BREXIT'S IMPACT ON HOUSING ASSOCIATIONS [BY WWW.GABRIEL-STAR.CO.UK]

THE BUSINESS PLANNERS GUIDE

We don't know what the impact of Britain leaving the EU will mean for housing associations. We don't even know when Britain will leave the EU legally. We certainly don't know the pace at which new agreements can be agreed with individual member states. Quite frankly, we don't know much about the fallout from Brexit. However, to paraphrase Rumsfeld, at least we know that we don't know many of these things.

It's common for housing associations to form a living will scenario or a "dooms day" scenario when business planning and the recent Brexit result has certainly delivered additional complexity and risk that has potential downsides. We'd like to walk you through what could form a "Worst Case Brexit Scenario" on HA's.

This paper seeks to address the items as they'd hit the sections of the primary statements.

OPERATING

Operating Costs

The strength of the pound has fallen to a 31 year low, even after rallying from its lowest ebb immediately after the result was announced. Imports of components and their constituent materials have just become 15% more expensive than on the 23rd of June 2016.

Of the UK's $664 billion imports, computers make up $17b, stone and glass make up $6.4b and perhaps most significantly gas, crude and refined oils make up $73b. We, as a country, broadly import 29% more than we export. This leads us to believe that it would be prudent to assess:

- Increased facilities, office and utility costs above inflation from years 2 -4 in your LTFP (long term financial plan). Starting from year 2 because many utility companies will have next year's prices pre-defined from contracts this year.
- Increases in major repairs years 2-5 within the LTFP.
- Increases in maintenance costs years 2-5 within the LTFP.

Many big businesses have warned of mass job cuts within the UK, this may effect some HA's more than others as redundancies are likely to be geography specific. However, consider:

- Increase in bad debts years 3 - 10.
- Marginally increased voids. (fraction of a %)

Sales & Cost of Sales

Demand for sales will be linked to what happens within the mortgage sector. There are broadly two scenarios that could play out. The best involves mortgages staying priced where they are and creeping up over the next 5 years, but as we are assessing the worst case scenario; there is the potential that mortgages dry up and we enter a short lived credit crunch world, that will last until quantitative easing kicks in.

- We advise considering what would happen if mortgages dried up, resulting in dampened sales from years 1-4.

Should assets (covered below) fall in value, then it may be prudent to conduct an impairment test with assumed lower recoverable amounts. However, it is noted that many units will be impairment tested at their "value in use" based on rental streams, which is largely insulated from the Brexit result.

- Make note of what would happen if there was impairment within your LTFP in year 2.

Should share values remain suppressed, then the SHPS pension scheme may require greater amounts of funding to service the obligation. Consider embedding an assumption that reflects a worsening pension deficit position.

- Costs of employment to rise marginally (years 2-15).

SUPER EXCEPTIONAL

Super exceptional items are items of cost that are unlikely to reoccur. One such item would be restructuring.

It may be worth considering the cost of a potential restructure should the above costs in the operating section materialise. We suggest a small but prudent restructure cost in year 2 of the business plan.

FINANCING

There are a broad range of forecasts predicting the effects on financing within the UK; a helpful view of the main contenders along with the weaknesses within their models explained can be found in "Source (financing impact)" at the bottom of this document.

However, the most skeptical view is that trade (GDP) within the UK will be hit by 9.5%. In this case, banks will largely see lending as a riskier option and embed this risk into the price of their financial products.

This is backed up by Moody's recent downgrading of the UK's credit outlook from stable to negative. However, Moody's has also reaffirmed that the UK as a whole will remain a AA+ country.

All of the above may result in the cost of financing, specifically future bonds increasing.

- We recommend that new debt required within your LTFP has a scenario where it costs 0.25% more to borrow.

Under FRS102 both pensions unwinding and non-effective hedging is reported within financing. We suggest making a prudent medium term assumption around these items.

- As pension deficit may increase, assume a greater unwinding cost (years 2-15).
- Assume mark to market pricing goes away from the HA in year 2 of the plan.

ASSETS

If sales fall and financing costs increase, it is natural to assume that values of properties will fall. This will affect the assets held at fair value.

- Model a decrease in value of assets held at fair value.

Should the UK economy slow down and uncertainty increase, then it is reasonable to assume that existing tenants have less ability and less inclination to stair case within existing shared ownership properties.

- Consider modelling a decrease in your stair casing forecast.

LIABILITIES

Pension obligations are likely to rise (with the movement taken as an actuarial loss through the OCI).

- Consider modelling a decrease to in the value of your pension scheme (increase in obligation, and increase in servicing costs). Years 2 – 15.

CONCLUSION

It is part of the role of good business planning to be aware of what a worst case scenario looks like and we hope the above points go some way to reflecting the possible negative effect of Brexit upon HA's.

It should be noted that the above points do not constitute our points of view, but simply reflect an amalgamation of the bleakest forecasts from reputable sources.

THIS PAPER WAS MADE POSSIBLE BY USE OF THE FOLLOWING SOURCES

Source (employment): http://www.theguardian.com/politics/2016/jun/24/brexit-vote-business-leaders-call-for-urgent-action-to-shore-up-uk-economy

Source (financing impact): https://next.ft.com/content/68c61094-3870-11e6-a780-b48ed7b6126f

Source (sterling index): https://next.ft.com/content/8d8a100e-38c2-11e6-a780-b48ed7b6126f

Source (major imports): http://atlas.media.mit.edu/en/profile/country/gbr/

Source (mortgages): http://www.telegraph.co.uk/personal-banking/savings/brexit-outcome-what-it-means-for-savings/

Source (financing / Moodys) http://www.independent.co.uk/news/business/news/brexit-moodys-downgrades-uks-credit-outlook-from-stable-to-negative-a7102031.html