number of diverse organisations, with differing constitutions, ranges of activities, focuses and drivers. However, there are consistent themes in the objectives of many associations which refer to:

- quality of and excellence in service delivery;
- continuous improvement across all services and in performance;
- being customer focused;
- providing affordable yet desirable homes;
- growth aspirations;
- asset management both in terms of maintenance and maximising the potential of assets;
- strength in financial position and performance;
- maintaining reputation with stakeholders;
- excellence in business management – ensuring effective governance and structures;
- neighbourhood renewal;
- equality and diversity;
- providing an excellent and enjoyable working environment for employees; and
- expanding client groups and areas of operation.

Dynamics of the social housing sector

The financial performance of the sector in 2007 demonstrates the sector in aggregate continues to be financially sound, although clearly the economic operating environment is less benign now than it has been for a number of years, and financial results appear vulnerable. There are a number of challenges – both risks and opportunities – which associations face. The extent to which issues affect individual associations vary according to their financial structure, activities, geographical location and other factors.

They include:

- increasing reliance on property sales and potential downturn in the housing market;
- demand for equity share homes and potential impact of a restriction in mortgage availability for potential purchasers;
- availability of competitive funding in the light of the ‘credit crunch’;
- managing interest rate risk, given that 18% of total costs relate to interest;
- differential inflation rates, particularly in respect of maintenance and staffing costs;
- pressure on development grant rates, through increased challenge from the Housing Corporation and other grant bodies;
- competition from unregistered developing organisations;
- retaining partner status;
- availability of land for development;
- continued involvement in the regeneration of deprived areas and extending the role to meet government expectations and increased working with a range of local authorities;
- supporting people funding decisions;
- compliance with rent influencing;
- achievement of the Decent Home Standard and ensuring sustainability of the stock;
- retention of staff and expertise; and
- increased customer expectations.

Performance in the period

Operating performance

The full range of Housing Corporation performance indicators (PIs) are published for each association on the PI website at www.housingpis.co.uk. A selection of key performance indicators are set out below. A number of the performance indicators are published for the first time this year, hence no prior year comparatives are available. Where prior

year comparative figures are available, they are provided in the table in brackets.

In summary, at a national level, there has been an increase in average performance in four of the five PIs above for which there are comparative 2006 figures. Indicator results are relatively compact, and some associations operating near optimum levels are limited in their scope to improve. New associations (usually stock transfers) typically record comparatively poor results in their early years, which tend to depress the national averages.

PI description	Average (mean)	Top quartile	Median	Bottom quartile
Stock failing Decent Home Standard	13% (15.8%)	2.2% (3.4%)	7.3% (10.0%)	14.8% (19.0%)
Vacant dwellings	2.6%	1.1%	1.9%	3.1%
Re-let time (managed stock)	40 days	28 days	37 days	50 days
Current tenant arrears at year end	5.2% (5.2%)	3.1% (3.4%)	4.5% (4.7%)	6.3% (6.3%)
Routine repairs completed in target	94.0% (93.5%)	97.5% (97.5%)	95.7% (95.3%)	92.0% (92.0%)
Tenant satisfaction overall	80% (79%)	85% (86%)	80% (80%)	75% (75%)
Re-let time (for general needs managed stock)	40 days (42 days)	26 days (25 days)	34 days (35 days)	47 days (48 days)
Tenants satisfied with repairs and maintenance	76%	82%	77%	70%

Therefore, the improvement across a majority of PIs represents a sound performance.

Efficiency

Following the Gershon review of efficiency across government, the sector was set challenging efficiency targets in four work stream areas of new provision, capital works, management and maintenance and commodities. 2006-07 represented the second year for which associations reported the annual savings achieved across three of the four work streams (excluding new provision) through annual efficiency statements. Following the first year gains reported of £318 million, well in excess of the Government's first year interim targets, reported gains in year two were similarly strong. The sector reported increased efficiency at March 2007 (over March 2006 levels) of £469 million, against a target of £120 million.

The final year of the three-year programme of efficiency targets will be reported in July 2008. From the forecasts provided by associations, and the efficiencies gained to date, indications are that the three-year target of £195 million is achievable.

Financial performance

The sector continues to grow at a steady rate driven by the transfer of stock from the local authority sector and the acquisition and construction of new homes funded both with and without public subsidy. In addition, almost 70,000

homes were transferred from local authorities to associations in the year to March 2007.

The sector's operating surplus has increased by 11.7%, resulting from a £783 million increase in turnover (up from £8.3 billion to £9.1 billion) and an increase in operating costs and cost of sales of £634 million (from £7.1 billion to £7.7 billion).

The surplus on social lettings activity increased by £135 million or 10.7%, which is notably more than last year's increase of £15 million and is slightly ahead of the increase in turnover from social lettings of 7.7%. Expenditure on social lettings increased by 7% (£424 million). However, an increasing proportion of major repair spend was capitalised (up from 41% of total major repair spend to 46%). The performance in other (non-social lettings) activities remained largely constant with last year's (margin 1.3% compared to 1.1% the previous year) based on an increased turnover of some 20%. Turnover on other activities represents 14% of total turnover compared to 13% last year. Profits on sales of properties continue to boost the surplus in year and increased by 8.6% on 2006 levels. Without the surplus on sales, the traditional sub-sector would have returned a deficit for the year. This underlines the importance of sales to the sector.

The net result of these changes was a 6.6% increase in surpluses after tax to £270 million. EBITDA interest cover was 117.6% for traditional associations and 106.9% for the sector overall.

Three-year financial highlights and key financial ratios

	2007	2006	2005
Turnover (£ million)	9,117	8,334	7,568
Operating costs and costs of sales (£ million)	7,685	7,055	6,312
Operating surplus (£ million)	1,417	1,268	1,250
Surplus on social housing lettings (£ million)	1,397	1,262	1,247
Net interest payable (£ million)	1,596	1,476	1,400
Profit on sales of assets (£ million)	542	499	419
Surplus for the year (£ million)	257	241	364
Operating margin (%)	15.5	15.2	16.5
EBITDA interest cover (%)	106.9	105.8	111.9
Growth in turnover (%)	9.4	10.1	N/A
Growth in total assets (%)	10.7	9.7	N/A
Debt per unit (£)	14,111	13,658	12,849
Management cost per unit (£)	780	730	695
Routine and planned maintenance cost per unit (£)	878	863	848

Investment for the future

The sector delivered over 40,000 new homes funded with Social Housing Grant (SHG) in the 2006-07 year and this rate of growth is expected to continue with further targets for delivery of new homes of over 40,000 in 2007-08 and an expectation of an increase in delivery to 2011.

In addition, the sector continues to invest heavily in existing assets to ensure they meet the Decent Home Standard within the required timeframe. Investment in 2007 on planned and major repairs (including both capital and revenue) totalled £2.5 billion, an increase of 10% on the previous year. Whilst this represents a slow down in the rate of increase from the previous year of 21%, investment in current stock spend is maintained at 34% of all operating expenditure.

Capital structure and treasury policy

The sector's two main sources of capital finance remain SHG and debt. In the latest financial year the debt of the sector rose by 9.2% to £30.9 billion. This compares to a 10.1% increase in capital grants (combining both SHG and other capital grants) to £31.8 billion. The overall impact of this was to reduce adjusted net leverage of the sector from 39.8% to 39.5%. The proportion of debt and grant is markedly different for traditional and stock transfer associations, with the latter funded initially by external debt, and a much smaller proportion of total assets funded with grant. As

a result, adjusted net leverage for stock transfer associations is 57.7%, but only 33.5% for traditional associations.

During the year to 31 March 2007 the Bank of England base rate rose three times from 4.5% to 4.75% (in August 2006), 5.0% (in November 2006) and 5.25% (in January 2007). It has since risen a further two times by a total of 0.5% until returning to current levels of 5.25% (in February 2008).

Interest costs have been constrained, however, during this period of growth as associations seek to mitigate their interest rate risk. Interest rate rises appear to have abated recently, however, key treasury issues remain for associations as a consequence of the so-called credit crunch and effect of the sub-prime market in the US.

A number of associations have rules which allow them to enter into complex derivative and financial instruments. However, from a review of information provided within financial statements, it appears that only a relatively small number of associations put those powers to use beyond using fairly routine interest rate hedging agreements.

Cash flows

Year end balances on cash and short-term investments increased by £261 million over 2006 levels. Private finance of £2.5 billion was received mainly to fund new development, stock transfer, improvements and major repair programmes. Increasingly, associations are reviewing and

where appropriate re-financing their existing treasury arrangements. Breakage and other costs associated with redemption of loans amounted to some £119 million this year, compared to £38 million last time round.

Current liquidity

Associations' level of net current assets and cash has increased and the sector's aggregate current assets to liabilities ratio is 1.4 (1.3, 2006).

Going concern and regulatory compliance

In overall terms, the sector is financially viable. The performance of individual associations is, however, masked by the aggregation of financial data. At the time of writing, only six associations with more than 1,000 homes did not have a green traffic light for viability in their Housing Corporation Assessments (HCAs). A green traffic light for viability signifies compliance with the Housing Corporation's Regulatory Code. Amber and red traffic lights signify non-compliance, with a red light denoting more serious concerns than an amber light. Of the six associations, five had amber lights and one red. The six red and amber traffic lights represent around just 1.6% of the total viability assessments.



Global
accounts
2007

Methodology

This analysis is based on a database of information derived from housing associations' audited financial statements. The database contains the data from the annual account regulatory returns (FVAs) which are completed by associations. Financial statements containing aggregate balance sheets and aggregate income and expenditure accounts for 2004-05 and 2005-06 are included to allow comparisons to be made.

The aggregate figures relate to information received via the FVA from all associations that manage 1,000 or more homes. We do not include the consolidated accounts of groups of associations, which would include a degree of financial information from unregistered bodies. We also exclude the accounts of non-asset holding parents of association groups to prevent significant double counting of income and costs. These parents often provide centralised corporate services which are recharged to group subsidiaries. However, since individual group member accounts are included, there remains a small degree of grossing up of income and expenditure reflecting intra-group recharging.

Following on from the Elton review of the burden of regulation, we have changed the submission criteria from associations, so we only require FVAs from organisations with more than 1,000 homes, as opposed to the 250 home cut-off that was used previously. Following this change, we have restated

the global accounts for 2004-05 and 2005-06 so they are comparable with this year's data.

Given the very distinct financial characteristics of stock transfer associations and the influence of those characteristics on the sector as a whole, we have provided a breakdown of the aggregate figures between stock transfer and traditional associations. This segmental presentation continues throughout the analysis.

Aggregate balance sheet

The aggregate balance sheet is the sum of individual housing association balance sheets whose financial year ends fall within the period from 1 April 2006 to 31 March 2007.

Aggregate income and expenditure account

The aggregate income and expenditure account reflects the sum of housing association activity for all accounting periods ending between 1 April 2006 and 31 March 2007.

Additional information

Additional information is provided on aggregate income and expenditure on social housing lettings, income and expenditure on other activities and stock numbers.

Balance sheet

All figures in £ million	LSVT 2007	Traditional 2007	Total 2007	Total 2006	Total 2005
Fixed assets					
Housing properties at cost	9,078	51,174	60,251	54,835	50,445
Housing properties at valuation	10,862	6,314	17,175	15,460	13,711
SHG/HAG	2,345	28,038	30,383	27,642	27,111
Other capital grants	245	1,186	1,432	1,249	1,052
Depreciation	400	1,224	1,624	1,304	1,121
Net book value of housing properties	16,950	27,040	43,987	40,100	34,872
Other fixed assets - tangible	417	789	1,205	1,025	884
Other fixed assets - intangible	7	-69	-63	-80	35
Other fixed assets - investments	63	748	811	743	670
HomeBuy loans	82	947	1,029	820	735
HomeBuy grants	-81	-942	-1,023	-813	-732
Total fixed assets	17,438	28,513	45,946	41,795	36,464
Current assets					
Non-liquid current assets	907	525	1,432	1,077	656
Cash and bank	263	661	925	725	791
Short-term investments	109	307	417	356	373
Other current assets	633	1,579	2,212	1,918	1,698
Total current assets	1,912	3,072	4,986	4,076	3,518
Current liabilities					
Short-term loans	103	409	512	519	325
Bank overdrafts	8	33	41	43	32
Other current liabilities	951	2,040	2,991	2,516	2,361
Total current liabilities	1,062	2,482	3,544	3,078	2,718
Net current assets (excluding pension)	850	590	1,442	998	800
Pension assets	-120	-56	-176	-111	-7
Net current assets (including pensions)	730	534	1,266	887	793
Total assets less current liabilities	18,168	29,047	47,212	42,682	37,257

Balance sheet continued

Financing and reserves

Long-term loans	10,953	19,422	30,375	27,806	24,773
Other long-term creditors	1,066	1,287	2,353	1,563	961
Provisions	812	99	911	781	538
Accumulated surplus	-854	4,869	4,012	3,590	3,691
Designated reserves	206	995	1,201	1,031	1,020
Restricted reserves	49	63	112	151	111
Revaluation reserves	5,859	2,270	8,129	7,521	6,148
Pension reserves	77	42	119	239	15
Total reserves	5,337	8,239	13,573	12,532	10,985
Total financing and reserves	18,168	29,047	47,212	42,682	37,257

The Gross Book Value (GBV) of the sector's assets (at cost and valuation) has risen by 10.1% to £77.4 billion. This has been financed by a 10.1% rise in capital grants (up to £31.8 billion) and a 9.2% rise in external debt (up to £30.9 billion).

The growth in the sector has been weighted more to traditional associations than in the previous year. The growth in GBV was split 73% in the traditional sector and 27% in the LSVT sector, which compares to a 62%/38% split in 2005-06. In part, this reflects the increased level of grant funded programme being delivered and also the increasing number of stock transfers from local authorities (both whole and partial) that are going directly into traditional associations, rather than into new stand-alone entities.

The percentage of the sector's social housing assets held at valuation, rather than historic cost, has remained steady during the three years under

review at 22%. The main difference is between LSVTs and traditional associations. In 2006-07, 46% of LSVTs' housing stock was at value compared to 11% for traditional associations.

The level of HomeBuy activity shown in the balance sheet of associations has passed the £1 billion mark for the first time, underlining its increasing importance to the sector.

Associations' level of net current assets and cash has increased again, probably reflecting the increased development programme and the need to have cash drawn and ready to use. Levels of short-term debt and bank overdrafts remain low, amounting to less than 2% of the total outstanding debt.

The sector's external debt passed the £30 billion mark for the first time this year and for the last two years associations with more than 1,000

homes have more debt than SHG showing on the face of the balance sheet, although the total level of capital grants (SHG plus other capital grants) still exceeds the external debt.

However, the significant increase in debt relative to SHG is largely driven by the transfer of stock from local authorities, which is solely debt funded. Within traditional associations, debt amounts to £19.8 billion compared to SHG at £28.0 billion. For LSVTs, the figures are debt at £11.1 billion and SHG at £2.3 billion. This means that despite some recent speculation the relative proportions of debt to grant within traditional associations have remained relatively unchanged.

This continuity is reflected in the global housing association balance sheet which remains relatively lowly geared. Using the Corporation's preferred measure (Adjusted Net Leverage), gearing stands at 39.5% down slightly from the previous year's figure of 39.8%. This reflects the relatively slower growth in LSVT associations compared to traditionals. With the former having much higher levels of gearing than the latter (57.7% compared to 33.5%), this means that if the traditional sector grows faster than the stock transfer sector, the overall sector gearing drops.

Summary income and expenditure account

All figures in £ million	LSVT	Traditional	Total	Total	Total
	2007	2007	2007	2006	2005
Turnover	3,263	5,853	9,117	8,334	7,568
Operating costs	-2,903	-4,563	-7,466	-6,927	-6,222
Cost of sales	-16	-203	-219	-128	-90
Exceptional items	-5	-10	-15	-11	-6
Operating surplus	339	1,077	1,417	1,268	1,250
Surplus on sale of fixed assets	164	378	542	499	419
Gift aid	14	11	24	-1	2
Other items	4	-2	2	-3	119
Interest receivable and other income	25	106	131	134	115
Interest payable and similar charges	-633	-1,094	-1,727	-1,610	-1,515
Exceptional items relating to early redemption of loans	-21	-98	-119	-38	-17
Surplus before tax	-108	378	270	249	373
Corporation tax	-4	-9	-13	-8	-9
Surplus after tax	-112	369	257	241	364
Transfer (to)/from reserves	118	309	427	-69	294
Accumulated surplus brought forward	-502	4,058	3,556	3,694	2,982
Prior period adjustments	-100	-128	-228	-310	54
Accumulated surplus carried forward	-596	4,608	4,012	3,556	3,694

Overall turnover has risen by 9.4% to £9,117 million, whilst operating costs have grown more slowly (by 7.8%) to £7,466 million. This means that overall operating surplus has risen by 11.7% to £1,417 million. Unlike the growth in housing assets the rate of growth in the turnover and operating costs lines is broadly consistent between the two main sub-sectors.

The main point of interest above the operating surplus line is the growth in cost of sales, which is up by 71% to £219 million. This reflects the early adoption of the new SORP disclosure on first tranche sales of shared ownership homes by a handful of associations. This will also have increased the growth of turnover, although its impact will have been marginal. Despite the level of impact this year, we can expect to see a

continued growth in this area and a greater impact on the levels of turnover and surplus reported by the sector.

These figures confirm the continuing growth in surplus on disposal, which has risen by 9% to £542 million. However the rate of growth is slowing and the current year's position is well down on the 19% increase between 2004-05 and 2005-06. Interestingly, this slowdown is largely because the profits generated on disposals by LSVTs have actually fallen, but within the traditional sector the profits have grown by 28% compared to 22% in the previous year. This suggests that associations have continued to benefit from the recent buoyancy in the housing market. However, the drop in sale activity for stock transfer landlords suggests that the Right to Buy (RTB) product may be becoming less affordable to existing tenants.

The impact of this growth is that for the first time the traditional sector would not be reporting a pre-tax surplus without the income from disposals. The Corporation's research in this area has shown that the majority of this income is from the sale of shared ownership tranches and RTB and Right to Acquire (RTA) properties; but it is now clear that many traditional associations are developing business models where the income from shared ownership sales is integral to their success. These accounts report the financial performance of associations before the current turbulence in the credit markets and the impact of any slowdown in the housing market has yet to feed into the global accounts.

The growth in interest costs has remained largely in line with the growth in debt. Overall interest has risen by 7.3%, compared to a 9.2% increase in debt. However, the increase in total interest (including capitalised interest) is 9.3%, taking total interest paid to £1,912 million. This relatively restrained growth is despite the fact that during the 12 months under review the base rate increased from 4.50% to 5.25%. This suggests that associations have managed to mitigate their interest rate risk to a reasonable degree. Indeed, the 2007 Annual Review of Housing Association Private Finance shows that only 36% of debt is held at unhedged variable rate.

However, as discussed elsewhere, the increasing levels of capitalisation of both interest and repair costs reflects a broader trend to try to move costs out of the income and expenditure account and onto the balance sheet. The reason for this is probably best explained by looking at the surplus before tax as a percentage of turnover. In 2004-05 this stood at 10.5% for traditional associations, but by 2006-07 this had dropped to 6.5%.

In short, traditional associations are finding their margins being squeezed as the cost of decent homes and the impact of rent restructuring continue to bite. The impact of this within different sub-sectors is explored more fully later on in this publication. But it is clear that associations need to find a way to manage within a less benign operating environment and still deliver viable business plans.

Income and expenditure on social housing lettings

All figures in £ million	LSVT	Traditional	Total	Total	Total
	2007	2007	2007	2006	2005
Rents	2,845	3,930	6,775	6,289	5,726
Service income	122	441	563	495	443
Charges for support services	51	115	166	181	194
Net rental income	3,018	4,486	7,503	6,965	6,363
Housing Corporation revenue grants	1	20	21	12	13
Major repair grants	1	18	19	14	12
Other revenue grants	17	130	147	153	159
Other	14	134	148	137	90
Total turnover from social housing lettings	3,051	4,788	7,838	7,281	6,637
Management	665	993	1,658	1,470	1,321
Service costs	194	663	857	825	707
Care/support costs	52	152	203	191	209
Routine maintenance	606	700	1,306	1,219	1,140
Planned maintenance	276	286	562	519	470
Major repairs	700	344	1,044	1,024	832
Bad debts	24	48	72	67	62
Lease charges	6	174	181	256	254
Depreciation of housing properties	157	213	371	338	300
Impairment of housing properties	8	13	21	5	5
Other	48	120	168	105	89
Total expenditure on social housing lettings	2,736	3,706	6,443	6,019	5,389
Surplus on social housing lettings	315	1,081	1,396	1,262	1,248

Overall rental income has increased by 7.7% and service charges are up 13.7%, giving a combined income of £7,337 million. However, this level of increase has largely been driven by new homes coming into the sector (from both stock transfer and new build). The increase on a per unit basis for rent and service charge income is 2.3% for all organisations and 2.0% for stock held by traditional associations.

These sub-RPI levels of increase suggest that rent restructuring is constraining associations' rental growth. It is particularly interesting that traditional associations are seeing sub-RPI income growth on a per unit basis, as we would not expect this to be materially affected by the impact of lower rent homes from stock transfers. It seems likely that associations whose rents have to come down in real terms under rent restructuring are using the last half of the ten-year period to reduce their rents.

The issue for associations is that parts of their cost base are growing at a faster rate than their rental income. For example, on a per unit basis, management costs increased by 6.7% for all associations and 5.7% for traditional organisations. By contrast, routine and planned repairs increased by 1.7% per unit for all associations, but 3.4% for traditional organisations.

What is happening on major repairs is perhaps even more interesting. For the whole sector, the cost of major repairs written off through the income and expenditure account rose by 2.0%,

but the cost of repairs capitalised rose by 22.2%. This meant that the average capitalisation rate for major repairs rose from 41% in 2005-06 to 46% in 2006-07 and the position for the traditional sector saw rates rise slightly from 50% to 51%. In other words, associations are increasingly using their capitalisation policies to improve the level of surplus reported in their accounts and within traditional associations over half the cost of major repairs is not being reported through income and expenditure account.

The position with LSVTs is always complicated by the transfer of new organisations from the local authority sector and the movement of others through their catch-up repairs. But it is clear that traditional associations are seeing the major expense items within their cost base grow faster than their income and this is not a sustainable trend indefinitely.

Whilst the rise in repair costs is linked to the need to meet the Decent Home Standard and it is possible that costs will fall once the 2010 deadline passes, the continuing above-RPI rises in management costs are potentially more of an issue and for this reason the issue of costs per unit are explored more fully in Appendix 1.

More positively, the levels of voids and bad debts reported by associations remain at historic lows, suggesting continued strong demand for their properties, together with good performance on rent collection. Overall void levels were 2.3%

(consistent with the previous year) and bad debts also stayed constant at 1.0%.

It is also encouraging that despite the levels of capitalisation, impairment within the sector remains modest at £21 million.

The other point of note from the detailed breakdown is that whilst care and support costs have remained relatively static over the three years (falling from £209 million in 2004-05 to £203 million in 2006-07) the level of income from charges for support services has fallen by £28 million (14%) over the same period.

Income and expenditure on other activities

All figures in £ million	LSVT 2007	Traditional 2007	Total 2007	Total 2006	Total 2005
Other social housing activities					
Turnover	107	574	680	619	542
Expenditure	110	621	731	659	591
(Deficit) on other social housing activities	(3)	(47)	(51)	(40)	(49)
Non-social housing lettings					
Turnover	40	118	158	150	159
Expenditure	22	89	111	103	114
Surplus on non-social housing lettings	18	29	48	48	45
Non-social housing - other activities					
Turnover	65	375	440	292	232
Expenditure	57	363	420	287	227
Surplus on non-social housing - other activities	8	12	20	5	5
Total other activities					
Turnover	212	1,067	1,278	1,061	933
Expenditure	189	1,073	1,262	1,049	932
Total surplus/(deficit) on other activities	24	(6)	17	12	1

Turnover on activities other than social housing lettings totals £1,278 million and represents 14.0% of total turnover. Both turnover and expenditure on non-social housing lettings activities have remained relatively constant at around 14% and 17% of total turnover and expenditure respectively since 2005.

Typically, activities reflected in other social housing include Supporting People contract income and community based and regeneration activities, for which there will not necessarily be a defined income stream to match the costs. In addition, some associations use this part of their accounts to disclose development costs not capitalised and central overheads not apportioned to specific activities.

Around 70% of the associations providing FVAs reflect social housing non-lettings activity in their returns. Of these, approximately half record a surplus on the activity and half record a deficit. Overall, the sector has recorded a small deficit in each of the years since 2002. As associations divert more resources to social housing activities that are not lettings based, for example key community or regeneration projects, with limited funding sources, the losses in this area may grow.

Conversely, the sector has recorded surpluses in non-social housing activities, with turnover from these activities representing 6.6% of total turnover. Associations return the largest aggregate surplus on non-social housing lettings activities, which includes key worker accommodation, market

renting, student accommodation and specialist care homes.

Overall the sector has returned a surplus of £20 million on other non-social housing activities, which represents an operating margin of 4.5%. Traditional associations in aggregate have recorded a loss of £6 million on total other activities. The aggregate results do, however, mask significant differences in the level of activity and results for individual associations.

Number of homes

	2007	2006	2005
Social housing			
Traditional	1,185,884	1,136,940	1,123,243
Stock transfer	941,198	874,952	776,215
Total	2,127,082	2,011,892	1,899,458
Non-social housing			
Traditional	48,321	50,126	45,951
Stock transfer	13,424	11,930	7,798
Total	61,745	62,056	53,749
Total homes			
Traditional	1,234,205	1,187,066	1,169,194
Stock transfer	954,622	886,882	784,013
Total	2,188,827	2,073,948	1,953,207

Total homes managed by associations included in the global accounts increased by 114,879, which is an increase of 5.5%. Social housing homes increased by 5.7% and non-social housing homes fell by 1%. Non-social housing represents only 2.8%

of homes in management (compared to 3% last year). In both stock transfer and traditional sectors the increase reported here is net of any sales or demolitions. Also, there are a small number of associations that fall within or outside the data set each year caused either through changes in accounting periods or marginal changes in stock numbers around the 1,000 home mark.

The homes disclosed in management on the FVA, indicate that stock transfer associations now manage around 44% of the stock in the sector (compared to 43% last year). The number of homes managed by stock transfer associations in the sector will continue to grow as the transfer programme continues.

D

Sector and
sub-sector
analysis

Methodology

The analysis that follows complements the summary of associations' financial statements. It provides insights into the overall position of the sector and movement over time by firstly focusing on trends in key financial ratios and the relationships between them over the period 2005-07.

The financial position of the sector in aggregate does, however, mask the very different financial characteristics of some segments within it and the significant variance in performance of individual associations. Therefore, segmental analysis is completed on a range of ratios, highlighting how the results for the sector as a whole in 2007 are influenced by sub-sectors within it. This approach facilitates some useful peer group analysis and insights into varying patterns within the sector.

The key financial information provided in part C highlights some of the key differences between the traditional and stock transfer segments of the sector, particularly in terms of growth and balance sheet strength. Additionally, the age of a stock transfer also impacts on its financial characteristics. These characteristics are influenced by a number of issues but predominantly they come about because:

- growth in the stock transfer sub-sector is characterised by new associations joining the sector with an existing asset base transferred from the local authority. In comparison,

growth in the traditional sector is very much characterised by organic growth within individual associations. Merger activity affects the segmental analysis by size as associations move between size bandings but does not influence the overall growth in the sector;

- stock transfers typically complete significant re-improvement works in the first five years of transfer. As a consequence, 'young' stock transfers tend to record deficits or small surpluses in the first five to six years. These deficits are funded with debt; and
- stock transfers are initially in the main funded by external private finance. Typically, they transfer with business plans forecasting high and increasing debt compared to asset values in the early years. Thereafter, debt to value ratios will decrease, but compared with the traditional sector, which has benefited from significant capital grant financing, they remain highly geared.

Since trends over time in all key ratios for the stock transfer sector are constantly affected by the stream of new transfers, trend analysis provides limited additional information. Therefore, for the key ratios that follow, three-year trend information is provided for the traditional sector only. In order to highlight the impact of the different financial characteristics on key (and common) financial ratios stock transfer results are provided for 2007.

Following the ratio trend analysis, the segmental analysis includes analyses of traditional

associations by broad size bands, with stock transfers as a separate category.

Key ratios

Key ratios have been calculated based on the financial statements from 2005-07. The results are arranged under three headings – growth, profitability and balance sheet capacity. The ratios are used specifically to identify key relationships and to provide some insights into recent trends. They are also used by the Corporation in assessing the financial viability of associations as set out in our document *How We Regulate: Viability*.

The ratios have been calculated using aggregate data, to reflect the average movement in the sector as a whole, and median and upper and lower quartiles to demonstrate the range of results across the population.

The aggregate average ratios are based on the sum total figures for all housing associations with 1,000 homes or more, calculated separately for traditional associations and stock transfer associations (for some of the ratios). Effectively, the aggregate average result represents the weighted or geometric average for the particular segment of the sector.

Because the global accounts have been restated for the last two years we do not have aggregate average growth ratios for the period 2003-04 to

2004-05, although we still have the quartile figures for this period.

For each ratio the median represents the figure for the housing association in the middle of the distribution. The median figure might be said to represent the ‘typical housing association’, whereas the aggregate average will be weighted towards the larger housing associations.

The first and third quartiles represent the points which cut off the top 25% and the bottom 25% of housing associations for each ratio. Differences between these various measures will be commented on by exception.

The ratios are derived only from the data in associations’ recent published accounts and therefore the analysis is historical rather than forward looking. Taken as a snapshot, the ratios of recent stock transfers look weak compared to more traditional associations, but for well-understood reasons.

Growth ratios - traditional associations only

	2007	2006	2005
Growth in turnover			
Aggregate average	8.7%	7.4%	
Upper quartile	11.6%	11.3%	10.1%
Median	5.6%	6.1%	5.7%
Lower quartile	1.3%	2.8%	3.1%
Growth in SBIT			
Aggregate average	8.4%	5.0%	
Upper quartile	29.0%	18.1%	19.6%
Median	9.0%	2.2%	8.1%
Lower quartile	-1.6%	-10.7%	-5.3%
Growth in interest			
Aggregate average	10.7%	9.6%	
Upper quartile	0.0%	0.0%	2.6%
Median	8.5%	6.5%	8.8%
Lower quartile	18.6%	16.5%	16.6%
Growth in total assets			
Aggregate average	10.3%	8.0%	
Upper quartile	12.0%	12.6%	9.3%
Median	6.7%	6.0%	5.6%
Lower quartile	2.3%	3.1%	2.3%
Growth in total capital and reserves			
Aggregate average	8.4%	4.2%	
Upper quartile	8.7%	8.3%	8.2%
Median	4.4%	4.0%	4.7%
Lower quartile	1.7%	1.3%	2.0%
Growth in total debt			
Aggregate average	11.9%	12.5%	
Upper quartile	-1.2%	0.0%	-0.5%
Median	6.5%	9.9%	5.5%
Lower quartile	19.7%	21.6%	15.2%

Overall, the picture confirms that the traditional sector is growing in a consistent and balanced manner. At an aggregate level turnover a surplus before interest and tax (SBIT) rose at similar rates (8.7% and 8.4% respectively) and both grew faster than the previous year. Similarly, interest costs grew slightly more slowly than debt levels (10.7% against 11.9%), emphasising that associations are managing their treasury risk well at a time of rising rates.

Asset and capital growth was also up on the previous year (10.3% against 8.0% for assets and 8.4% against 4.2% for capital growth) despite the growth in debt slowing slightly, confirming that 2006-07 has seen the balance sheet of traditional associations strengthen due to an increased level of development, funded in part by the Housing Corporation.

Despite the slowing growth in turnover seen amongst the lower quartile associations (1.3% in 2006-07), there is evidence that associations are paying close attention to their debt and interest costs. The highest quartile of associations shows no growth in interest and debt levels falling by 1.2%. However, the fall in the SBIT position for the lowest quartile (down 1.6%) suggests that some associations are failing to keep the growth in their operating cost base below the increase in turnover.

At an aggregate level, turnover has grown slightly faster than in the previous year (8.7% compared to 7.4%), but growth rates for the median and lower quartiles have dropped slightly (6.1% down to 5.6%

and 2.8% down to 1.3% respectively), suggesting that growth is being driven by the upper quartile organisations. It is likely that these associations are the ones developing the most new stock and taking transfers of stock directly from local authorities.

The growth rate for turnover in the lower quartile association has fallen again this year (1.3%) and is now less than half the rate of growth recorded in 2004-05. This confirms that growth in the sector is increasingly concentrated in a smaller number of associations. It is also likely that the impact of rent restructuring is now constraining some associations to sub-RPI growth in rent levels.

The strong rise in SBIT figures for the upper and median quartiles is well above the growth shown in the previous year (up 29.0% and 9.0%), the median quartile in particular has quadrupled the rate of growth, compared to a 68% increase in the growth rate for the traditional sector as a whole. Whilst this suggests that these associations are managing to grow incomes faster than costs, this optimism has to be tempered by the fact that the SBIT figure includes the surplus on the disposal of housing properties.

As discussed in the next section, the operating margin, which excludes income from disposals, has fallen for all quartiles (and in aggregate) for the last three years. The fact that even allowing for property sales some associations are seeing their SBIT figure falling is a clear signal that some associations are struggling to balance rent

Profitability ratios

	LSVTs	Traditional HAs		
	2007	2007	2006	2005
Operating margin				
Aggregate average	10.4%	18.4%	19.2%	20.7%
Upper quartile	28.0%	26.4%	26.9%	29.0%
Median	16.3%	20.2%	20.9%	22.2%
Lower quartile	-1.5%	13.9%	13.0%	15.3%
Turnover to total operating assets				
Aggregate average	15.2	9.9	10.0	10.1
Upper quartile	31.7	12.4	12.8	12.4
Median	17.0	9.6	9.3	9.3
Lower quartile	11.7	7.6	7.6	7.8
SBIT to assets				
Aggregate average	2.4	2.6	2.6	2.7
Upper quartile	5.0	3.1	3.0	3.1
Median	3.0	2.4	2.4	2.5
Lower quartile	1.1	1.8	1.9	1.9
Effective interest rate				
Aggregate average	5.9%	6.3%	6.4%	6.6%
Upper quartile	4.9%	5.6%	5.7%	5.9%
Median	5.4%	6.3%	6.3%	6.7%
Lower quartile	5.8%	7.1%	7.1%	7.4%
Cash cost of capital				
Aggregate average	2.8	1.5	1.6	1.8
Upper quartile	1.9	1.0	1.5	1.4
Median	2.9	1.4	1.9	1.8
Lower quartile	4.4	2.0	2.3	2.3
Margin over cash cost of capital				
Aggregate average	-0.4	1.0	1.0	0.9
Upper quartile	1.7	1.4	1.0	1.1
Median	0.1	0.8	0.4	0.6
Lower quartile	-2.4	0.5	0.1	0.2

restructuring, decent homes and wage inflation in a sustainable manner.

Overall, associations are seeing growth in debt levels running ahead of the growth in interest costs (debt up 11.9% and interest up 10.7%), which suggests that most organisations managed to mitigate their interest rate exposure in a year when base rates rose from 4.50% to 5.25% (up 17%). However, the median quartile, which saw debt grow by 6.5% and interest costs rise by 8.5%, shows that not all associations are in this happy position and rising interest rate costs can still represent a threat to some businesses.

In general, assets also grew slightly more slowly than debt levels which was reflected in the adjusted net leverage for the traditional sector increasing slightly from 32.9% to 33.5%. However, the rate of increase in asset growth at both an aggregate level and for the median quartile has picked up from the previous year (the aggregate growth rate picked up from 8.0% to 10.3%), whereas the rate of growth for debt levels fell (the aggregate growth rate fell from 12.5% to 11.9%). This suggests that as associations increase their levels of development to meet government targets they are not doing so by taking on unreasonable levels of debt, although this may in part be explained by the strong growth in surpluses from sales proceeds that we know are used by associations to help fund the development of rented homes.

Overall, these ratios show the traditional sector is experiencing a tightening of its profitability, but that it is managing to control its interest costs and so is able to maintain its margin over cash cost of capital. Within the stock transfer sector the differentiation is increasingly clear between those associations that have completed their catch-up repairs and now have a financial structure more akin to a traditional association and those organisations that have recently transferred. The result of this split is that the upper quartile of the stock transfer sector has a financial profile that is stronger than the traditional upper quartile (for example, the stock transfer operating margin is 28.0% compared to 26.4% for traditionals).

These accounts confirm that operating margin is coming under increasing pressure as both the aggregate average and all the quartiles have seen operating margin decline. As discussed throughout this report, the main trigger for this appears to be the constrained level of income growth compared to the increases in key cost lines such as management and maintenance costs. The reasons for the differential inflation rates include the increase in partial stock transfers to traditional associations and the increased maintenance spend to meet DHS. That associations are feeling the strain of growth in their cost base can be seen by the increase in the rates of capitalisation of major repairs. If all the repairs that had been capitalised were to be treated as income and expenditure items, the traditional sector's operating margin would be 12.3% this year (down from 16.0% in

2004-05). Although capitalisation of major repairs is often the correct accounting treatment of the works, it is clear that there is pressure for increased capitalisation as associations' operating margins fall.

There are two possible ways to increase operating margin, one is to increase income and the other is to reduce costs. However, as the performance of the upper quartile on operating margin is nearly twice that of the lower quartile (26.4% against 13.9%) it is clear that some associations need to look closely at their cost base to identify where they can improve performance.

Turnover to total operating assets is consistent with previous years at both an aggregate and quartile level. Similarly, SBIT as a percentage of total assets is largely consistent with previous years, although with a slightly declining position, which is to be expected given the reduced growth in SBIT compared to growth in assets. However, as discussed earlier, the SBIT position has been mitigated by the increasing surpluses being made on disposal. This indicates that the environment associations are working within remains relatively stable, despite the pressure on operating margins.

The most striking thing about the effective interest rate is that the sector managed largely to mitigate the risks from the rising interest rates during the year. Although the lower and median quartiles saw their effective interest rate static at 7.1% and 6.3% respectively, both the aggregate average and the upper quartile saw small drops in

their effective interest rate. It is interesting that stock transfer associations have a lower effective interest rate compared to traditional associations (5.9% as against 6.3%). A significant explanation for this is that stock transfers do not have any of the relatively high interest fixed rate debt that associations entered into during the early 1990s.

The good performance on interest rate costs is also partly explained by the level of fixing and hedging of interest rates that has been carried out by associations. The 2007 Annual Review of Housing Association Private Finance shows that only 36% of association debt is held at unhedged variable rate and that the average rate paid on variable rate debt was 5.53%. Given that by the end of the year the base rate was 5.25%, this emphasises how well associations have managed that risk. However, it needs to be recognised that this strong performance on interest payable, does come at the price of up-front costs and arrangement fees that have to be borne by the association.

The improvement in the effective interest rate is also reflected in the cash cost of capital and it is the improvement here which allows traditional associations to improve their margin over the cash cost of capital. However, it is worth emphasising again the importance of disposals to the strong SBIT performance. Without disposal proceeds, associations' margin over cash cost of capital would be halved.

Debt servicing ability

	2007	Traditional HAs		
	LSVTs	2007	2006	2005
EBITDA interest cover				
Aggregate average	86.3	117.6	125.0	135.5
Upper quartile	162.6	172.5	173.6	185.4
Median	110.4	131.4	134.0	142.1
Lower quartile	49.7	110.4	109.8	118.9
EBITDA interest cover, adjusting for capitalisation of major repairs				
Aggregate average	5.8	89.3	98.7	112.6
Upper quartile	112.9	145.8	154.0	170.7
Median	67.6	109.7	116.6	126.8
Lower quartile	-114.4	78.0	80.7	95.2
EBITDA interest cover, adjusting for capitalisation of major repairs and sales proceeds				
Aggregate average	30.8	119.4	124.6	135.9
Upper quartile	128.3	173.8	169.6	162.9
Median	85.4	127.8	132.5	124.9
Lower quartile	-105.1	97.9	96.9	88.0
Adjusted net leverage				
Aggregate average	57.7	33.5	32.9	31.1
Upper quartile	42.0	20.9	21.5	20.2
Median	65.5	29.4	28.8	27.3
Lower quartile	95.2	38.1	37.0	35.4
Debt per unit				
Aggregate average	11,581	16,068	14,925	13,471
Upper quartile	5,378	8,389	8,217	7,211
Median	12,467	13,327	12,841	11,789
Lower quartile	17,618	20,025	18,416	16,349

The key message from this table is that the repayment ability of the sector (and, in particular, the traditional segment), as measured by interest cover, is very dependent on how the ratio is defined.

Traditionally, the Housing Corporation's preferred measure of interest cover is the EBITDA ratio, which adjusts operating surplus for the impact of depreciation and brings capitalised interest payable into the equation. However, over the last few years there has been an increasing divergence of capitalisation policies by housing associations, with some writing off all their major repairs through the income and expenditure account and some capitalising at almost 100%. Whilst there may be good accounting reasons for either treatment, depending on the specific circumstances of the association, at a global level it makes it hard to compare on a consistent basis and for this reason we have developed an EBITDA ratio in which all capitalised major repairs are treated as if they have been written off through the income and expenditure account.

This version of the EBITDA interest cover (known by the short hand of EBITDA MRI) is now the Corporation's preferred measure as it is the most prudent calculation of interest cover. However, a number of associations have renegotiated their lenders covenants so they can include the surplus on disposal and to help capture the impact of such a treatment. A third variant of the EBITDA interest cover is shown in the table above, which takes

the EBITDA MRI calculation and allows profits on disposals to be brought into the equation.

The striking thing about all these ratios when calculated on the aggregate position for traditional housing associations is that they are all getting tighter with each passing year. Indeed, on the EBITDA MRI basis, the traditional segment of the sector would not be generating sufficient cash to meet its interest payment obligations.

The other issue on all the measures of interest cover is the range between the lower and upper quartile position. This large divergence (with upper quartile performance being almost twice lower quartile) shows that some associations are able to cope with the increased levels of development and strong pressures on their cost base much better than others. One of the key challenges of the sector is to get the lower quartile performance up to the average.

The associations that are of most concern for the Corporation are those that fall into the lower quartile for EBITDA MRI sales (97.9%), this segment of organisations has effectively failed to generate sufficient cash from operations and sales to meet their interest costs for the past three years, a time of buoyant house prices and before the full impact of rent restructuring is felt. How these associations perform over the next few years will be key to how financially robust the sector is seen to be by key stakeholders.

The position for stock transfer associations highlights that for those in the upper quartile their financial profile has become similar to traditional organisations, where the lower quartile reflects those that are still undertaking their catch-up repairs. The other issue for this sub-sector is that the impact of capitalisation policies is even more stark than for traditional organisations. However, this reflects the need for many stock transfer associations to upgrade their stock substantially (and strengthen their balance sheets) following years of under-investment, rather than a desire to report an accounting surplus each year.

A final point of interest on the interest cover ratios is that the Corporation's traditional ratio (EBITDA interest cover) has remained above 100% for each of the three years for both the aggregate average and all the quartiles. This emphasises the fact that most traditional associations manage to report a surplus each year, even if the accounting basis for this surplus can be quite different.

The adjusted net leverage and debt per unit figures demonstrate that the sector remains relatively lightly geared, with even the lower quartile remaining below 40% for adjusted net leverage and at only just above £20,000 for debt per unit.

The position for stock transfer associations shows that debt per unit is lower on both an aggregate and quartile basis than traditionals, but that levels of gearing are much higher. This reflects the low value of assets shown in many LSVT balance sheets. However, it also suggests that as stock

transfers take on a more traditional profile there may be significant extra capacity within their balance sheets.

Segmental analysis

The global accounts and ratios mask a wide diversity within the sector. Major differences occur not only with the size of housing associations but also between stock transfers and traditional housing associations. Among traditional housing associations, the larger ones tend to have higher gearing and lower interest cover ratios because of more ambitious development programmes and also expansion into a wider diversity of activities. Some of the smaller traditional associations are much more conservative in terms of development programmes and use of private financing. This section of the report presents segmented data in an attempt to quantify some of these differences across the sector.

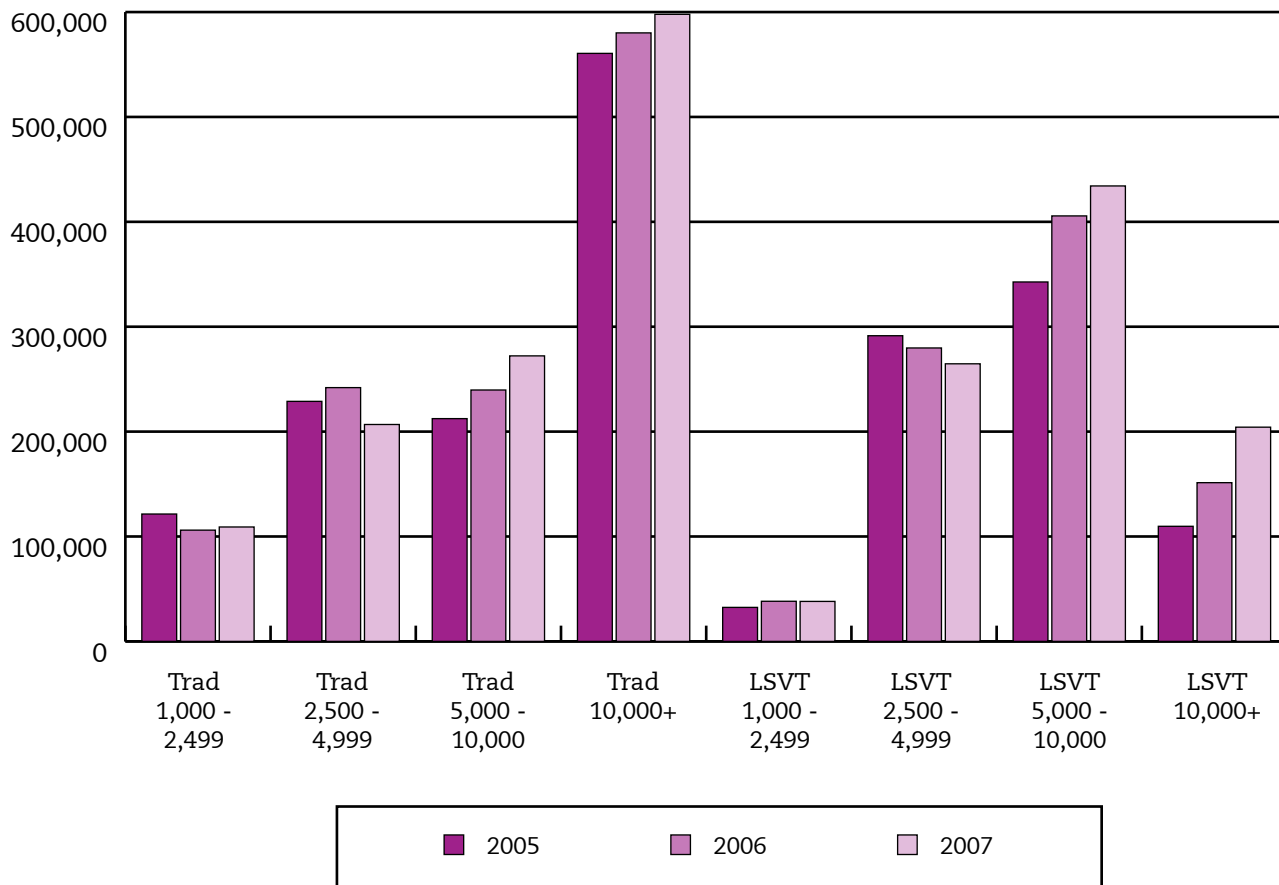
Graph 1 shows where the social housing homes owned by the sector are concentrated. The biggest single concentration of homes is within the 31 traditional organisations that own or manage more than 10,000 homes, which account for 28% of all the sector's stock. This is followed by the 68 LSVT organisations between 5,000 and 9,999 homes, which account for 20% of the stock. Between them these 99 organisations account for almost half (49%) of all social housing stock within the RSL sector.

There are also clear differences between the traditional and stock transfer sectors, with the traditional organisations' homes being concentrated within the largest organisations, whereas the LSVT stock is more evenly spread between the 2,500 and 9,999 sub-sectors. This diffusion within the LSVT segment is a legacy of the government policy of not allowing more than 6,000 homes to be owned by any one stock transfer landlord. Since this policy was relaxed in 2001, there has been a marked increase in stock transfer

with more than 10,000 homes, as some of the group structures that transferred before 2001 have been collapsed to produce larger single entities.

Although there has been an increase in the amount of stock owned by traditional associations with more than 5,000 homes (up from 68% of traditional stock in 2005 to 73% in 2007) these figures do not reflect the increasing concentration of stock within large group structures. This is because the global accounts are based on

Graph 1: Spread of homes



legal entity and not group accounts and most organisations that enter into group structures retain their legal existence rather than transferring their stock into a different entity.

Graph 2 shows how the gross book value (assets at historic cost and valuation), SHG and debt are spread between the different size bandings and between traditional and LSVT organisations (for the sake of clarity from here on LSVTs are treated as a single sub-sector).

The biggest single sub-sector for all categories is the traditional associations with more than 10,000 homes. These 31 organisations account for 34% of the GBV, 43% of the SHG and 30% of the debt of the sector. Moreover, if traditional associations with more than 5,000 homes are also included, these 71 organisations account for 53% of the GBV, 66% of the SHG and 47% of the debt, underlining starkly how the social housing sector is concentrated within fewer than 100 organisations.

Graph 2: Assets, SHG and debt



What also emerges from these figures is that although, at a global level, there is now more external debt shown on the sector's balance sheet than SHG, this is because of the particular financing structure of LSVT organisations. Within traditional organisations debt only amounts to 71% of the level of SHG. Indeed expressed as a percentage of GBV for traditional associations SHG stands at 49% and debt at 34%. Although these figures changed slightly over the last three years, in 2005 SHG was 53% of GBV and debt was 33%, it does not yet appear that falling grant rates are pushing up the level of debt in the balance sheets of traditional organisations.

The associations with the highest debt to SHG figure is those organisations with 5,000-9,999 homes, whose ratio is 78% compared to 71% for all traditional organisations. It is also organisations that have the highest debt per unit and adjusted net leverage figures, suggesting a sub-sector that has been taking on debt to help fund expansion in an attempt to not get 'left behind' by the emerging group of very large organisations.

This is confirmed by looking at the changes in turnover over the past three years as shown in Graph 3.

Graph 3 shows that as a whole, the sector has managed to grow turnover and debt in line with each other, suggesting that the additional debt is helping to fund assets that are generating a new income stream, rather than simply investing to protect existing income. However, as the graph

shows, there are important variations within the sector.

The picture with the smallest associations is clouded by the fact that over the course of the three years a number of these organisations have grown sufficiently in size to move into the next size banding, but even allowing for this it is clear that there has been a degree of net debt repayment amongst this cohort. However, the amounts involved are relatively modest, with the total change in debt only amounting to £257 million.

The change in the next cohort (2,500-4,999 homes) is also interesting in that it has seen a £680 million increase in debt levels, but only a £56 million increase in turnover. It is perhaps no surprise that this cohort has also seen the largest fall in its interest cover ratios – for example EBITDA MRI has dropped by nearly a third in the period for 2005-07. This suggests that these organisations are having to use debt to pay for investment in existing stock (to meet the Decent Home Standard) rather than using it pay for new productive assets.

The biggest percentage growth of any sector is the traditional organisations between 5,000 and 9,999 homes. These have seen turnover grow by 35% and debt by 30%, confirming that this is a cohort working hard to grow their businesses as the average size of organisations increases year on year. However, the biggest absolute growth was with the already large associations which saw turnover increase by £460 million and debt increase by £2,038 million.

Graph 3: Change in turnover and debt 2005-07



The increase of debt and turnover within the LSVT sector is the most skewed to turnover, which has risen by 28% against a 15% increase in debt. This largely reflects that the growth within the LSVT sector is driven by the transfer of new organisations from local authorities and that in the past few years the type of stock transferring has been predominately low-value urban homes, which have had low or even negative transfer values. This has meant the level of debt taken on has been relatively low in the early years. Because these organisations have had to spend significant sums on their stock, if the comparison

had been between debt and operating surplus the picture would have been quite different. This is emphasised by looking at the operating margins in Graph 4.

As would be expected, the margins achieved by LSVTs is much smaller than for traditional (10.4% in 2007 against 18.4% for all traditional). However, what is also clear is that margins for traditional associations are coming under pressure across all segments. There has not been a precipitate fall in any one segment, rather there is a steady increasing pressure on organisations as they have

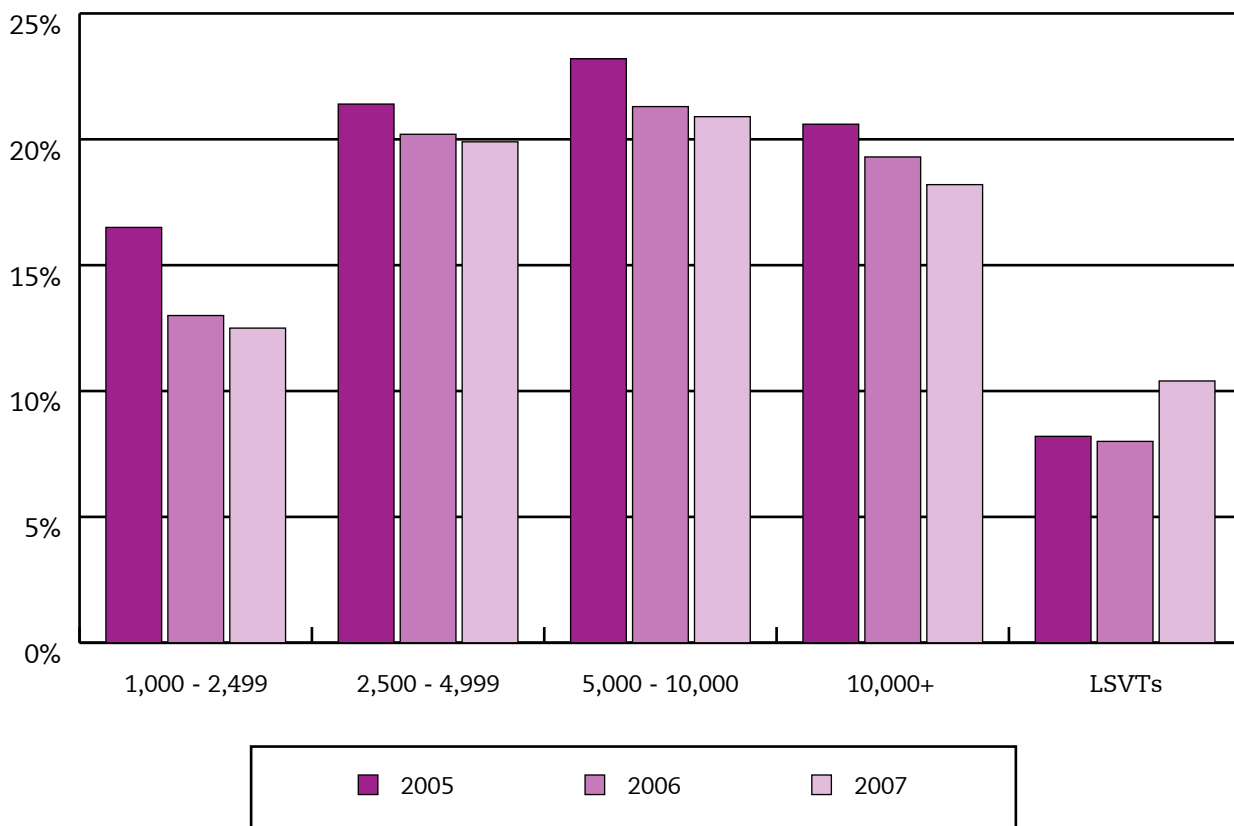
to juggle constrained income levels per unit, with a cost base that often runs ahead of RPI.

As might be expected in such circumstances, those organisations with the smallest numbers of homes over which to spread costs are those that have seen the biggest pressure on their operating margin: associations with fewer than 2,500 homes have seen margins drop from 16.5% to 12.5%. Perhaps the most impressive performance on

margins was the 2,500-4,999 unit group, which saw a drop from 21.4% to 19.9%, the smallest fall amongst any of the cohorts. However, given the significant rise in debt (and associated interest costs) it was important that these organisations defended their margins as much as possible.

The other two cohorts have both seen their margins fall by 10% compared to 2004-05, reflecting the increasing cost pressures faced by

Graph 4: Operating margin



these organisations. Whilst margins are down across the sector, it does not seem as though the reduction is correlated to the size of the associations, because whilst the biggest fall is within the smallest size cohort, the next size up saw the smallest reduction in margins. This emphasises that the control of an association's cost base is probably most closely correlated to the quality and commitment of its management and board.

The importance of controlling margins is emphasised by looking at the interest cover ratios for the sector. The EBITDA MRI ratio that adjusts for capitalised major repairs is the Corporation's preferred measure and Graph 5 shows the results for the last three years for the different sub-sectors.

This paints a sobering view of the traditional sector. For the 2007 year only, associations with fewer than 2,500 homes has an EBITDA MRI cover greater than 100%. All the other groups were not generating enough operating cash to pay for their interest costs when calculated on this basis.

It is interesting to note that when EBITDA interest cover is calculated without adjusting for major repairs, then all cohorts (apart from LSVTs) have a ratio above 100% and this is also the case for the EBITDA MRI cover which also allows for the inclusion of sales proceeds. This seems to indicate that associations have found ways over the past few years to meet their interest obligations that

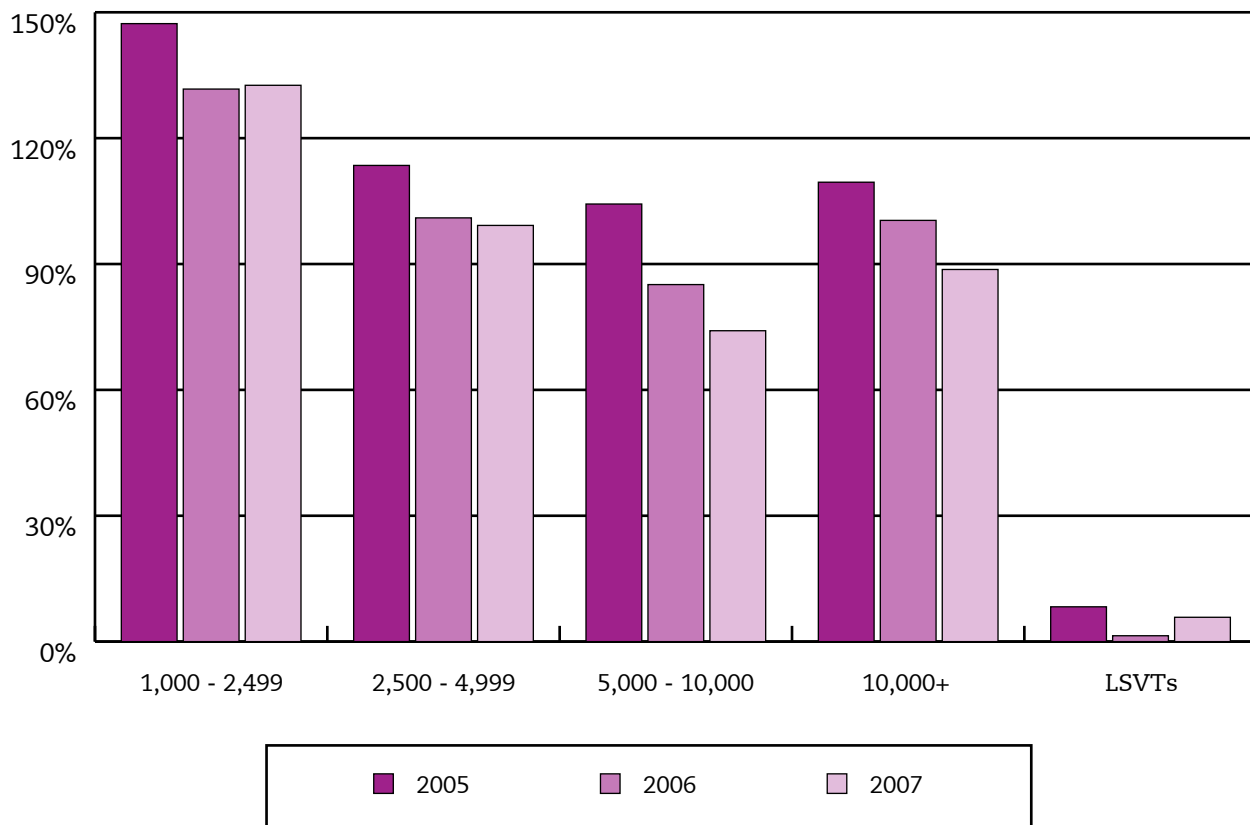
are not the straightforward generation of sufficient cash from operating activities.

The fact that this situation impacts all associations apart from the very smallest suggests that most organisations' business models are changing away from one based purely on rental streams to one that used rental income and sales proceeds (mainly from shared ownership homes) in order to balance the needs of their stakeholders with the need to meet their obligations to funders. Whilst the quartile analysis showed that even despite these pressures some associations continued to generate sufficient cash from ongoing activities to meet their interest payments, the analysis in Graph 5 shows that pressure to meet interest cover ratios is felt across all sizes of organisations.

The extent to which associations are now using sales proceeds to fund their businesses is shown in Graph 6. This shows the surplus on disposal as reported in the accounts against the surplus before tax. Where this figure is above 100% it shows that a deficit would be reported without the disposals.

This confirms that for the larger organisations (over 5,000 homes) there would be no surplus without the disposals and that this dependence has grown markedly over the last three years. Indeed, for the 10,000+ homes segment, this figure has jumped from 38% in 2005 to 103% in 2007. It is the larger organisations that have driven the overall traditional sector's increasing dependence upon disposals.

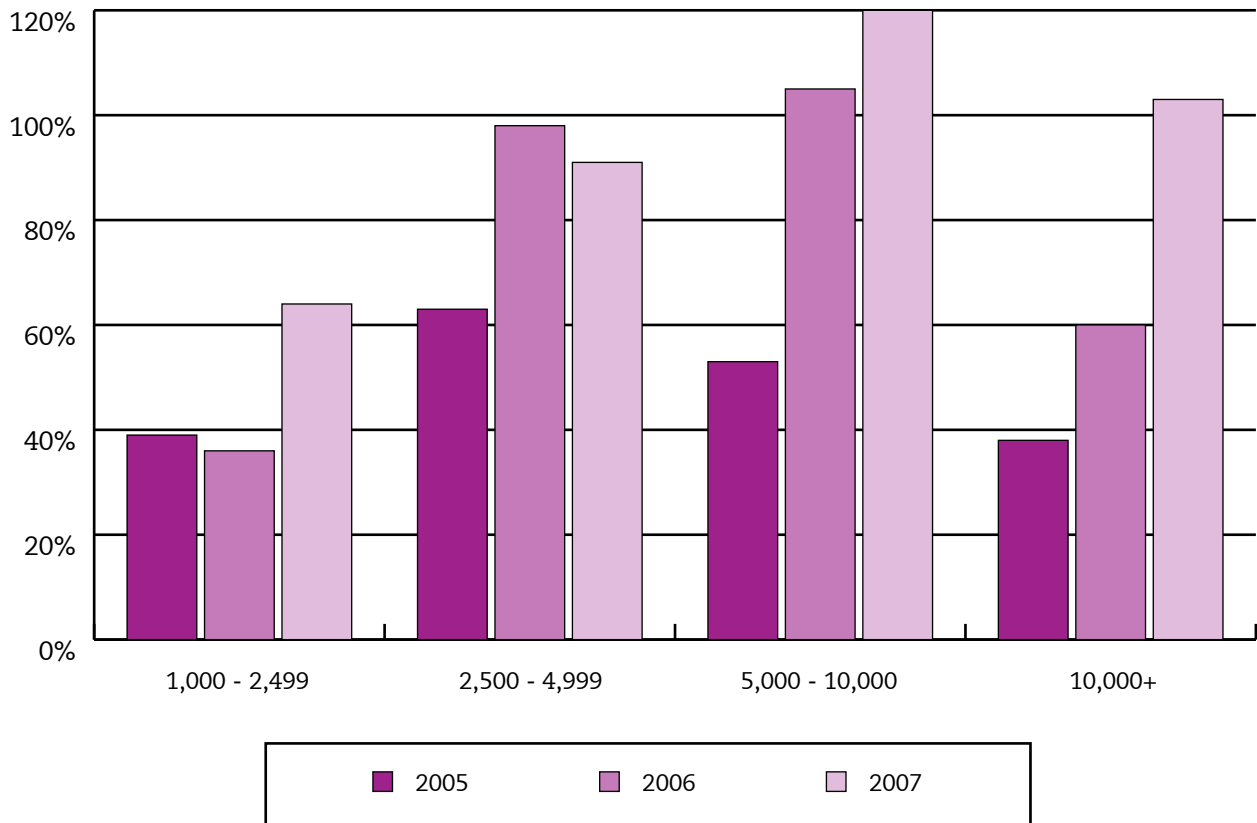
Graph 5: EBITDA MRI interest cover



It is worth noting that there are larger organisations that would generate a surplus without the need for shared ownership sales, but there has also clearly been a structural shift within the sector over the last five to ten years as associations have been able to generate significant surpluses from the various shared

ownership products that are currently used. The key question for associations, and their regulator, is whether this new business model can cope with a downturn in the housing market or whether associations will need to change their model again to take account of a more hostile operating environment.

Graph 6: Profit on disposal as a percentage of surplus before tax



E

Appendices

Appendix 1 - Average per unit cost comparisons

Executive summary

- The rate of growth in costs per unit has slowed between 2006 and 2007 and most associations showed sub-RPI growth in unit costs;
- The cost structures of LSVT, specialists and traditional associations show marked differences, with mature LSVTs showing the lowest management costs per unit;
- London-based associations have the highest costs per unit, matched by the highest income per unit;
- Northern associations have the second highest cost per unit, but have the lowest income per unit; and
- There is no clear linear relationship between size of organisation and costs per unit.

Introduction

This appendix provides information on the range and distribution of a number of unit cost and income measures at both a sector and sub-sector level. The information is derived from the detailed income and expenditure account, provided in associations' FVA forms and relates to the operating costs of social housing lettings activity.

The first part of the analysis looks at the 2007 average per unit costs and compares between the different types, location and size of association. The location analysis is based on which of the Housing Corporation's five regulation fields the association's headquarters is located. It should

be noted that this does not necessarily relate to where all of an association's stock is located and therefore may not relate to prevailing costs in those (very broad) areas.

The measures used are the aggregate average for the sector and the quartile analysis of the individual sets of accounts. In the majority of cases the range of results is wide and variance can occur for many reasons, but the analysis helps to provide an indication of how unit costs compare in the sector.

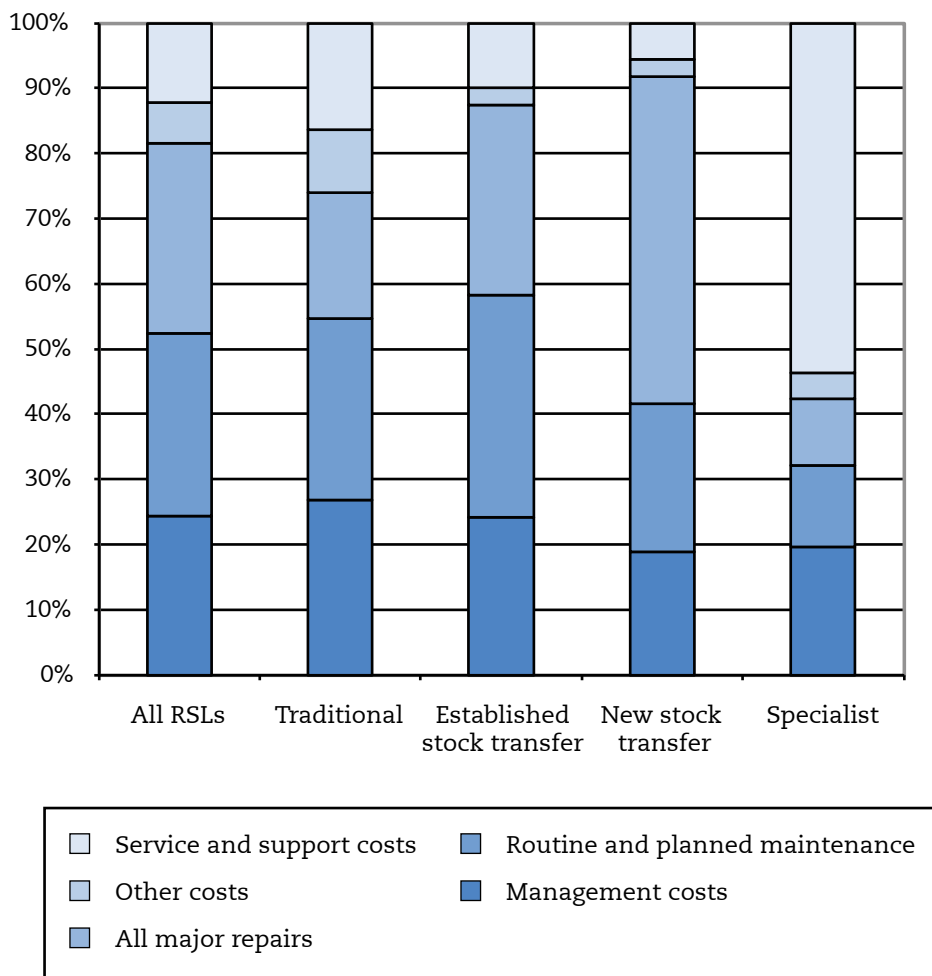
Spread of costs within the sector

As a starting point, Graph 1 below sets out the share of total social lettings costs between its different elements.

The graph demonstrates the differing profile of spend between traditional associations, stock transfers and specialist support providers. In addition, the stock transfer organisations are further split out between those more than five years old and those younger than five years. This enables a differentiation to be made between the organisations that are still engaged in 'catch-up' repairs and those that are on their way to becoming more like traditional organisations.

Not surprisingly, the majority of the specialist support providers' costs relate to support and care provision and, relatively, a minor proportion is spent on maintenance and repairs. In contrast,

Graph 1: Proportion of total social housing operating costs including capitalised major repairs



new stock transfers spend around 50% of total costs on major repairs (here calculated as both revenue and capitalised major repairs), whereas the older LSVT organisations’ repairs costs are closer to the all association average – but still above the average for traditional organisations.

There is a significant disparity between the total repair costs (both responsive and major repairs) which account for 73% of the expenditure for new LSVTs, 63% for established stock transfers and only 47% for traditional organisations. This suggests that even after the catch-up period, stock transfers have to deal with a significant repair bill.

By contrast, management costs for traditional amount to 27% of all social housing expenditure, whereas they amount to 19% for new stock transfers and 24% for established LSVT organisations. However, although traditional organisations do spend more per unit on management costs than stock transfers, it is the relative size of the repair bill that accounts for the relative proportions.

Impact of association type

In addition to the average unit cost of the four sub-sets of associations identified above, Table 1 also shows the increase (decrease) in the unit costs compared with 2006.

Average unit costs in total across all association types show modest increases, below inflation in three out of the four sub-sets, with only specialist organisations seeing an above inflation increase. However, the component parts of operating costs demonstrate a great variability in rates of

Table 1: Average per unit cost in 2007 across the different types of associations

	Traditional		Established stock transfer		New stock transfer		Specialist	
	£ per unit	Change from 2006	£ per unit	Change from 2006	£ per unit	Change from 2006	£ per unit	Change from 2006
Total operating costs	2,919	2.1%	2,735	1.4%	3,104	(1.8%)	6,030	3.6%
Operating expenditure (less depreciation) plus capitalised major repairs	3,031	2.5%	2,750	(1.2%)	4,019	6.0%	6,105	6.0%
Management costs	815	5.4%	665	7.1%	755	10.0%	1,194	13.1%
Routine and planned maintenance	841	4.2%	938	1.6%	919	(4.8%)	762	1.5%
All major repairs	588	10.4%	802	(7.7%)	2,015	6.1%	632	43.8%
Other costs	292	(10.8%)	74	(17.0%)	103	93.2%	243	13.57%
Service and support costs	495	(4.0%)	272	(3.3%)	227	21.1%	3,275	(0.8%)

increase. Of note are the increase in average per unit management costs, which range from 5.4% to 13.1%, and the increase in major repairs spend per unit for traditional especially.

Typically, major repairs spend is not distributed equally across all stock as it tends to be programme based, focused on a proportion of the stock. However, the average per unit spend is a useful comparator of the relative size of the major repair programme between different associations.

The repairs and maintenance spend per unit by new stock transfer associations is entirely consistent with the significant backlog of repairs and improvement works required in the early

period following transfer. For both established and new stock transfers, average management costs per unit are significantly less than traditional associations and investment in stock, both routine and planned maintenance and major repairs, conversely significantly above that of traditional associations. The fact that the established LSVTs' management costs are below that of newly transferred organisations and significantly (18%) below the costs of traditional organisations suggests that this group has been successful in challenging the size of its cost base.

Other costs include lease costs associated with temporary housing, bad debts and other

Table 2: Two-year trend in cost increases for different types of association

	Traditional		Established stock transfer		New stock transfer		Specialist	
	2006	2007	2006	2007	2006	2007	2006	2007
Total operating costs	7.5%	2.1%	5.8%	1.4%	0.2%	(1.8%)	13.2%	3.6%
Operating expenditure (less depreciation) plus capitalised major repairs	8.9%	2.5%	6.6%	(1.2%)	3.8%	6.0%	12.4%	6.0%
Management costs	8.2%	5.4%	11.5%	7.1%	(4.1%)	10.0%	1.8%	13.1%
Routine and planned maintenance	6.3%	4.2%	(2.9%)	1.6%	(6.4%)	(4.8%)	22.9%	1.5%
All major repairs	19.8%	10.4%	17.7%	(7.7%)	16.4%	6.1%	9.9%	43.8%
Other costs	6.3%	(4.0%)	2.2%	(3.3%)	(9.1%)	21.1%	15.9%	(0.8%)
Service and support costs	5.3%	(10.8%)	(2.0%)	(17.0%)	(23.6%)	93.2%	(7.2%)	13.5%

miscellaneous social housing lettings costs not included elsewhere.

The average costs of homes managed by specialists are approximately twice that of traditional and stock transfer associations. However, these costs mark a significant difference between providers of care and support, with a wide range of per unit costs. It should also be noted that this does not represent the full costs of support and care since the majority of support provision cost is excluded from this analysis. The unit costs of specialists – which here are those associations with 70% or over support/housing for

older people/care stock – show consistent above inflation increases over each measure in the year. However, care should be taken in interpreting the results for this sub-set of associations, since it is small (19 associations) and the per unit cost figures are highly influenced by a small number of large specialists whose movement in cost is not typical of the remainder.

The following table examines the increase in costs for the two years 2005-06 and 2006-07 for the sub-sectors identified in table one.

Table 3: Average per unit costs by field of regulation – all associations

	London	South East	South West	Central	North
Income measures					
Rent income per unit (£)	3,870	3,621	3,198	2,995	2,796
Voids %	2.4%	2.0%	1.6%	1.9%	2.5%
Bad debts %	1.1%	0.9%	0.6%	1.0%	1.3%
Cost measures per unit					
Operating costs	3,317	2,697	2,683	2,720	2,862
Operating costs less depreciation plus capitalised major repairs	3,593	2,648	2,656	2,890	3,275
Management costs	952	667	624	706	730
Routine and planned maintenance costs	900	884	831	880	883
All major repairs costs	786	546	848	830	1,218
Service and support costs	482	365	276	412	318
Other costs	473	186	77	62	126
Total costs as % of rental income	93%	73%	83%	96%	117%

It is difficult to conclude on trends in cost using only two years' information. However, clearly on the more substantial areas of costs, increases in 2006 were significantly ahead of those observed in 2007. Overall, the rate of increase in operating expenditure on social lettings activities for traditional and established stock transfers associations in 2006 was three to four times higher than in 2007.

The rate of increase in per unit cost has also slowed for traditional associations in management costs and repair costs. This may be a response

to the financial position of associations, as they increasingly find margins being squeezed. It might also be due to improvements in efficiency feeding through to management and repairs expenditure. Whatever the driver, it is reassuring to see associations managing their cost base at a time of increasing economic uncertainty.

Impact of location of associations

The table below illustrates the difference between the unit cost and rental income for

Table 4: Average per unit costs by field of regulation – all associations

	London	South East	South West	Central	North
Income measures					
Rent income per unit (£)	3,970	3,535	3,070	2,972	2,890
Voids %	2.5%	2.6%	2.4%	1.9%	2.6%
Bad debts %	1.1%	1.4%	0.6%	1.3%	1.4%
Cost measures per unit					
Operating costs	3,446	2,751	2,389	2,522	2,672
Operating costs less depreciation plus capitalised major repairs	3,682	2,741	2,346	2,578	2,723
Management costs	991	752	580	736	704
Routine and planned maintenance costs	916	687	740	774	854
All major repairs costs	743	467	522	435	548
Service and support costs	485	484	440	560	471
Other costs	548	352	65	73	147
Total costs as % of rental income	93%	77%	76%	87%	94%

the associations regulated from each of the five Corporation fields.

In the long term, organisations can only spend the income they receive, so to provide some context for the cost per unit information the tables also provide the per unit level of rental income as well as an indication of rent losses from voids and bad debts.

It is interesting to note the 24% differential in operating cost between the highest value in London and the lowest (South West). However, it is South East associations which appear to be spending least of their rental income on operating costs. Conversely, Northern associations spend more than they receive in rental income (although rental income does not represent all turnover). This unsustainable position is largely explained by the prevalence of stock transfers, particularly new stock transfers in the North (and, to a lesser degree, Central). To help control for the impact of stock transfers, Table 4 restates the figures for the traditional associations in each field.

When stock transfers (and specialist associations) are removed from the data, Northern associations are managing to spend less than they receive in rental income. It is interesting to note that the average rental income per unit for Northern traditional associations is 27% less than for London associations. However, the London associations spend on average the largest amount per unit on maintenance, repairs (all types) and management of any region.

The biggest spread of costs between highest and lowest is on management costs, with South West associations spending 41% less per unit on managing their stock than London-based organisations. Indeed in the South West, management costs are 28% lower than the next cheapest region (North).

The range in maintenance costs is most remarkable for the fact that London and Northern associations spend the most on repairing and maintaining their stock despite the stark difference in their income levels. Indeed, the percentage of rental income taken by operating costs is highest for these two sets of associations. This suggests that elsewhere in the country (and in particular in the South outside of London) associations are benefiting from relatively higher rent levels, but do not face the same operating cost inflation pressure experienced in London or the need for significant stock investment in the North.

Impact of size of association

In order to examine whether the size of associations is seen to have a significant impact on the per unit costs, associations have been split between four unit size bandings, 1,000-2,499 units, 2,500-4,999 units, 5,000-9,999 units and greater than 10,000 units.

The comparison of cost here appears much skewed by the prevalence of care and support providers included within the smallest unit size

Table 5: Average per unit cost and rent figures for all associations in each of the four size bandings

	Traditional HAs			
	1,000-2,499	2,500-4,999	5,000-9,999	10,000+
Income measures				
Rent income per unit	3,385	3,193	3,219	3,314
Voids %	3.9%	2.2%	2.2%	2.3%
Bad debts %	1.2%	1.0%	0.9%	1.1%
Cost measures per unit				
Operating costs	3,765	2,839	2,943	3,080
Operating costs less depreciation plus capitalised major repairs	3,900	2,961	3,251	3,324
Management costs	956	735	761	790
Routine and planned maintenance costs	827	850	911	875
All major repairs costs	586	821	1,031	904
Service and support costs	1,327	421	364	511
Other costs	204	135	185	245
Total costs as % of rental income	115%	93%	101%	100%

and stock transfers in the larger size bands. This is indicated by service and support costs being so in excess of the previous results and major repairs costs similar to those for stock transfers.

This is borne out when examining the associations included within each band. The difference between the highest and lowest per unit operating cost is over 30%, with management cost differences of a similar order. Since specialists and stock transfers are clearly not distributed evenly throughout the different size bands, the same calculations are performed on traditional associations in each size band only. The results are set out in Table 6.

The size effect is now less marked and there is a more even spread of costs across all size bands. However, there remains a 15% difference between the average operating cost per unit of associations in the 2,500-4,999 band compared to the 5,000-9,999 band. The 2,500-4,999 band also indicates the lowest average per unit management cost, 8% less than the highest management cost observed in the 5,000-9,999 band.

The lower costs per unit for the 2,500-4,999 band are borne out by the total costs as a percentage of income, which is 84% compared to a high of 95% for the 1,000-2,499 band. This suggests that there is not a straightforward linear relationship

between the size of an organisation and its costs per unit. In other words, the argument that having more units over which to spread costs helps to drive unit costs down does not hold without committed management action.

Table 6: Average cost measures by size banding for traditional associations

	1,000-2,499	2,500-4,999	5,000-9,999	10,000+
Income measures				
Rent income per unit	3,258	3,198	3,476	3,384
Voids %	2.9%	2.5%	2.6%	2.2%
Bad debts %	1.1%	1.4%	1.1%	1.3%
Cost measures per unit				
Operating costs	3,014	2,685	3,094	2,902
Operating costs less depreciation plus capitalised major repairs	3,084	2,677	3,272	3,031
Management costs	804	772	830	826
Routine and planned maintenance costs	862	762	842	867
All major repairs costs	504	464	648	617
Service and support costs	750	475	609	402
Other costs	163	204	341	320
Total costs as % of rental income	95%	84%	94%	90%

Appendix 2 - An association's view of the sector

The following is a review of the 2007 Global Accounts data by David Montague of London and Quadrant Housing Group. It represents a personal view of the sector and is not necessarily the same as the Housing Corporation's view. However it does provide a useful additional analysis of the sector.

Executive summary

At first glance, the headline facts and figures for the sector's 2007 global accounts of associations owning over 1,000 properties appear to show a strong and viable sector:

- surplus before tax up 9% to £270 million;
- operating margin up by 0.3% to 15.5%;
- a 1% fall in gearing, to 83%;
- gross interest cover unchanged at 109%; and
- properties owned or managed have risen in the last year by 115,000 to 2.2 million.

But underneath the headlines, performance varies across regions, between traditional and stock transfer associations, and often by size of association, and a number of worrying trends emerge:

- reducing surpluses for traditional associations – down by 30% in three years;
- increasing pressure on large associations – interest cover excluding sales down from 107% to 92%, gearing up from 51% to 59%;

- a mismatch between capacity and growth – 23% of the sector's surplus produced by associations of under 2,500 homes, which delivered just 2% of new homes;
- capacity in the South, none in the North – a surplus of £335 million in the South and a deficit of £64 million in the North;
- increasing capitalisation, increasing sales – overall surplus of £271 million becomes a deficit of £1.1 million adjusting for sales and capitalised repairs; and
- the overall capacity of the sector is negative – with 47% of associations reporting positive capacity and 53% reporting negative capacity.

Housing Corporation Assessments, which are also in the public domain, suggest that many associations are making more aggressive assumptions in their business plans to deliver continued growth and investment. Combined with the 2007 Global Accounts as a starting point, we will all need to keep a very close eye on the dials in what is at best an uncertain economic environment.

It is true that some associations have as yet unused capacity, and it is their responsibility to use it wisely. But an awful lot more associations don't have any, and if we all set off in the same direction, some of us will come unstuck.

We all want to embrace the double challenge of investing in growth and existing homes, services and communities, but the combination of reducing grant rates, capped rents and an uncertain

economic environment is not the best incentive. The easy way out might be to keep on pushing, capitalising more expenditure and selling more homes, but this inevitably leads to overtrading, and normally ends in tears.

Before we attempt to put forward our suggestions as to how this can be avoided, let us first take a look at the sector's year on year figures in greater detail so that we can get a real picture of where it is heading.

Pressure on traditional housing associations

The 2007 accounts highlight the financial pressure on traditional associations – whilst stock transfer associations appear to be climbing out of their early year deficits, traditional associations are reporting a significant reduction in their annual surplus.

Surplus before tax – by HA type	2005 £ million	2006 £ million	2007 £ million
Traditional	531	408	377
LSVT	(160)	(159)	(106)
Combined	371	249	271

Pressures on larger associations

In 2007, 97 associations with 1,000 to 2,499 homes held just 7% of the sector's properties but generated nearly 23% of the surplus before tax. But this group of associations is developing very little, producing just 2,000 of the 115,000 additional properties in the year. In other words, 23% of the sector's surplus is delivering 2% of the sector's growth.

The main growth in properties comes from the remaining larger traditional associations and from stock transfers. However, the plans to grow through new development, together with the need to improve services and increase maintenance expenditure to meet the Decent Home Standard, are placing increasing pressures on financial viability, particularly for larger associations. This is illustrated by the three-year interest cover trend – up for smalls and down for large.

Traditional HA net interest cover	2005	2006	2007
Size 1,000-2,499	133%	120%	151%
Size over 2,500	107%	100%	92%

It is also illustrated by the three-year gearing trend – down for smalls and up for large.

Traditional HA gearing	2005	2006	2007
Size 1,000-2,499	41%	37%	36%
Size over 2,500	51%	56%	59%

The pressure on larger associations to meet the demand for new homes whilst investing in existing homes and services, is creating a two-tier sector – those with modest growth plans are quickly growing financially stronger, but those with ambitious plans are rapidly exhausting their financial strength.

Regional variations

Any conclusion as to viability and sustainability must allow for regional performance. Financial strength continues to be concentrated in the South.

In 2007, the London, South East, and South West regions produced a £335 million surplus before tax and the other regions made a loss of £64 million.

The table also illustrates the beneficial effect of asset sales and capitalising repairs. The illustration of revised losses without asset sales and capitalisation reveals a far weaker sector.

The split between traditional and stock transfer associations shows that this is not a stock transfer phenomenon – traditional associations are similarly affected.

Region	Surplus/ (deficit) 2007	Asset sales	Capitalised repairs	Revised deficit
	£ million	£ million	£ million	£ million
London	233	(231)	(226)	(224)
South East	86	(59)	(70)	(43)
South West	16	(18)	(25)	(27)
Central	(30)	(90)	(173)	(293)
North	(34)	(144)	(389)	(567)
Total	271	(542)	(883)	(1154)

	2005 £ million	2006 £ million	2007 £ million
Traditional surplus before tax	531	408	377
Less:			
Asset sales	(241)	(295)	(378)
Capitalised repairs	(237)	(299)	(356)
Restated surplus /(loss)	53	(185)	(357)
LSVT surplus before tax	(159)	(159)	(107)
Less:			
Asset sales	(178)	(205)	(164)
Capitalised repairs	(339)	(424)	(527)
Restated loss	(676)	(788)	(798)
Total	(624)	(974)	(1,154)

Capitalisation policies

For two thirds of associations, capitalisation of major repairs was key to producing a surplus. In 2007, capitalised repairs rose by 22%, from £723 million to £883 million. Ten years ago few traditional associations capitalised repair costs, by 2007 traditional associations capitalised £356 million.

Capitalised repairs – by HA type	2005 £ million	2006 £ million	2007 £ million
Traditional	237	299	356
LSVT	339	424	527
Combined	576	723	883
% Change		26%	22%

Not every association has chosen to capitalise, but most of us do, and almost ten per cent of us capitalised more than £5 million:

Amount capitalised in 2007 accounts	No. HA	Homes owned	Capitalised £ million
Nil	126	590,000	0
Under £2 million	152	649,000	101
£2-£5 million	67	453,000	209
Over £5 million	38	496,000	573
Total	383	2,188,000	883

Clearly, any change in accounting standards that limits future capitalisation will be extremely damaging to the sector. Currently most business plans assume no future restriction on capitalisation – this assumption may prove to be optimistic.

Asset sales

Traditional associations' accounts report an increasing reliance on sales to achieve a surplus and maintain an acceptable interest cover ratio:

Traditional HA interest cover	2005	2006	2007
Gross cover	132%	127%	124%
Net cover (excluding asset sales)	109%	101%	94%
Asset sales surplus	£241 million	£295 million	£378 million

Traditional associations holding 1,000-2,499 homes produced a £23 million surplus on sales. The balance of £355 million came from larger associations. Forty-three per cent of the sales surplus was made in the London region.

The property market appears at least temporarily to have peaked. A downturn in property prices would require even more homes to be sold just to break even.

Capacity

Taking all housing associations with over 1,000 homes and applying the “unlocking the door” approach to calculating capacity, the net capacity (ie in addition to drawn borrowings) of those associations reporting a positive figure is falling – from £308 million in 2006 to £272 million in 2007.

The net capacity of the sector is negative and rising – from £621 million negative in 2006 to £751 million negative in 2007.

	2006		2007	
	Inc sales	Exc sales	Inc sales	Exc sales
	£ million	£ million	£ million	£ million
Positive	509	308	529	272
Negative	-630	-929	-738	-1023
Total	-121	-621	-209	-751

Of the 383 associations included in the Global Accounts, 221 (58%) have positive capacity including sales and 180 (47%) excluding sales.

The Housing Corporation is right to encourage those of us with as yet unused capacity to invest it wisely, but those of us who are in negative territory should have deliverable plans in place to move into positive territory.

Business plans

Many of the recent Housing Corporation Assessments on viability refer to exposures that make the association liable to deterioration in the future. The most common reasons referred to in the HCAs for this qualified assessment are:

- ambitious development programmes;
- substantial future debt funding;
- reliance on high levels of shared ownership sales to part finance new development programmes;
- reliance on property disposals and capitalised repairs to meet loan covenants for many years into the future;
- managing risks of diversification and reliance on future property inflation;
- optimistic assumptions regarding future efficiency savings; and
- optimistic assumptions for future interest rates and maintenance cost inflation.

The 2007 Global Accounts are not a sound base upon which to build such risky assumptions.

Next steps

So given this look at the sector, what's the answer for those associations looking to invest in both growth and existing communities, but faced with fewer incentives to do so along with an uncertain economic environment?

Some might call for greater regulatory intervention, and there is a case for tougher action sooner for those of us that are living on borrowed time. But it is our responsibility to ensure that we adopt a sustainable approach to growth and service improvement.

And that responsibility starts with a closer look at viability, followed by a concerted effort to deliver it. Dependence on capitalisation and sales is not a sustainable answer to our investment needs. Instead, housing associations should set themselves a target of eliminating capitalisation and sales dependence over a five-year period, moving back into core business viability and using the value created to deliver more homes and better communities.

There is much we can do ourselves:

- more consolidation – the big question that all housing association boards should be asking themselves is, “Should we continue to operate as independent associations, or could we deliver more for today’s and tomorrow’s customers by merging?” Mergers may not yet all be delivering the economies of scale they set out to deliver, but the potential is considerable, and it is achievable;
- more efficiency – the Annual Efficiency Statement may have put efficiency on the agenda, and we have enjoyed the debate over large versus small, and efficiency versus community investment. But the efficiency of our core services is vital to our continued ability to invest, and it is our responsibility to deliver it; and
- more risk taking and risk sharing – housing associations are perfectly poised to benefit from changes in housing markets. We have the potential to become both long-term property investors and short-term developers for sale, and this means that we should be capable of adapting to changing market conditions, switching between tenures and locations to maintain viability and increase supply. This, combined with our preparedness to invest every penny of our surplus into our social purpose, is our unique selling proposition, and it should make us an attractive partner to local authorities, developers and the Homes and Communities Agency.

Along the way, we could use a little help from our friends:

- more flexibility on rents – with as little as a 25% differential between the rent on a one-bed and five-bed home, current rent restrictions do not incentivise the development of more family homes. A small increase in our rent could lead to a large increase in housing supply, and of the right kind; and
- retained discretion over our financial plans – the setting of new quality standards and direction of investment through new traffic lights may influence housing association boards and place at risk the value of our long-term income streams which are vital to raise new loans.

Publication of the 2007 Global Accounts is a timely reminder that we have a big challenge on our hands, and that if we want to meet it, something has to change. We will achieve a great deal more with a new understanding between housing associations and our new stakeholders, but if we value our independence, we should take the first step.

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Global accounts of housing associations 2007

In the year 2006-07, the housing association sector continued to grow. This publication provides a financial overview of the sector and some of its key segments for the year, and details just how much the sector grew, in terms of assets, turnover and debt.

It also highlights and analyses key ratios and trends within England's housing associations. It pinpoints challenges for the sector and shows just how much they are affecting housing associations' financial strength.