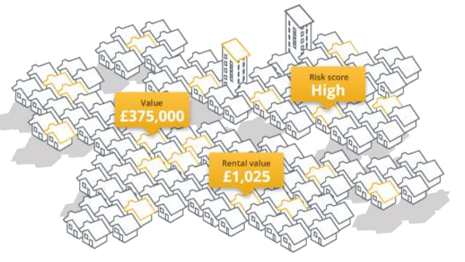
Unlocking strategic asset management

Executive Summary

De-regulation and the shift towards mixed tenure regeneration and new development means housing associations are considering multiple price points for assets as they develop strategies and business plans.

This report presents unique analysis on the market value of social housing and how this relates to social and affordable rents and the attractiveness of intermediate tenures at a localised level and the key implications for strategy.

The analysis highlights how big data and market analytics used by mortgage lenders and other property sectors can be applied to the affordable housing sector.



Introduction

Asset management has been a key area of focus for housing associations in recent years. Long run estate level cash flows have driven strategic decision making with stock rationalisation via asset swaps and disposals. De-regulation and greater flexibility has expanded the range of factors that boards and executive teams need to consider as they target their key organisational objectives. The impacts of welfare reform and funding for new delivery have increased the pressure to fully understand the market context for rent policies, investment decisions and strategic asset management.

Big-data and market analytics used by mortgage lenders and other property sectors can be applied to the affordable housing sector.

The need to consider a wider array of price points to inform decisions

De-regulation and the shift towards mixed tenure regeneration and new development mean housing associations need to consider multiple price points for rents and capital values. Information on private housing capital values is widely available but is the market value of social housing assets, in the local areas they are located, the same as private housing? Is there a difference between the variance for capital and rental values? After 15 years of social housing rent guidance and the application of a national rental growth rate to all homes are there areas of mis-pricing against the private housing market and what does this mean for policy and strategy making?

This research report presents unique analysis on market values for all social and affordable housing (social housing) to uncover the answers to some of these questions and to highlight some of the national trends that housing associations may wish to consider as they plan decision making on funding, new investment and diversification into alternative tenures to help deliver on their core social objectives.

The research

Understanding the market value of social housing assets (both capital and rental value) is becoming an increasingly important benchmark enabling a more strategic analysis of housing association portfolios. Combined with data on existing target rents, and other pricing benchmarks such as January 1999 values (a component of the social rent formula) it is possible to rapidly assess the profile of a portfolio and the market dynamics against which more informed asset management and business planning decisions can be made.

The analysis in this paper is based upon capital and rental valuations for every address in the UK, averaged up at local authority level across England and split between addresses identified as social housing and private housing i.e. owned by private individuals.

The market values are based upon Hometrack's Automated Valuation Model (AVM) which delivers an estimated market value for each address. Hometrack's AVM is used extensively by mortgage lenders to originate new mortgage loans and value entire portfolios of mortgages. A growing number of housing associations are using the same to appraise their existing asset base.

Alongside the local authority level capital and rental data we have appended data on target rents and affordable rents as well as 1999 values calculated from the Hometrack data and also implied from current social rents. This large database was used as the basis for a wide range of analytics to draw out key geographic trends and enable a strategic view of the sector drawing out implications for policy, strategy and business planning.

The remainder of this report draws out some of the key findings from the research and presents some unique analysis that showcases how data and analytics can inform the next generation of strategic asset management across the affordable housing sector.

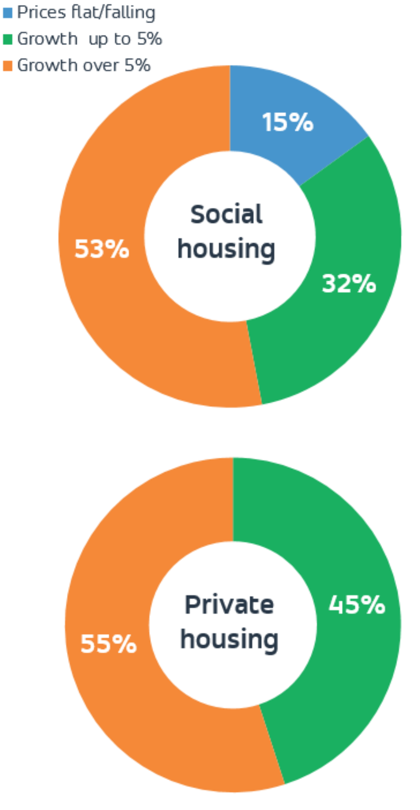
The market value of social housing assets

The basis of rents and valuation across the social housing sector are well established. Rents are established using pre-defined rent setting guidance while capital values are typically defined on an EUV-SH basis (existing-use value for social housing) with growing use of market value subject to tenancy (MV-T). Private housing values are precisely that with information on registered sales listed in the HM Land Registry.

Analysis of the valuation data from the Hometrack AVM finds that the average market value of social housing at the end of 2015 was £152,000. This is 33% lower than the average value of private housing nationally across England. The discount to EUV-SH will be higher. The variance between private and social housing capital values at local authority level ranges from as little as 10% to 60% reflecting different local market conditions and type of stock.

Looking at house price inflation over 2015 the analysis shows that over half of local authorities registered an increase in social housing capital values of over 5%. However the analysis found that 15% of local authorities registered flat or falling social housing capital values over the year, most likely on the back of weak demand and constrained access to credit. Despite headlines of rising house prices, there are localised pockets of the housing market where house price growth remains weak.

Fig 1: House price growth by type of housing (2015)



Source: Hometrack

Rental values

Turning to rental values, the variance between social housing and private housing market rents is smaller than for capital values, averaging just 14%. While rents are being cut over the next 4 years, market rents for social housing assets have grown, on average, by 2.3% in 2015 (compared to 3.8% for private housing rental values). This overall average change masks a wider variation in rental growth for social housing with average rents flat or falling across 40% of local authorities (15% for private housing market rents)

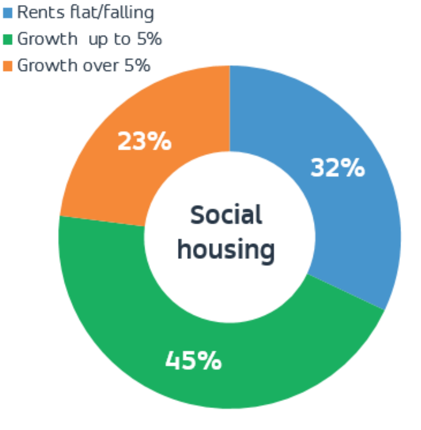
Hometrack's analysis of capital and rental values shows that while parts of the social housing sector have performed in line with the private housing market there is a significant variance across the country.

This is especially true for rents where media reporting gives the impression that market rents have been rising inexorably. Yet much of this growth emanates from London where rental growth has been high on strong demand and rising occupancy. There are many parts of England where rental growth has been subdued for the last 8 years as rents have struggled to keep pace with earnings.

These findings underline that business plan assumptions driven by above-inflation rent increases need to be verified based on local market trends.

Understanding the market value of social housing assets (both capital and rental value) is becoming an increasingly important benchmark

Fig 2 – Growth in market rents of social housing (2015)



Source: Hometrack

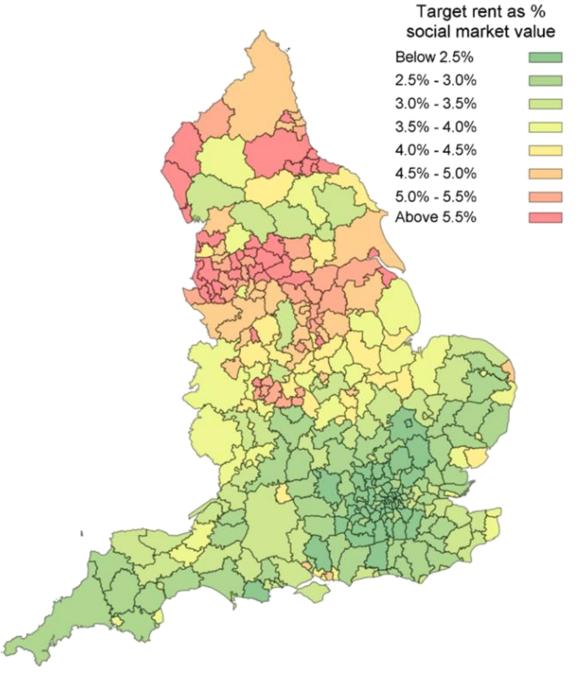
Gross yield on 'core' social housing assets

While EUV-SH and MV-T are the bases of valuation for accounting and funding, the lack of grant funding to supply new social housing means the sector needs to consider the cost and return it gets from core social housing assets let at target rents. Our analysis of capital values already registers a discount to private housing capital values and indicates the effective price of stock in the open market. If this is the price that stock could be acquired then what yield would this generate towards servicing debt or delivering a return?

Figure 3 shows the current target rent expressed as a percentage of the market value of social housing across English local authorities in 2015. The average gross yield is 3.3% with yields ranging from less than 2% in London to over 7% in parts of northern England. This pattern of yields should be no surprise given the comparison of regulated rents against market values but it sets the context for how the sector could view the financial drivers of expanding new affordable housing supply.

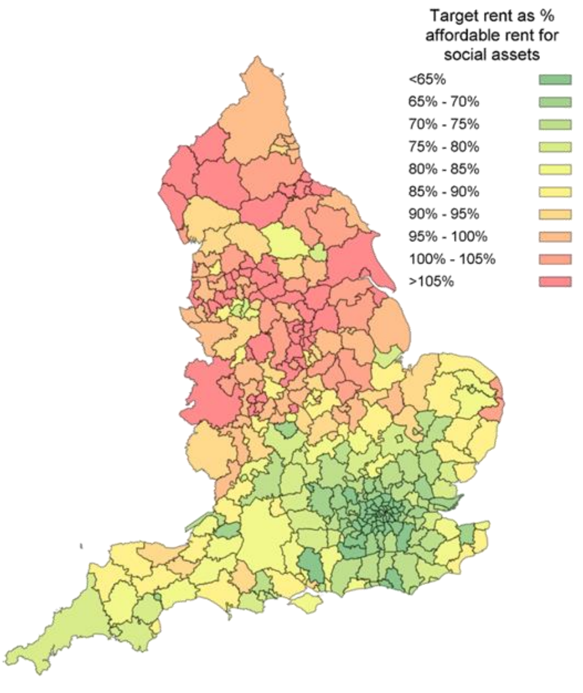
The cutting of grant to fund the supply of social rented property means housing associations are looking to other tenures and market sale to deliver intermediate housing and surpluses to enable the delivery of more affordable housing. With yields on private rented housing at 4% and upwards with total flexibility it is clear why PRS has a role to play in mixed tenure development in the most suitable areas.

Fig 3 – Yield on target rent as percentage of market value



Source: Hometrack

Fig 4: target rent as percentage of affordable rent at 80% market



Source: Hometrack

Target rent as a percentage of affordable rent

With the introduction of affordable rent in 2010 to increase borrowing capacity in lieu of grant housing associations have had to monitor financial performance and the perceived uplifts obtainable from letting at affordable rent more closely.

Figure 4 illustrates a clear north-south divide - specifically in the North-West and North East, where existing social rents are comparable or greater than an affordable rent of 80% of the market rent for social housing (capped at local housing allowance).

Local authorities south of the midlands have much greater headroom to increase rent towards affordable rents as part of development. This gaps also highlights the existence of a much wider affordability gap which could encompass a number of tenure options.

With reduced reliance on grant and the reclassification of what affordable housing constitutes, housing associations will need to monitor the market metrics to ensure risk is managed on an ongoing basis. It will be interesting to follow how housing associations will approach the tenure mix of developments going forward and whether affordable rent has a place in the north beyond the 2015-2018 programme in favour of more localised rent setting policies.

Shared ownership and mixed tenure

Hometrack's experience in analysing portfolios shows that a wide array of capital and rental value metrics on the price points in the market enables more accurate assessment of development opportunities and planning for estate regeneration and option appraisals including a fuller understanding of affordability. The move to mixed tenure development means it is vital that rents and values are assessed accurately to ensure business plan objectives can be achieved and contingencies are understood should market conditions change.

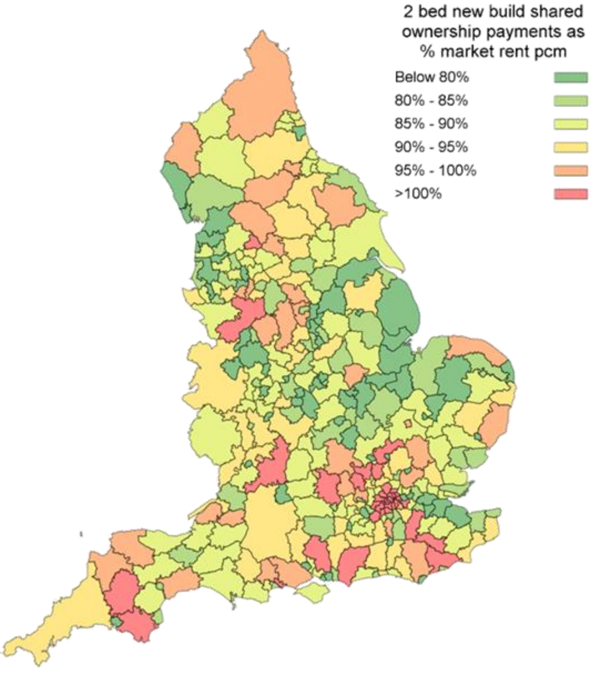
The latest bidding round re-enforces the shift towards low cost home ownership as a means of enabling households to access home ownership at lower income levels. The target market for shared ownership homes will be existing tenants who are in employment looking to take up part ownership, which helps create churn in existing housing, and private renters who are unable to access full ownership.

Figure 5 shows the differential between the monthly costs of privately renting a 2 bed property and the cost of servicing the purchase of a new build 2 bed shared ownership property. The analysis shows that shared ownership works in the majority of markets across England. There are 12 local authorities, primarily in London, where the income required to buy shared ownership at 'fully priced' new build pricing levels is above the respective income caps – in these cases, being less aggressive on end-sale values could open up the market to those on lower incomes.

There are a further 25 local authorities where buying new shared ownership property is more expensive than the average rent, largely as a result of either very high or relatively low private rents. There will be buyers for these homes in the upper reaches of the rental market as 50% tenants pay above the average rent but it is the depth of this market that is the important question for financial appraisals and business plans.

This variation in the financial dynamics of shared ownership will be greater at a localised level meaning business plans and strategies for the development of shared ownership need to be tested against trends in the wider market.

Fig 5 – Cost of new build shared ownership as % market rent



Source: Hometrack

Summary

The choices facing housing organisations as they look to meet their objectives in a changing policy environment are growing.

The challenge is how to take a more strategic view of the options and potential risks quickly and cost effectively across many housing markets.

This short analysis has highlighted some of the analysis that is available to consider the options for strategic asset management based on having a wider understanding of values and price benchmarks across a portfolio.

Hometrack help businesses make better decisions. Businesses right across the residential property ecosystem, such as housebuilders, investors and social housing providers, use our independent market intelligence when making business decisions and deciding where to invest. Our automated valuations are used by 17 out of the top 20 UK mortgage lenders.

Contact Hometrack at enquiries@hometrack.com or +44 (0)203 744 0410 to discuss our services for housing providers.