



Viability Report

East End Homes L4434

November 2010

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PURPOSE AND INTRODUCTION

The purpose of this report is to form an annual assessment of the financial viability of the association, and of its compliance with the viability element of the Governance and Viability Standard.

This report is based on our assessment of the association's latest Business Plan and supporting Financial Forecast Return approved by the board in July 2010, responses to quarterly surveys (most recently in June 2010), annual accounts for the period 2009/10 and other enquiries we have made in coming to our assessment.

The report may refer to appropriate financial ratios to support its assessment.

Overview

East End Homes (EEH) was established in 2002 to take transfer of 1,465 units from the London Borough of Tower Hamlets in 2005 followed by four subsequent transfers during 2006 and 2007 as part of the Boroughs housing choice program to regenerate housing estates in the borough and bring all stock up to decent homes standard. EEH has a 100% owned subsidiary in East End Homes (Community Development) Limited through which land sales are made.

EEH owns and manages 2,105 rented units and 1,428 leasehold units in the London Borough of Tower Hamlets as at March 2010. Group turnover of £15m is reported in the 2009/10 accounts (2008/09: £13.2m) generating net surplus of £1.7m (2008/09: £1.6m). Its main activity is existing stock investment with £68.1m spent to date. A development program is underway with a private development partner; to date 24 general needs units have been completed with another 186 units on site.

As a stock transfer association, EEH is funded by a 30 year £60m facility from Barclays who review and agree the business plan annually (latest approval September 2010). Peak debt of £54.9m is forecast in 2012/13, compared to the prior year forecast of £51m in 2011/12 due to an increase in the capital program and delays in obtaining planning permissions and granting contracts.

JUDGEMENT

The provider meets the requirements set out in the Governance and Financial Viability standard of the Regulatory Framework in relation to financial viability, however exposures exist which make it vulnerable to deterioration.

This judgement is unchanged from the previous Viability Report published in March 2009, which concluded that 'The association meets the expectations set out in the Regulatory Code in terms of financial viability, however exposures exist which make it vulnerable to deterioration'.

- The latest business plan forecasts continued surplus generation and covenant compliance
- A loan facility of £60m is in place and sufficient to meet stock investment commitments
- Reports to LB Tower Hamlets demonstrate continuing compliance with tenant promises on transfer
- DHS compliance is forecast for December 2010 and is fully funded in the business plan
- Full compliance with rent influencing is expected by the 2012 deadline

In the medium term the group faces a number of key challenges to ensure viability:

- Operating margin improvement from 12% to 30% forecast by 2012
- Capital investment program may be subject to delays or an increase in cost
- Significant land sales program forecast to generate a surplus of £26.8m from 2011 to 2012 to fund capital works

EEH is 5 years into its 9 year regeneration and reinvestment program. Future regeneration and development is funded by the sale of land to Telford Homes for development and drawdown from the Barclays loan facility, of which £29.5m is currently undrawn. Major repairs expenditure of £71.4m is committed from 2009/10 to 2012/13.

A challenging operating margin target of over 30% from 2012 is assumed in the business plan. Failure to achieve this margin will reduce operating cash flows and put pressure on interest cover covenant compliance. This improvement is forecast to be achieved by increasing recovery of leaseholder repairs costs and reduction in service costs. The group audited annual accounts for 2010 report an operating margin of 19.7% which falls short of the business plan projection of 25%. A sensitivity analysis to reduce forecast operating profit to 20% continues to generate an operating surplus and operating surplus interest cover above 100%, however would increase the amount and timing of peak debt.

Capital expenditure of £71.4m is forecast from 2010 to 2014 across the main estates (appendix 2). Any increase in the cost or delay in delivering the capital investment program risk increasing the amount and timing of peak debt. Current peak debt is forecast at £54.9m in 2013 leaving £5.1m of headroom against the £60m facility.

The forecast land sales program is summarised in appendix 3 and is essential to both fund regeneration and stock investment works, and enable development. Sales are made to Telford Homes, a private developer who access social housing grant (SHG) for mixed tenure development. Any future reduction in SHG available to fund social housing development will directly reduce land sales proceeds. The business plan includes sales where full planning permission has been received and a contract for sale agreed with Telford Homes, thus allowing proceeds to be estimated with some certainty and reducing the risk. Land sales in the 6 months to September 2010 are only £3m compared to full year forecast of £9m.

DHS compliance at 30 October is 82.6%, with the majority of failures on St Georges estate. Works are scheduled to commence from October and complete by the December 2010 deadline. This leaves little margin for any time delay in completing the works, however does not have an adverse effect on the viability of EEH.

Future Financial Regulatory Engagement

In addition to the standard regulatory returns

- Monthly DHS compliance reporting and review
- Quarterly update on land sales progress and impact on business plan
- Review of strategy and progress to increase leaseholder repair cost recovery

Appendix 1 - Financial profile table

East End Homes FFR submission summary										
Year ending	Actual 2008	Actual 2009	Forecast 2010	Forecast 2011	Forecast 2012	Forecast 2013	Forecast 2014	Forecast 2015	Forecast 2020	Forecast 2030
Turnover £'000	11,686	12,975	14,312	15,504	16,087	16,026	17,978	15,921	18,194	22,987
Operating Surplus £'000	832	1,615	3,529	4,527	4,915	4,628	6,302	4,038	5,275	6,875
Surplus on Disposal of Land £'000	3,046	577	10,424	9,019	17,732	0	0	0	0	0
Interest Payable £'000	(185)	(757)	(1,443)	(1,880)	(2,578)	(2,867)	(2,999)	(2,883)	(2,706)	(1,611)
Surplus for Year £'000	4,249	1,840	12,511	11,666	20,068	1,761	3,303	1,154	2,569	5,264
Operating margin	7.1%	12.4%	24.7%	29.2%	30.6%	28.9%	35.1%	25.4%	29.0%	29.9%
Operating cash flow	n/a	n/a	(21,586)	(27,458)	(16,464)	(1,588)	5,674	5,357	3,651	4,427
Cash balance	16,210	7,087	1,447	50	50	50	50	50	50	50
Routine / planned maintenance costs per unit £	1,068	1,147	386	559	625	638	651	651	652	795
Major repairs per unit (Including capitalised) £	2,874	6,272	7,434	9,543	5,891	1,720	381	0	737	1,038
EBITDA ratio	978%	366%	296%	325%	231%	197%	244%	179%	238%	517%
Total debt £'000	12,500	21,500	30,500	48,694	49,943	54,891	52,353	49,918	46,422	25,834
Number of units	3,526	3,535	3,514	3,514	3,650	3,700	3,736	3,736	3,736	3,736
Forecast gearing ratio	n/a	n/a	74.9%	87.5%	75.9%	79.9%	75.3%	71.7%	61.1%	28.1%

Source: Forecast data - Group FFR submission based on group business plan update September 2010.

Actual data - FVA submission relating to annual accounts of association.

n/a: Information not available

- Increase in turnover in 2010 driven by £800k of other income and an increase in social housing lettings income as 24 new units come into management in the year.
- Significant increase in operating margin forecast from 12% in 2009 peaking at 35% in 2014. This is driven by a reduction in service costs and greater leaseholder recovery of repair costs. Operating margin of 19.7% was reported in the final accounts for 2010.
- Routine maintenance costs per units appear to decrease in the business plan; however this is due to reclassification of costs in the FFR submission. Analysis of the business plan demonstrates forecast routine maintenance costs are in line with historical costs.
- The increase in capitalised major repairs spend as part of the capital works program results in negative operating cash flow until 2014 when the regeneration program is scheduled for completion. 100% of major repairs are assumed capitalised as component accounting is applied.
- Forecast asset cover ratio based on forecast asset valuation is within the 100% target set by Barclays.

Appendix 2 – Capital investment program

Capital investment summary					
£m	Forecast 2010	Forecast 2011	Forecast 2012	Forecast 2013	Forecast 2014
Mile End All	8.2	14.0	5.7	0.0	0.0
The Island	1.7	1.1	0.1	0.0	0.0
St Georges	8.2	7.9	5.7	2.0	0.0
Holland	0.6	4.8	5.1	2.8	1.1
Glamis	0.1	0.7	0.3	0.0	0.0
Other	0.0	0.5	0.8	0.0	0.0
Total	18.8	29.1	17.6	4.9	1.1

Source: Business plan update September 2010

Appendix 3 – Forecast land sales to Telford Homes

Breakdown of land sales by site	Actual 2010	Forecast 2011	Forecast 2012
British	2,669		
St Georges	2,830		
Bede	3,825		
British Overage			844
St Georges	1,100		
Holland		120	
Eric & Treby		2,800	
British Overage		107	
St Georges & Bede		5,992	
Holland			513
Holland			7,688
St Georges, Bede & Eric			8,688
	10,424	9,019	17,732
% surplus from property sales	83%	77%	88%

Source: Business plan update September 2010

- Land sales to Telford Homes are included in the plan if full planning permission has been received and a contract for sale agreed.
- As land sales represent less than 100% of net surplus, risk is reduced, however if land sales do not occur then regeneration works will not proceed as planned.