

THE SCOTTISH HOUSING REGULATOR

Number Crunching
March 2010

About us

The Scottish Housing Regulator (SHR) is an agency that operates the regulation and inspection powers in the Housing (Scotland) Act 2001 to:

- protect the interests of current and future tenants, and other service users;
- ensure the continuing provision of good quality social housing in terms of decent homes, good services, value for money and financial viability; and
- maintain the confidence of funders.

We regulate over 240 registered social landlords and 26 local authority landlords, who between them house one in four households in Scotland. We also regulate the homelessness functions of the 32 Scottish local authorities. Around 56,500 people apply as homeless every year. And we assess how well registered social landlords and local authorities provide factoring services to owners and sites for Gypsies/Travellers.

Registered Social Landlords (RSLs) are independent landlords run by professional staff and governed by volunteers. They are non-profit distributing organisations that are mainly housing RSLs or co-operatives.

Number Crunching

2008/09

**The Scottish Housing
Regulator's Analysis of
the Finances of
Registered Social
Landlords**

The Sector in Numbers

212	167	We regulate 212 Registered Social Landlords (RSLs). The analysis in this report is based on data returns from 167 small and mainstream RSLs.
72	3	3 lending institutions are responsible for 72% of all lending to RSLs.
51	23	23 RSLs are responsible for 51% of the debt owed to lending institutions by RSLs.
18	0.36	The amount of interest paid in 2008/09 increased by 0.36% over the previous year. The loans outstanding per our Loan Portfolio increased by 18% in the same period.
10.2	9.3	In 2007/08 RSLs used 10.2% of their annual turnover to service debt. In 2008/09 this fell to 9.3%.
88.9	87.8	In 2007/08 RSLs used 88.9% of their annual turnover to meet their operating costs. In 2008/09 this fell to 87.8%.
68	21	68 RSLs made a net loss (after interest charges) in 2008/09. Of these 21 made an operating loss (before interest charges).
9	1	The largest RSL that we regulate, Glasgow Housing Association (GHA), has an annual turnover that exceeds that of the combined turnover of the next nine RSLs, in order of turnover.
67	33	33% of RSLs operating costs in 2008/09 were to pay staff and 67% were non staff.
73.1	69.4	73.1% of net assets were funded by Government Grants in 2004/05. By 2008/09 this had fallen to 69.4%.

Introduction

This report provides commentary and analysis on the information that we have collected from the annual accounts, loan portfolios, and five year financial projections of Registered Social Landlords (RSLs).

The financial analysis underpinning *Shaping Up For Improvement*, which we published in July 2009, looked at the changes that had taken place in the sector mainly over a ten year period to 31 March 2008. This time frame provided a long-term perspective but comparability was made more difficult by major changes to the sector such as the creation of the Glasgow Housing Association (GHA). Therefore major adjustments had to be made in order to ensure that we were comparing like with like.

In this report we have analysed data from 2004/05 to 2008/09 for most time-trend analyses throughout the report. We chose this time-span because it is long enough to provide a good indication of direction (i.e. whether a measure is generally increasing, decreasing or remaining stable) but short enough to reflect the current composition of the sector. We will from time to time consider a longer time frame where that is appropriate.

That said, even over a five year time frame, changes in the sector have the potential to influence the figures that are published. For example our aggregated accounts for 2008/09 brought together the financial results of 167 RSLs: the corresponding figure for the previous year was 171. The change was mainly a consequence of consolidation within the sector and was not of a sufficient magnitude to have an effect upon inter-year comparison. Of more significance was the registration of a large stock transfer RSL, River Clyde Homes, in December 2007. In this case some four months results were consolidated into the 2007/08 accounts with the first full year's results being included in our 2008/09 accounts (see Figure 3 below). This is a material change and where appropriate we have referred to the effect of this in the report. Changes in accounting policy also have the potential to make it difficult to interpret trend data. Over the five year period there was one such change which had a major effect on the reported results. Where appropriate this is referred to in the report.

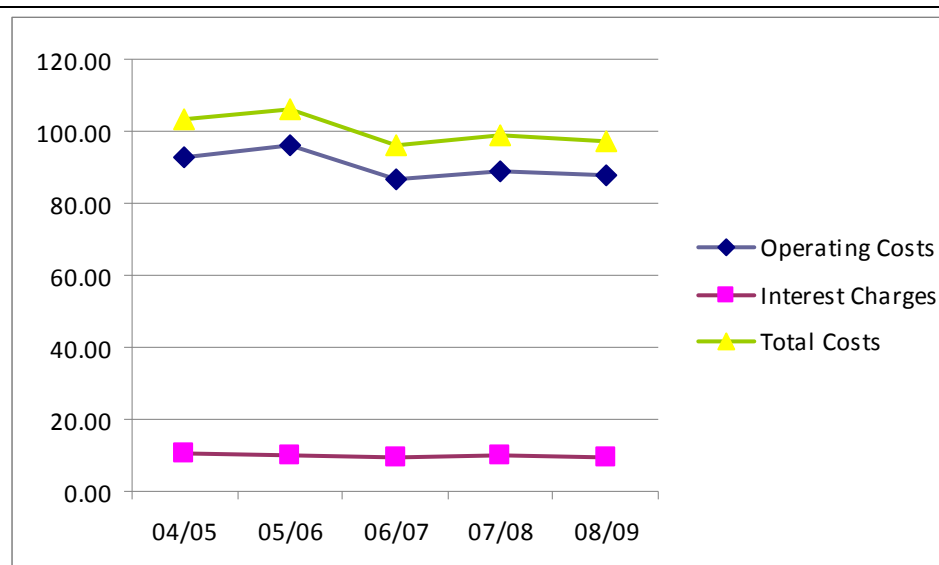
Summary

Financial Sustainability

In 1997/98 sector-wide aggregate operating costs represented approximately 72% of aggregate turnover. By 2007/08 this had risen to almost 90% (excluding GHA). After interest charges were included total costs were in excess of 100% of turnover.

Figure 1 illustrates the position across the sector during the period from 1 April 2004 to 31 March 2009 (including GHA).

Figure 1: Operating costs, interest charges & total costs as % turnover, 2004 - 09



Source: SHR Accounts Consolidation System

(the substantial fall in operating costs and total costs in 2006/07 was mainly due to a change in accounting policy which resulted in items which were previously charged to the Income & Expenditure Account being capitalised.)

The aggregate position indicates a marginal improvement during 2008/09 in comparison with the previous year. Operating costs accounted for 87.8p of every pound earned in turnover (2007/08, 88.9p) while interest charges cost 9.3p (10.2p). Total costs therefore amounted to 97.1p of turnover in 2008/09 as opposed to 99.1p in the previous year.

This improvement is also evident when we compare like with like with regard to the analysis that we published last year (which excluded GHA). In 2008/09 the figure for operating costs was 88.9p (2007/08 89.6p), interest costs were 11.4p (13.2p) giving a total of 100.3p as opposed to 102.8p in the previous year.

This progress is welcome, particularly in the face of the continuing difficult economic conditions. The improved aggregate position was due to the fact that RSLs were able to increase turnover at a higher rate than the increase in total costs. Our analysis of the underlying reasons for this relatively large increase in turnover indicates a considerable risk that increases on this scale will not be sustained in future years. So cost control remains essential to secure a sustainable future for the sector and for individual RSLs.

It should be stressed that this is an aggregate position: the extent to which we engage with RSLs and the manner in which we engage with them is determined by the circumstances of each RSL. In that context, in the year ended 31 March 2009 there were 68 RSLs where operating costs, plus interest charges exceeded turnover. Further, within those 68 RSLs, there were 21 where operating costs alone exceeded turnover.

Not generating a surplus in any particular year is not in itself a matter of concern for us. We look at a number of information sources in order to gauge the financial health of the organisations which we regulate. Wherever necessary we seek additional information from RSLs in order to gain the assurances that we need.

Financing

RSLs continue to attract private funding on good terms. Our loan portfolio returns indicate that, in the year ended 31 March 2009, RSLs had outstanding borrowings of the order of £2.1bn, an increase of almost 18 per cent on the corresponding figure in the previous year. By contrast the cost of debt servicing rose by less than half of one per cent in relation to the previous year.

In *Shaping Up for Improvement* we commented on market concentration amongst lenders to the RSL sector. At that time the latest information that we had indicated that approximately three quarters of all lending to RSLs came from just five lenders. Consolidation within the sector means that, as at 31 March 2009, three lenders accounted for almost 73% of all lending to the sector.

During 2008/09 RSLs drew on existing facilities at a faster rate than new facilities were put in place. This means, for the first time since we began to monitor these statistics, the amount of undrawn facilities available to the sector fell in the course of a financial year. The reduction was modest, some £32m or 2.5%.

In 2004/05 the proportion of RSLs net housing assets that was funded from Housing Association Grant (HAG) and other government capital grants was 73.1%. By 2008/09 this had fallen to 69.4%. This illustrates the increasing extent to which RSLs are using private borrowings, as well as their own internally generated reserves, to grow their asset base.

1. Income

Aggregate Sector Income

Total sector income in 2008/09 was £1,154.8m, an increase of 8% on the previous year. For the second year running, both total income and turnover exceeded one billion pounds. Figure 2 gives the breakdown of total income for the past five years.

Figure 2: RSL Sector, Total Income 2004 – 2009

	2004/05 £000	2005/06 £000	2006/07 £000	2007/08 £000	2008/09 £000
Turnover	808,178	856,068	930,714	1,012,262	1,120,019
Profit on sale of fixed assets [∞]	18,243	19,704	29,126	35,015	19,367
Interest receivable & other income	17,600	16,462	15,117	21,831	15,445
Total Income	844,021	892,234	974,957	1,069,108	1,154,800

Source: SHR Accounts Consolidation System

[∞] Profit on sale of fixed assets is an aggregation of individual amounts taken from RSLs' accounts and represents the difference between the proceeds of sale and book value at the time the asset was sold.

Turnover

Turnover includes all income from all sources with the exception of profit on the sale of fixed assets and interest receivable. Aggregate sector turnover in 2008/09 was £1,120m, an increase of just over 10.6% on the previous year. After allowing for the differential effects associated with consolidation of a full year's accounts for River Clyde Homes in 2008/09, the like for like increase is 8.8%.

Some 22% of the sector's turnover (£249.6m) was earned by GHA, the largest RSL in Scotland. This is more than the combined turnover of the next nine RSLs ranked in order of turnover (See Figure 3 below).

Figure 3: Top 20 Scottish RSLs Ranked by Turnover 2008/09

	Turnover 2007/08 £000	Turnover 2008/09 £000	% Change
Glasgow Housing Association Ltd,	238,414.0	243,473.0	2.1
Bield Housing Association Ltd	33,554.0	35,975.0	7.2
Key Housing Association Ltd	34,317.5	35,481.1	3.4
Dumfries and Galloway Housing Partnership	26,849.0	28,169.0	4.9
River Clyde Homes Ltd	8,611.0	27,611.0	220.6 [∞]
Hanover (Scotland) Housing Association Ltd	24,543.0	24,520.0	-0.1
Hillcrest Housing Association Ltd	17,317.5	21,528.0	24.3
Castle Rock Edinvar Housing Association Ltd	18,435.0	20,442.0	10.9
Link Group Ltd	17,945.0	20,197.0	12.5
Trust Housing Association Ltd	15,836.0	17,178.0	8.5
Kingdom Housing Association Ltd	12,238.8	17,017.3	39.0
Argyll Community Housing Association Ltd	16,369.0	16,937.0	3.5
Dunedin Canmore Housing Association Ltd	14,126.0	16,594.0	17.5
Scottish Borders Housing Association Ltd	14,616.0	15,969.0	9.3
Albyn Housing Society Ltd	13,901.0	15,482.0	11.4
Grampian Housing Association Ltd	10,427.0	15,019.0	44.0
Ark Housing Association Ltd	13,119.0	13,805.0	5.2
West of Scotland Housing Association Ltd	9,375.6	12,871.1	37.3
Cairn Housing Association Ltd	12,343.9	12,814.0	3.8
Margaret Blackwood Housing Association Ltd	11,464.0	11,977.0	4.5

Source: SHR Accounts Consolidation System

[∞] Large increase in turnover as 2008/09 was the first full year of operation. The Association commenced trading on 3 December 2007.

Profit on Sale of Fixed Assets

When we published *Shaping Up for Improvement* in July 2009 we commented:

“Substantial and lucrative asset sales have been possible in a growing and buoyant property market. The downturn in the housing sector, alongside the likely pressure on other income streams, will constrain the sector’s ability to secure substantial non-rental incomes from such sources in the coming months and years.”

The much reduced profit on sale of fixed assets in 2008/09 provides tangible evidence of the difficulty that RSLs are experiencing in maintaining other income streams in the face of the credit crunch and the economic recession. The total of £19.3m represents a fall of almost 45% on the previous year. Some 32% (£6.1m) of the sector’s profit on sale of fixed assets was earned by GHA. The corresponding figures in 2007/08 were 26% and £9.2m.

Interest Receivable and Other Income

The limit on the ability of RSLs to secure such income streams is also illustrated by the decline in Interest Receivable and Other Income. The sector total of £15.4m in 2008/09 represents a reduction of almost 30% on the previous year. Some £1.8m or 12% was attributable to GHA. The corresponding figures in 2007/08 were £3.1m and 9%.

2. Expenditure

Total Expenditure

Total expenditure by the sector increased by £84.5m or 8.4% in the year ended 31 March 2009. After allowing for the differential effects associated with consolidation of a full year's accounts for River Clyde Homes in 2008/09 the like for like increase is 6.6%.

Figure 4 illustrates how the sector's costs have changed over the past five years.

Figure 4 : Total Expenditure, 2004 - 2009

	2004/05 £000	2005/06 £000	2006/07 £000	2007/08 £000	2008/09 £000
Non Staff Costs	503,884	556,798	523,068	592,777	656,442
Staff Costs	246,339	266,695	283,446	306,995	327,466
Total Operating Costs	750,223	823,493	806,514	899,742	983,908
Interest Payable	84,291	85,180	89,360	103,284	103,656
Total Expenditure	834,514	908,673	895,874	1,003,026	1,087,564

Source: SHR Accounts Consolidation System

Operating Costs

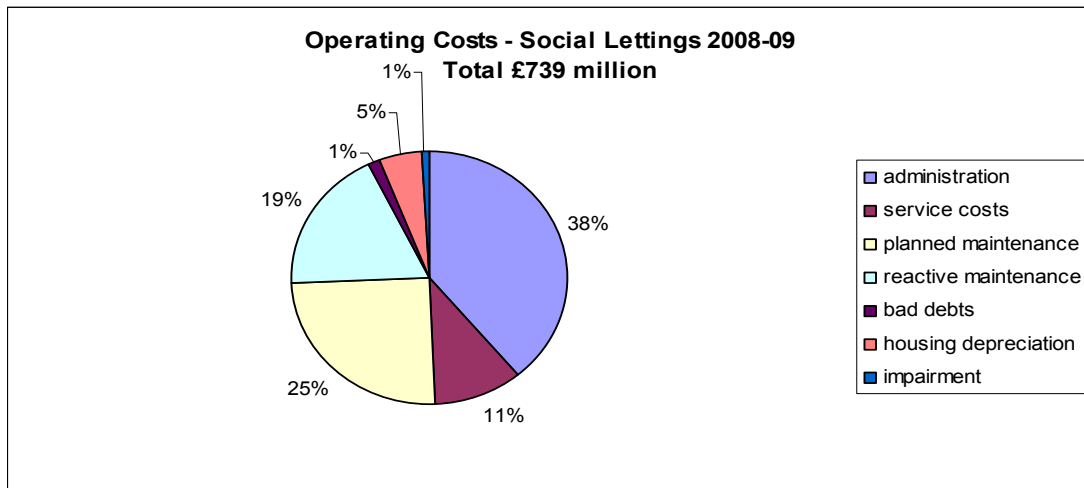
Operating costs in the year ended 31 March 2009 were £983.9m, an increase of 9.3% on the previous year. After allowing for the differential effects associated with consolidation of a full year's accounts for River Clyde Homes in 2008/09 the like for like increase is 7.3%.

Figure 5 below shows the 2008/09 distribution of these costs, using the categories specified under the 2007 Accounting Order.

Social lettings operating costs at £739m¹ represented around 75% of all costs. Around 84% of this sub-total is attributable to administration and maintenance headings.

¹ Social lettings operating costs relate to housing management activities and are funded by the rents and service charges due in respect of the properties managed.

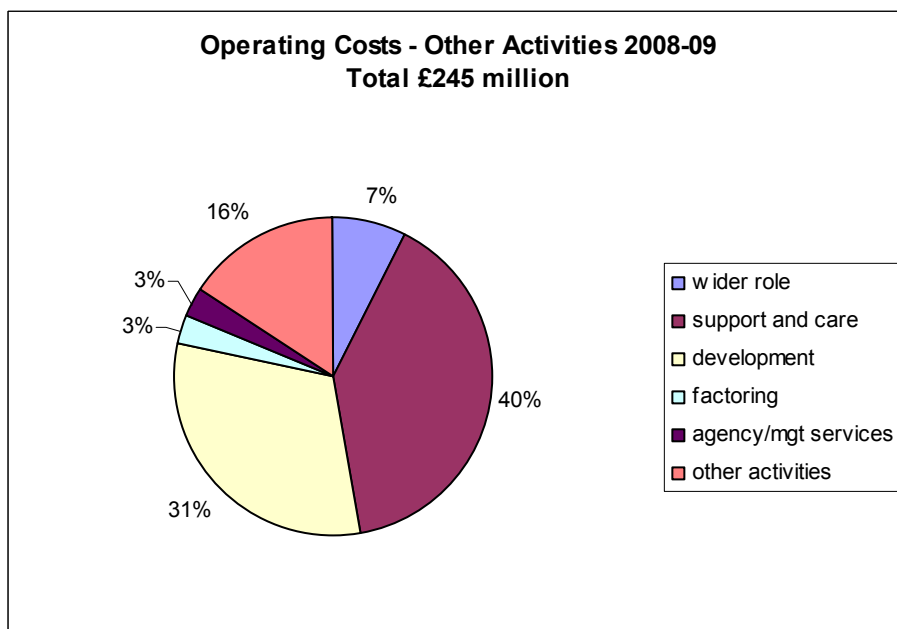
Figure 5: Social letting operating costs 2008-09



Source: SHR – Accounts Consolidation System

Non-letting operating costs were £245m. Figure 6 below shows that care & support activities and development activities accounted for more than 70% of this sub-total between them. RSLs have allocated almost £40m (16%) to ‘other’ activities as they did not fit under any of the standard headings the 2007 Accounting Order.

Figure 6: Non letting operating costs 2008-09



Source: SHR – Accounts Consolidation System

Social letting management and maintenance costs

Any analysis of operating costs is affected by capitalisation policies for major repair costs. RSLs can have significantly different policies on the capitalisation of major repairs and they have only had to disclose the amount of any capitalised major repairs since the 2008 Statement of Recommended Practice (SORP) came into effect on 1 April 2008 (the last year reported here). In 2008/09 RSLs reported capitalised major repairs of £177m, therefore coming close to doubling the £187m of planned maintenance that was charged to the income and expenditure account. By contrast capitalised repairs costs reported in 2007/08 year were less than £4m.

Figure 7 below shows all the components of operating costs that are reported in the revenue account.

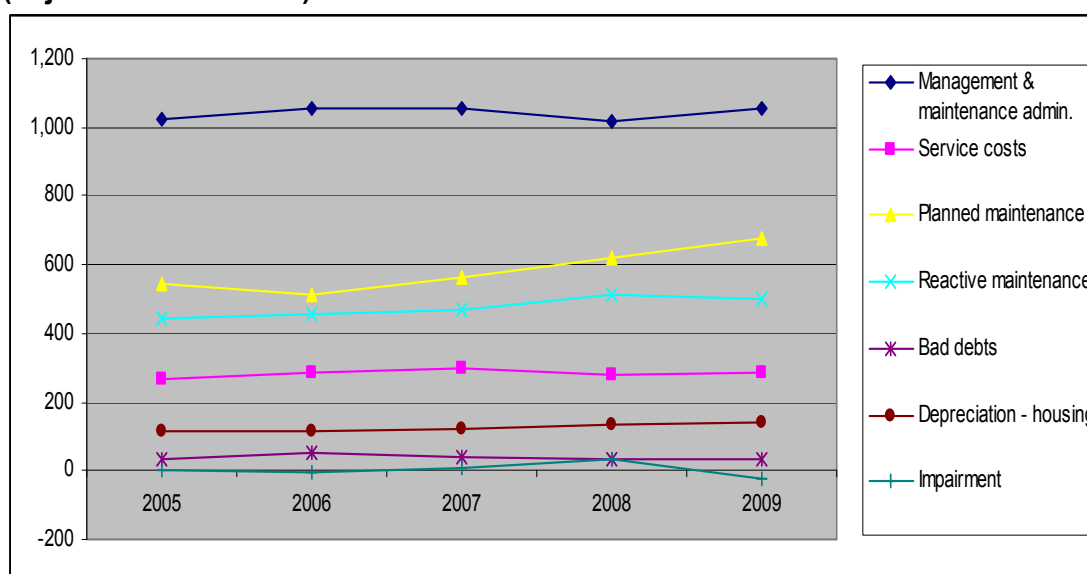
Figure 7: Social lettings operating costs 2004-05 to 2008-09

	2005	2006	2007	2008	2009
	£000's	£000's	£000's	£000's	£000's
Management & maintenance admin	230,263.7	242,831.4	251,811.1	271,847.6	291,949.4
Service costs	59,429.9	65,119.2	70,948.6	74,064.3	79,452.3
Planned maintenance	123,228.4	117,256.6	135,082.2	166,002.1	186,553.0
Reactive maintenance	100,454.3	104,590.3	112,267.8	136,509.5	138,936.5
Bad debts	6,982.3	11,931.3	9,458.7	8,389.9	9,163.4
Depreciation – housing	26,006.1	26,403.0	28,424.0	35,603.1	38,749.5
Impairment	569.8	-757.0	1,767.7	8,830.2	-5,996.5
Grand Total	546,934.5	567,374.8	609,760.1	701,246.7	738,807.6

Source: SHR Accounts Consolidation System

The table shows that total costs have risen by 35% over the five years. However, when the above figures are displayed in unit costs, and adjusted for inflation (See Figure 8) this illustrates that management and maintenance costs have been relatively constant but planned maintenance expenditure (excluding any capitalised expenditure) has risen steeply, probably in response to the requirement for SHQS compliance.

Figure 8: Social letting operating costs per housing unit 2004-05 to 2008-09 (adjusted for inflation)



Source: SHR – Accounts Consolidation System

Expenditure varies considerably from RSL to RSL and from classification to classification. In 2008/09 the median management and maintenance administration cost per unit was £965. This represents a more than 20% increase from 2004/05²

In 2008/09 a quarter of all RSLs spent more than £1,123 per unit and a quarter spent less than £819 per unit. General RSLs had the highest per unit expenditure with a median spend of £993 per unit, however they were very closely followed by the Care and Support RSLs, only £1 behind at £992 per unit.

On direct maintenance costs the medians in 2008/09 were £505 per unit for planned maintenance and £416 per unit for reactive maintenance. These represent significant increases in both from the 2004/05 levels, with planned maintenance up 48% from £340 per unit and reactive maintenance up 56% from £266 per unit. This level of increase will, at least in part, reflect the work being done towards meeting the requirements of Scottish Housing Quality Standard (SHQS) by the 2015 deadline.

Non Staff Costs

Another way that we analyse costs is between staff and non staff. With regard to the latter, non staff costs rose by £63.7m or 10.7%. After allowing for the differential effects associated with consolidation of a full year's accounts for River Clyde Homes

² . We use medians in this report as an average or mean is sometimes not appropriate for our data. This is because the distribution of RSL stock is very skewed: a small number of organisations account for a large proportion of the total stock.

in 2008/09, the like for like increase is 8.6%. Again it is likely that upward pressure will increase as we approach the 2015 deadline for SHQS compliance.

Staff Costs

Staff costs rose by £20.5m or 6.7% during 2008/09. The number of staff employed in the sector rose from 11,339 to 11,600 (full time equivalent posts), an increase of 2.3%. This means that the staff cost per member of staff increased from £27,074 to £28,230, an increase of 4.3%. The increase in the Retail Price Index for the period was 3%.

In spite of the trend towards fewer, larger organisations over recent years, staffing levels in the sector have grown relative to stock numbers; staff numbers increased by 12% between 2005 and 2009, compared to an increase in stock of 7%.

The biggest increases were in direct labour and concierge staff (29%) and office-based staff, which increased by (18%). Care and support staff numbers increased by only 1%. As a result, the ratio of staff to stock has decreased from 1:24 in 2005 to 1:23 in 2009. This trend does not necessarily point to a decrease in efficiency: higher staff numbers might be the result of services taken in-house that had previously been contracted out (although a decrease or at least some moderation of the increase in non staff costs might have been evidence of this), or of additional income generating services being offered.

Between 2004-05 and 2008-09:

- total staff costs rose by 31%;
- staff costs per unit rose by 23%;
- staff costs per full time equivalent member of staff rose by 17%; and
- EVH salary scales³ have risen by 17%.

After adjusting for inflation, between 2004-05 and 2008-09:

- total staff costs rose by 15%;
- staff costs per unit rose by 7%; and
- staff costs per full time equivalent member of staff rose by 2%.

³ A number of RSLs use the Employers in Voluntary Housing (EVH) salary scales,

Interest Costs

The amount paid by RSLs in interest charges in 2008/09 was £103.6m, an increase of just £372,000 or less than 0.5%. Our loan portfolio returns indicate that, in the year ended 31 March 2009, RSLs had outstanding borrowings of the order of £2.1bn, an increase of 18.4% on the corresponding figure in the previous year.

Last year, in *Shaping Up for Improvement*, we noted that for every pound that RSLs earned in turnover some 10.2p was spent in servicing debt. RSLs' ability to grow turnover and control interest costs against a background of increased borrowing means that this figure has fallen to 9.3p. Over the five year analysis period, interest payable (and similar charges) has increased by around £19.4m (23%), from £84.3m to £103.7m.

When assessing financial risk one useful measure is interest cover (operating surplus net of accounting adjustments as a proportion of interest costs). This gives a measure of the affordability of an RSL's debt servicing costs. In 2008/09 a total of 35 RSLs recorded interest cover below 110% an improvement on 2007/08 (40 RSLs).

The continuing ability of the sector to borrow money at relatively favourable rates is to be welcomed. It is likely that changes to the banking sector will result in increased charges for borrowing for the social housing sector and beyond, but this was not yet manifest in the figures for the year ended 31 March 2009. That said, we still anticipate RSLs having the ability to gain favourable rates when compared to commercial borrowers.

3. Borrowing and asset values

The year ended 31 March 2009 saw RSLs continue to use external financing in order to deliver new build programmes and other capital expenditure.

Long term borrowing over the period from 2004/05 to 2008/09 increased by approximately 50%. During 2008/09 total loan facilities available to the sector increased by 9.7% or £318m to almost £3.6bn, while the amounts owed by RSLs to lenders increased from just under £1.8bn to a little more than £2.1bn.

Figure 9: Change in Borrowing in Year Ended 31 March 2009

	Total Loan Facility £000	Drawn Down £000	Facility Undrawn £000	Balance Outstanding £000
Year Ended 31 March 2009	3,594,416	2,309,077	1,285,339	2,122,167
Year Ended 31 March 2008	3,276,697	1,958,801	1,317,895	1,792,259
Difference	317,719	350,276	-32,556	329,908
% Change	9.70	17.88	-2.47	18.41

Source: SHR Loan Portfolio System

The amount drawn down by RSLs increased at a faster rate (£350.3m or 17.9%) than the growth in the overall loan facility available to the sector (£317.7m or 9.7%). This means, for the first time since we started monitoring these figures, the aggregate undrawn facility available to the sector was less than in the previous year. The reduction (£32.5m or 2.5%) is modest, but we will continue to monitor this.

In *Shaping Up for Improvement* we commented that there was a high level of market concentration amongst lenders to the sector. This concentration increased further as a result of consolidation within the banking sector during the year.

In March 2009, the core assets of the Dunfermline Building Society, then the second largest lender to the RSL sector were acquired by the Nationwide Building Society, then the fourth largest lender to the sector. The core assets did not include the Dunfermline's social housing portfolio which at that time was transferred to the DBS Bridge Bank. However, in June 2009 the social housing portfolio was also transferred to the Nationwide Building Society following a competitive auction process. As a result of this acquisition, the Nationwide Building Society is now the second largest lender to the sector. This came shortly after the takeover of Halifax Bank of Scotland, the fourth largest lender to the sector, by Lloyds TSB, the third largest lender to the sector. Figure 10 illustrates the position at 31 March 2009.

Figure 10: Top 3 Lenders to the Sector, Year Ended 31 March 2009

	Total Loan Facility	Market Share	Balance Outstanding	Market Share
	£000	%	£000	%
Royal Bank of Scotland	940,223	26.16	596,694	28.12
Nationwide/Dunfermline	869,529	24.19	562,621	26.51
Lloyds/HBoS	719,972	20.03	378,872	17.85
	2,493,422	70.38	1,538,186	72.48

Source: SHR Loan Portfolio System

There was a substantial increase in housing asset values during the period from 2004/05 to 2008/09. The value of housing assets (net of accumulated depreciation) stood at £8,830m at March 2009. After accounting for Housing Association Grant (HAG) and other government capital grant funding, the consolidated balance sheet for the sector reported net housing assets of £2,701m. These figures compare to £6,326m and £1,701m for 2004/05 and represent increases of 40% and 58% respectively. This difference in the growth rates between government funding and other funding means that the proportion of net housing assets funded by government grant has fallen to 69.4% from 73.1%. This illustrates the extent to which RSLs are using private borrowings as well as their own internally generated reserves to grow their asset base.

4 Conclusion

When we engage with individual RSLs and whether we choose to engage with particular RSLs depends upon the circumstances at each organisation. But we also attempt to look at the sector in general through the interpretation of sector wide aggregates. This can be difficult as the ability to analyse the figures over a period of time can be constrained by factors such as changes in accounting policy, mergers and consolidation, and new entrants to the sector. That said it is possible to comment upon sector wide facts and trends, through careful interpretation and analysis of the sector information that we collect.

Based on our analysis we conclude:

Cost Control: it remains important for RSLs within the sector to maintain tight control on cost growth. In 2008/09 operating costs and interest charges accounted for 97.1% of annual turnover (2007/08, 99.1%). This improvement arises from the fact that turnover in 2008/09 rose faster than the growth in costs, but we think the current rate of growth of turnover is unlikely to be sustainable.

Concentration of Lenders: the sector is increasingly relying upon a small number of large lenders. Some 72% of borrowing comes from 3 large financial institutions.

Government Grants: in 2004/05 73.1% of net housing assets were funded by Housing Association Grant and other government grants. By 2008/09 this had fallen to 69.4%.

Interest Charges and Borrowing: The sector's borrowing is growing at a much faster rate than the cost of servicing that borrowing. Interest charges rose by 0.36% in 2008/09, but our loan portfolio returns showed that total borrowing rose by more than 18%. For the first time since we began to maintain these figures the sector's aggregate undrawn facility fell during 2008/09. This was a consequence of the amount drawn down increasing at a faster rate than the growth in new facilities.