East Midlands Housing Group Limited

VALUE FOR MONEY STATEMENT

FOR THE YEAR ENDED 31ST MARCH 2018

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EXECUTIVE SUMMARY

Delivering **Value for Money** is integral to the way the Group operates and as such is overseen directly by the Group Board. A key part of delivering our services as efficiently as possible is understanding the costs and main drivers, setting targets for key financial measures and understanding how our costs compare to our peers. We adopted the new **Sector Scorecard** approach during the pilot last year and have since started to embed this within our financial management and budgeting process.

OVERVIEW AND FINANCIAL PERFORMANCE

The Sector Scorecard, comprises a number of indicators across 5 categories:

- Business Health
- Development
- Outcomes Delivered
- Effective Asset Management
- Operating Efficiencies

These indicators; mostly taken directly from our financial accounts, allows us to track our progress with delivering cashable savings and demonstrate how we are controlling costs whilst still delivering our core services and developing new homes.

We welcome the regulators new *Value for Money Standard* and associated *Code of Practice* which sets out very clear expectations for *Registered Providers* in how they demonstrate that they are delivering Value for Money through their services and over the coming months we will be reviewing and updating our *Value for Money Strategy* to align it to the *Standard* and the *Sector Scorecard.*

We apply a commercial approach to our decision making and our new leaner operating model requires us to focus our attention on the activities that support the achievement of our corporate objectives. As such we have fully embraced the *Sector Scorecard* approach to delivering and measuring Value for Money as it closely aligns with our business objectives.

We delivered strong performance against the key measures in the Sector Scorecard during the year and our key highlights include:

- Maintaining **top quartile** performance for total social housing cost per unit
- Improved EBITDA from **164.5** to **177.3%**
- Delivered **340** new affordable homes achieving **1.9% growth** in units
- Delivered **£1.7m** efficiency gains in cash terms during the year

SECTOR SCORECARD

	EMH GROUP 2018	EMH GROUP 2017	TREND	PEER GROUP 2018*	RANKING 2018**
UNIT COSTS					
Headline social housing unit cost	£2,413	£2,487	↑	£3,220	Upper Quartile
Management	£849	£960	↑	£932	Upper Quartile
Service charges	£366	£353	↓	£363	2nd Quartile
Maintenance	£759	£721	↓	£906	Upper Quartile
Major repairs	£438	£448	↑	£756	Upper Quartile
Others	£1	£5	↑	£191	Upper Quartile
BUSINESS HEALTH					
Operating margin (excl surplus on sales)	31.4%	31.6%	↔	29.1%	2nd Quartile
Operating margin – social housing lettings	36.0%	35.7%	↔	32.7%	2nd Quartile
EBITDA MRI % interest cover	177.3%	164.5%	↑	187.8%	3rd Quartile
DEVELOPMENT CAPACITY					
Social housing units developed	340	392	↓	300	2nd Quartile
Social housing units developed as % of unit owned	1.9%	2.1%	↓	0.7%	2nd Quartile
Gearing	49.7%	55.1%	↑	44.7%	3rd Quartile
OUTCOMES DELIVERED					
Customer satisfaction with services provided by landlord	81%	75%	↔	83.5%	2nd Quartile
Reinvestment %	6%	7%	↓	6%	2nd Quartile
Rent collected	99.9%	100.7%	↔	99.7%	2nd Quartile
EFFECTIVE ASSET MANAGEMENT					
Return on capital employed	4.1%	4.2%	↔	4.2%	2nd Quartile
Occupancy	99.3%	99.0%	↔	99.4%	3rd Quartile
Ratio of responsive repairs to planned maintenance	1.06	0.90	↓	0.69	Bottom Quartile

*Peer group median (peer group consists of approximately 70 other Housing Association; LSVT and traditional; managing in excess of 10,000 units in the year in England)

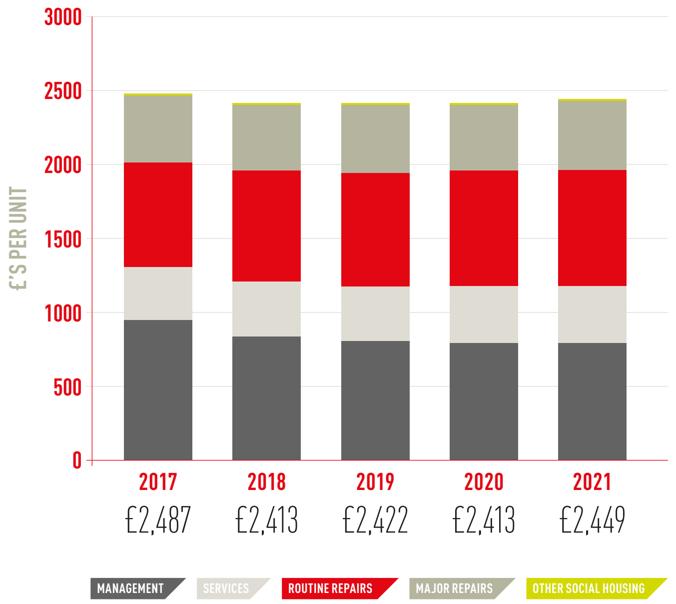
**Ranking system against peer group ● Upper Quartile ● 2nd Quartile ● 3rd Quartile ● Bottom Quartile

↑ Indicator has improved ↔ Indicator has stayed the same (or within 1% of prior year) ↓ Indicator has worsened

UNIT COSTS

The graph below shows how we continue to challenge ourselves on the routine costs of delivering our core social housing activities.

UNIT COST ANALYSIS (EXC PENSION) 5 YEAR TREND



2017 and 2018 are actuals taken from our latest audited financial statements. 2019, 2020 and 2021 are projected costs from our latest Board approved financial plan. For comparability with other registered providers we have excluded the direct costs of delivering our care & support activities from our unit costs. These costs are funded through their own income streams and are contained within a separate subsidiary where we measure the profitability of each activity separately. Even with the inclusion of these costs, our total cost per unit for 2018 is **£3,172** which is still better than the median for our peer group.

Our 4 year efficiency gains programme will conclude in 2019; delivering in excess of **£4.7m** cashable savings from our operating costs to compensate for the lost income from the Government forced rent cuts (1% annually from 2017 to 2020). Our strategy to sustain these savings post 2019 is to contain any increases in unit costs below inflation and deliver efficiencies through growth in unit numbers; both of which have been built into the assumptions in our latest financial plan.

Our unit costs continue to compare favourably against our peer group with a total social housing cost per unit of **£2,413** being the in top quartile when compared against similar organisations. In particular, our management costs are now top quartile at **£849** per unit, having reduced from **£960** through the restructure of our operational and back office teams as part of our targeted efficiency gains. This **12%** reduction has been achieved whilst maintaining our front-line services and improving customer satisfaction and by comparison the peer group median has reduced by just **3%**.

Service charge costs are now better then the peer group median with our cost per unit increasing by **4%** compared to the peer group median increase of **7%**. This increase is a result of both inflationary price increases in the services provided and the addition of new extra-care schemes which attract significantly higher costs.

Maintenance cost per unit have increased in line with our peers at **5%** and are now in the top quartile. This increase in costs is predominantly a result of delivering on our promise to complete a programme of **fire safety** risks assessments and remedial works to all of our properties which incurred additional costs during the year.

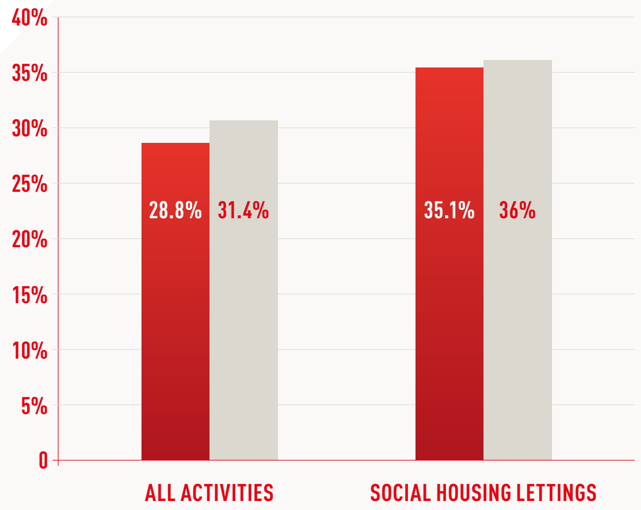
BUSINESS HEALTH

As a responsible landlord, we aim to balance the delivery of quality services to our existing customers with the provision of new homes to meet growing demand. We are a *profit for purpose* organisation; aiming to maximise the operating margin on our core social housing activities whilst maintaining customer satisfaction. Surpluses are then reinvested back into the capital reinvestment in our existing properties and the development of new homes to meet the diverse range of housing need within our geographical area of operation.

Our results for 2018 compare favourably to our targets; achieving an overall operating margin of 31.4% against the target of 28.8%; largely attributable to a few areas:

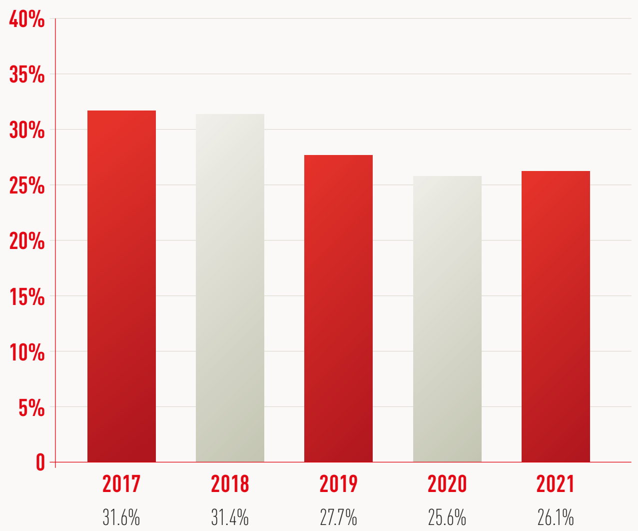
- We improved the margin on our core social housing activities through lower bad debts and rent loss as a result of our robust income collection strategy and improved management of empty properties
- We achieved higher than expected savings on our care & support costs following the collapse of the 2 legal entities into one along with a new management structure
- We experienced higher volumes of first tranche sales than expected and generated an average surplus of £12k on each property sold

OPERATING MARGIN:

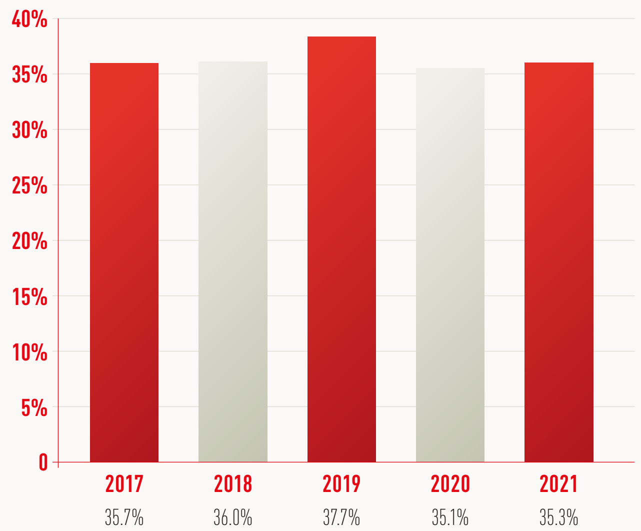


Whilst there are significant pressures on our finances from the challenging operating environment, the operating margins on our core social housing lettings remain strong. We aim to increase our income each year despite the curtailment of our social rents through the forced 1% annual reduction over the 4 year period from 2017 to 2020, through developing new homes to generate additional rental income and robust management of our empty properties.

OPERATING MARGIN: ALL ACTIVITIES



OPERATING MARGIN: SOCIAL HOUSING LETTINGS



BUSINESS HEALTH

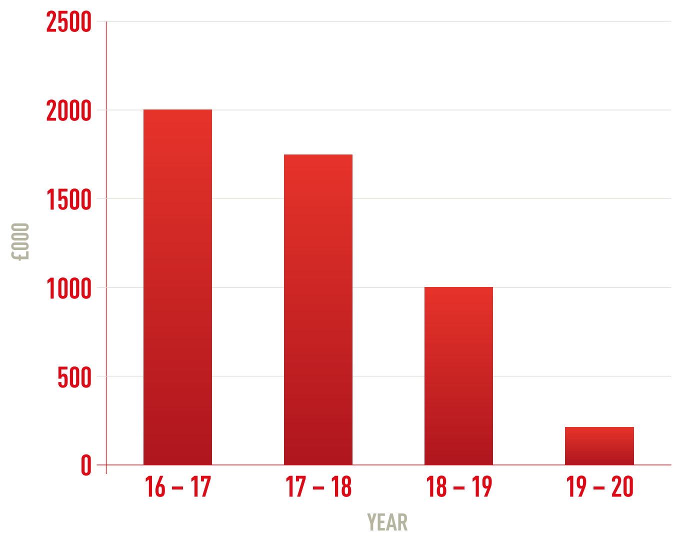
2017-18 was the second year of the 4 year rent reduction imposed by the Government in the 2015 Budget. Our Group Board responded quickly to this announcement, developing an *Efficiency Gains Strategy* that would ensure we remain financially viable whilst protecting our front-line services and development programme.

A front-loaded 4 year savings programme to deliver **£4m** of cashable savings was put in place. At the half way point we have already achieved **90%** of the total savings required and are on track to out perform the original target. We predict total 4 year savings of **£4.7m** with the restructure of our maintenance team set to deliver the required savings in 2018-19 leaving just the productivity gains within our *In-House Maintenance Service* to be delivered in the final year.

The Group's procurement regulations mean that when significant contracts come to an end they are being subjected to open competitive procurement processes. In 2017/18 new contracts were awarded for vehicle fleet, the main property services contractor, utility supply arrangements, occupational health services, employee healthcare, workwear and PPE, decorating, kitchens, and a number of others. These contracts were awarded on the basis of most economically advantageous tenders, and some in conjunction with other buying consortia, delivering a combination of cashable savings, and the right quality and levels of service.

EBITDA MRI measures our ability to generate sufficient cash from our operating activities to meet our interest commitments. Comparability with other providers is difficult due to variability in risk appetite, development strategy, and treasury policies. Our EBITDA MRI has improved again during the year due to improved operating surpluses and despite being below the peer group median, at **177.3%** demonstrates that as a group, we are generating sufficient funds to more than meet our interest commitments. We have sufficient headroom in our loan covenants, which are calculated on the results of emh homes alone and through rigorous stress-testing of our financial plan, are confident that we can continue to meet the obligations placed upon us by our funders.

ANNUAL EFFICIENCY GAINS



Our ratio of responsive repairs to planned maintenance is bottom quartile; where generally a higher spend on planned works is considered to be a more efficient and effective way for an organisation to spend its maintenance budget. This measure has been impacted during the year by significant spend on health and safety compliance works to ensure that all of our homes are safe. This was a strategic decision taken by our Board and the prioritisation of this spend has impacted on this indicator this year. The group have recently invested in a new maintenance system which will give us greater visibility over the maintenance spend and inform decision making around our future maintenance programmes.

DEVELOPMENT CAPACITY AND OUTCOMES DELIVERED

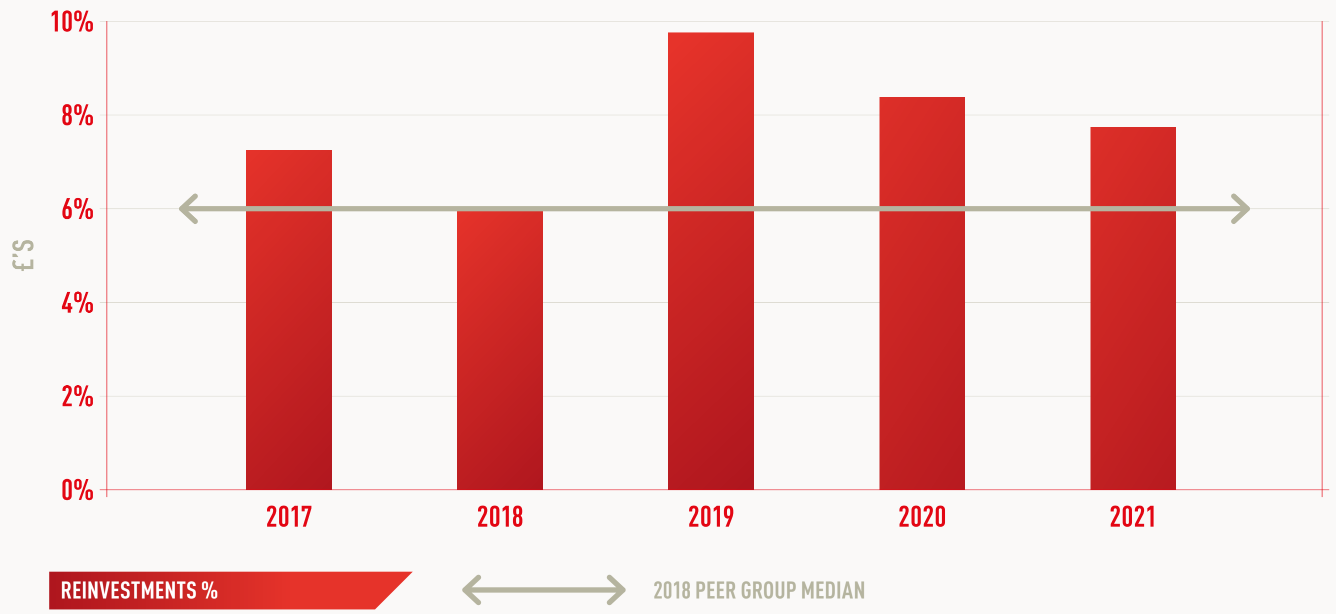
During the year we completed **340** new units and whilst this is fewer than in the prior year, the development programme is not linear and was affected by the timing of the *Shared Ownership & Affordable Homes Programme* (SOAHP 2016-21) and the hiatus on committing to new development spend following the 2015 Budget announcement on rents, whilst the Board developed our *Efficiency Gains Strategy*. With **50%** more units in the development pipeline at the year end compared to 2017, we remain on track to achieve our target of managing at least **21,500** homes by 2023 and have recently put resources in place to support our growth ambitions through expansion of our development team.

In July 2018, it was announced that emh group have been successful in becoming a *Strategic Partner* with *Homes England*; securing **£30.5m** grant funding to develop over **700** additional new homes in the East Midlands over the next 4 years. This is a prestigious status, with only 8 *Strategic Partners* across the country and gives us greater certainty over the funding of our development programme and more flexibility over the types of new homes required to meet demand in our region. We have updated our *Financial Plan* and *Business Plan* to reflect our new growth targets and are already identifying new sites with development potential.

Despite the fact that development has a negative impact on our financial viability and gearing; with each new property developed having a negative *Net Present Value* of up to **£40k**, the Board are committed to the provision of new homes. This is carefully balanced with the need to reinvest in our existing properties to maintain standards for our customers and on average we reinvest **£9m** each year back into our properties through our rolling programme of capital maintenance such as windows, kitchens and bathrooms.

The chart below summarises our reinvestment activity (taken from the Sector Scorecard definition) and demonstrates our commitment to investing excess surpluses into maintaining our existing stock and building new homes.

REINVESTMENT

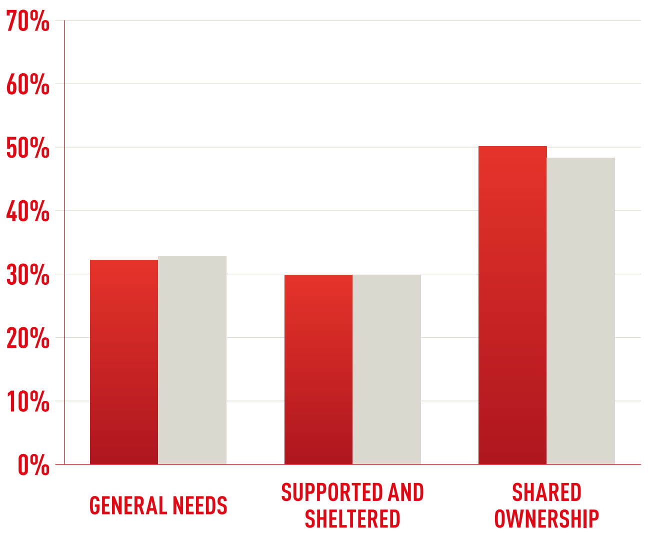


EFFECTIVE ASSET MANAGEMENT

As the majority of our income is asset generated, we measure the overall return on investment and operating margins for each significant class of income generating asset as identified in our audited accounts. The charts below show that year on year we have achieved strong operating margins of between **37%** and **55%** across the 3 categories of assets.

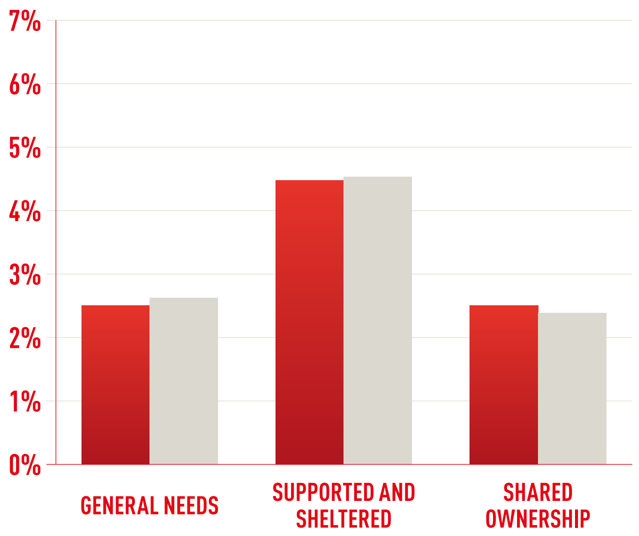
MARGIN

2018 | 2017 (RESTATED VALUATIONS)



RETURN

2018 | 2017 (RESTATED VALUATIONS)



This improvement in operating margin has been matched by an increase in the value of our properties to give returns of between **3.0%** and **4.8%** for the year. We have seen increases in the re-valuations of properties within our portfolio during the year due to the reinstatement of the rent settlement of CPI plus **1%** for 5 years post 2020 driving improved cash flows. As such we have restated 2017 for comparability.

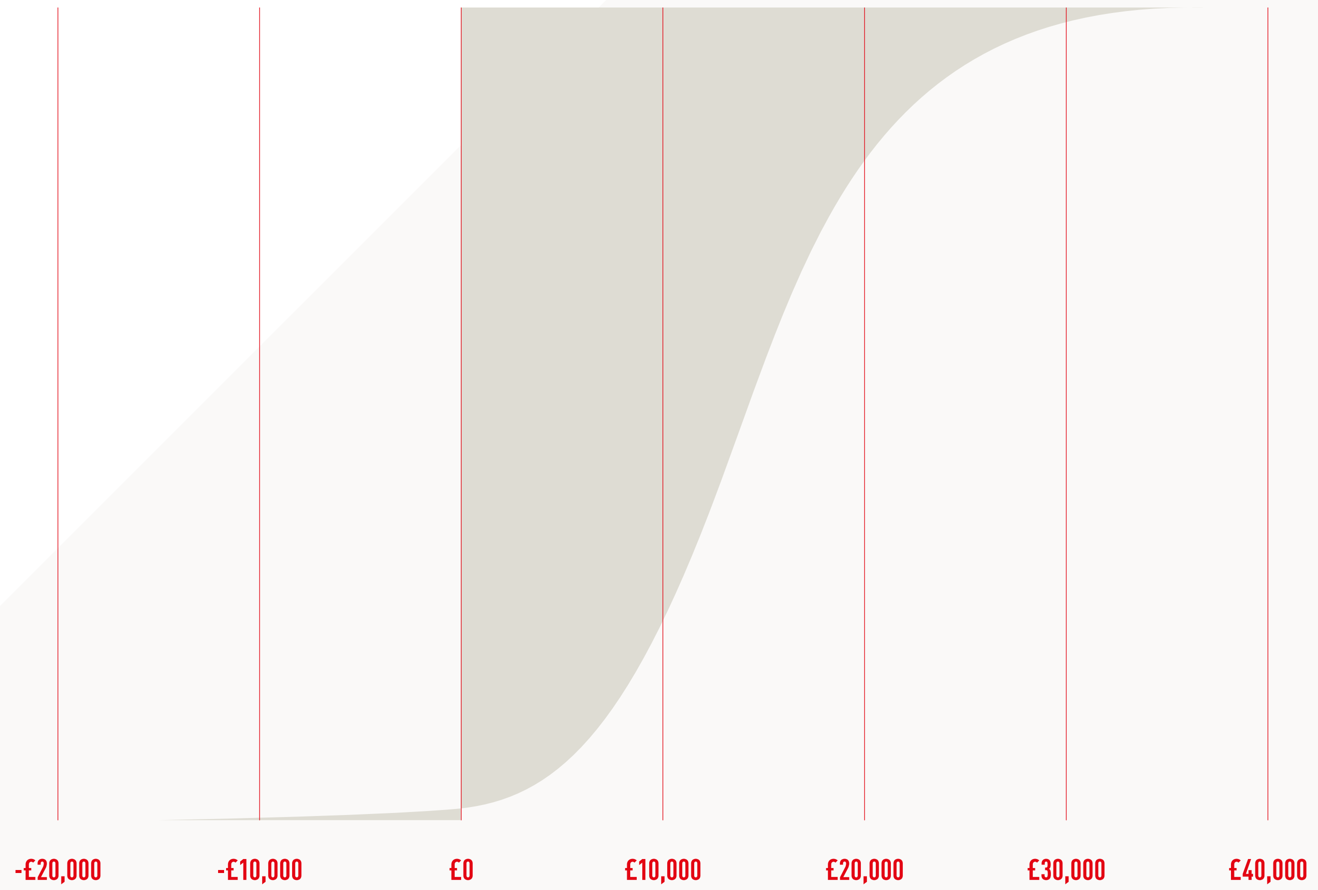
We also measure the returns on individual assets in line with our *Stock Rationalisation Strategy*. Any property that generates a net present value of **£2,500** or less is not considered financially viable. In the last financial year we voluntarily disposed of 24 poor performing properties, a homeless hostel and disused office premises; generating sales proceeds in excess of **£2.3m**.

EFFECTIVE ASSET MANAGEMENT

The chart below summarises the outputs from the model by property.

NET PRESENT VALUES BY PROPERTY / ALL PROPERTIES

TOTAL



We continue to appraise properties as they become vacant and have set ourselves a target to achieve at least **£0.5m** per annum in net sales proceeds from the voluntary sales of properties that are deemed financially unviable. We are actively managing those properties that have been approved for disposal by the Board and will look to incentivise tenants to vacate properties where appropriate so that disposals can be accelerated.

EFFECTIVE ASSET MANAGEMENT

The chart below summarises the outputs from the model by property.

LOW AND NEGATIVE NET PRESENT VALUES