THE NATIONAL AFFORDABLE HOMES AGENCY

Central Field financial review

2007-08

HOUSING CORPORATION

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1 EXECUTIVE SUMMARY

At the end of March 2007 Central field was responsible for the regulation of 98 groups and individual associations which owned and managed over half a million homes. Over half of these properties were transferred from local authorities, and the costs associated with the ongoing improvement programmes of LSVT associations continue to dominate the field financial results.

The overall financial performance of RSLs regulated by the Central field at the end of March 2007 was satisfactory and the field in aggregate is financially sound. Associations are generally complying with the financial requirements of the Regulatory Code, and have an acceptable financial condition represented by a green light in their published Housing Corporation Assessment.

The sector continues to grow in terms of assets, turnover and private finance. This is due to continuing new development, investments in assets and new stock transfers, in addition to a general growth in rent levels. Associations are progressing well towards target rent levels without any significant impact on business plans.

Overall the Central field has continued to grow in 2007. Total assets have risen by 8.9%, turnover by 6.9% and debt by 6.6%. Growth has been slower than in the previous year. Growth is represented by new developments and the transfer of stock into the field from four local authorities in 2007.

Operating margins remain under pressure but on average these have increased from the previous year. Increased margins are attributable to LSVTs as on average traditional associations have shown no change. Margins are affected by repair and maintenance spend as associations continue to work towards the Decent Homes Standard (DHS) and rent increases that are constrained as they move to target rents.

The aggregate deficit after tax for the period was reduced by 18% down to £30 million despite the number of LSVTs in the field increasing. Revenue interest charges rose by 5.3% (£22m). Uncertainty over base rates and lending margins for the sector represent a risk for associations.

A further increase in the overall field deficit is predicted for 2008 but thereafter strong improvement is forecast with an overall field surplus predicted in 2009. Costs appear to be well controlled to meet the efficiency agenda. However, the funding of pension deficits and increased pension contributions will have an impact on future cost profiles.

Associations have responded well to the government efficiency agenda with progressive savings being reported. Joint working arrangements have helped secure gains. Initiatives include local management and maintenance agreements, joint procurement and development consortia.

The field has seven associations with over 10,000 units. Together they account for 25% of the field stock, 27% of the field turnover and account for 26% of the net assets.

Associations are continuing to explore diverse activities such as student housing. Financial forecasts indicate some growth but this is not expected to become a material activity for most associations.

The supporting people regime has put pressure on some associations. During the period of this review one association became unviable due to the loss of supporting people contracts. Its residual activities have now been transferred to another association. Generally associations are taking a risk based approach to the financial assessment of supported housing schemes but improvements are still needed in accounting for this revenue stream.

The adoption of the partner approach to development, and the introduction of private developers, has affected the process of allocating social housing grant with most of the allocations made to the lead partners. The prospectus for the 2008-11 development programme sets clear efficiency targets for each investment region.
We and our investment colleagues will continue to monitor the financial position of lead partners and the other associations that contribute to the development agenda.

There is pressure from the Government to increase the number of affordable social housing units with associations expected to contribute to this agenda. Given that for traditional associations in the field interest cover is improving, leverage is low and as there is a significant amount of unutilised security, there appears to be scope to increase borrowing to fund new development. This assumption is supported by analysis work undertaken by the Housing Corporation indicating additional capacity although this analysis shows a reduction from the previous year. The additional capacity for traditional associations appears to be reliant on the sale of assets that are a less predictable source of income and will be affected by the current housing market issues.

Central associations are on track to meet the Decent Homes Standard with 89% of properties meeting the standard by the end of March 2007.

Associations continue to approach the Housing Corporation to discuss mergers and other group structure proposals. The current level of activity suggests that there will be further changes in the coming year. The drivers for consolidation within the sector appear to be the increasing emphasis on operational efficiency and large scale development. We will continue to support proposals that contribute to the effective delivery of housing priorities.

2. INTRODUCTION

This is the fifth report describing the financial condition of regulated social landlords (RSLs) that are regulated by the Housing Corporation's Central field. The Corporation has three offices in the field, Wolverhampton, Leicester and Cambridge covering three government regions, West Midlands, East Midlands and the East of England. The report is a high level analysis based on all associations with over 1,000 units regulated by the field. Previous reports included all associations with over 250 units regulated by the field. Following a review of the regulatory approach, most associations with less than 1000 units are regulated under a lighter regulatory regime from a single office. Prior year figures have been based on the revised dataset. Therefore prior year comparatives differ to previously published reports due to this change.

The Housing Corporation's main sources of information for its assessment of financial viability are the associations' audited accounts but reference is also made to financial forecasts. Despite every effort to specify and define the financial data clearly and unambiguously, its interpretation (and compilation) within and across associations may not always be consistent.

The Corporation has four assessments of viability that are represented by traffic lights in the published Housing Corporation Assessments. If the association meets the expectations set out in the Regulatory Code in terms of financial viability or meets expectations but exposures exist which make it vulnerable to deterioration it is assessed as having a green traffic light. The traffic light is amber if the association's financial viability is of concern. Associations whose financial viability is of serious concern have a red light.

In previous years sub-analysis has been undertaken for LSVTs, black and minority ethnic led associations (BMEs) and specialist housing providers. With the exception of unit numbers, sub-analysis has not been prepared for BMEs and specialist housing providers due to the falling numbers of independent associations in these sectors.

Analysis of LSVTs is included within the main body of the report as a result of the impact that their results have on the performance of the Central field. The nature of early years LSVTs means that they compare unfavourably on a number of key financial ratios. However, as LSVTs mature, the financial results begin to mirror more closely those of developing traditional associations.

All of the ratios used in this analysis are fully documented in the Housing Corporation publication "How we Regulate 5 – Viability" which is freely available from our website www.housingcorp.gov.uk.

2.1 NATIONAL OVERVIEW

- The 2007 Global Accounts shows the sector growing in a strong and balanced fashion. Turnover is up 9.4% to £9,117m, whilst the surplus before tax has grown by 8.4% to £270 m.

- Other highlights from the 2007 figures include:
    - The gross cost/ valuation of associations' housing properties stands at £77.4bn up 10.1% on 2006.

- The global housing association balance sheet remains relatively lowly geared. Adjusted Net Leverage stands at 39.5% down slightly from the previous years figure of 39.8%.
- The sector's external debt passed the £30bn mark for the first time this year.
- However, the increase in debt relative to SHG is largely driven by the transfer of stock from local authorities which are solely debt funded.
- Turnover has risen by 9.4% to £9,117m, whilst operating costs have grown more slowly (by 7.8%) to £7,466m. This means that the operating surplus has risen by 11.7% to £1,417m
- There is continuing growth in surplus on disposal (which has risen by 9% to £542m) however the rate of growth is slowing and the current year's position is down on the 19% increase between 2004-05 and 2005-06.
- The growth in interest costs has remained largely in line with the growth in debt. Total interest payable (including capitalised interest) is up 9.3%, to £1,912m.
- Overall rental income has increased by 7.7% and service charges are up 13.7% giving a combined income of £7,337m. The level of increase has largely been driven by new homes coming into the sector (from both stock transfer and new build).
- The increase on a per unit basis for rent and service change income is 2.3% for all organisations and 2.0% for stock held by traditional associations.
- Associations' cost base is growing at a faster rate than rental income. On a per unit basis management costs increased by 6.7% for all associations. By contrast routine and planned repairs increased by 1.7% per unit for all associations.
- Levels of voids and bad debts remain at historic lows, suggesting continued strong demand for properties, together with good performance on rent collection. Overall void levels were 2.3% (consistent with the previous year) and bad debts also stayed constant at 1.0%.
- Turnover on activities other than social housing lettings totals £1,278m and represents 14.0% of total turnover. Both turnover and expenditure on non social housing lettings activities have remained relatively constant at around 14% and 17% of total turnover and expenditure respectively since 2005.

- At a global level the sector continues to perform well, but there are some distinct challenges emerging for traditional associations, where margins are coming under increasing pressure as the impact of rent restructuring and meeting the Decent Homes Standard begins to be felt.
- It is also clear that traditional associations are more exposed to the housing market than ever before. The widespread development of shared ownership properties means that the business model for many organisations has come to rely on the surpluses generated by sales to fund their development of rented units. As we enter a less benign economic climate this changed business model will be tested more than ever.
- The impact of tighter operating margins and greater sales proceeds for traditionals means that many associations are renegotiating interest cover covenants to include surpluses on disposal. This emphasises that interest cover is the biggest constraint associations' capacity. However, the global accounts also show a wide spread of financial profiles and there are a significant number of organisations who continue to have very robust financial positions.

3. FIELD PROFILE

3.1 Central Field Aggregate Data

	All Associations		LSVT	
BALANCE SHEET				
£'000	**2006**	**2007**	**2006**	**2007**
Fixed Assets				
Housing Properties at cost	12,242,845	13,283,901	2,681,444	2,815,013
Housing Properties at valuation	2,281,878	2,621,537	1,743,622	2,441,322
SHG/HAG	(5,341,180)	(5,739,425)	(448,050)	(523,904)
Other Capital Grants	(288,623)	(303,499)	(60,427)	(74,492)
Depreciation	(322,542)	(406,576)	(101,102)	(140,301)
NET BOOK VALUE OF HOUSING PROPERTIES	**8,572,378**	**9,455,938**	**3,815,487**	**4,517,638**
Other fixed assets - tangible	222,188	246,970	83,339	106,309
Other fixed assets - intangible	1,108	3,751	2,450	2,450
Other fixed assets - investments	193,100	118,047	11,313	11,103
Homebuy - Loan	80,597	85,431	45,112	45,021
Homebuy - Grant	(80,443)	(85,260)	(44,958)	(44,867)
TOTAL FIXED ASSETS	**8,988,928**	**9,824,877**	**3,912,743**	**4,637,654**
Current Assets				
Non Liquid Current Assets	218,972	260,585	115,733	170,459
Cash and Bank	142,905	137,772	42,060	46,995
Short term investments	137,764	115,360	45,655	32,745
Other current assets	396,797	509,561	153,894	241,053
TOTAL CURRENT ASSETS	**896,438**	**1,023,278**	**357,342**	**491,252**
Current Liabilities				
Short term loans	104,317	75,407	2,505	12,918
Bank Overdrafts	15,507	5,873	3,371	3,920
Other current liabilities	529,721	584,532	254,557	288,575
TOTAL CURRENT LIABILITIES	**649,545**	**665,812**	**260,433**	**305,413**
NET CURRENT ASSETS/LIA (excl pens)	246,893	357,466	96,909	185,839
Pension Assets	(38,209)	(58,035)	(38,209)	(55,794)
NET CURRENT ASSETS/LIA (inc pens)	208,684	299,431	58,700	130,045
TOTAL ASSETS LESS CURRENT LIABILITIES	**9,197,612**	**10,124,308**	**3,971,443**	**4,767,699**
Financing and Reserves				
Long term loans	7,189,188	7,697,050	3,299,995	3,631,867
Other long term creditors	140,769	358,398	76,100	309,695
Provisions	51,312	98,898	46,173	93,517
Accumulated Surplus	334,993	259,366	(509,129)	(587,283)
Designated Reserves	189,405	204,596	14,225	17,406
Restricted Reserves	24,168	25,509	11,089	12,007
Revaluation Reserves	1,227,796	1,435,858	1,007,536	1,265,193
Pension Reserves	39,981	44,633	25,454	25,297
TOTAL FINANCING AND RESERVES	**9,197,612**	**10,124,308**	**3,971,443**	**4,767,699**

Central field

INCOME & EXPENDITURE ACCOUNT	**All Associations**		**LSVT**	
£'000	**2006**	**2007**	**2006**	**2007**
Turnover	1,871,354	1,999,959	793,335	937,967
Operating Costs	(1,587,575)	(1,676,944)	(762,341)	(854,031)
Cost of sales	(25,710)	(17,861)	(4,509)	(1,701)
Exceptional items	(3,958)	(864)	125	(864)
OPERATING SURPLUS (Def)	**254,111**	**304,290**	**26,610**	**81,371**
Profit on sale of fixed assets	95,435	90,705	48,206	43,923
Gift aid	(4,244)	(4,387)	5,299	654
Other items	8,558	1,021	(1,014)	(2,389)
Interest Receivable and other income	31,594	29,451	5,776	5,762
Interest payable and similar charges	(416,527)	(438,542)	(179,445)	(203,559)
Exceptional items relating to early redemption of loans	(2,165)	(12,208)	(843)	(6,659)
DEFICIT ON ORDINARY ACTIVITIES BEFORE TAX	**(33,238)**	**(29,670)**	**(95,411)**	**(80,897)**
Corporation tax	(4,422)	(1,111)	(4,478)	257
DEFICIT ON ORDINARY ACTIVITIES AFTER TAX	**(37,660)**	**(30,781)**	**(99,889)**	**(80,640)**

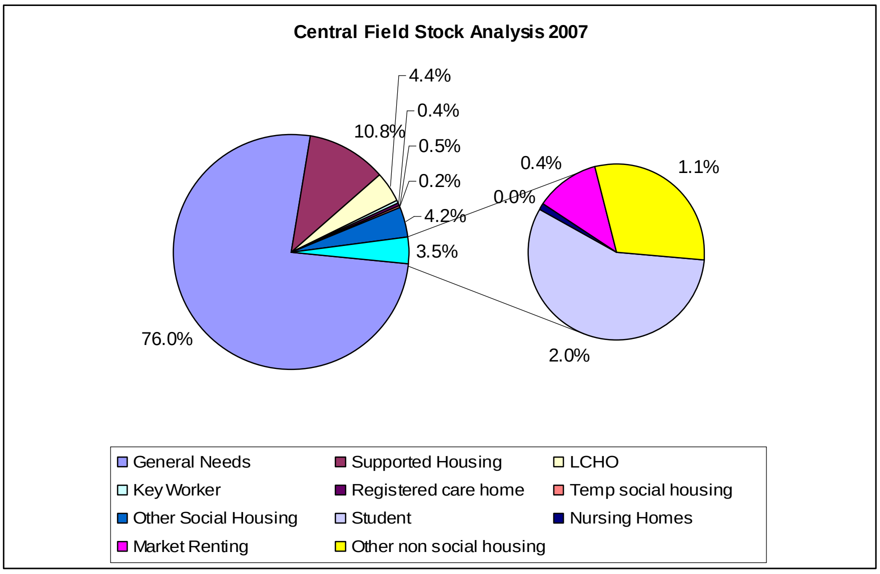
Central field all associations £'000	**2005**	**2006**	**2007**
Turnover	1,720,379	1,871,354	1,999,959
Operating Costs and costs of sales	(1,473,282)	(1,613,285)	(1,694,805)
Exceptional Items	(3,415)	(3,958)	(864)
Operating surplus	243,682	254,111	304,290
Surplus on social housing lettings	231,854	249,725	299,060
Net interest payable	(378,559)	(416,527)	(438,542)
Profit on sale of assets	85,555	95,435	90,705
Deficit for the year	(26,737)	(37,660)	(30,782)
%age			
Operating margin	14.2	13.6	15.2
EBITDA interest cover	95	89	97
EBITDA interest cover adjusted for capitalised repairs	52	50	60
EBITDA interest cover adjusted for capitalised repairs and surpluses from fixed asset sales	74	72	80
SBIT as a % of total assets	2.6	2.5	2.5
Cash cost of capital	2.6	2.5	2.4
Margin over cash cost of capital	(0.1)	(0.1)	0.1
Adjusted net leverage	47	49	49
Debt per unit £	13,061	14,287	14,620
Growth in turnover %		8.8	6.9
Growth in total assets %		11.1	8.9
Growth in total debt %		15.9	6.6

The 2006 figures have been re-stated from the previous field financial review due to a number of changes in the dataset. For the year ended 31 March 2007 only those associations with in excess of 1,000 units were required to submit an electronic version of their financial statements. Those associations with less than 1,000 units have therefore been removed from the comparative figures. The comparative figures are therefore not those calculated and published in the 2006 review.

As at the 31st March 2007 the Central field regulated 98 registered groups and/or associations with more than 1,000 units in ownership or management. Within this population there were 28 group structures that accounted for 45 of the registered associations. These figures are constantly changing as registrations, mergers and amalgamations continue to be popular activities. Associations are included in the review because the parent organisation is regulated by Central field, usually because the head office is located within the geographical boundaries of the East of England, East Midlands and West Midlands government regions. The table below shows an analysis of units owned and/or managed by associations regulated in the Central field based on statutory accounts up to 31st March 2007.

Breakdown of Units in Central Field by Category

	2005 Units	2006 Units	2007 Units	2005 %age	2006 %age	2007 %age
General Needs	384,689	398,385	404,049	79.87	78.04	76.00
Supported Housing	37,072	45,847	57,534	7.70	8.98	10.82
LCHO	19,306	18,897	23,197	4.01	3.70	4.36
Key Worker	1,582	1,970	1,891	0.33	0.39	0.36
Reg Care Homes	2,763	2,738	2,415	0.57	0.54	0.45
Temp SH	1,070	1,019	1,147	0.22	0.20	0.22
Other SH	20,264	25,024	22,518	4.21	4.90	4.24
Student	8,402	9,772	10,641	1.74	1.91	2.00
Nursing Homes	1,011	996	213	0.21	0.20	0.04
Market Rented	2,399	2,009	2,234	0.50	0.39	0.42
Other NSH	3,081	3,849	5,784	0.64	0.75	1.09
Total NSH	**14,893**	**16,626**	**18,872**	**3.09**	**3.25**	**3.55**
Total Stock	**481,639**	**510,506**	**531,623**	**100**	**100**	**100**



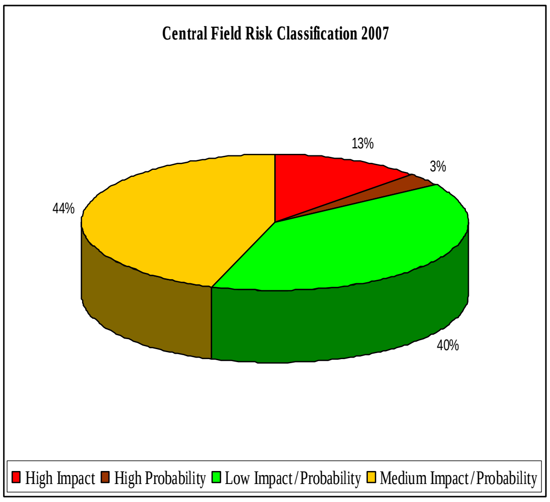
Breakdown of Units in Central Field by Association Type

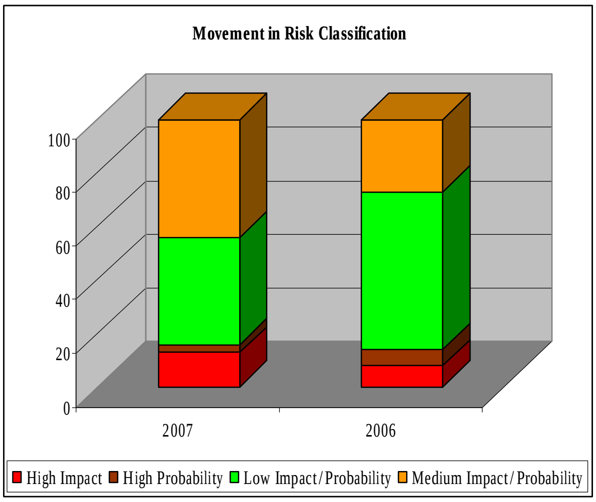
	2005	2006	2007
All HAs			
Total Social Housing Units	466,746	493,880	512,751
Total units	481,639	510,506	531,623
Traditional			
Total Social Housing Units	230,511	236,904	230,525
Total units	240,896	251,304	246,245
LSVT			
Total Social Housing Units	230,702	246,954	274,870
Total units	235,210	249,180	278,022
BME			
Total Social Housing Units	3,277	6,914	3,866
Total units	3,277	6,914	3,866
Specialist			
Total Social Housing Units	2,256	3,108	3,490
Total units	2,256	3,108	3,490

At the end of 2006/07 there were only two BME associations and two specialist associations regulated from the Central field. In order to preserve their anonymity these four associations have been included in the traditional sub-sector analysis in this report.

3.2 Risk based regulation

From April 2005 the Housing Corporation introduced risk based regulation. This style of regulation is based on a risk assessment via a risk tracking model of all lead regulated associations. The risk tracking model allows us to assess the probability and impact of significant risks in each lead regulated association. Each association has then been graded as low, medium or high risk, with a differential between high risk due to a high impact arising from the size of the organisation and high probability due to the association being involved in risky activities or potential problems arising due to weaknesses in governance, management or viability. The 2007 risk profile of the Central field is illustrated by the following diagrams:





Between 2006 and 2007 there has been a movement in the risk classifications of the organisations in the Central field from low impact/probability to medium impact/probability.

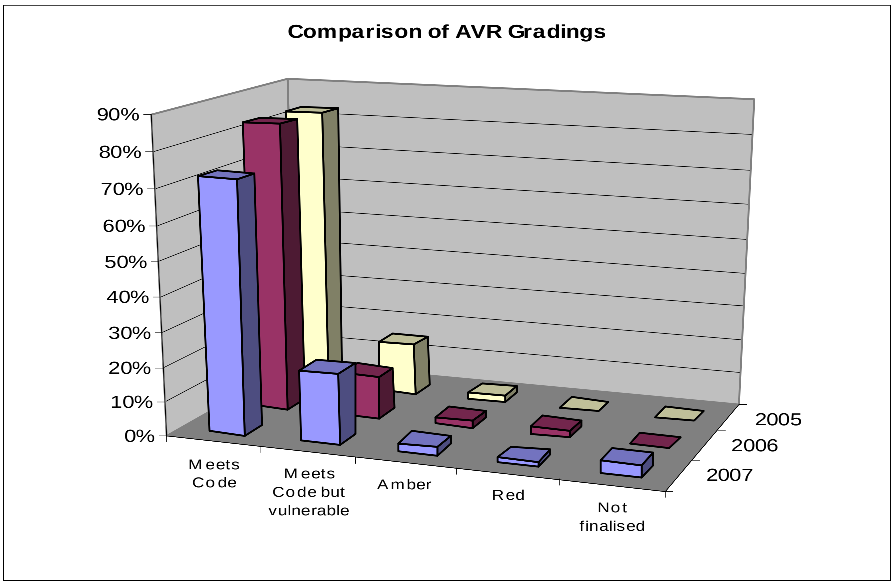
"How we Regulate 5: Viability" introduced four new strap lines as discussed in the introduction to this report. The review of the financial returns submitted in the Central field concluded that the majority of associations complied with the Regulatory Code with 93% Housing Corporation viability assessments being graded green (4% of assessments remain outstanding) compared to 96% being graded green in 2006.

Of the two associations graded amber in the previous year, one has now been transferred into a group the other remains amber with a further association graded amber in 2007.

Two associations received a red grading in 2006; one has now been upgraded to amber and one transferred to a group. A further association has been graded red during 2007 and this association is under supervision enforcement action. This association is to transfer to a group in 2008.

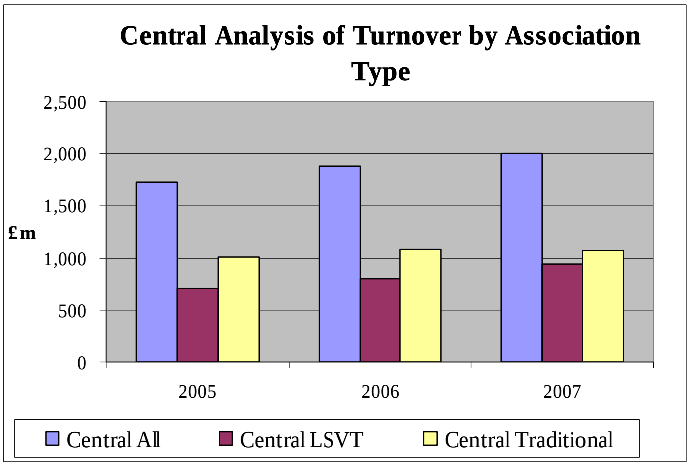
There were fewer AVRs issued in 2007 mainly as a result of the transfer of the majority of associations who own 1,000 units or less to be regulated by the RASA team. Where significant issues have arisen organisations with less than 1,000 units have remained with the regulation team. There were also changes arising as a result of a number of associations entering into group structures. This has resulted in either consolidated returns being submitted or the regulation of the association transferring to the field regulating the new parent association.

Although the majority of assessments are green traffic lights, there has been an increase in the number of associations who are considered vulnerable to deterioration as shown by the following graph. The majority of these are based in the West Midlands.



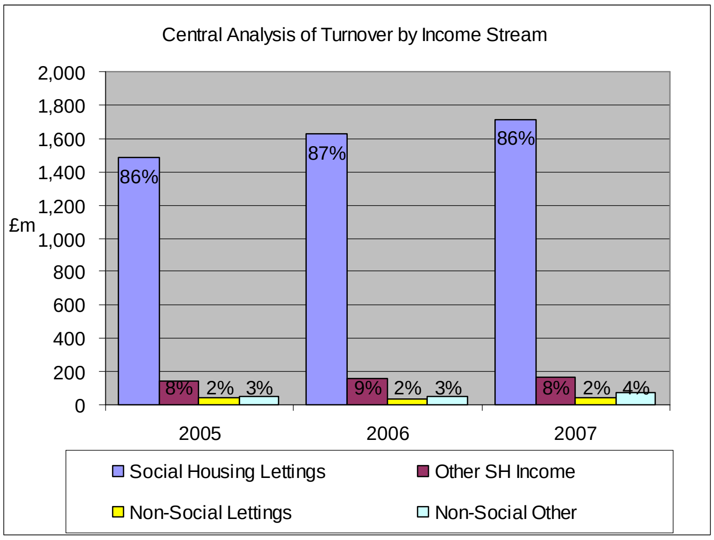
3.3 Turnover

£m	2005	2006	2007
Central LSVT	710	793	938
Central Traditional	1,010	1,078	1,062
Central all	1,720	1,871	2,000
Social Housing lettings	1,483	1,625	1,714
Social Housing other income	145	161	168
Non-social lettings	40	35	46
Non-social other income	52	50	72
Central all	**1,720**	**1,871**	**2,000**



The total turnover of Central field housing associations in the year to March 2007 was £2,000 million, an increase of £129 million, or 6.9%, on the previous year. The largest apparent percentage increase is in LSVT associations with an increase of over 18%. 9% of this increase arises from new LSVTs. The true LSVT growth in turnover is 9% as the 2007 total data is distorted by the inclusion of four newly registered transfer associations whose data did not feature in the previous year's data.

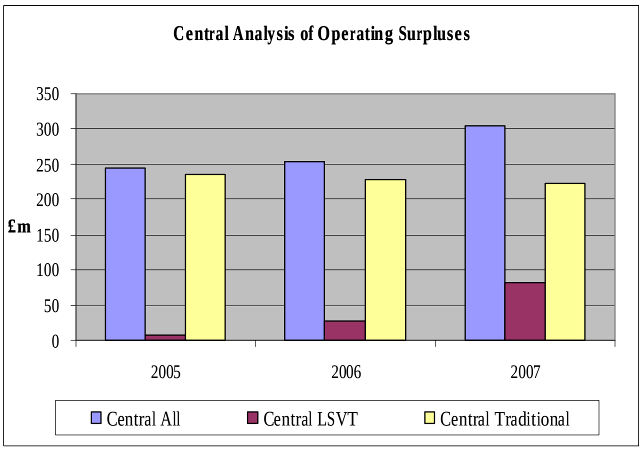
The apparent fall in turnover for traditional associations is misleading. There is one significant association whose data does not feature in the 2007 data and accounting policy changes at two other associations distort year on year comparison. Excluding these anomalies results in an overall growth of just below 10% that compares favourably with the national average growth rate of 8.7%.

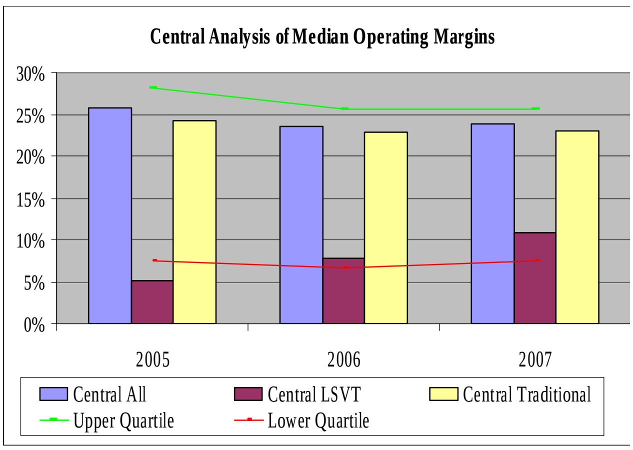


A more detailed analysis shows that all categories of income grew in 2007. The largest increase of £89m was in social housing lettings reflecting annual rent increases and new development. Non-social housing lettings and other non-social activities both showed strong growth together of 39%. This turnover represents only 5.9% of total turnover up from 4.5% in the previous year. This indicates that associations might be increasing the level of diverse activities but this cannot be stated with certainty due to the anomalies referred to above. Capacity model forecasts indicate that non-social housing turnover will only increase very marginally over the next five years. This forecast position remains unchanged from our last field review.

3.4 Surpluses

£m	2005	2006	2007
Operating surplus			
Central LSVT	8	27	81
Central Traditional	236	227	223
Central all	244	254	304
Net surplus before tax			
Central LSVT	-102	-95	-81
Central Traditional	76	62	51
Central all	-26	-33	-30





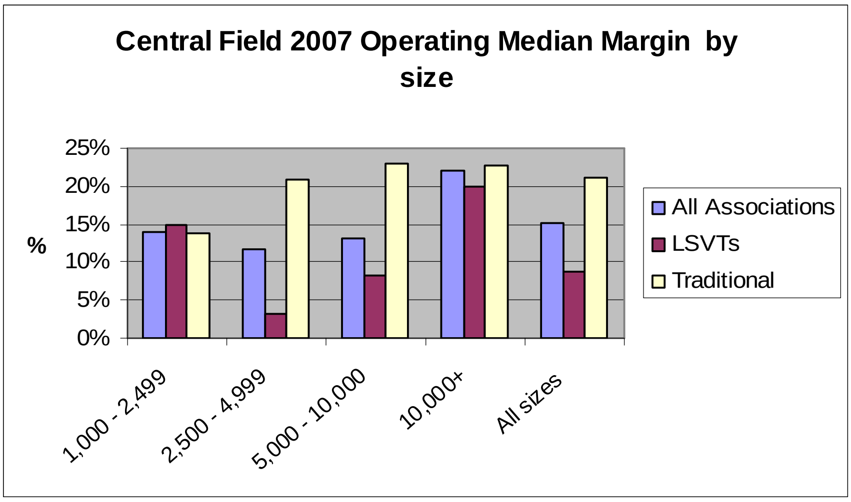
The analysis of aggregated operating surpluses shows that overall in the Central field there has been a year on year increase. Whilst the traditional sector has reported a year on year reduction, the LSVT sector has shown strong annual growth. This same general pattern is seen in the operating margin ratios with a strong growth in the LSVT sector offsetting modest reductions in the traditional sector. However, the average operating margins of the LSVT sector have some considerable way to go to reach the levels achieved by the traditionals.

The 2007 growth in overall operating margin reflects a turnover growth that exceeded the rate of growth of operating costs including costs of sales and exceptional items. Turnover increased by 6.9% but operating costs (excluding costs of sales and exceptional items) rose by only 5.6%. Cost of sales and exceptional costs reduced by 37% (£11 million). Operating margins are under pressure due to restrictions in income growth, due to rent restructuring, and increasing operating costs driven by the requirements of the Decent Homes Standard and inflation assumptions. The overall growth for the field is largely a result of the maturity of a number of LSVTs that have come to the end of their period of heavy expenditure on major repairs and reimprovements.

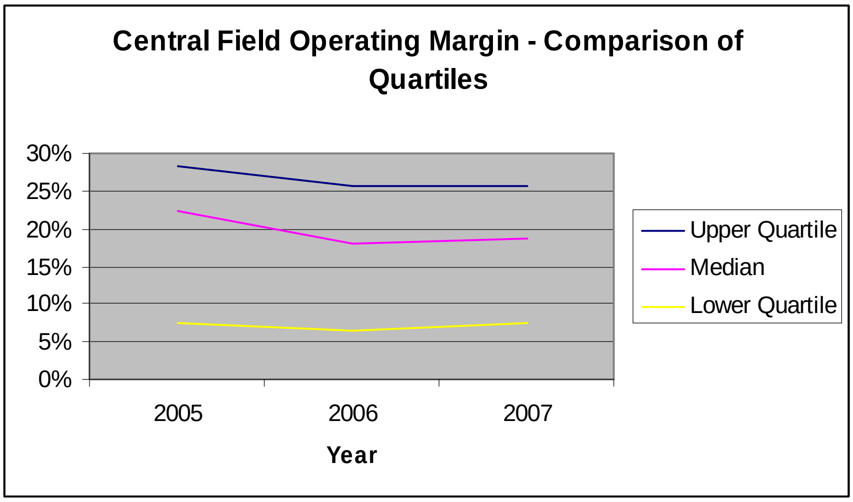
Central field's average operating margins are suppressed by the number of LSVTs in the field with the stock numbers of LSVTs exceeding that of the traditional sector for the first time in 2007. Whilst operating margins have been decreasing for traditional associations, the results for LSVTs were more severely affected up to 2005. 2006 saw a reverse in the trend for LSVTs. Interestingly the total revenue repair costs per unit of LSVTs increased by less than inflation in 2007 despite four new registrations that would be expected to have had heavy expenditure per unit that could adversely impact on the average per unit. Conversely, traditional associations reported a 6.4% increase in the expenditure per unit on total revenue repairs costs having an impact on this sector's reduction in operating margins.

Traditional associations have experienced year on year reductions in operating margins largely as a result of an annual growth in the per unit expenditure on major repairs as associations progress towards meeting the Decent Homes Standard. In 2006 major repairs revenue expenditure per unit grew by 24.3% for Central traditional associations followed by an increase of 4.1% in 2007.
In 2006 major repairs revenue expenditure per unit grew by 25.0% for LSVT associations followed by a reduction of 14.5% in 2007. If major repairs revenue expenditure is excluded, traditional associations saw expenditure per social housing unit increase by 5.3% in 2006 followed by a fall of 2.8% in 2007. Comparative figures for LSVTs show a reduction of 5.8% in 2006 and an increase of 5.7% in 2007. In 2007 the revenue cost per social housing unit inclusive of major repairs was higher for LSVTs than traditional associations but this is reversed if major repairs are excluded.

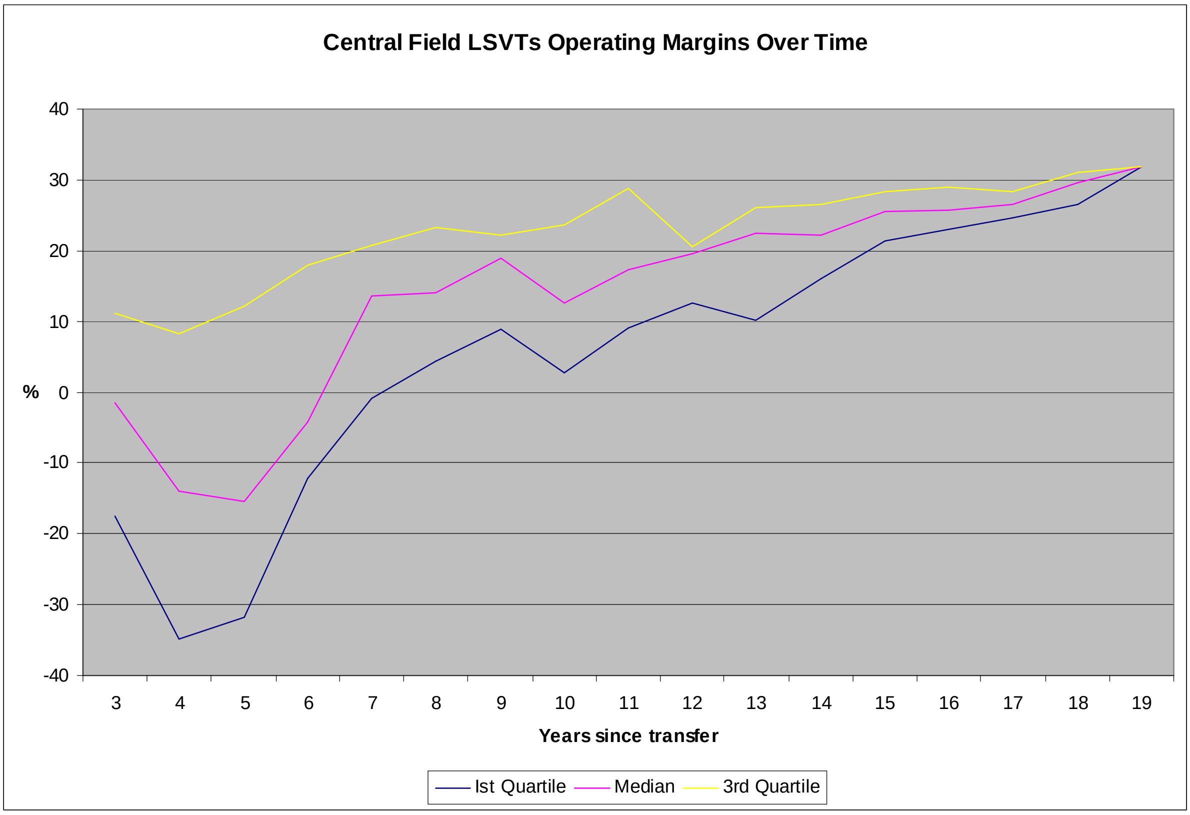
The Central field total surplus on social lettings activity increased by over £49 million, or 19.7%, far exceeding the increase in turnover from social lettings of 5.5%. The performance in other activities showed a strong increase in turnover of 14.9% but suffered an increase in costs of 15.4%. This resulted in a decrease in surplus on other activities of £0.48 million to £5.3 million. A reduction in profit on sales of fixed assets of 4.9% from £95.4 million to £90.7 contributed to the overall surplus reduction in the year.

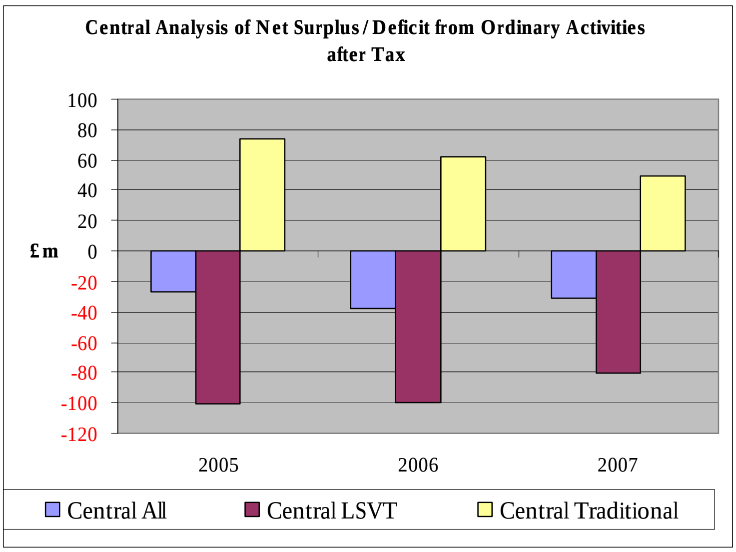


The adjacent graph shows that generally operating margins improve with size through the benefit of economies of scale, and that traditional associations generate higher operating margins than their LSVT peers in all size categories except the smallest.



The graph opposite illustrates the modest increase in the operating margin for the Central field in 2007. Operating margin forecasts taken from capacity models suggest a steady increase over the next few years as turnover increases but operating costs remain relatively static. These forecasts appear be linked to the efficiency agenda, merger savings and a reduction in revenue expenditure on repairs in relation to the Decent Homes Standard. This growth is very modest in traditional associations but is significant in LSVT associations. The following graph shows the trend in LSVT operating margins over time. As LSVTs mature their margins mirror more closely those of traditional associations.



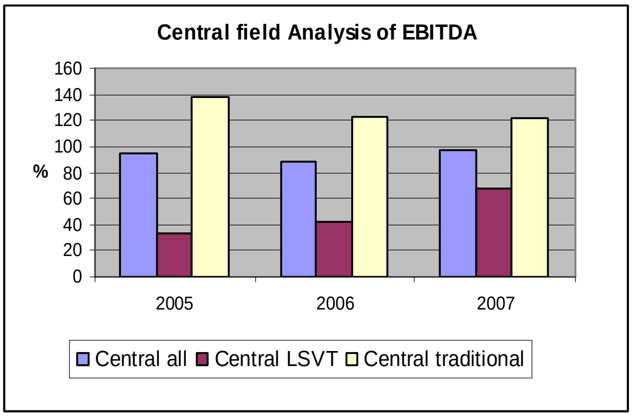


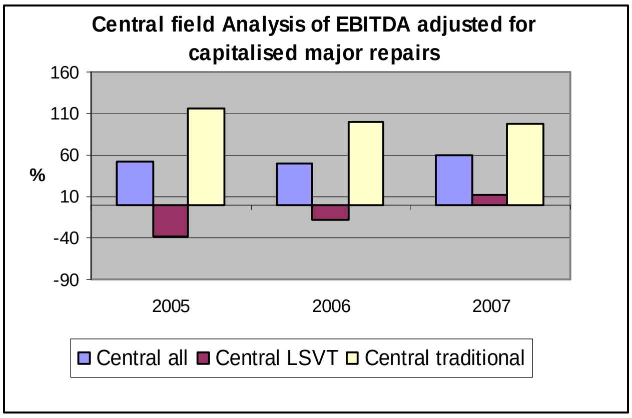
The net surplus/deficit position reflects a similar trend to the operating surplus. The total field position is heavily influenced by LSVTs and the rapid growth in interest costs over the early years of their existence, although additional borrowing to fund Decent Homes Standard repairs is also a key factor.

Despite the overall fall in net surplus, a significant feature of the results for traditional associations is the contribution to the net surplus from profits on fixed asset disposals. Of the net profit after tax of £50 million, £47 million (94%) comes from profits from the sale of fixed assets. A number of associations depend upon the sale of fixed assets, essentially properties to generate a surplus. This is mainly the sale of properties developed in the past as part of an asset management strategy and staircasing sales from shared ownership schemes. It also includes right to buy sales that are a notable feature of LSVT accounts. All traditional associations made a surplus after tax. There were 19 traditional associations in the Central field that might have been in deficit if profits had not been made on fixed asset disposals. This can not be asserted with certainty because the associations might well have adjusted expenditure in response to the emerging deficits. There were 10 traditional associations in a similar position in 2006. Of the 52 LSVT associations, 34 made a deficit after tax but this would increase to 39 if profits from fixed asset sales were excluded. Capacity model forecasts indicate some reduction in the profit from fixed asset disposals in the short term but steady growth thereafter. The model forecasts predict a higher net deficit for 2007-08 but then strong annual improvements with an overall field surplus forecast for 2008-09 onwards.

3.5 Interest cover

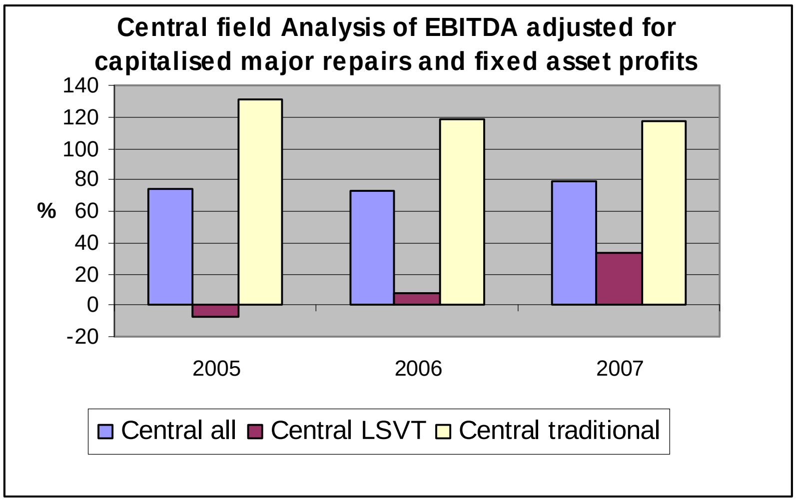
The Housing Corporation benchmark for EBITDA (earnings before interest, tax, depreciation and amortisation) for traditional associations is set at 110%. The EBITDA level for LSVT associations is tailored to each individual association's business. The first graph below shows that Central traditional associations on average meet the benchmark but that there is a trend of deterioration.



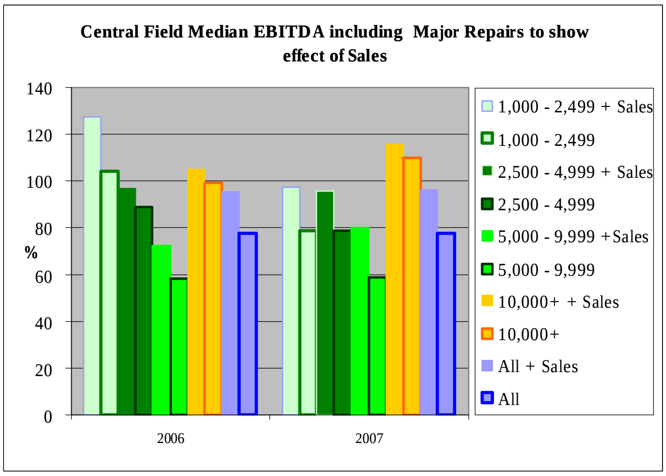


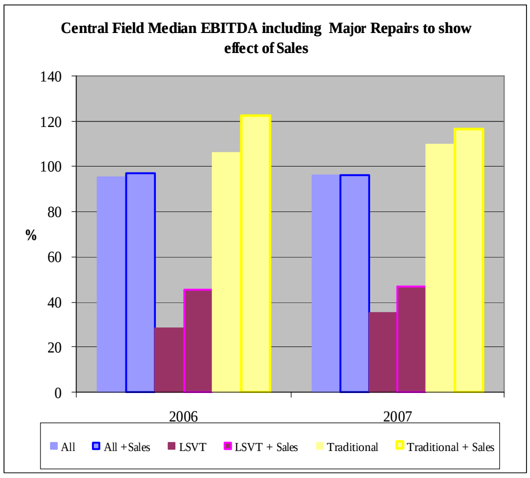
However, accounting policies in respect of the capitalisation of major repairs vary considerably between associations. In order to make the data comparable, the second graph above shows EBITDA after adjusting for capitalised major repairs. This shows that on average in 2006 and 2007 traditional associations did not meet the Housing Corporation's benchmark. A sustained low level in the future would indicate little capacity to absorb any deterioration in the operating position. Forecasts taken from capacity models show that on average traditional associations do expect to meet the less refined Housing Corporation benchmark in 2008 and will not meet the EBITDA MRI until after 2012. EBITDA levels for existing LSVTs are expected to show strong growth as would be expected with the less refined EBITDA meeting the Housing Corporation benchmark by 2011 and EBITDA MRI achieving it in the following year.

As referred to earlier, a significant feature of association's accounts is the effect of profits derived from the sale of fixed assets (primarily property disposals). A further EBITDA measure has been calculated that recognises that the profit generated from

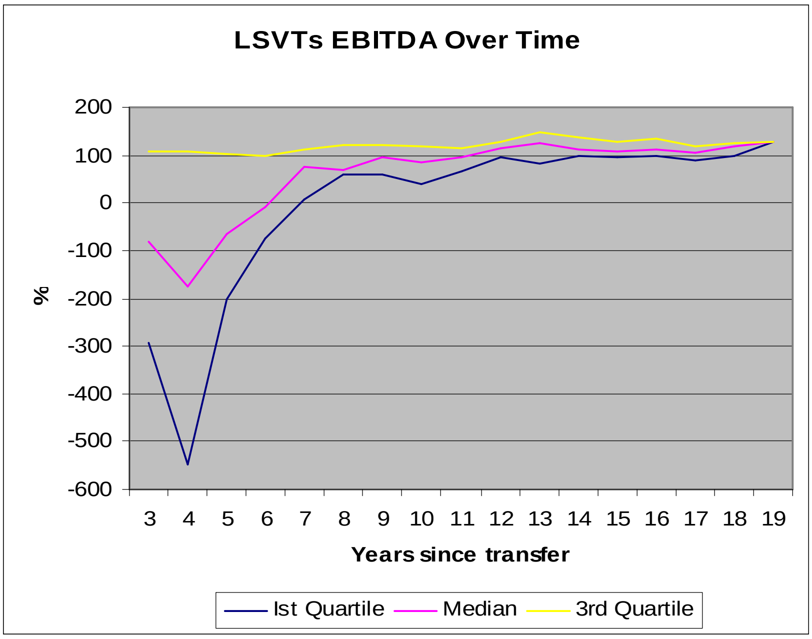


fixed asset sales is also available to service interest costs. The adjacent graph reflects this adjustment and shows that on average traditional associations exceeded 110% in all three years giving some comfort. Capacity model foreceasts indicate that this will improve progressively.

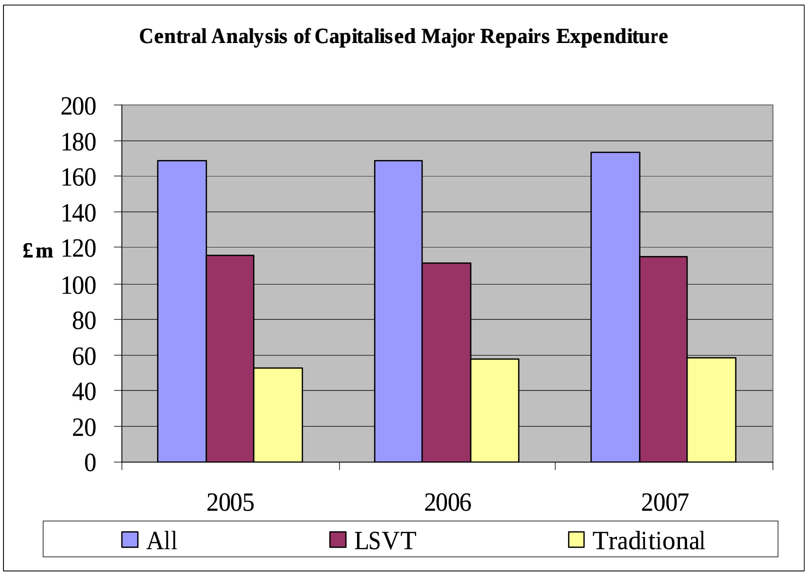




The graphs above and give a comprehensive picture of the effect that adding profits from sales of fixed assets has had on the median EBITDA ratio adjusted for capitalised major repairs over the last two years. Overall the traditional sector has shown modest decline and generally the larger sized associations have shown improvement.



The performance of LSVTs in 2007 again had a significant impact upon the overall results of the Central field. The graph opposite shows the results of LSVTs over time and illustrates the volatility of the results in the first five years when it is common for the major repairs works to be completed. The median reaches around 100% 11 years after the transfer which is consistent with the period identified in the previous report.



The adjacent graph shows the increase in capitalised major repairs expenditure over recent years. Expenditure has increased due to the growth in number of LSVTs that have significant improvement programmes. There were an additional four LSVTs in 2007 but none in the previous year. The increase in capitalised major repairs is also due to traditional associations accelerating work required to meet the Decent Homes Standard. Capacity forecasts indicate that the growth in capitalised major repairs expenditure will reduce after 2009/10 and increase thereafter by inflation. EBITDA levels should steadily improve as work to meet the Decent Homes Standard is completed and LSVTs mature.

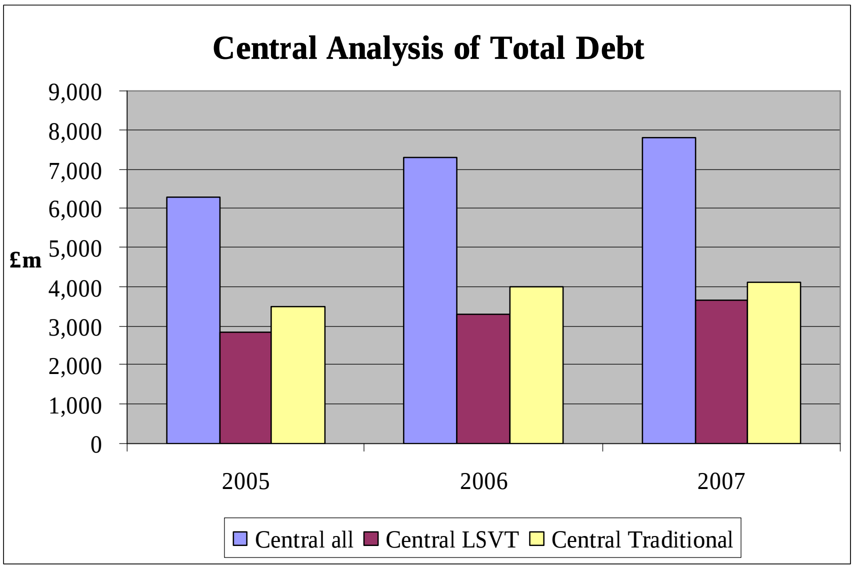
Interest cover ratios can also be suppressed due to development activity where interest charges on loans financing new developments occur prior to rental income being generated on the developed units. Nevertheless aggregated figures for Central field lead development partners (excluding LSVTs) showed a marked improvement in interest cover in 2007.

3.6 Debt

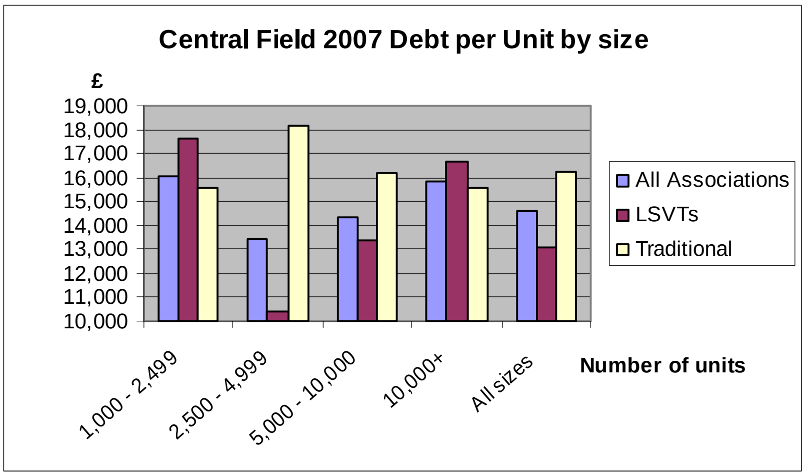
Central Analysis of Debt

£m	2005	2006	2007
Central LSVT	2,813	3,306	3,649
Central Traditional	3,487	4,003	4,129
Central all	**6,300**	**7,309**	**7,778**
Short term loans	52	104	75
Bank overdrafts	10	16	6
Long term loans	6,238	7,189	7,697
Central all	**6,300**	**7,309**	**7,778**

Loan debt in Central field continues to grow increasing by an average rate of 6.4% in 2007, increasing by £469 million to £7,778 million. LSVT debt increased by 10.3% whereas the traditional sector debt increased by just 3.6%. The rate of growth in debt was greater for LSVTs, as would be expected as the associations draw heavily on debt to finance the improvements to stock agreed at transfer. The expenditure required by all associations to meet the Decent Homes Standard is also responsible for some of the increases currently being seen. Capacity model forecasts suggests the total debt will increase at a much higher rate (almost 16% in 2008 alone), increasing by over 62% in the next five years. The total debt will actually increase to higher levels when new stock transfers not included in the forecasts are registered. The continued ability of associations to raise additional debt is discussed in part 8.



The unadjusted EBITDA cover achieved by traditional associations during the period between 2005 and 2007 reduced from 138% to 121% whilst the total debt increased by 18% (£642 million). The decreasing trend in the ratio reflects the increases in debt to fund development and meeting the Decent Homes Standard.



The adjacent graph shows that on average the smaller associations in the Central field have a the highest debt per unit. This is heavily influenced by the LSVT results that comprise five associations of which four have completed their major repairs programme some time ago. LSVTs usually display an accelerating debt per unit up to the point of reaching peak debt when debt starts to be repaid. The age profile of LSVTs will therefore affect the level of debt per unit. Generally the highest debt per unit was found in those associations with over 10,000 units.

Association's forecasts include assumed levels of development. Actual investment in new properties may vary somewhat from forecast making it difficult to predict with any certainty the growth in debt and growth in debt per unit for the field. The capacity model forecasts show that debt per unit is increasing steadily over the initial five years followed by some reductions. Debt per unit is expected to increase by an average of 44% over the next five years.

LSVT associations have reported a lower effective interest rate than traditional associations due to LSVTs having fixed large amounts of debt in recent times when interest rates were relatively low. Traditional associations have some much older debt that was negotiated when interest rates were far higher. Nevertheless the traditional associations have shown a continuing trend of reducing effective interest rates.

Recent turmoil in the financial markets is expected to have an affect on the number of funders offering loans to the sector and to adversely affect the pricing of new debt.

3.7 Adjusted Net Leverage

The RSL sector’s two main sources of capital finance are social housing grant (SHG) and debt. The purpose of the adjusted net leverage ratio is to demonstrate what percentage of the adjusted assets (i.e. adding back SHG) is made up of debt.

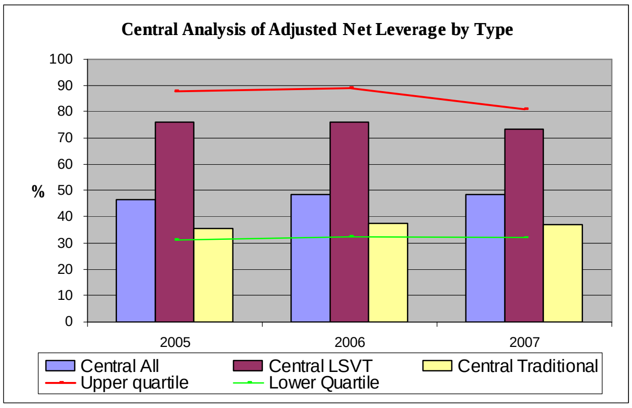
Central Adjusted Net Leverage

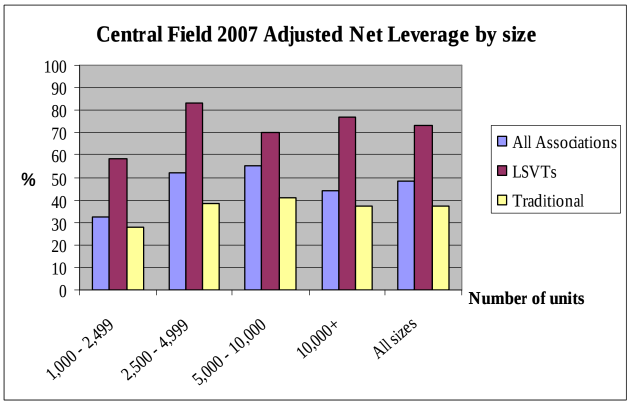
%	2005	2006	2007
Central all	46.62	48.69	48.58
Central LSVT	83.55	86.15	83.62
Central Traditional	35.49	37.41	37.26

In 2007 the debt of the field rose by 6.4% to £7.8 billion. This compares to a 7.63%increase in capital grants, to £6.0 billion. The overall impact of this was to marginally reduce the adjusted net leverage.

There is a fundamental difference between the balance of funding between LSVTs, that are almost wholly debt-financed, and traditional associations, that have historically had more SHG funding. As a result adjusted net leverage for LSVTs was 83.6%, but only 37.3% for traditional associations.

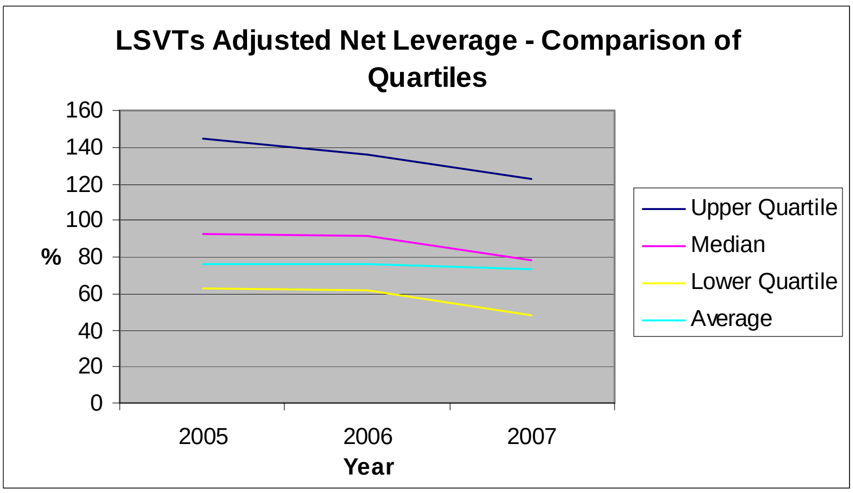
Over recent years average gearing for the Central field has grown modestly due to the impact of the growth in LSVT associations whose existence in the early years is predicated on high levels of debt relative to asset values. Traditional associations on average have shown no significant movement in adjusted net leverage over the last 3 years. The quartile range for adjusted net leverage for traditional associations in 2007 ranged from 28% to 41% which is narrower than the previous year as a result of the lower quartile increasing from 15% but little change to the upper quartile. Nevertheless, the ratio still indicates potential spare capacity within this group of associations.





The relationship between the size of an association and its debt level is illustrated in the graphs above that show that the highest level of adjusted net leverage in the Central field was in associations with between 2,500 and 5,000 units for both LSVTs and 5,000 and 10,000 for traditional classifications. Traditional associations would appear to have available asset value to increase leverage but the limiting factor would be the ability to service additional debt.

LSVTs have high initial funding requirements and are reliant on long term cash flow forecasts.This results in high adjusted net leverage as shown above and adjacent. The level of adjusted leverage for LSVTs is not a cause for concern as these levels are consistent with expectations but we would expect to see improvements in the long term.



Capacity model forecasts show that the adjusted net leverage for the Central field is expected to increase gradually for the next five years and then modestly reduce. This will in part be a result of some associations only forecasting development over the first five years of their forecast.

4 Sector Growth

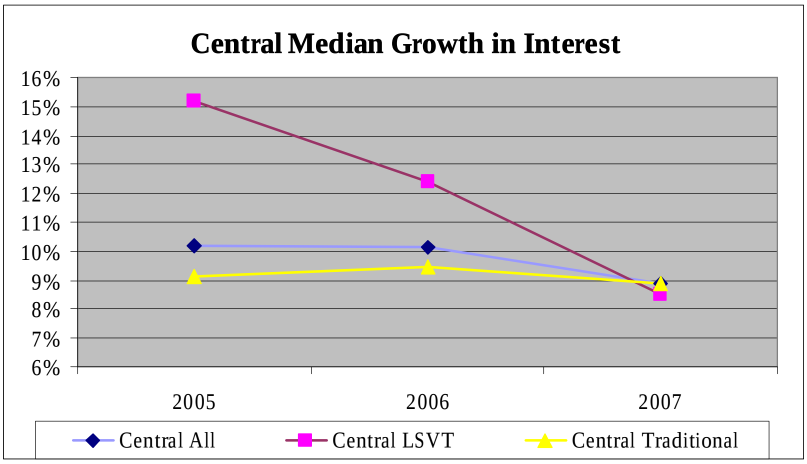
Ratio	Statistic	2005 Traditional	2006 Traditional	2007 Traditional	2007 LSVTs
Growth in turnover	**Aggregate average**		**6.8**	**(1.5)**	**18.2**
	First quartile	9.1	9.8	12.0	8.9
	Median	5.9	5.5	6.4	5.8
	Third quartile	2.7	2.9	3.7	4.2
Growth in SBIT	**Aggregate average**		**1.9**	**(2.4)**	**62.6**
	First quartile	17.2	10.7	15.4	32.3
	Median	9.4	0.6	7.7	6.7
	Third quartile	(1.3)	(10.5)	2.7	(22.9)
Growth in interest payable	**Aggregate average**		**10.5**	**0.7**	**12.5**
	First quartile	15.5	15.3	17.4	23.5
	Median	9.1	9.5	8.9	8.5
	Third quartile	5.8	2.4	2.5	2.2
Growth in total assets	**Aggregate average**		**8.0**	**4.0**	**19.9**
	First quartile	9.8	12.8	11.4	16.7
	Median	5.9	6.4	7.4	8.6
	Third quartile	2.7	4.1	4.4	5.1
Growth in total debt	**Aggregate average**		**14.7**	**3.4**	**10.4**
	First quartile	15.6	21.8	20.4	12.1
	Median	8.6	11.8	11.9	6.8
	Third quartile	3.3	6.0	0.8	0.7
Growth in total Capital and reserves	**Aggregate average**		**4.4**	**4.5**	**26.5**
	First quartile	7.3	7.1	7.8	35.9
	Median	4.6	3.3	5.1	13.6
	Third quartile	2.3	1.1	2.4	4.7

The growth ratios show that the LSVT part of the field is growing at a strong rate but that the rate of growth for the traditional associations has been declining following very strong growth in the previous year.

Growth in turnover appears to have fallen for traditional associations but as referred to in section 3.3 the comparable growth rate after excluding distorting data was 8.7% with the rate of growth in the upper quartile remaining strong. Since the upper quartile growth is notably above the aggregate average, this may be indicative of an increasingly concentrated SHG development programme and particularly the growth in shared ownership developments.

The impact of major repairs programmes is a significant factor in SBIT growth rates. As has been discussed earlier, major repairs expenditure has increased over the last three years. The upper quartile growth in SBIT is below the growth in turnover which is partly a result of the reduced profits on property sales.

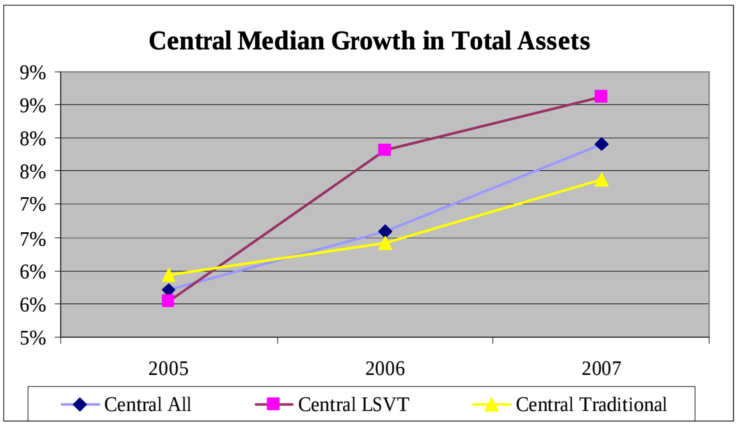
The growth in interest payable is inconsistent with the growth in debt and the increase in interest rates in 2007. Some of the difference between the two ratios will be due to number of associations having refinanced debt at finer margins.



In recent years interest costs have been increasing rapidly, due to new stock transfers, new developments and additional borrowing to fund repairs to achieve Decent Homes Standard. Future growth in interest will be affected by the recent base rate movements together with a general expectation that margins in the sector will increase following the credit crunch in late 2007.

Growth in total assets for both traditional associations and LSVTs increased in 2007. The difference between the upper and lower quartiles for traditional associations suggests that development is concentrated in a limited number of associations although the major repairs capitalisation policies will also have a variable impact. Growth in total assets is partly dependent on how associations reflect the housing assets in the balance sheet, either at cost or value.

The graph shows accelerating growth for LSVTs with a median growth rate in 2007 of 8.6%, more than double inflation. This is partly due to new development, offset by disposals but predominantly to re-valuations and the effect of capitalised repairs. Revaluation reserves grew on average by over 25% from £1,006 million to £1,265 million.



The growth in total capital and reserves shows how the difference between the upper quartile and the average has widened in 2007. The current and growing disparity between the two sets of figures implies that growth at the top end is concentrated in those associations growing through capital growth driven partly by development, whilst those relying on growth through steady accumulation of surpluses are growing at a much lower rate. The strong growth in the upper quartile was mainly driven by new development and the associated increase in SHG receivable.

5 PROFITABILITY

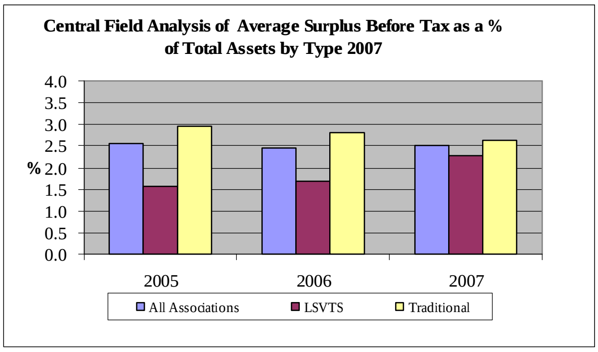
Ratio %	Statistic	2005 Traditional	2006 Traditional	2007 Traditional	2007 LSVTs
Operating margin	**Aggregate average**	**23.4**	**21.1**	**21.0**	**8.7**
	First quartile	30.2	28.6	28.1	21.1
	Median	24.2	22.8	23.0	10.8
	Third quartile	19.9	16.5	17.1	(4.9)
Turnover/total operating assets	**Aggregate average**	**10.5**	**10.4**	**9.8**	**16.6**
	First quartile	13.0	13.5	12.2	34.8
	Median	9.9	10.0	10.2	20.8
	Third quartile	8.6	8.2	7.7	12.2
SBIT% total assets	**Aggregate average**	**3.0**	**2.8**	**2.6**	**2.3**
	First quartile	3.4	3.1	3.1	4.1
	Median	2.9	2.7	2.6	2.4
	Third quartile	2.5	2.2	2.3	(0.2)
Effective interest rate	**Aggregate average**	**6.6**	**6.4**	**6.2**	**5.7**
	First quartile	7.3	6.8	6.9	5.7
	Median	6.5	6.3	6.2	5.4
	Third quartile	5.9	5.6	5.4	4.9
Cash cost of capital	**Aggregate average**	**2.1**	**2.0**	**1.9**	**3.5**
	First quartile	2.5	2.4	2.2	6.2
	Median	2.3	2.2	1.9	4.1
	Third quartile	1.8	1.9	1.4	2.6
Margin over cash cost of capital	**Aggregate average**	**0.9**	**0.8**	**0.7**	**(1.2)**
	First quartile	1.1	0.8	1.1	0.7
	Median	0.6	0.4	0.7	(1.0)
	Third quartile	0.3	0.1	0.4	(4.6)

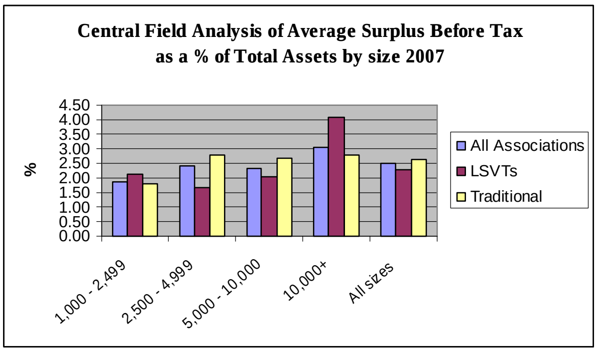
As discussed in 3.4 operating margins remain under pressure but capacity models submitted by Central field associations indicate that these are expected to improve steadily over the next few years.

Turnover to operating assets has shown progressive decline over the three years. The movement can be predominantly attributed to the growth in development whereby partly developed and newly developed properties are included as assets but are yet to generate any turnover and to the increase in valuations. The trend for this ratio is consistent with the aggregate average surplus before tax (SBIT) as a percentage of total assets that reflects the reduction of 2.4% in SBIT. The reduction in these two ratios over the three years shown above reflects the growth in pressure in the operating environment for the sector.

The largest sized associations showed better growth in SBIT in 2007 than their smaller counterparts but this was not reflected in the net surplus where this group recorded an aggregate reduction in surplus before tax. Associations between 2,500 and 4,999 units were the only group to report an aggregate growth in surplus before tax, an increase of 91.3%.

Generally LSVTs compare unfavourably with traditional associations until their major re-improvement works have been completed.



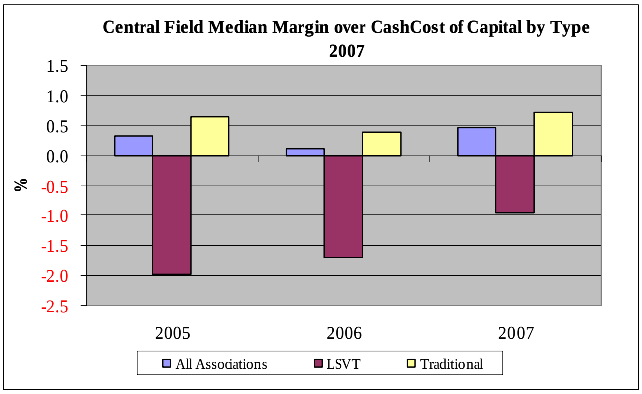


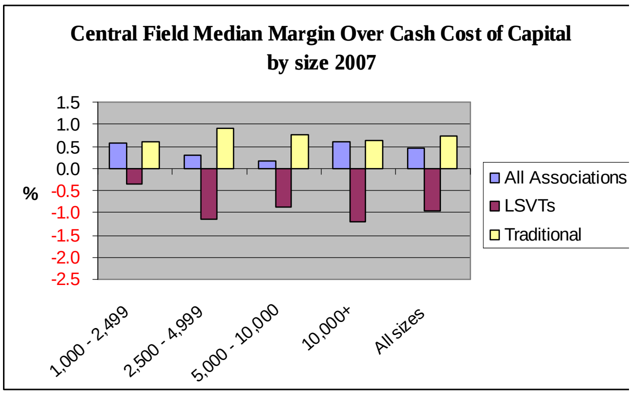
The average effective interest rate for traditional associations decreased again in 2007. This is contrary to the movement in the Bank of England base rate that increased by 0.75% from 4.50% at the beginning of the year to 5.25% by the year end. This could reflect successful refinancing of historically expensive debt but may also be due to the fact that the ratio is calculated on the year end debt balance rather than a weighted average debt level. LSVTs have a lower effective interest rate than traditional associations reflective of cheaper finance more available in more recent years. Capacity models submitted by Central field associations in 2007 indicated that modest increases in the effective interest rates were expected. These models were submitted prior to the turmoil in the financial markets in the latter part of 2007. The general consensus now is that the sector faces higher loan margins and it is anticipated that the 2008 capacity models will include higher effective rates of interest.

The cash cost of capital has shown successive improvement. This ratio continues to exceed SBIT to total assets indicating the sector is making adequate profit to pay the interest due. The margin over cash cost of capital reflects the difference between the return on assets (SBIT% total assets) and the cash cost of capital. The margin between the two ratios has reduced indicating a less comfortable position.

The margin over cash cost of capital is a useful measure of the pre tax return on assets. Ideally it should be a positive figure but not too large as a large figure may mean that borrowing is low and growth potential is being lost. A sustained negative margin would be a sure sign of longer-term viability problems.

Overall the performance for the Central field has remained satisfactory, but with a slightly declining trend. The impact of the transfer associations is illustrated by the graphs below. LSVTs that submitted a capacity model in 2007 are forecasting negative margins for the next five years because revenues and surpluses have not yet grown sufficiently to cover interest on substantial borrowing levels. The ratio is expected to be positive for the LSVTs in the Central field by 2012 but this will obviously be influenced by future transfers.





The profitability ratios calculated for LSVTs in 2007 are significant for the extent to which many of them vary. The difference between the median and the mean is much more pronounced than that of traditional associations. This is consistent with the marked variance in financial performance between LSVTs that is heavily influenced by the age of the association and accounting policies particularly the capitalisation of major repairs.

6 EFFICIENCY

6.1 Annual Efficiency Statements

In the autumn we provided to CLG the gains made by RSLs, as reported in Annual Efficiency Statements for the period to March 2007. 2008 is the final year of the current Comprehensive Spending Review target round and associations will only be required to report on their gains achieved, there currently being no requirement to predict future efficiency gains.

Results for 2007

In headline figures, the sector achieved substantial efficiency gains in 2006-07, outstripping, in aggregate, the forecasts set in 2006 and ahead of the Governments targets for the second year of the three year round of efficiencies, April 05 to March 08.

The aggregate results for the Central field are set out below, with 2006 results in for comparison

£ million	Gains Achieved to March 2006	Gains achieved to March 2007	2007 Gains projected in 2006 (1)
Capital Works	16	24	14
Management & Maintenance	28	45	31
Commodities	6	7	3
Work stream total	50	76	48
Other	19	22	18
Total	69	98	66

(1) This is taken from the 2007 AES returns and differs from that reported in the 2006 returns. The difference in the main comprises exclusion of associations with <1,000 units and inclusions of recurring savings (where they had been excluded previously).

Gains across all work streams are ahead of all of gains reported for 2006, forecasts in the prior year and the CLG interim targets. Conversely, in 2006, we reported gains in capital works and 'other' which fell short of the forecast the prior year, caused by forecast inflation factors well above outturn for capital works and a degree of non-reporting of recurring savings.

Again the sector has reported significant gains in the ‘other’ work stream. The savings of £22million in Central comprise a mix of treasury savings, organisational restructure, a combination and/or other gains.

The scale of the gains in 2007 is set out in the table below, where gains in 2007 are recorded as a percentage of 2006 reported gains, forecast gains for 2007 and national CLG interim targets to 2007. Gains should of course increase since they include sustainable gains from the

2004-05 baseline year. What perhaps is significant is the rate of increase in gains across the various work streams and the extent to which each work stream nationally is ahead of the CLG's targets.

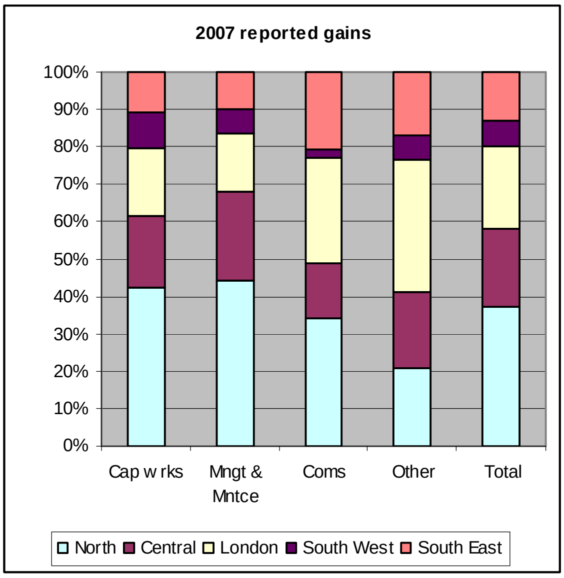
£ million	Gains in 2007 as % of 2006 gains		Gains in 2007 compared to that forecast		Gains in 2007 as % of CLG interim targets
	Central	**National**	**Central**	**National**	**National**
Capital Works	150%	156%	171%	129%	420%
Management & Maintenance	160%	144%	145%	135%	312%
Commodities	117%	185%	233%	139%	167%
Work stream total	116%	153%	158%	133%	303%
Other	116%	133%	122%	120%	N/A
Total	142%	147%	148%	130%	391%

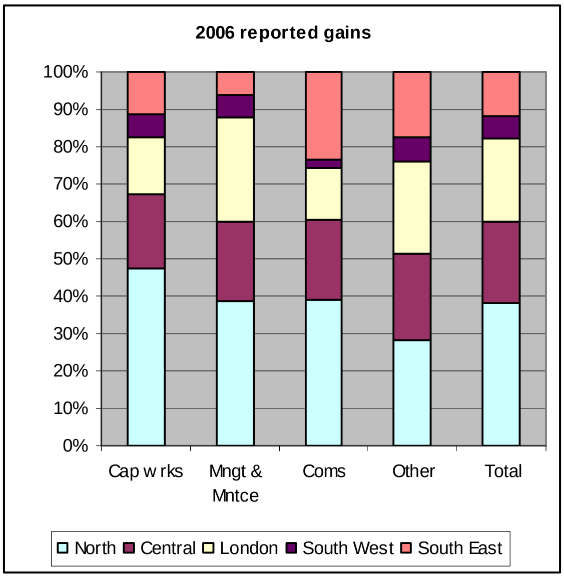
Central figures vary from the national picture in that Capital works actual gains were well ahead of forecast but showed a lower increase from 2006. Conversely management and maintenance cost savings increased at a higher rate than the national figure. However, overall the total savings increased from 2006 at a similar rate to the national trend but when compared to forecasts it suggest that central associations may have been less aggressive in securing gains.

2006-07 AES recorded efficiencies by field of regulation

	Capital Works	Management & Maintenance	Commodities	Work stream gains	OTHER	Total
Central	23,803	44,724	7,440	75,967	21,712	97,679
London	23,223	28,667	14,077	65,967	37,764	103,731
North	53,404	82,252	17,213	152,869	21,951	174,820
South West	11,970	12,721	1,051	25,742	6,908	32,650
South East	13,626	18,256	10,502	42,385	18,051	60,435
Total	**126,026**	**186,620**	**50,283**	**362,929**	**106,386**	**469,315**

The following two graphs depict the share of the total each field achieved for 2006 and 2007 for comparison.



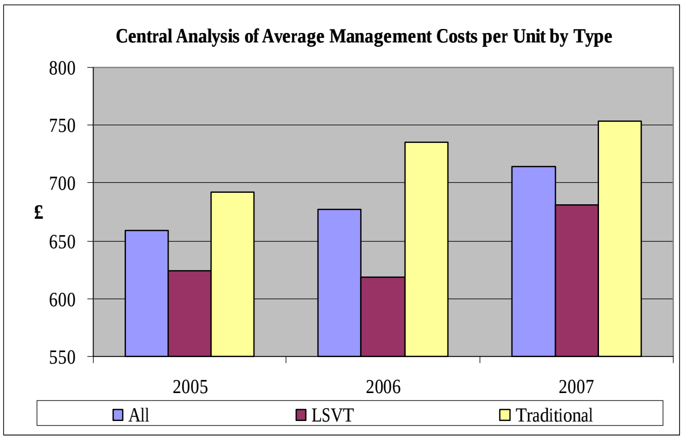


The share of efficiency gains is similar to that of last year, with Central's share remaining broadly similar but London's increasing, largely at the expense of North's share. Another factor of difference in efficiencies is observed between stock transfer and traditional associations.

An analysis of efficiency gains per unit for stock transfer and traditional associations in Central field shows that the average saving per unit in 2007 was £155 for traditional associations compared to £261 for stock transfer associations. A similar picture is replicated nationally.

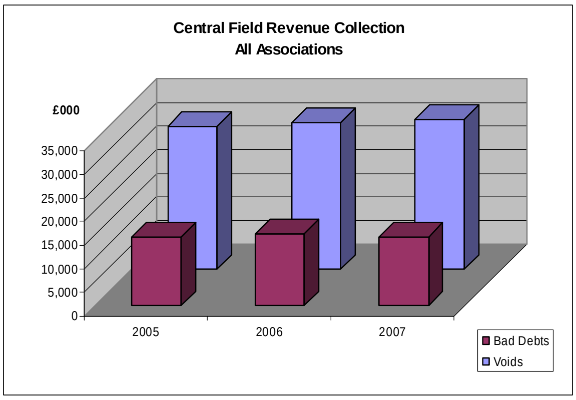
When analysed by size the larger associations show a greater saving per unit at £236 compared to £146 for associations with between 5,000 and 10,000 units; £263 between 2,500 and 5,000 units and £184 for less than 2,500 units. This is also similar to the national picture.

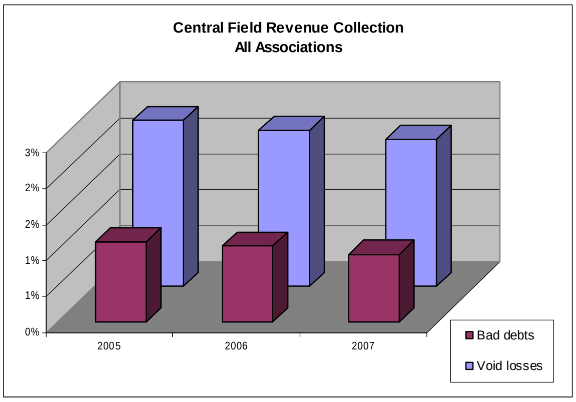
6.2 Housing Management



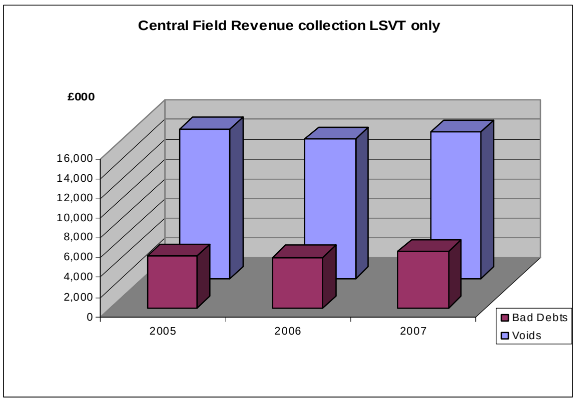
In 2007 the average management cost per unit for Central field increased by 5.6%. Whereas traditional associations cost per unit grew by around inflation that of LSVTs increased on average by over 10%. LSVT management costs per unit are now approaching that of traditional associations. An analysis of pure management costs can be misleading due to the ways in which associations allocate costs. It is for this reason that the Operational Cost Indicator was developed by the Housing Corporation to enable a more sophisticated analysis of operating costs.

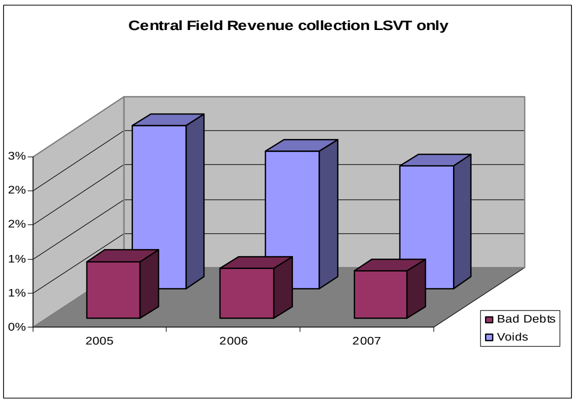
The ability of an association to maximise its rent collection is another strand of efficiency. The graphs below show that the total void losses for the Central field in 2007 were £31.7 million, up slightly from £31.0 million in the previous year. However the void losses relative to income were reduced from 2.2% to 2.0% showing improved performance. Bad debt losses were similarly improved falling from 1.1% of income to 0.9%. The two ratios show a year on year continuous improvement for the field.



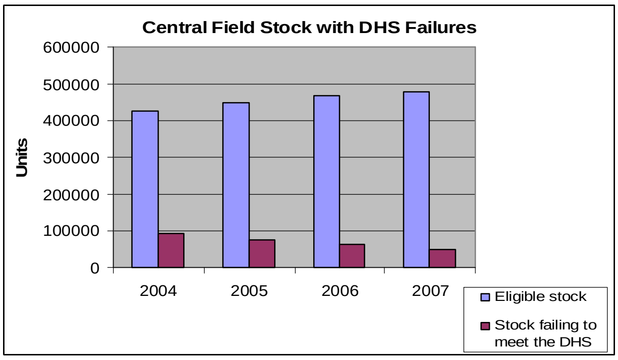


The analysis of LSVT voids below shows that there was a reduction from £15.2 million in 2005 to £14.9 million in 2007 despite new transfers joining the field. Void losses as a percentage of LSVT turnover were only 1.79% in 2007 down from 2.00% in the previous year. Losses from bad debts saw a similar improvement down to 0.69% from 0.73%. On average LSVTs show a better overall management of losses compared to traditional associations.





7 DECENT HOMES STANDARD

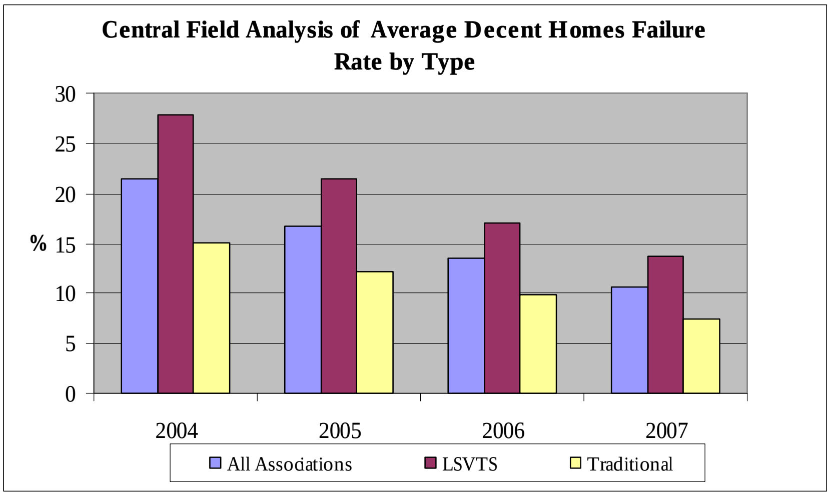


Data on Decent Homes Standard (DHS) is derived from the Regulatory and Statistical Return (RSR). Stock data in the RSR is based on units owned whereas the stock numbers from annual accounts, as used in the majority of this report, are based on units managed. This gives rise to a difference in the total stock numbers used in the analysis.

The graph above shows that whilst the number of eligible properties has increased, the percentage of failures is continuing to reduce as we approach the 2010 deadline. Forecasts indicate that there is still significant expenditure to be incurred to bring the remaining properties up to standard but that all associations expect to achieve the standard by the deadline. The Housing Corporation is able to issue waivers to associations who make a strong business case as to why they are unable to meet the DHS by 2010. There have been no waivers issued in the Central field.

Central field DHS failure rates

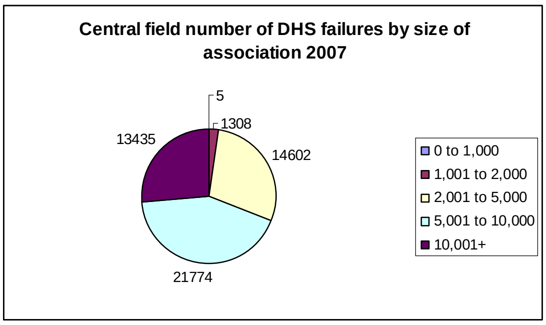
	2004	2005	2006	2007
Field average DHS failure rate	21.4%	16.8%	13.5%	10.7%
Average for traditional associations	15.1%	12.2%	9.9%	7.5%
Average for stock transfer	27.9%	21.4%	17.1%	13.7%
Preferred partner	12.23%	11.61%	9.53%	7.23%

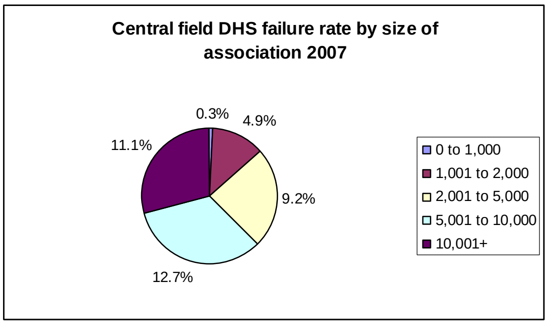


The average failure rate of Central field associations is reducing with the rate of improvement supporting the assertion that the Standard will be met by the deadline. The average failure rate of traditional associations in the Central field fell to below 8% in 2007. LSVTs had a higher failure rate of 14% that reduced from 17% in 2006.

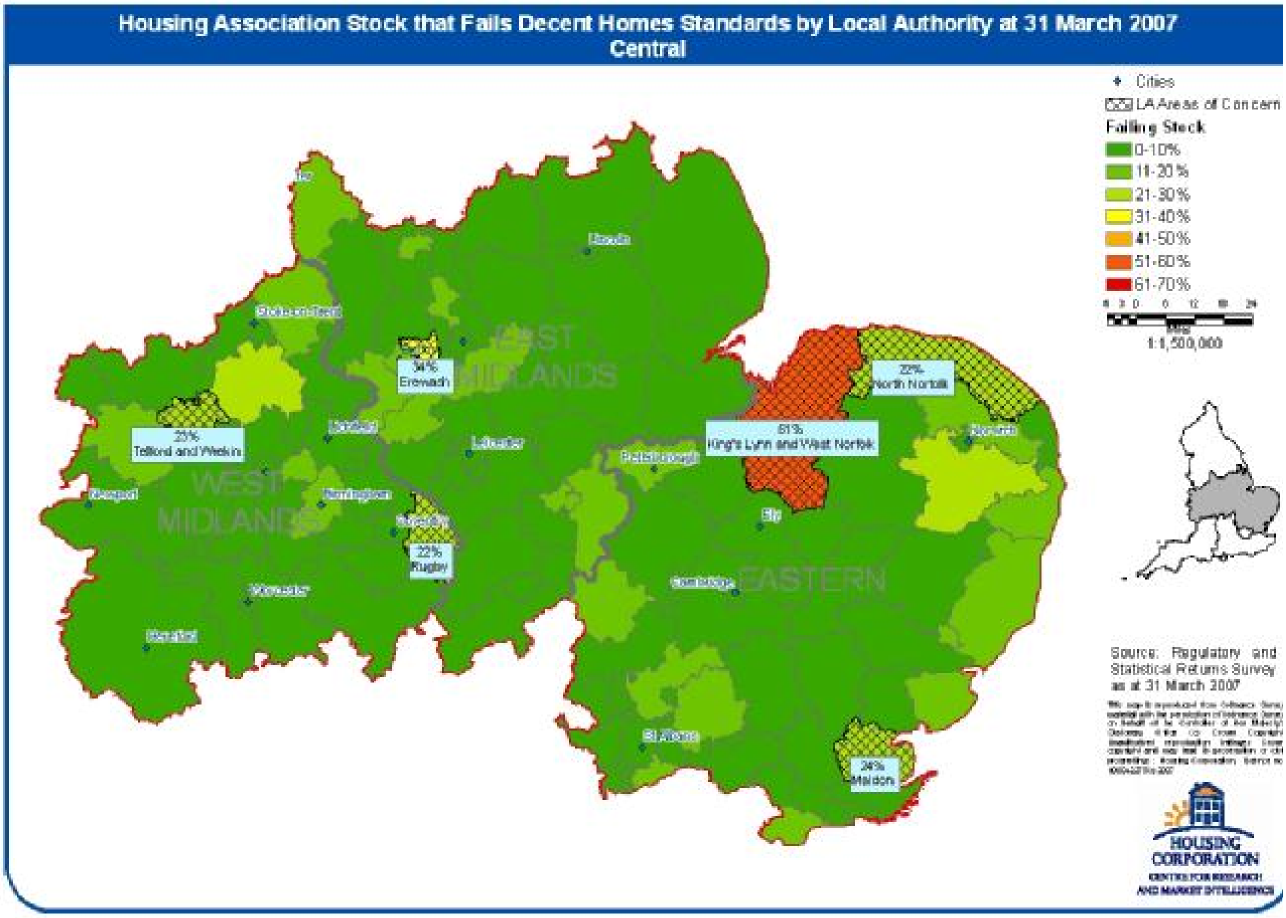
Overall the average DHS percentage performance of the Central field preferred investment partners is notably better than the total regional average, but only marginally better than the average performance of traditional associations. Out of the 17 preferred partners only one is a stock transfer and this does not have the highest failure rate amongst this group being above the group average. This association transferred in the late 1980s and its characteristics are more consistent with that of a traditional association. Seven of the preferred partners have a failure rate above the development partner average, six above the traditional group average and of more concern are the four above the total field average. Nevertheless these organisations have confirmed they will meet the Standard by the deadline.

LSVTs continue to have higher average failure levels that could deteriorate as new LSVTs are transferred into the field. However, there is now an extended deadline for newly registering LSVTs in recognition that they would need a reasonable period of time to complete improvements required to meet the Standard.





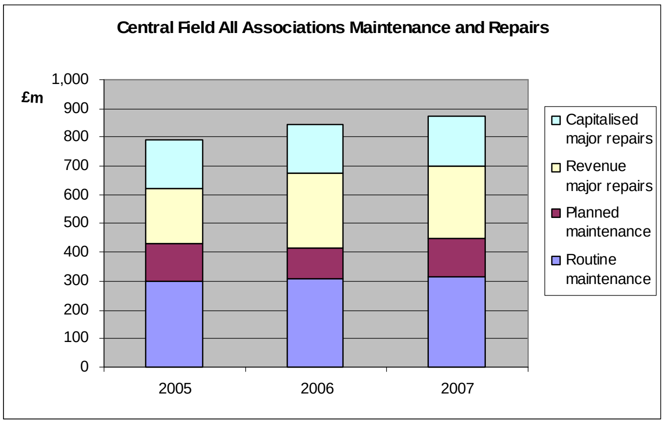
Analysis shows that the highest number of Decent Homes failures is in mid-sized associations. Associations with between 5,001-10,000 units again showed the smallest rate of improvement in failure rates in 2007 with an average failure rate of 12.7% down from 13.7%. Associations with between 5,001-10,000 units had the highest failure rate in 2007 at 12.7%.



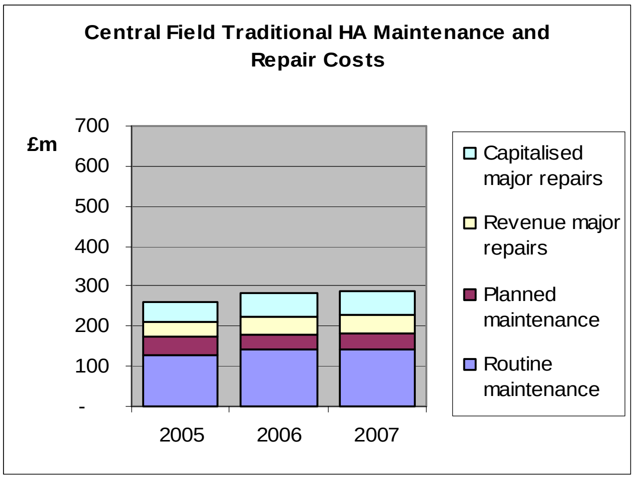
The higher failure rate of LSVTs noted previously is reflected in the above map where the highest levels of housing association failure appears generally in local authorities where stock transfers have taken place. As this analysis does not include local authority stock it does not reflect the full picture of decent homes failures in those authorities that have retained ownership. It does however include some associations not regulated in Central field.

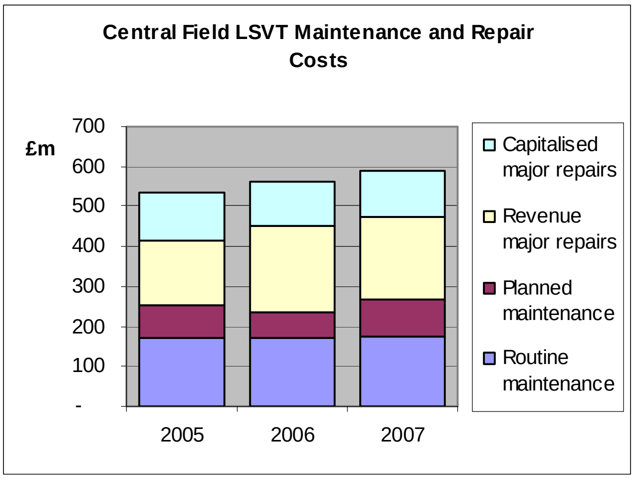
From the map above it can be seen that there are six LA areas identified as having high densities of stock not meeting the DHS. Five of these can be attributed to individual stock transfer associations one of which is regulated outside of the Central field.

The following graphs show how the expenditure profile of all repairs and maintenance,

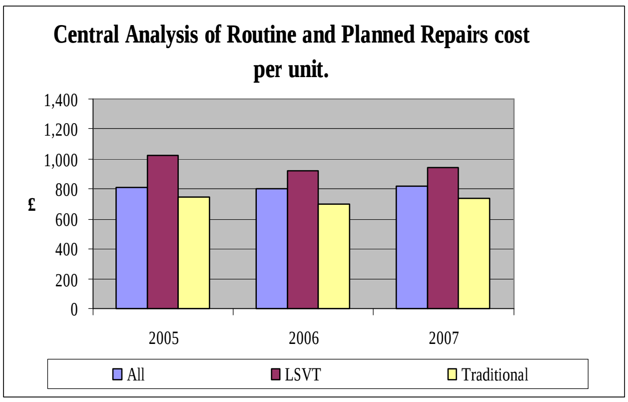


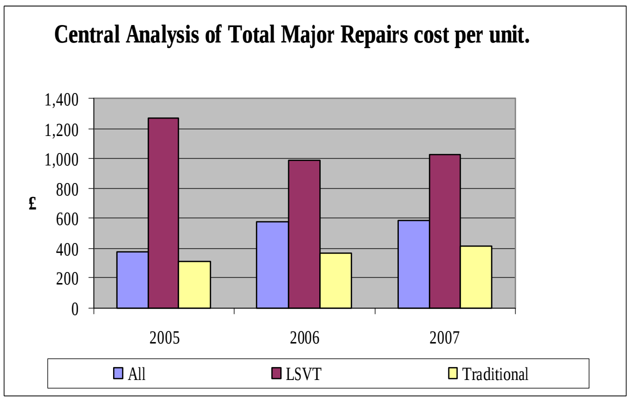
including responsive repairs, planned maintenance and revenue and capitalised costs has increased over recent years. This is largely influenced by LSVTs as traditional associations have experienced more modest increases since 2005. Planned maintenance fell in 2006 but has increased in 2007. Planned maintenance and major repairs are increasing as more investment is made in major repairs to meet the Decent Homes targets.





The graphs below show the wide disparity between per unit repair costs between LSVT and traditional associations in the field with LSVT expenditure significantly above that of traditionals.

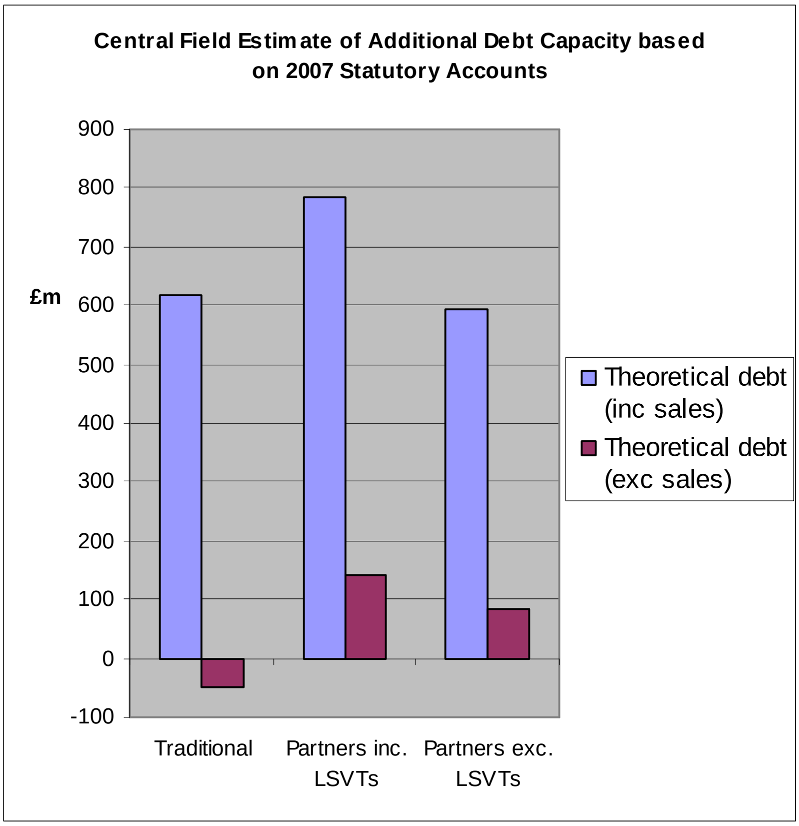




8. BORROWING CAPACITY

Based on forecasts submitted by RSLs in the Central field, there is significant amount of headroom in terms of unutilised security building up in associations over the next five years. This indicates that there is sufficient headroom within the Central field to increase levels of development further beyond the forecast levels of development. However, free cash flow to service additional debt will act as a limiting factor.

A crude assessment of Central field's apparent additional debt capacity has been carried out using the 2007 statutory accounts data. This assessment is based upon the amount of additional debt that could have been serviced in 2007 from available free cash flows. It pays no recognition to future positive cash flows that could be generated from investment of the additional debt and assumes prudent interest levels above the 2007 upper median for the field. The calculation has been made both including and excluding the profits declared on fixed asset sales as these may not be a recurrent feature in RSL accounts. The results of this assessment are shown in the graph below:



The apparent additional capacity for traditional associations has reduced since 2006 and there is again no capacity to support additional debt if profits from asset sales are excluded from the assessment. In 2006 the same calculation including profits from asset sales indicated a theoretical additional debt capacity of over £673 million for traditional associations but no additional capacity if sales were excluded.

The apparent additional capacity has increased for lead development partners and is above the total for traditional associations. This indicates that some of Central's traditional associations have no additional capacity. The lower result for lead partners excluding LSVTs reflects the fact that there are a number of mature LSVTs that are subsidiaries of lead development partners that, unlike early years LSVTs, have additional capacity.

LSVT funding models are fundamentally different so this type of analysis is not appropriate for LSVTs before they reach peak debt.

In 2007 the Central partner associations had the highest debt per unit at £16,396 compared to an average for all Central associations of £14,620. This reflects the progressively higher costs of developing new units as a result of inflationary impact.

9 DEVELOPMENT

The 2006-08 NAHP continued the partnering theme of the 2004-06 ADP, whilst introducing a more competitive element to the bid round with non-RSLs becoming eligible to receive Social Housing Grant (SHG) as a result of the 2004 Housing Act

Across the field the SHG for the 2006-08 programme averaged 29% of total scheme costs but this increased to 31% when other public subsidy was added. The average grant across Central field was £17,968 for low cost home ownership properties and £42,795 for rental properties.

A breakdown of average grant per unit for each of the three investment regions in the Central field is shown below:

Average grant per unit for NAHP £	East Midlands	West Midlands	East of England
Intermediate rent	N/A	39,167	27,982
LCHO	20,111	20,278	14,749
Rent	44,150	49,722	39,563

The Government has set out the scale of its ambition to tackle the unmet and emerging demand for affordable housing in England in its publication Homes for the Future. This has been matched with significant additional investment through the National Affordable Housing Programme 2008-11. To achieve the outputs sought, significant further efficiency in the use of NAHP resources is required. Affordable housing providers have been set regional efficiency targets reflecting the achievements needed to produce target outputs for the resource available. These efficiency targets are shown in the table below:

Annual efficiency target	East Midlands	West Midlands	East of England
LCHO	5.5-7.5%	6.5-8.5%	4.5-6.5%
Rent	5.5-7.5%	6-8%	4.5-6.5%

Early indications are that not all associations have embraced these requirements when making their initial bids for the 2008-11 programme. We are encouraging associations to review a number of bids with a view to resubmitting them at a lower grant rate. If these bids are resubmitted they will be reviewed along with other new bids as part of on-going regular market engagement.

10 RENTS

The following table analyses the regional and national rents and target rents at 31 March 2006 and 2007. The data is taken from the information on the Dataspring website commissioned on behalf of the Housing Corporation:

Investment Region	Average actual net rent		Average target rent		Actual rent as a percentage of target rent	
All figures in £	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**
West Midlands	58.85	60.66	59.22	63.00	99.38	96.29
East of England	66.15	68.78	68.55	71.24	96.50	96.55
East Midlands	58.14	61.36	60.49	61.89	96.12	99.14
Central	61.19	63.87	63.17	65.92	96.87	96.89
National	64.51	66.66	67.21	69.65	95.98	95.71

The 2007 national average target rent was £2.44 (3.63%) higher than the 2006 target. This was broadly in line with the permitted increase under rent influencing of 3.70%.

Nationally the movement between average and actual target rents for 2007 and 2006 again shows divergence from target. This will be influenced by new LSVTs that generally have a large gap between actual and target rents.

In the Central field all the regions are within 5% of target rents with the East Midlands on average having almost achieved convergence to target. It is interesting to note that West Midlands actual rents as a percentage of target rent fell in 2007. This was due to the average target increasing by 6.38% whereas actual rents increased by only 3.07%.

There are two LSVT associations regulated by Central field that need to implement rent restructuring over an extended period. BME associations have rents on average which are significantly higher than target therefore a five year extension was allowed as part of the BME rent determination. This was applied to three BME associations in the Central field two of which have now merged.

The September 2007 RPI on which the following years rent increases are based was materially higher than that forecast in capacity models. This will result in increased turnover above that indicated by existing forecasts. Generally higher RPI has a positive effect through higher rents but reduced interest costs relative to income.

11 Pensions

All RSLs make some pension provision for their employees. In 2005-06 the full provisions of FRS17 on pensions became mandatory resulting in pension liabilities being included in the balance sheet together with any prior year adjustment for defined benefit schemes. A significant number of RSLs are members of the Social Housing Pension Scheme (SHPS) that is a multi-employer defined benefit scheme. However the fund trustees have been unable to quantify the individual employer's share of the overall fund deficit of £283 million as at 30 September 2005. The aggregated statutory accounts disclosures in respect of pension liabilities are therefore significantly understated.

Reported aggregated pension scheme deficits for the Central field in 2007 totalled £103 million (up from £78 million in 2006). £81 million (79%) of this was disclosed by LSVT associations. This is due to LSVTs usually being members of local authority pension schemes where trustees have been able to quantify the individual employer's share of deficits.

Traditional associations are generally members of the SHSP. The average deficit per unit for associations that disclosed a deficit in 2007 was £359 down slightly from £364 in the previous year.

A key risk for the sector is the future funding of pension scheme deficits. Employers are already having to fund increased contributions that will impact on future profitability.

12 Supporting People

Associations providing support services work with relevant administering authorities to ensure that services meet strategic requirements and offer value for money. The General Determination 2006 requires associations to match the income and expenditure arising from Supporting People so far as it is possible. It also requires an accounting policy on Supporting People to be disclosed. Compliance with both requirements has again been patchy making it difficult to make any definitive comments on this area of Central field's RSL business. Disclosures made indicate expenditure on tenancy related support for the field exceeded disclosed income by £10 million (21% of income), a reversal of the situation in 2006 when income exceeded expenditure by £27 million. Our engagement within the field confirms that margins are much lower for this income stream but a 21% loss appears contrary to anecdotal evidence from the field. This might indicate that in some cases costs are still not being accurately matched with the associated income.

The continuity of funding for Supporting People activities remains a key risk for the sector. Associations are required to have robust risk management strategies in place that address both financial and reputational impacts.

2007 saw the first association to become non-viable due to the loss of supporting people contracts. The residual activities of this association were transferred to another group regulated outside of Central field.

APPENDIX - GLOSSARY OF TERMS

This is a glossary of some of the terms that you will find in this report. A complete and more detailed list of financial ratios, how they are calculated, their definitions and how to interpret them, can be found in the Corporation's 'Financial Analysis Framework' document. This document can be downloaded free of charge from the Corporation's website www. housingcorp.gov.uk

1. **Operating margin:** Operating surplus divided by turnover and expressed as a percentage.

Operating surplus is income (predominantly from rents) minus the everyday costs of running the business – salaries, insurance, maintenance, service costs – but not interest payable.
Operating margin gives an idea of the profitability or efficiency of an organisation and it impacts directly on cash flow as it is where the cash comes from to make interest and loan payments to funders.

2. **Net interest cover:** Operating surplus plus interest receivable divided by total interest payable and expressed as a percentage.

This ratio is mainly concerned with assessing whether the association's surpluses are sufficient to cover interest payments, and whether it can afford more borrowing. It also provides an indication of the association's potential vulnerability to adverse conditions. The closer interest cover is to covenant (or prudent) levels, the less time the association will have to react to such adverse conditions.

3. **EBITDA interest cover:** Operating surplus plus interest receivable plus total depreciation divided by total interest payable and expressed as a percentage or ratio.

EBITDA is **E**arnings **B**efore **I**nterest, **T**ax, **D**epreciation and **A**mortisation
Similar to interest cover, this measure removes any distortions caused by the depreciation charge and provides a closer indication of the cash surplus available to meet interest payments.

4. **Debt per unit:** Total loans divided by total units in management at the period end.

Provides a practical measure of the association's reliance on loan finance without the distortion of different asset valuation methodologies.

5. **Debt as a multiple of EBITDA:** Loans divided by (operating surplus plus interest receivable plus total depreciation).

This ratio provides a measure of the association's ability to repay its debt by comparing the level of debt with the operating surplus on a cash basis.