Homes & Communities Agency

The social housing regulator

Viability Report

Paradigm Housing Group Ltd L4215
Including: Paradigm Homes Charitable Housing Association Ltd LH4138

September 2012

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PURPOSE AND INTRODUCTION

This report is an assessment of the financial viability of the registered group, and of its compliance with the viability element of the Governance and Viability Standard.

This report is based on our assessment of the group's latest Business Plan and supporting Financial Forecast Return approved by the board in July 2012, responses to quarterly surveys, annual accounts for the period 2011/12, the auditor's management letter for 2011/12 and other enquiries we have made in coming to our assessment.

Overview

The group comprises the non-asset-holding parent, Paradigm Housing Group Ltd (PHG); one registered subsidiary, Paradigm Charitable Homes Ltd, (formerly Chiltern Hundreds); and three unregistered subsidiaries; Paradigm Development Services Ltd, Paradigm Commercial plc, and Paradigm Maintenance Ltd. It is also the corporate trustee for the Welwyn Hatfield Foyer Charitable Trust. It owns and manages 12,249 properties, mainly in West London and the home-counties to the north west of London.

In the financial year ended 31st March 2012 the group achieved a net surplus of £5.2m on a turnover of £74.8m (£3.9m from £77.3 in 2010-11). Non-social housing activities contributed £1.4m of this surplus. Having agreed a further £50m loan during the year to March 2012, PHG now has agreed facilities of £671.9m, of which £43.5m is undrawn at June 2012. This is sufficient to meet current commitments but further financing will be required to complete the development programme during 2014-15. The tightest loan covenants are interest cover of 110% and gearing of 65%. No material issues were raised during the audit, apart from a restatement of asset values for prior year accounts.

PHG is a development partner with the Homes and Communities Agency and has entered into a contract with them to deliver 853 homes with grants of £12.2m under the affordable rents regime. 433 of these homes will be rented, at affordable rents of up to 80% of market rent, and 420 sold under affordable home ownership arrangements. These homes are delivered via Paradigm Development Services Ltd. and the programme was ahead of targets at year end.

JUDGEMENT

Strapline

The provider meets the requirements on viability set out in the Governance and Financial Viability standard and has the capacity to mitigate its exposures effectively.

This judgement is unchanged from the grading of the previous Viability Report published in November 2011 which stated that 'the group meets the requirements set out in the Governance and Financial Viability Standard of the Regulatory Framework in relation to financial viability'.

Paradigm Housing Group:

- has sufficient funding to meet its current commitments,
- is not reliant on sales to meet interest payments or make a surplus,
- meets and is forecast to meet all covenants with adequate headroom and
- has stress tested its business plan, which is based on reasonable assumptions.
- Social housing rents are compliant with the rent restructuring scheme and all homes meet the Decent Homes Standard.

The operating environment in which housing associations are working is increasingly difficult. The housing and financial markets continue to present significant exposures, and the introduction of the Affordable Rent product creates additional challenges as well as opportunities. In addition reductions in government expenditure, including the funding of Supporting People contracts, and welfare reform will impact on associations.

The programme over the next five years now includes 1,182 shared ownership properties. Although this increases PHG's exposure to the housing market, the plan does not assume any profit from these sales and total surpluses from properties sales do not exceed 15% of net surplus in any year. PHG does not currently have any difficulty in selling its shared ownership properties and sold 77 homes during the first four months of this financial year, with a further 111 reservations on sites yet to complete. Additional sales of uneconomic properties, homes sold under the right to acquire and shared ownership staircasing are also healthy. Total surpluses from asset sales in the first six months of this year exceed the forecast for the year, and the total for last year. The majority of the new rental units will be let at affordable rents of up to 80% of market rent and 48 properties have been converted to affordable rent on re-let in the first quarter of the year. There has been no reduction in demand for these units but prospective tenants are vetted to ensure that the tenancies are sustainable.

Less than 50% of tenants are in receipt of Housing Benefit. PHG operates in an area of low unemployment, but wages are also low. The tenancy sustainment team works with residents to provide financial advice, and PHG works with a credit union to assist residents who may not have access to main-stream banking. Measures such as offering flexible direct debit dates for rent payments and targeting support to those most at risk from future benefit reductions are expected to reduce the potential impact on rent arrears. However, arrears are now forecast at a lower level than historically achieved and this forecast may prove to be ambitious. PHG is also considering introducing a variable service provision whereby non-core services will be priced separately and tenants can opt out in order to reduce outgoings.

Business Plan

PHG now has profitability and customer satisfaction as its two key priorities, with the focus on cutting costs whilst improving services. PHG's aim is to be in the top quartile in terms of low cost and high performance, for the whole sector. The forecast growth in property numbers, combined with increased income from affordable rents and the proceeds from shared ownership sales, results in increasing turnover and surpluses throughout the plan. In addition to new properties being let at 80% of market rent (capped at housing benefit limits where applicable) existing properties which are re-let will also be let at affordable rent where appropriate. Rental income therefore increases by over 50% over the next five years and this, coupled with lower management costs per unit, leads to increasing operating margins. Fewer sales during 2011-12 (which have now completed) led to a reduction in turnover from 2010-11. However, both operating surplus and net surplus increased in the same period, reflecting cost restraint and lower interest payments.

The business plan assumes 2.5% RPI from 2012 onwards and increasing LIBOR rates to 5% by 2015. Maintenance and repairs expenditure is forecast to rise above inflation and bad debts are forecast to increase by 40% over the next five years. These assumptions are reasonable and provide some contingencies against rising costs. Sensitivity testing shows that financial loan covenants can be met under a range of negative scenarios, though gearing is negatively impacted in the short term by a restriction on rent increases below RPI and cash interest cover is most severely affected by a 3% rise in interest rates above base assumptions. EBITDA (MRI) less sales, which the regulator uses to assess a provider's ability to meet interest payments and which eliminates the impact of different accounting treatments for works to existing properties and sales proceeds, is above 110% throughout the plan, confirming that PHG is not dependent on sales to achieve a surplus or meet interest payments.

PHG has fixed the majority of its loans to protect against rising interest rates. Less than £46m of its loan profile is at floating rates. £121m is fixed for less than five years, with the balance fixed for more than five years, at rates between 3.04% and 7.75%. The organisation's exposure to the finance and housing markets are two of the key risks which are reviewed regularly by the board. New financing is under negotiation and it is expected that a further £50m facility will be available by October 2012.

PHG is in negotiation with another provider with a view to it transferring into the group. Due diligence is currently being carried out and if the transfer goes ahead a new group business plan will be produced at that time.

Future Financial Regulatory Engagement

We will continue to receive the standard regulatory returns, quarterly surveys and visit to meet with the management team and board as appropriate.

Appendix 1
Financial highlights includes figures from the underlying financial information, financial ratios are calculated from that information.

Financial Profile

	Actual 2009	Actual 2010	Actual 2011	Actual 2012	Forecast 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2022	Forecast 2032	Forecast 2042
Financial Highlights												
Income and Expenditure (£000)												
Turnover	68,998	72,560	77,270	74,842	99,679	114,034	106,231	106,949	104,844	145,861	255,606	436,306
Operating Surplus	16,906	17,283	25,441	26,942	34,257	37,625	41,596	45,217	48,594	67,855	126,652	226,600
Interest Payable	(22,463)	(21,545)	(24,528)	(23,630)	(24,044)	(27,344)	(30,701)	(32,907)	(35,425)	(47,617)	(76,644)	(82,127)
Surplus for the Year	(4,317)	2,392	3,880	5,173	11,812	11,299	12,125	13,675	14,635	22,320	54,073	151,498
Sales (£000)												
Surplus on Fixed Asset Disposals	1,289	6,724	2,048	1,474	1,599	1,017	1,230	1,365	1,466	2,082	4,064	7,025
First Tranche Sales Income	11,178	11,391	8,890	5,914	22,221	23,571	16,749	5,366	5,198	13,758	24,385	39,885
First Tranche Sales Surplus	(2,180)	(1,308)	311	124	0	0	0	0	0	0	0	0
Financial Ratios												
Balance Sheet Capacity												
EBITDA MRI Interest Cover Excluding FA Sales	62%	64%	93%	118%	118%	119%	122%	126%	128%	138%	165%	270%
Operating Margin MRI	19%	17%	23%	26%	26%	25%	31%	34%	38%	40%	44%	47%
Effective Interest Rate	5%	5%	4%	4%	4%	5%	5%	5%	5%	5%	6%	6%
Net Debt to EBITDA MRI	29.9	30.5	22.6	22.5	19.3	18.0	16.7	15.8	15.3	13.4	10.4	6.2
Net Debt to Turnover	7.3	7.1	8.0	8.1	6.4	5.8	6.4	6.7	7.1	6.6	5.6	3.5
Cost Structure and Efficiency												
Management Cost per Unit (£)	607	583	542	554	532	528	549	561	573	631	768	938
Routine/Planned Maintenance Cost per Unit (£)	948	925	450	421	459	468	481	491	506	576	755	1,002
Major Repairs Cost per Unit (£)	781	1,621	442	1,145	1,205	1,163	1,161	1,168	1,185	1,200	1,479	1,923
Arrears	n/a	11.7%	9.4%	8.8%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Voids	n/a	1.8%	1.3%	0.8%	1.0%	1.0%	1.0%	1.1%	1.1%	1.2%	1.4%	1.5%

Higher first tranche sales income, coupled with additional rental income from new units and conversions let at up to 80% of market rent is reflected in higher turnover and surpluses from 2013.
Major repairs expenditure in 2011 was lower than usual due to an acceleration of the DHS programme.
Arrears at year end did not reflect the cash received but not banked. The true arrears figure was 5%.