

Current Valuation Issues including Building Safety, MMC and Decarbonisation: How does it affect a business' financial capacity?

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7th October 2021



Market Update



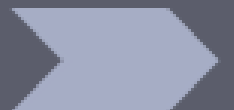
Fire Safety and High Rise



MMC & Loan Security



Green Agenda



Financial Capacity

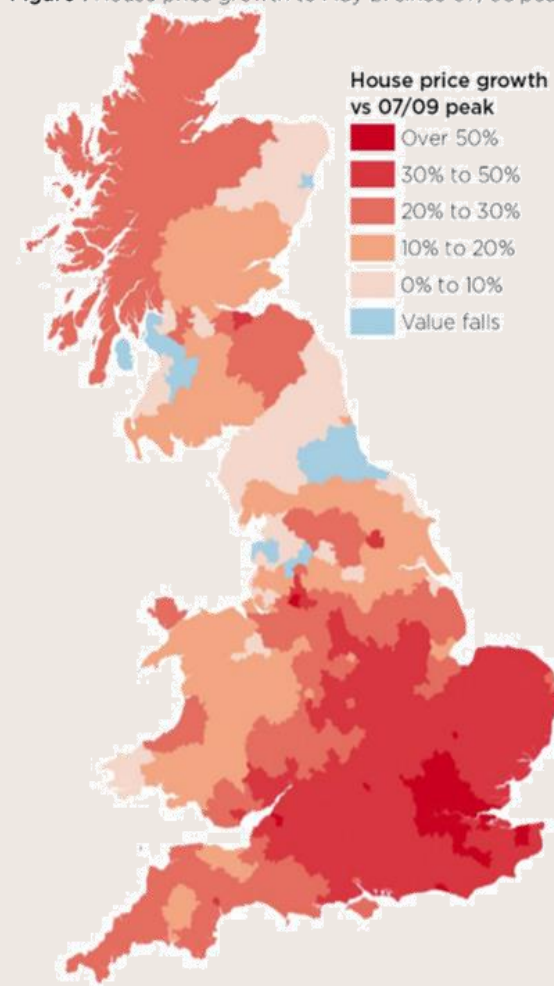


Market Update

The housing market showed incredible resilience in the face of Covid

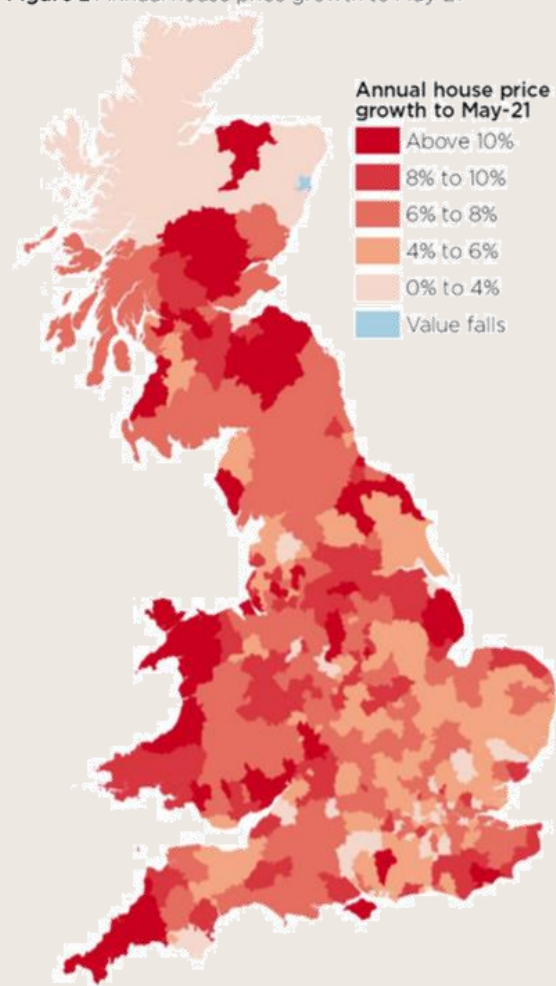
- House prices grew by 0.5% in July
 - Annual house price growth at +10.0%
 - Highest annual growth since 2004
 - This was supported by:
 - The stamp duty holiday
 - High levels of demand
 - Pent-up demand
 - Low cost/interest rate Mortgages
 - Average UK rent up 1.5% in year to July
 - Increases in most areas
 - Fall of -0.1% in London, now corrected
- Rental demand outpacing landlord supply = stronger rental growth returning over coming months

Figure 1 House price growth to May-21 since 07/08 peak



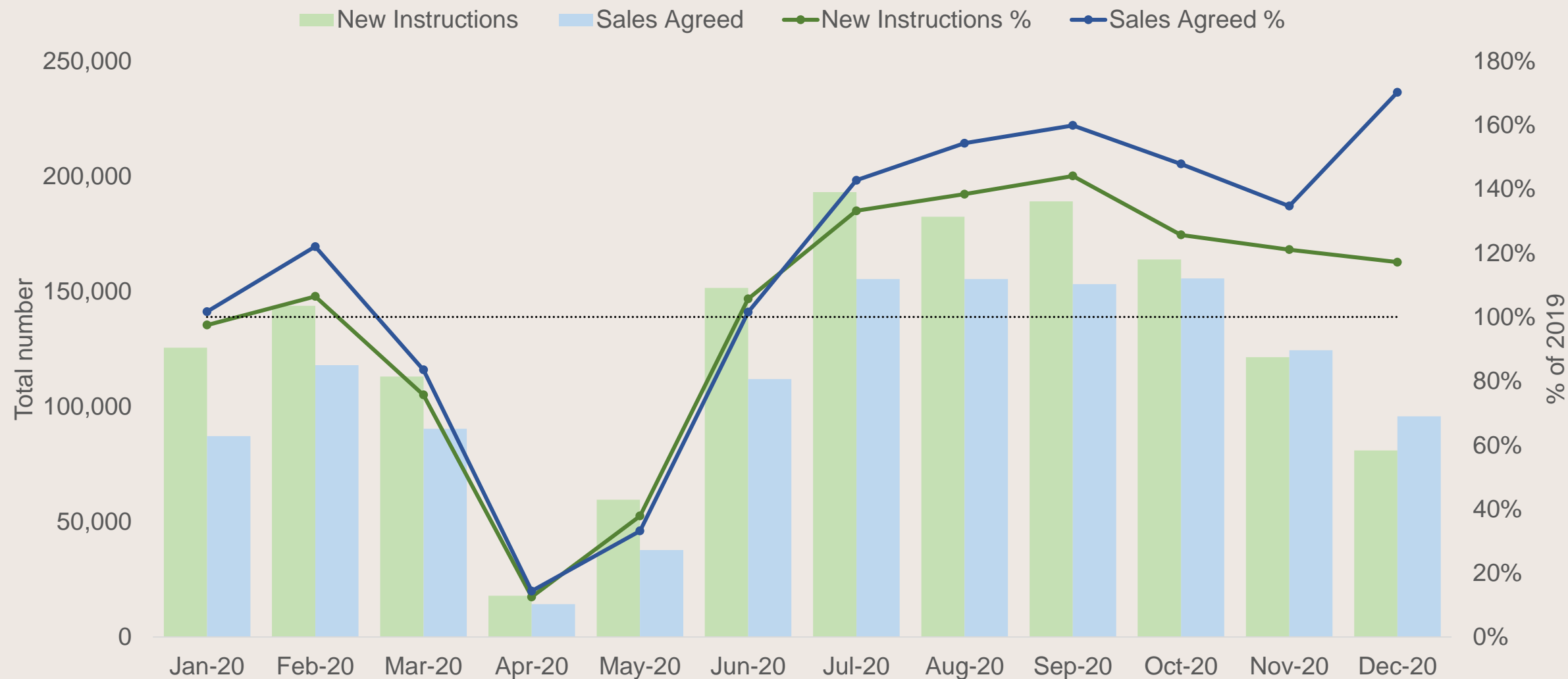
Source Savills using HM Land Registry and Registers of Scotland (6 month smoothed)*

Figure 2 Annual house price growth to May-21



Source Savills using HM Land Registry and Registers of Scotland (6 month smoothed)*

Housing market activity 2020 & recovery from lockdown



Regional House Price Outlook (Published July 2021)

Region	2021	2022	2023	2024	2025	5 years to 2025
UK	9.0%	3.5%	3.0%	2.5%	2.0%	21.5%
London	7.0%	2.0%	1.5%	1.0%	0.5%	12.4%
South East	9.0%	3.0%	2.5%	2.0%	1.5%	19.1%
East of England	8.0%	3.0%	2.5%	2.0%	1.5%	18.0%
South West	8.5%	3.5%	3.0%	2.5%	2.0%	20.9%
East Midlands	9.0%	4.0%	3.5%	3.0%	2.5%	23.9%
West Midlands	9.0%	4.0%	3.5%	3.0%	2.5%	23.9%
North East	8.0%	4.0%	3.5%	3.5%	3.0%	23.9%
Yorks & Humber	10.5%	4.5%	4.0%	3.5%	3.0%	28.0%
North West	10.5%	4.5%	4.0%	3.5%	3.0%	28.0%
Wales	10.0%	4.0%	4.0%	3.5%	3.0%	26.8%
Scotland	9.5%	4.0%	3.5%	3.0%	2.5%	24.4%

Inspections – Post Covid19 Limitations

- Estate Agency / Housing was exempt
- However Internal Inspections problematic
- Valuer, Borrower & Tenant
- External only during (continuing...)
- Follow up internal 12 months
- If necessary or appropriate
- Banks mostly persuaded:
- Most of our data is SCS, not derived during inspections
- Marketability / quality is derived from external
- EPCs ratings and valuation



A low-angle, upward-looking photograph of several tall skyscrapers in a city. The buildings are made of glass and steel, with their lines converging towards the top of the frame. The sky is filled with soft, white clouds. A dark, semi-transparent horizontal band is overlaid across the middle of the image, containing the title text.

Fire Safety, High Rise & Cladding

2017

Certainty on social rents the #1 policy issue

Cross-subsidy from development activities key to meeting core housing objectives in an age of less grant

Brexit uncertainty hung over a market heavily supported by Help to Buy

2018

Society's conscience pricked by Grenfell with fire safety racing up the agenda

Intense competition for s106 and consented land

An increased focus on acquiring strategic land against the backdrop of planning reform

2019

A renewed sense of social purpose as tenant welfare and delivering more social rent become the top priorities

An increased need for a partnership approach with the recognition that "there is a enough housing crisis to go around"

2020

Covid-19 meant a shift towards tenant support & community engagement

Building safety no 1 investment priority, with zero carbon a longer term liability

An increased aspiration to develop stock "in-house"

Savills 2021 Housing Sector Survey

savills

Net
balance
more
important

+85%

stock
investment
(building
safety & zero
carbon)

+78%

tenant
support

+64%

community
engagement

+28%

New homes
development
of affordable
homes

+23%

Large scale
estate
regeneration
-5% last year

Compared to
+29%
last year

and **59%**
said it was
significantly
more
important

+53%

homelessness
& vulnerable
households

-10%

New homes
development
of market
homes



Consolidated
Advice Note



Building Safety
Bill



Fire Safety
Act



GTI P1 / Fire
Safety
Consultation(s)



White Paper

Not just remediation requirements

Some thoughts on improvements, management and maintenance:

“Don’t delay”
message

Roles,
responsibility
and competence

Business
planning and
governance

Increased
scrutiny and
visibility of
performance
stakeholders

Data – to
evidence
compliance and
understand
portfolio
requirements

Background to why we need EWS1 forms



External Wall Systems - EWS

- Prevalence of construction defects
- EWS1 survey forms – silver bullet has backfired
- Excessive caution amongst mortgage lenders
- Massive shortage of suitably qualified fire engineers – limited EWS1 signatories
- Scale of problems / unknowns in RPs
- Professional indemnity insurance
- Contractor capacity
- Pandemic working conditions
- Inadequate government funding
- Everyone blaming everyone else



- Consultation in January 2021 – results published 8 March
- Objective: achieving consistency on whether or not EWS1 forms are required
- New guidance - **effective 5 April 2021**
- RICS, UKF and BSA jointly
- RICS providing training for building surveyors and mortgage valuers
- Ministerial Statement 21 July – “EWS1 forms should not be a requirement on buildings below 18m”
- **BUT... RICS going to consult before amending guidance so it still stands**
- Clarification of when EWS1 **is** required – three categories of buildings...

Category 1 – buildings over 6 storeys

- EWS1 is required if:
- Any cladding* or curtain wall glazing; **or**
- Balconies stacked vertically above each other **and**
 - Both balustrades and decking are made of combustible materials **or**
 - Decking is combustible **and** balconies are directly linked by combustible material

** ACM, HPL, MCM, metal sheets, brick slips, plastic, tiling, timber, rendered systems*



Category 2 – buildings of 5 or 6 storeys

- EWS1 is required if:
 - Significant amount of cladding – approximately 25%; **or**
 - Any ACM, MCM or HPL panels; **or**
 - Balconies stacked vertically above each other **and**
 - Both balustrades and decking are made of combustible materials **or**
 - Decking is combustible **and** balconies are directly linked by combustible material



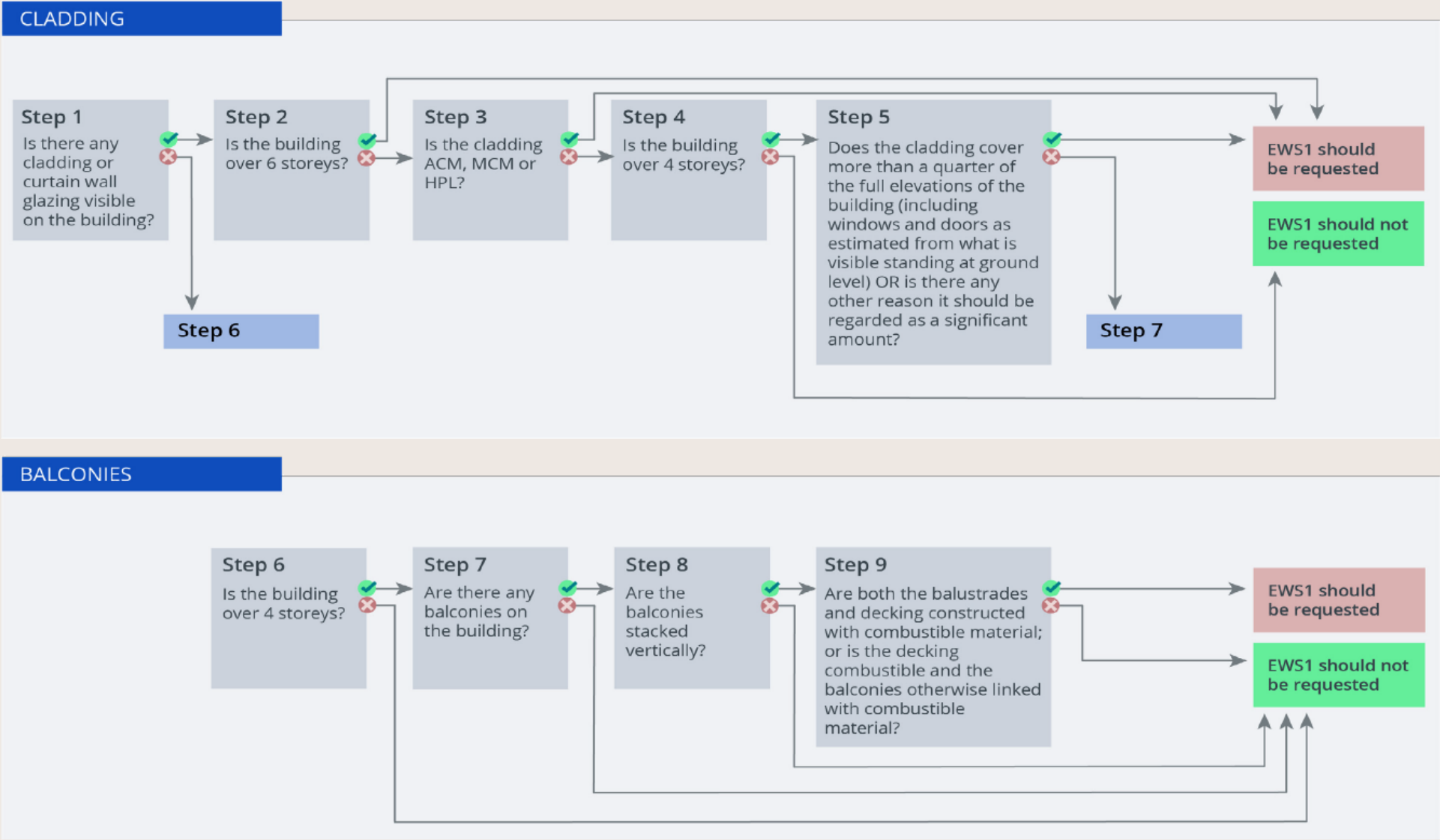
Category 3 – buildings of 4 storeys or fewer

- EWS1 is required if:
- Any ACM, MCM or HPL panels are present
- *ie other cladding materials would not require EWS1*



- Valuers will ask lots of questions – we have to!
- Borrowers can help us and help themselves – early and full information
- Information harder and slower below 6 storeys
- Freeholders and managing agents causing some long delays
- EWS1 forms remain rare in the sector
- Very little unsuitable stock coming forward for new charging
- We struggle to value some buildings without further and better information
 - Discuss and discourage charging
 - Would it transact?
 - To what type of buyer?
 - Can a sensible allowance be made?
 - Adequate loan security?

EWS1 form decision tree



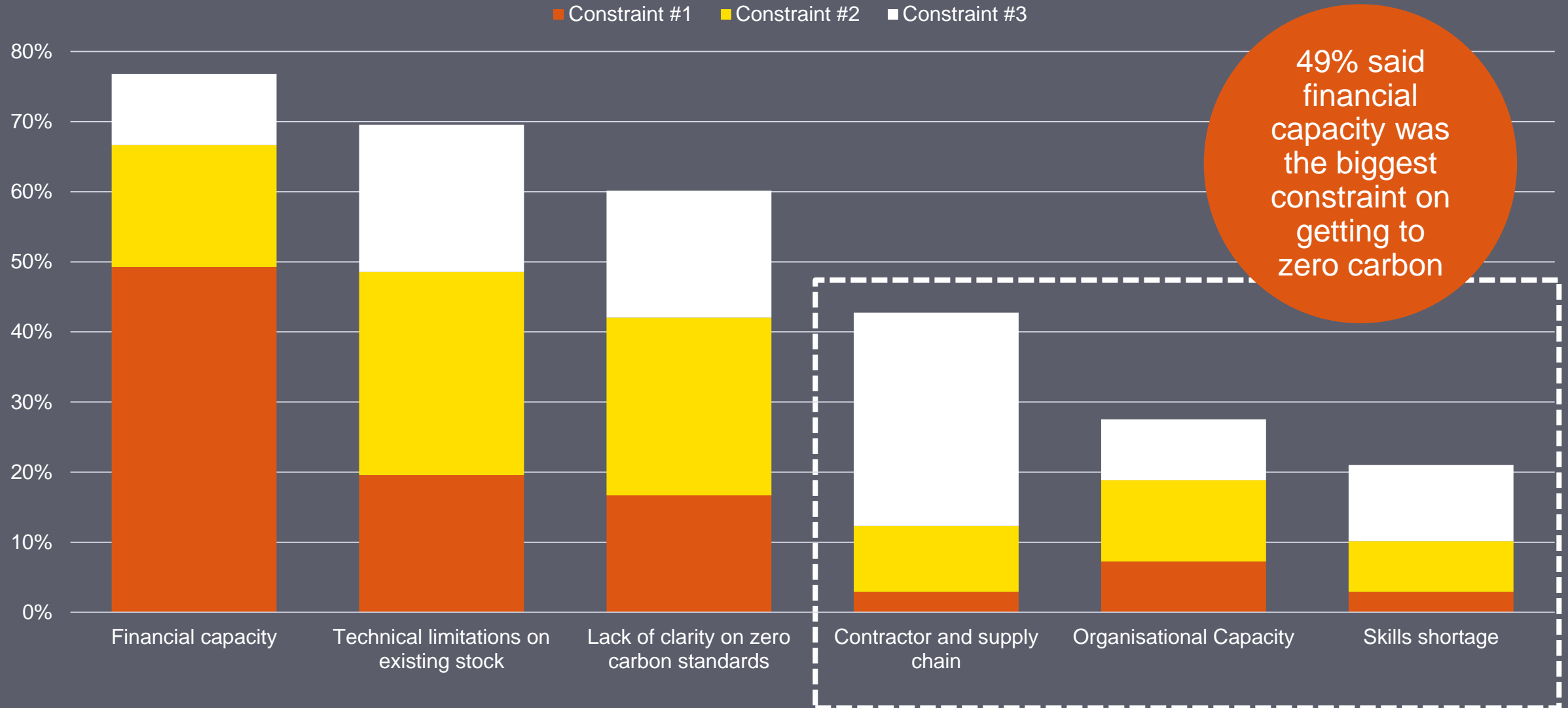


Green Agenda



- Business Plans may cope: What about valuations?
- Mitigation in existing SCS spend - All your stock? No – assess it now
- Will you be saved by...
 - Grant ? Not likely
 - Rent Formula ? – More likely
 - Technology? More likely : cost of green power has reduced 90%
 - Rationalise unviable stock sooner rather than later: energy inefficient stock will be worth less (worthless?!)
- Wider area regeneration? MMC?

Constraints on getting to zero carbon



Key issues to consider

- Basic costs – look scary / unaffordable
- RPs cannot apply to all stock - It is not about choosing a heat pump!
- Potential External Funding streams ? – nothing guaranteed
- Its not all about business plan - Valuation considerations
- Needs a long term strategy that allows time for technological innovations – hydrogen/heat networks etc/decarb of grid
- Lack of industry capacity and skills – not just in RPs
- Education and tenant engagement



Must form part of wider Asset Management Strategy – informed decisions

Scale of the delivery challenge

500

weeks to
2030 for
EPC C

Time needed to
review, analyse,
trial, procure –
assumed large
scale
implementation by
say 2025 (unless in
areas with earlier
climate
emergencies
declared)

Means work
on 4% or
110,000
dwellings per
year/ 2200
per week
nationwide -
£2.8bn pa

Low regret
interventions
in early
years

We have
some
2,747,671
properties to
tackle (HA
stock)

Component
replacement
vs whole-
house
retrofit?

Normal
stock
condition re-
investment
work must
still run in
parallel

How to
prioritise -
worst first or
area by
area?

Expected additional investment to meet zero carbon per home



Archetype costings

Typical total costs per dwelling – no regional variation included

Flats	£19,000 - £32,000
House – semi/EOT	£25,000 - £40,000+
Average total costs within range	£25,000 – £28,000

Net costs - reflect **deduction** for typical SCS/Business plan provisions of £9,000 - £11,000 per unit including:

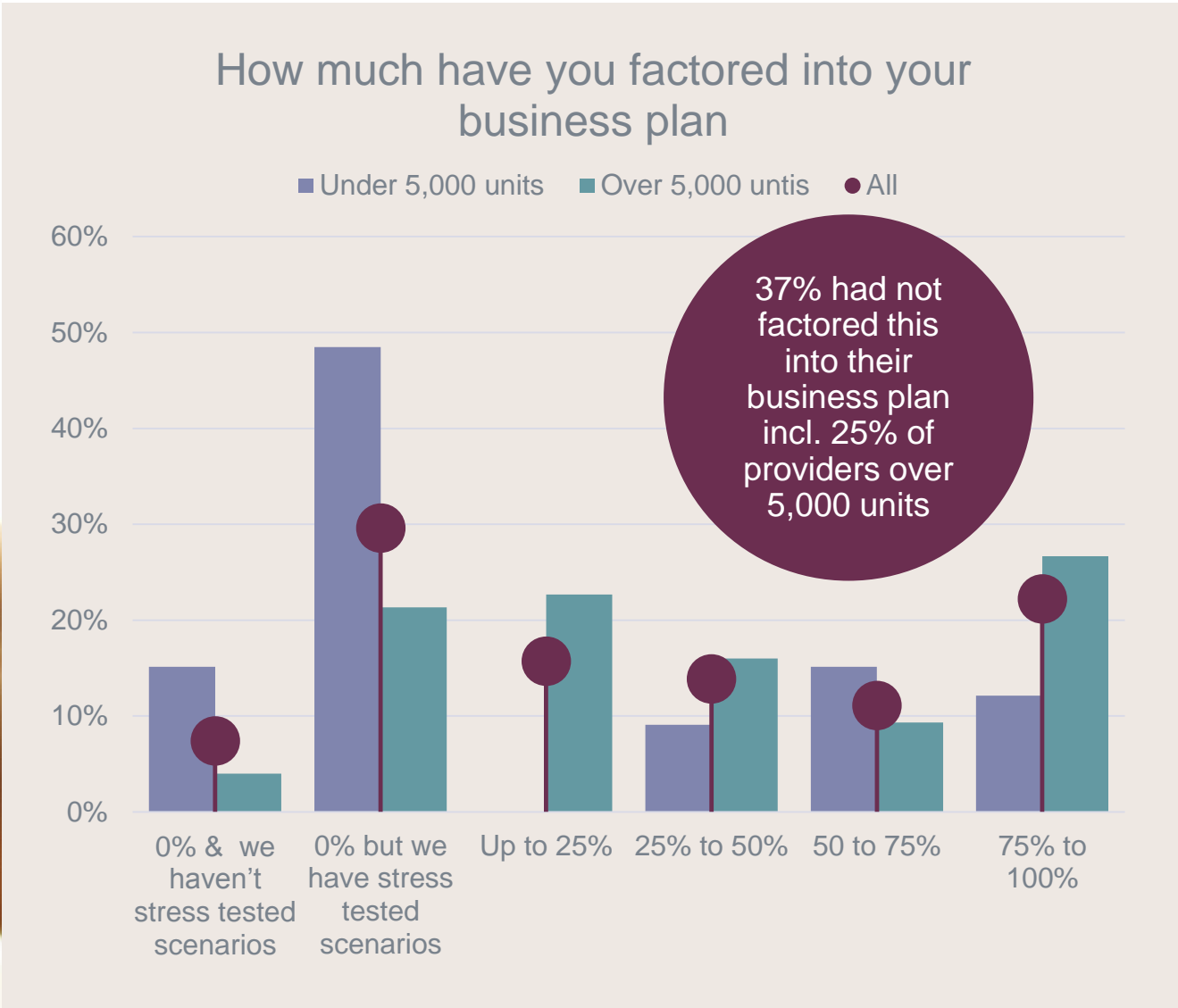
NET average cost say £17,000 per unit

BUT – varies significantly per archetype, therefore stock mix impacts business plan

NOTE: These measures do not achieve Net Zero Carbon

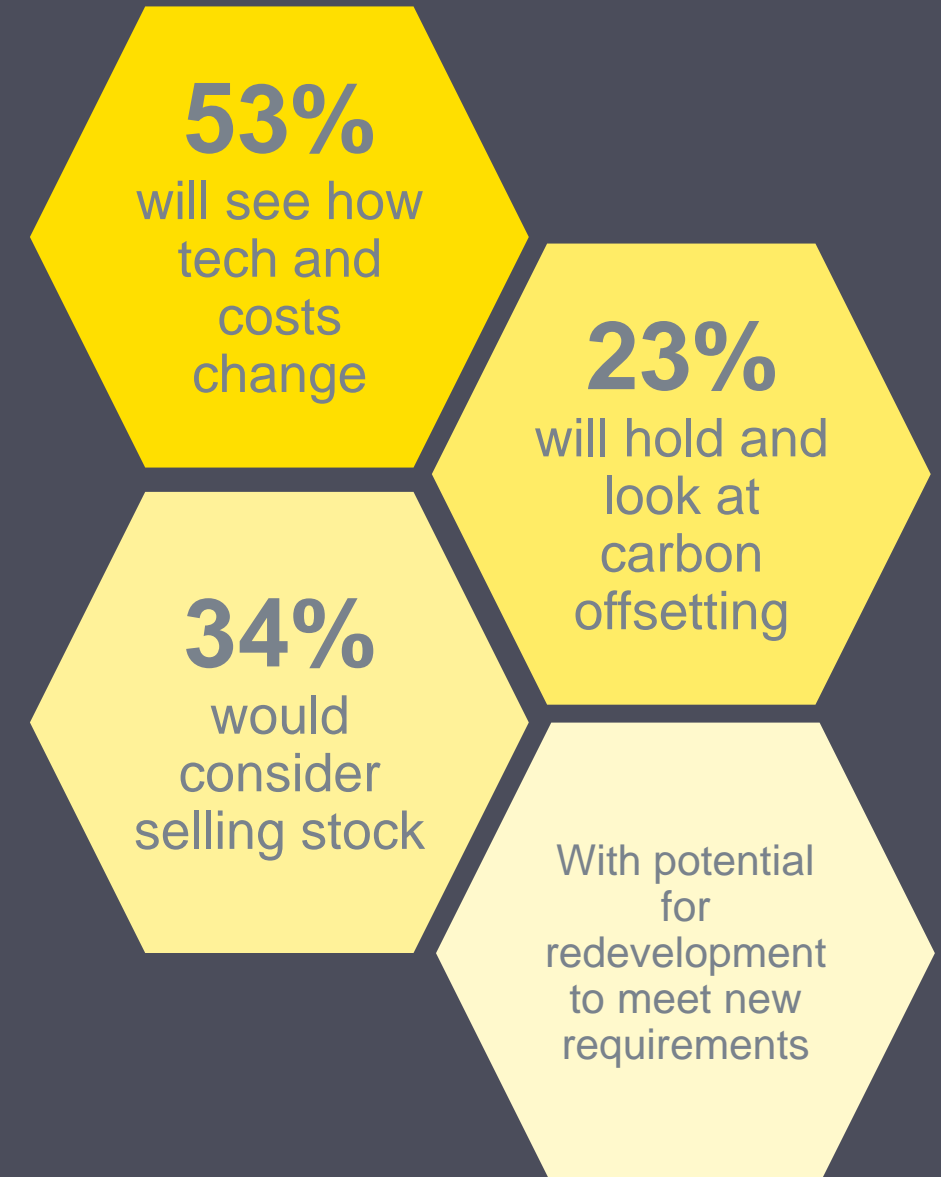
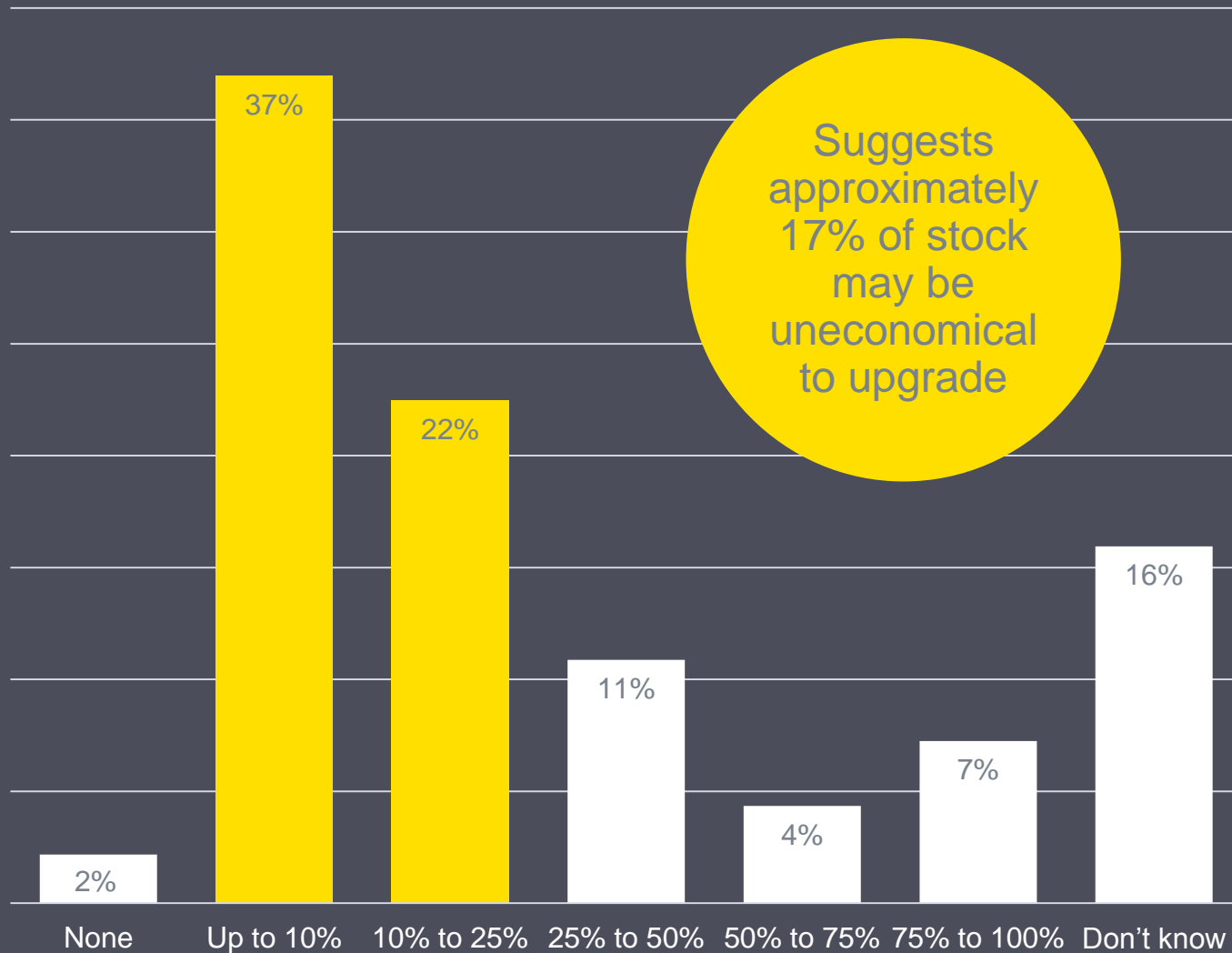


Factoring in the cost of zero carbon



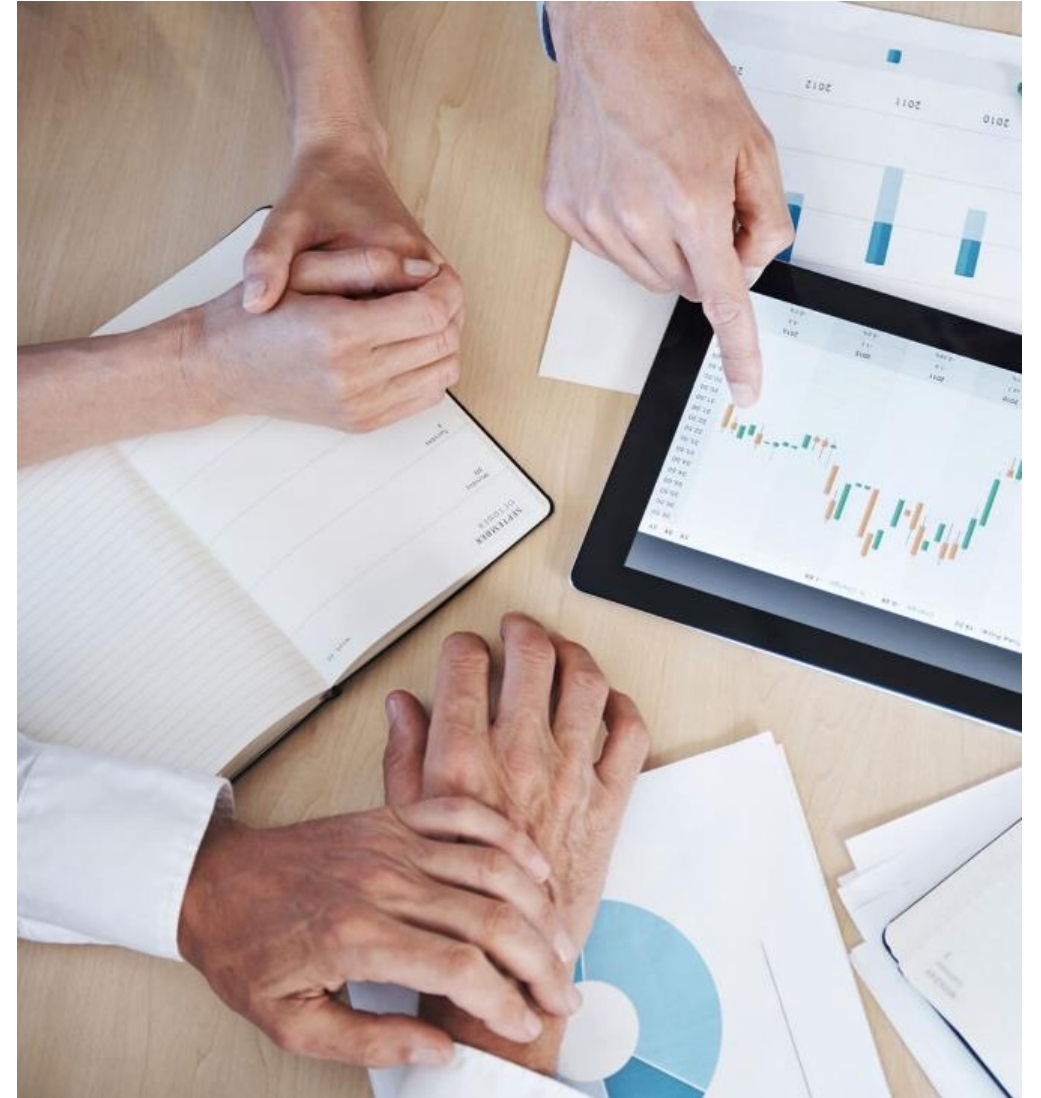
Uneconomical to upgrade

Proportion of stock uneconomical to upgrade



Next Steps

- Develop short/medium/long term plan for housing stock
- NPV assessments to reflect ZC and other challenges
- Consider Group targets
- New build standards – low carbon today/no gas by 2023
Why build brick & block ? Retro-fit in 15 years
- Means MMC
- Wider corporate objectives and strategy - transport, people, offices



MMC



MMC is coming

WHY?

- Big push by Government & Industry for MMC
- Registered Providers are being pushed towards MMC
 - Speed of delivery = cheaper (?)
 - Green agenda (build and energy use)
 - Planning approval may specify MMC
- Matching RP development ambition with lenders caution
- Its coming in bulk! Not 10% of newbuild...



Is MMC Capable of Supporting Long Term Debt ?

YES

- It will trade
- It has value
- Can be put in to charge to support debt
- It should support debt at MV

And... **GOOD NEWS!!** Several new loans
Including MMC Going Through



How will the Valuer report MMC?

MMC information standard

Treat as identical from day 1?

Monitor the product going forward

Maintenance schedule check

Report WILL VALUE IDENTICALLY as traditional, if:

MMC information standard is provided and is satisfactory

We deem it a perpetuity product

The system is deemed robust

Report contents are always dependent on lender policy



MMC Information Standard



To facilitate the property security charging process for new or newly completed MMC homes, valuers, solicitors and lenders must be supplied with additional information from the Borrower and/or manufacturer (over and above normal DEV1 charging data). Please note that if comprehensive data is not available this may be detrimental to the valuation and may jeopardise acceptance as security and valuation quantum.

The full list of data required is as follows:

KEY CONTACTS

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3 Wellington Place
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LS1 4AP

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M +44 7967 555 696
agsmith@savills.com

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Savills
33 Margaret Street
London
W1G 0JD

T +44 20 7330 8624
M +44 7967 555 618
catherine.wilson@savills.com

ESSENTIAL	DESIRABLE
<p>1. State manufacturer, model type/version/code and date of manufacture;</p> <p>2. Description, detail and specification of the MMC system;</p> <p>4. Maintenance schedule, standard template to include: Comparative lifecycle replacement for building elements, compared to traditional; Additional Costs that do not arise with traditional/are unique to this product</p> <p>5. New-build Insurance warranty. Provide detail of Insurers party to the warranty providers. Memorandum of Understanding (“MOU”) or other provider (also detail steps taken to achieve warranty provider approval);</p> <p>10. Confirm identity of installation contractor; was it the manufacturer or approved contractor</p> <p>12. Building Safety :FRA & EWS1 forms</p>	<p>3. Manufacturers’ warranty if available;</p> <p>4. Maintenance schedule, standard template to include Costs of lifecycle for system</p> <p>6. [If Timber Frame: Structural Timber Association accreditation]</p> <p>7. NHBC Accepts – does the product have NHBC Accepts?</p> <p>8. Has Product ever been refused a mortgage?</p> <p>9. BOPAS Assurance (if available);</p> <p>11. EPC Rating</p> <p>13. Does your Insurer have any MMC Criteria?</p>

If any of the above data is lacking – are Building Surveyor recommendations available?



Financial Capacity

Where is the Money – No easy answer

Cash Flow

How much additional borrowing could Welsh Housing Associations service through existing cash flow and improved operating efficiency?

How much additional borrowing could Welsh Housing Associations back with existing assets?

Balance Sheet

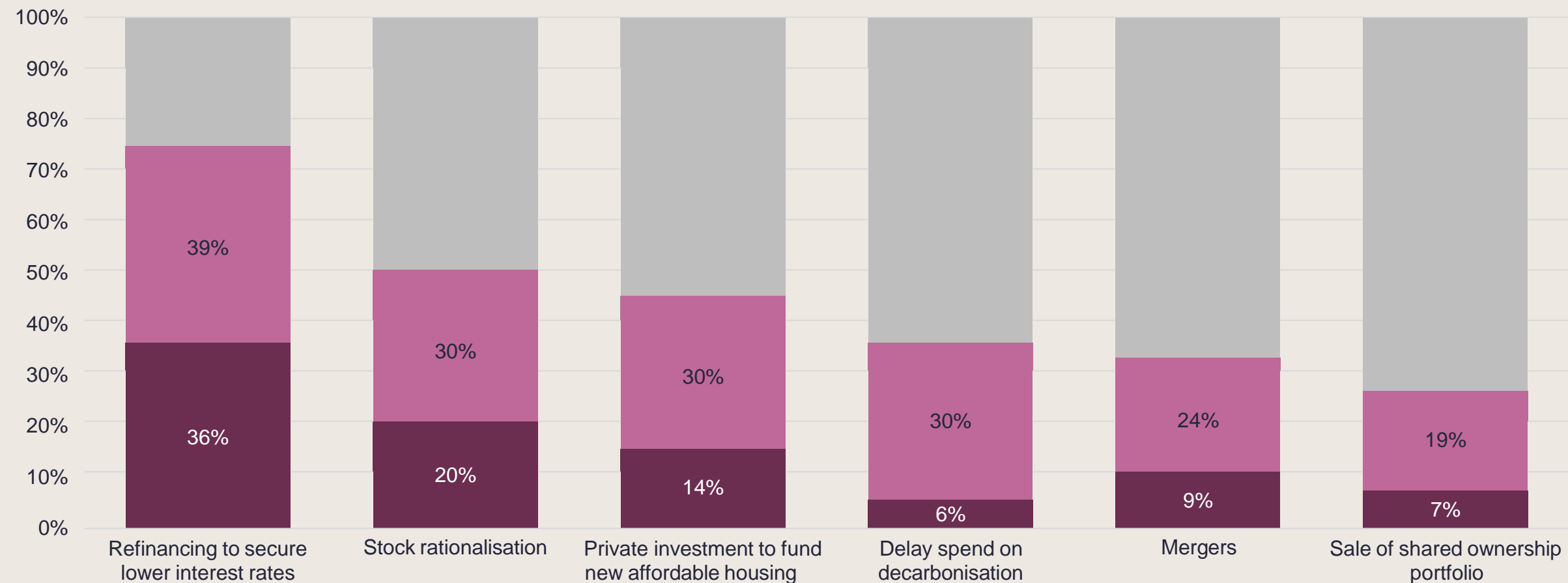
- Making the most of existing cashflow capacity
- Efficiencies in management and maintenance
- Valuations vs debt per unit
- Sweat existing assets including release security from older loans
- Asset Management and Stock Rationalisation

Unfortunately it does not grow on trees



How do you find the additional cash-flow needed?

■ We're already doing this ■ We're considering this ■ We're not currently considering this



Challenges to unlocking capacity

Management challenges, especially in rural areas

Ageing stock profile, population demographics and changing patterns of demand

Diverse housing market with significant regional differences

Some organisations still delivering transfer / regeneration promises

Methodology can be applied but parameters need to reflect these characteristics

A row of hands raised against a white background, with a dark blue horizontal band across the middle containing the text 'Q&A'. The hands are of various skin tones and are positioned as if participating in a group activity or voting. The dark blue band is semi-transparent, allowing the hands to be visible through it.

Q&A

Thank you

Thank you from Savills. If we were unable to answer your questions during this session please email Nigel Williams: nswilliams@savills.com
