



# **Crunch Time** for the Social Housing Sector

September 2008

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# Introduction

Welcome to Baker Tilly's Registered Social Housing (RSL) Credit Crunch Survey. Over the past few months our social housing clients have increasingly been raising the issue of the tightening credit situation following the recent credit crunch and its significant ongoing consequences for their organisations.

In order to understand more fully what impact this is having on the RSL sector, we undertook a survey in August 2008 to establish the perceptions of senior RSL executives on the topic and how it is directly affecting their organisations. We also wanted to see the steps Boards are taking to adopt their organisation to a rapidly changing and uncertain economic climate.

We were pleased with both the volume of replies and the senior level of executives who responded to our survey. Over 80% of the respondents were in senior positions, with over 50% of the responses coming from finance directors, representing a range of RSLs covering Large Scale Voluntary Transfers (LSVTs) and Traditional Housing Associations. The majority of respondents came from mid size RSLs with 5-10,000 housing units, with a third having 10-20,000 units.

In the following pages we examine the perceptions/trends and take a view on some of the results we have found, as well as providing information for you to benchmark your views against your peers.

In summary, our survey will show that you are optimistic that the economy will recover in 2009, however you believe the housing sector is feeling the crunch and RSLs acknowledge this by the fall in sales and prices, and by not pursuing commercial development opportunities. With long term lending facilities in place most of you are avoiding the current difficulties in obtaining finance. Of significant concern is the fact that 75% of you think RSLs will encounter financial problems in the next 12 months, yet a third haven't looked at risk management controls or started any extensive cost cutting.

We believe it is too early as yet to assess whether the recent measures announced by the Government will significantly help alleviate the pressures besetting the social housing sector.

Please feel free to contact me, or your local RSL contact, if you would like to discuss any of the issues this survey has highlighted.

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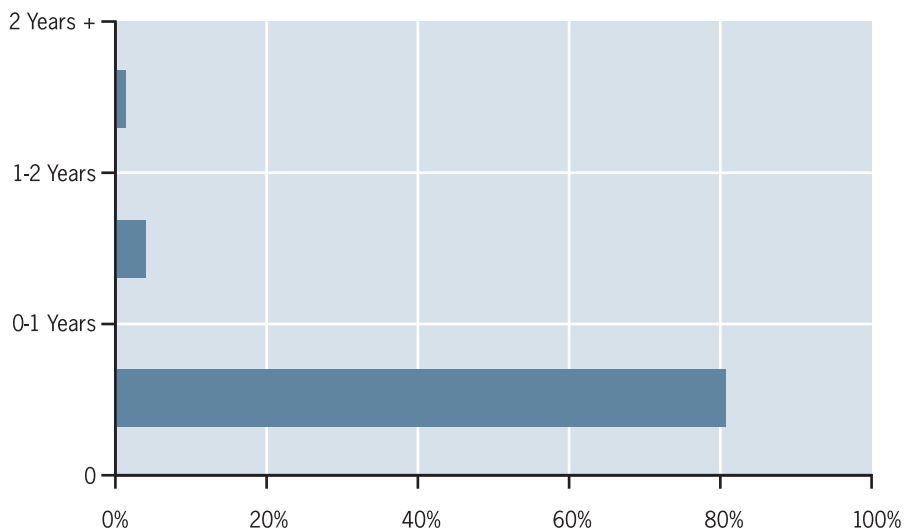
# 1. The state of the economy and Government Housing Policy

## Predictions for recovery

Although volatility in the global economy altered the economic outlook for 86% of respondents, most believed the instability will be short lived. An overwhelming 81% thought that rates of growth will recover in the next 12 months.

The chart below shows the majority of directors predict 2009 as the turnaround period.

**When will the economy recover to previous growth rates?**



However, two thirds of respondents (68%) do not concur with Gordon Brown's optimism that the UK is better placed than other major economies to survive the global credit crisis.

*Official figures last month revealed the economy had nil growth in the second quarter, with rising expectations that the economy will shrink, matched by the recent OECD prediction that the UK economy was headed for a significant downturn that will put government spending plans in danger. Capital Economics, an economic consultancy, became the first analysts to forecast an annual fall in GDP for 2009. Although these predictions are far from set in stone, senior executives should definitely prepare for a slowing if not halting economy.*

**Gary Moreton, Chair Social Housing Group**

## Some optimism for the Government

Even though there were mixed views on the current Government's social housing policy, most respondents were very clear on what the Government should do in the short term.

- 76% of respondents believe that social housing will remain a priority for the current Government in the run up to the next election.
- Despite this, 73% expect the Housing Corporation and its successor body, the Home and Communities Agency, only to inject the same or lower funding than at present.

*This could well be based on the Housing Corporation's publicised perceptions that RSLs have spare capacity and should be using internal funds and private finance*

*Peter Howard, Social Housing Audit partner*

- There was some reassuring news for the Government. 88% of respondents did not expect the credit crunch and general economic conditions to impact adversely on repairs programmes and the achievement of 'decent homes' standards by the targeted date. This should provide some relief that the "Decent Homes" programme is still broadly on track.
- With regard to short term government policy, 70% of respondents believe it should make additional funds available to allow RSLs to buy "hard to sell" homes from house builders in an attempt to kick-start the housing market. The government of the day did this to great effect 15 years ago.



## 2. Social Housing feels the crunch

As the credit crunch unfolded there was widespread disagreement as to whether the storm would be constrained to the financial sector or spill out to the wider economy and even the public sector.

The evidence from our survey shows that 78% of respondents consider that the credit crunch has had a significant impact on the social housing sector primarily in the areas of:

- development of new social housing,
- sales of new homes at market rates; and
- shared ownership tranche sales.

Interestingly, only about a third (31%) stated that they had encountered difficulties with lenders, either in renewing existing facilities or in securing funding for new schemes.

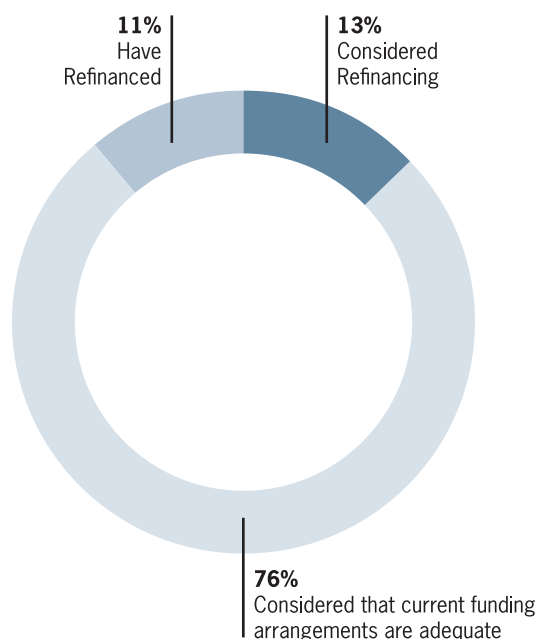
This view is supported by the fact that 76% consider that their current funding arrangements are adequate.

*This is probably because many RSLs still have undrawn loan facilities or have yet to try to obtain additional finance. Evidence suggests however, that banks are taking a harder attitude when renegotiating with rates being pushed up and/or additional conditions being demanded.*

*David Lewis, Social Housing Audit Partner*

The chart below shows that most executives consider current funding arrangements to be adequate.

### Has your organisation considered refinancing as a consequence of the credit crunch?



## Going under - Financial viability of the sector questioned

Of big concern is the ongoing financial viability of some of your peers.

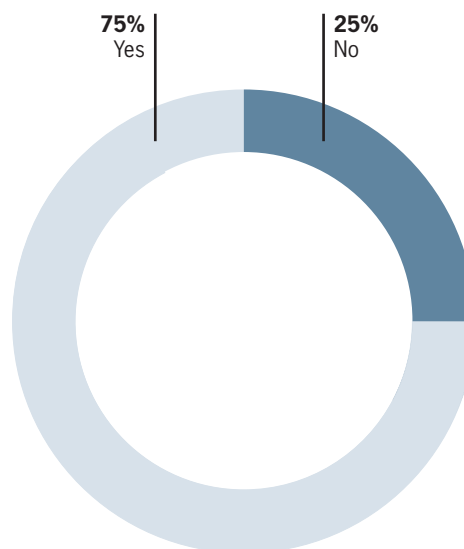
Respondents appear to have a low level of confidence in the current financial viability of the sector, with three quarters of respondents stating that they expect to see other RSLs having significant financial difficulties in the next 12 months.

Coupled with the following, that two thirds of respondents anticipate increased issues over arrears and bad debts over the next year, there are clear indications that the credit crunch will/has impacted tenants and RSLs.

This makes for worrying reading for senior management and the Housing Corporation and its successor body, the Tenants Services Authority, as its regulator.

The chart below shows increasing concern for financial viability of RSLs.

### Following the reported collapse of one housing association in the last 12 months, do you expect to see other RSLs having significant financial difficulties in the next 12 months?



*In a downturn you must focus on credit control to spot client weaknesses and assess the impact key supplier failure may have. Having identified imminent pinch points, early professional advice is essential to plan the course of the business accordingly.*

*Edward Corrigan, Business Services Partner*

## Commercial Development put on hold as property sales slow

One of the consequences of the crunch is that 54% of respondents' organisations are no longer pursuing new commercial development opportunities to help fund social housing projects.

We believe this is a result of increasing difficulties with selling surplus properties on the open market. 47% of respondents were affected by this and were having to drop prices to achieve sales.

In addition, 69% believed that first tranche Shared Equity scheme sales are becoming more difficult due to greater difficulty for individuals in obtaining funding.

### 3. Warding off the storm – RSL defence strategies

If we take stock of the actions being taken, they are primarily in the area of greater risk planning and forecasting, putting a hold on recruitment and reducing spend in large scale IT investments.

#### Forecasting and Risk Management – high priority

Timely and effective forecasting is essential in understanding your RSLs future position in a slowing economy. This is certainly becoming true for a significant majority of our respondents with 86% saying that financial forecasting is now even more important to their role in light of recent credit crunch developments.

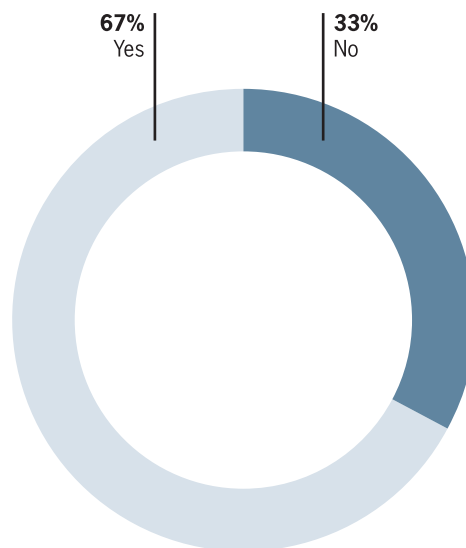
*In a difficult market, the timely production of management information is vital to understanding and reacting to the trends and opportunities in the sector. Similar robust and accurate forecasts are vital to managing stakeholder expectations and maintaining management credibility. Furthermore, effective working capital management requires up to date accurate information in spotting warning signs early on.*

*Keith Ward, Social Housing Audit Director*

67% of RSLs are looking at revising risk management frameworks to take into consideration the availability of finance and the effect of the credit crunch. Treasury procedures and development risks were noted as being particularly important. However, this does mean that conversely around a third of respondents have not yet revised their risk management processes.

The chart below shows revising risk management procedures and controls are a key priority.

#### Are you now looking at revising risk management and controls to take into consideration the availability of finance and the effect of the credit crunch?



*The number of respondents looking at risk management and forecasting is a welcome sign. By recognising key risks and managing them as part of a clearly articulated strategy, RSLs are much more likely to maintain stakeholder confidence in your managerial ability and the health of the organisation*

*Chris Lauder, Risk Management Partner*

## **No panic to cut costs**

Most executives' reaction when a downturn occurs is to cut costs, usually on resources which do not add value or profitability.

However, interestingly 65% of respondents stated that their RSL has not been cutting costs over the past 12 months in light of the credit crunch. For those who are cutting costs, reductions are mainly in areas of:

- recruitment,
- restructuring; and
- implementation of new IT systems.

A further 59% stated that they had not found pressure increasing for above inflation wage rises in the past year.

*It appears that the credit crunch has had little specific impact on additional cost cutting; we are not sure if this is complacency or because RSLs have already been actively focusing on efficiencies over the last couple of years.*

*In my experience a large proportion of organisations cutting costs may be missing a trick by ignoring more structural cost cutting strategies. Although restructuring and outsourcing can cause disruption to an organisation, it can make a company more flexible and responsive to sector change. Technology investment and process improvement should also not be overlooked, as it can generate cost saving by standardising and automating processes which could otherwise need more costly human resources.*

*Peter Lunio, Associate Director Management Consultancy*



## 4. Conclusion

The survey results have brought an interesting insight into the way the effects of the credit crunch are perceived within the social housing sector and also evidence of the actions being taken by RSLs.

Although the senior management surveyed fully expect the current situation to lead to significant financial difficulties for some RSLs, most are clearly closely guarding the position in their own RSLs by regularly reviewing and updating financial forecasts and internal risk management.

The efficiency agenda of recent years appears to have reduced the perceived need for drastic cost cutting measures by RSLs at this stage, but there is still concern over the impact on development, sales (including the viability of shared ownership projects) and on the ability of tenants to keep up with rental payments.

The good news appears to be that RSLs expect a recovery to come within 12 months, and since the majority have adequate funding for the present time, most RSLs surveyed were therefore not overly concerned about the apparent tightening of credit, and hardening of attitudes by banks.



## 5. Our Advice

### Our 10 point plan for dealing with the Crunch

Senior executives in the sector must take a structured rather than panicked approach to the challenges that the credit crunch may bring. By taking heed of our 10 point plan you can take advantage of the opportunities presented by the market slow down:

1. **Forecasting** - ongoing review and update of financial projections to provide an early warning of issues.
2. **Risk Review** - ongoing monitoring and update of risk management and corporate strategy.
3. **Credit Control** - increase emphasis on timely rent collection to identify and resolve issues.
4. **Governance** - ensure good governance and communication at Board and executive levels.
5. **Treasury** - monitor covenants and relationships with bankers generally.
6. **Assets** - review asset strategy and business appraisal techniques, carefully considering development and sales, including the viability of shared ownership projects.
7. **Opportunistic** - be ready for any opportunities which could arise at short notice, such as any government initiative over private developer housing surpluses.
8. **Advice** - ensure you obtain and use appropriate professional advice.
9. **Cost Reduction** - review cost reduction targets and accelerate reduction strategies.
10. **Tax and VAT** - review your tax and VAT strategy in light of the changing economic conditions.



## 6. Baker Tilly in the Social Housing Sector

### The social housing team

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Gary has spent the last 15 years advising the sector and has been a member of the Board of a local housing association for some years. His experience includes advising on matters affecting the sector such as strategic and business planning, mergers and acquisition and group structures.

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David is responsible for the provision of audit and related advisory services to our social housing clients in London and the South. His clients include LSVTs, mainstream RSLs, ALMOs and other social housing providers; their activities cover general housing needs, care and special needs.

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