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Today’s Session

- Bases of Valuation & Methodology
- Treatment of rents in EUV-SH for Loan Security
- Effect on values of:
  - -1 %
  - Cost reductions
  - Right to Buy
  - Welfare Reform
  - Deregulation
  - SAR – (Special Administration Regime)
  - LHA Rent Caps
Bases of Valuation

- RICS Valuation – Professional Standards ‘The Red Book’
- UK Appendix 13 - *Valuation of registered social housing providers’ stock for secured lending purposes*
- Valuations can be carried out on
  - Market Value (MV-STT)
  - Existing Use Value for Social Housing (EUV-SH)
- Both defined in The Red Book
Valuation Bases – What’s the Difference?

- Both are based on the same principles
  - Hypothetical sale, exchanging on date of valuation
  - Arm’s length transaction - willing buyer, willing seller
  - After proper marketing period
  - Where parties act “knowledgeably, prudently without compulsion”
  - Best price achievable

- Only difference is the assumed use
  - EUV-SH assumes use as social housing
Valuation Bases – Which One?

- For Loan Security - up to the lenders - set in the Loan Agreement
- Or borrower’s choice - different loan to value ratios
- But ....... sometimes determined by the legal background of the property being valued eg:
  - Statutory restrictions on sale eg LSVT stock s133
  - Title restrictions on use or disposal
- For Accounts, SORP requires EUV-SH
- Quality or Location of Asset
Valuation Methodology – MV-STT

- No restrictions on purchaser type
- Assumes sale to private investor
- Assumes quick increase to market rent
- Void units can be sold
- Value using evidence from sales transactions of investment portfolios
- Initial yield (typical net yields 5% - 7%)
- % of vacant possession value
  (60% - 70% for Assured Tenancies)
Valuation Methodology – EUV-SH

- Assumes sale to another HA
- Historically little or no evidence from HA to HA disposals
- Discounted cashflow “DCF” methodology
- Valuation is the Net Present Value of annual surpluses / deficits
- Assumes managed in accordance with regulatory framework
- **EXCEPT** – for loan security not Rent Standard
MV-STT Compared to EUV-SH

EUV-SH & MVSTT

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Value/Borrowing</th>
</tr>
</thead>
<tbody>
<tr>
<td>New House</td>
<td>£250,000</td>
</tr>
<tr>
<td>1990's NB Flat</td>
<td>£150,000</td>
</tr>
<tr>
<td>1930's Semi</td>
<td>£170,000</td>
</tr>
<tr>
<td>1970's PB Flat</td>
<td>£125,000</td>
</tr>
</tbody>
</table>
Attaining MV-STT at Development

- Must Be No Housing Restrictions

- *Historically*, Does Not Apply to LSVT Stock or LSVT Land (s.133) however – new asset freedom!

- Quality of Location / Type of Construction important factors

- Certificates & Restrictions
### Restrictions & Resultant Valuation

<table>
<thead>
<tr>
<th>Restriction</th>
<th>MV-STT or EUV-SH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid MPC Clause</td>
<td>MV-STT</td>
</tr>
<tr>
<td>Planning personal to HA for the development</td>
<td>MV-STT</td>
</tr>
<tr>
<td>Free or Discount Land Payback after funding repay</td>
<td>MV-STT</td>
</tr>
<tr>
<td>Free or Discount Land Payback</td>
<td>MV-STT less Land value</td>
</tr>
<tr>
<td>Rented only (no vacant sale)</td>
<td>MV-STT, but lowered</td>
</tr>
<tr>
<td>Alternative use as discounted sale</td>
<td>MVSTT or EUV-SH void sale</td>
</tr>
<tr>
<td>Sub-Market Rent, IMR, <strong>Affordable Rent</strong></td>
<td>MV-STT</td>
</tr>
<tr>
<td>Local letting</td>
<td>MV-STT <em>Lowered</em></td>
</tr>
<tr>
<td>LSVT / Binding Council Nominations</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Sale of units only to council –no spec basis</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Rented only to those in low paid employment:</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Rented to Housing Waiting list:</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Rented to local authority nominees</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Sale of units only to another HA</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Social or Affordable Rent</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Daft Rent formula</td>
<td>EUV-SH <em>?</em></td>
</tr>
<tr>
<td>“Release” after best &amp; reasonable endeavours sale to HA</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>“Release” after HA disposal hierarchy</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Local Letting/nominations- badly drafted</td>
<td>EUV-SH</td>
</tr>
<tr>
<td>Planning Personal to Specified HA for on-going use</td>
<td>Not Good Security</td>
</tr>
<tr>
<td>Not to dispose</td>
<td>Not Good Security</td>
</tr>
<tr>
<td>Recycle proceeds of disposal in LA area as Social</td>
<td>Ultra Vires ? Unworkable?</td>
</tr>
</tbody>
</table>
EUV-SH for Loan Security – Pre-Budget Treatment of Rents

- Insolvency provisions in Rent Standard (previously Rent Influencing Guidance)
- Valuers free to look at rents & rental growth outside regulatory regime
- We examine
  - household incomes
  - affordability ratios
  - market rents/LHA
- Derive an ‘affordable’ sustainable rent
- Rents adopted usually close to targets
- CPI+1% good proxy for income growth
Welfare Reform & Work Act 2016
Rent Reductions in England

- Social Landlord rents to reduce by 1% per annum for 4 years starting April 2016
- Rent cuts to be applied to social, affordable, other submarket rents, and any new lettings
- Shared ownership explicitly excluded
- Some exemptions for supported + 0.9% at last review; next year?
- Re-Letting at Last Target
- This does not currently apply in Wales
Rent Reductions – Effect on Valuations #1

- Loan Security - Market Value (MV-STT)
  - Valuations not affected by the rent cuts
  - Assumes sale outside the social housing sector
Rent Reductions – Effect on Valuations #2

- Loan Security EUV-SH valuations – not immediately affected by the rent cuts
  - Act contains Mortgagee / Successor exemption similar to Rent Standard
  - Wording was imperfect – however s.22 clarifies exemption.
- Valuer able to assume purchaser not bound
- Must make judgements around what rents and rent growth purchaser would assume
- Look at affordability and income growth as before
- But - gap between rents charged and adopted will grow

This does not currently apply in Wales – EUV-SH valuations are currently unaffected
Rent Assumptions – Valuation Pre April

- Actual rent @ CPI+1%
- Sustainable rent @ CPI+1%
- Market rent @ CPI+1%
- Loan Security rent profile
Rent Reductions – Effect on Valuations #3

- BUT, post April 2016 in England, Loan Security EUV-SH valuations will be affected
  - Starting rents successively lower each year = increasing gap to close
  - Values lower than they would have been
  - Valuer to judge reasonable rate of rent convergence
  - For many - values remain static or increase slowly over next five years
  - For some this may mean falls in value of 5%-10% without other mitigation

This does not currently apply in Wales – EUV-SH valuations are currently unaffected
Rent Assumptions – Valuation End Year 4
CPI+1% resumed – in England

- Actual rent @ -1%
- Followed by CPI+1%
- Sustainable rent @ CPI+1%
- Market rent @ CPI+1%
- Loan Security rent profile
Rent Assumptions – Valuation End Year 4
CPI flat – in England

- Actual rent @ -1% followed by CPI only
- Sustainable rent @ CPI+1%
- Market rent @ CPI+1%
- Loan Security rent profile
Special Assumptions - Valuation Projections

- Loan security valuations at EUV-SH likely to limited growth, flat-line or fall -5% to -10% over next five years in England
- Many Funders asking for forward projections of value
- No “Special Assumptions” as yet.
- Valuers need to be clear about assumptions made
- Appreciate things can and will change
Rent Reductions – Effect on Valuations #4

- **Accounts** valuations (EUV-SH) – affected
  - Can’t benefit from exemptions
  - Must reflect full impact of cuts – likely to fall by 20% - 30% or more without other mitigation

- **Stock Rationalisation** valuations / pricing – affected
  - Bids will reflect rent reductions
  - Difficult to judge current appetite
Are our EUV-SH valuations correct?

- Recent years – body of market evidence
- Portfolios – ie As One Lot EUV-SH correct
- Lotting – plus 20% / 30%
- Depends how we are instructed for EUV-SH:
  - Loan security valuations “One Lot”
  - Accounts valuations “Lotted”
- Clear that HAs maximise bids by various means
- **BUT** – evidence is from a Pre-Budget world
Evidence of Sales from Stock Rationalisation

Spread of Bids by lot and EUV-SH

Price Per Unit

£0  £20,000  £40,000  £60,000  £80,000  £100,000  £120,000  £140,000  £160,000

Lots sorted by EUV-SH per unit
What else could impact on values?

- Some things we can quantify .....  
  - Reduced operating costs?
- But effects of others uncertain .....  
  - Provisions of Housing Bill  
    - Right to Buy? – **to be abolished in Wales**  
    - Pay to Stay? – **is this likely in Wales**  
  - Reductions in Universal Credit Cap  
  - Reclassification / Deregulation
Reduced Operating Costs

- Most HAs identifying cost savings
  - Repairs & Maintenance
  - Management
- Valuers need to consider revised plans
- Justify assumptions changes
- **BUT** – many valuations already reflect optimal costs
Housing Bill - Extended Right to Buy

- Full detail awaited
- Voluntary
- Impact likely to vary with geography
- Northern HAs will struggle to replace with new build on 1:1 basis
- Positive for values where can replace more than 1:1
- Opportunity – are the sites out there?
- Does not apply in Wales as RTB to be Abolished
Welfare Reform - Pay to Stay

- Provisions in Housing Bill
- Out to consultation
- High earners in Social Housing to pay market rents if household earns above
  - £40,000 in London
  - £30,000 elsewhere
- Estimates of numbers affected vary: BBC 340,000 / English Housing survey 480,000
- Implementation issues
- Higher rents may increase revenue
- BUT – tricky to reflect in valuations

This does not currently apply in Wales – is it something the WG will consider?
Welfare Reform – Reduced Benefit Caps

- **Lowering the Universal Credit Cap**
  - from £26,000 to
  - £23,000 in London
  - £20,000 elsewhere

- **Also:**
  - A freeze on working age benefits for 4 years from April 2016
  - Includes a freeze on Housing Benefit – end the HB ratchet
  - No Housing Benefit for 18 - 21’s
  - Valuers need to consider effect on rent collection
Discount Rates?

- On the positive side .....  
  - new entrants
  - pricing tightening
- BUT ... lots of uncertainty
- Future risks have grown – CPI+0% post 2019
  Or - 2% are both possibilities
- Bond spreads have pushed out
- Effects of reclassification / deregulation?
- Expect to see
  - increase in discount rates
  - greater differentiation for type & geography
Special Administration Regime (SAR)

- Origins lie in Cosmopolitan – time pressure / knowledge
- Driven by HCA – want to protect credit worthiness of sector
- Coincidental – not part of deregulation
- What is Government trying to achieve?
  - Protect social housing assets
  - Protect tenants
  - Safeguard Grant
  - Preserve rights of lenders
- Are all four possible and compatible?
- In what order of priority?
SAR - 2

- Plays out in the old way – regulator intervenes and creditors hold back
- Insolvency Act 1986 Still Trumps SAR – Lenders are re-assured
- Wording is imperfect and Circumlocutory
- Nearly a problem in Definition of “Administrator” as Special Administrator may have affected existing s.106s
- “Howsoever Appointed”

- Not clear whether this applies in Wales or if it will be adopted by the Welsh Government
Brexit – What are the implications
Brexit – What are the implications

- Has resulted in an unprecedented situation of political, constitutional and economic uncertainty and we have seen some volatility across the financial markets – all of which is clearly unsettling and may lead to a drop in business and consumer confidence and spending, at least in the short term.

- Lead indicators, such as the RICS survey, revealed uncertainty pre-referendum impacted on new buyer enquires. A continuation of that uncertainty is likely to pull back price growth and transactions in the short term.

- The prospect of an increase in mortgage interest rates and a reduction in wage growth are expected to create greater affordability pressures over the medium term.
Brexit – What are the implications

- Standard and Poor’s (S&P) has issued credit downgrades to most of the housing associations it rates as a result of the Brexit vote.

- Housing associations are considered ‘government related entities’ for credit purposes, and some receive an inflated rating based on the strength of the UK as a result.

- In its judgements, it said the likelihood of Government support for housing associations now has a neutral effect on the ratings, rather than an uplift.
Thank you

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