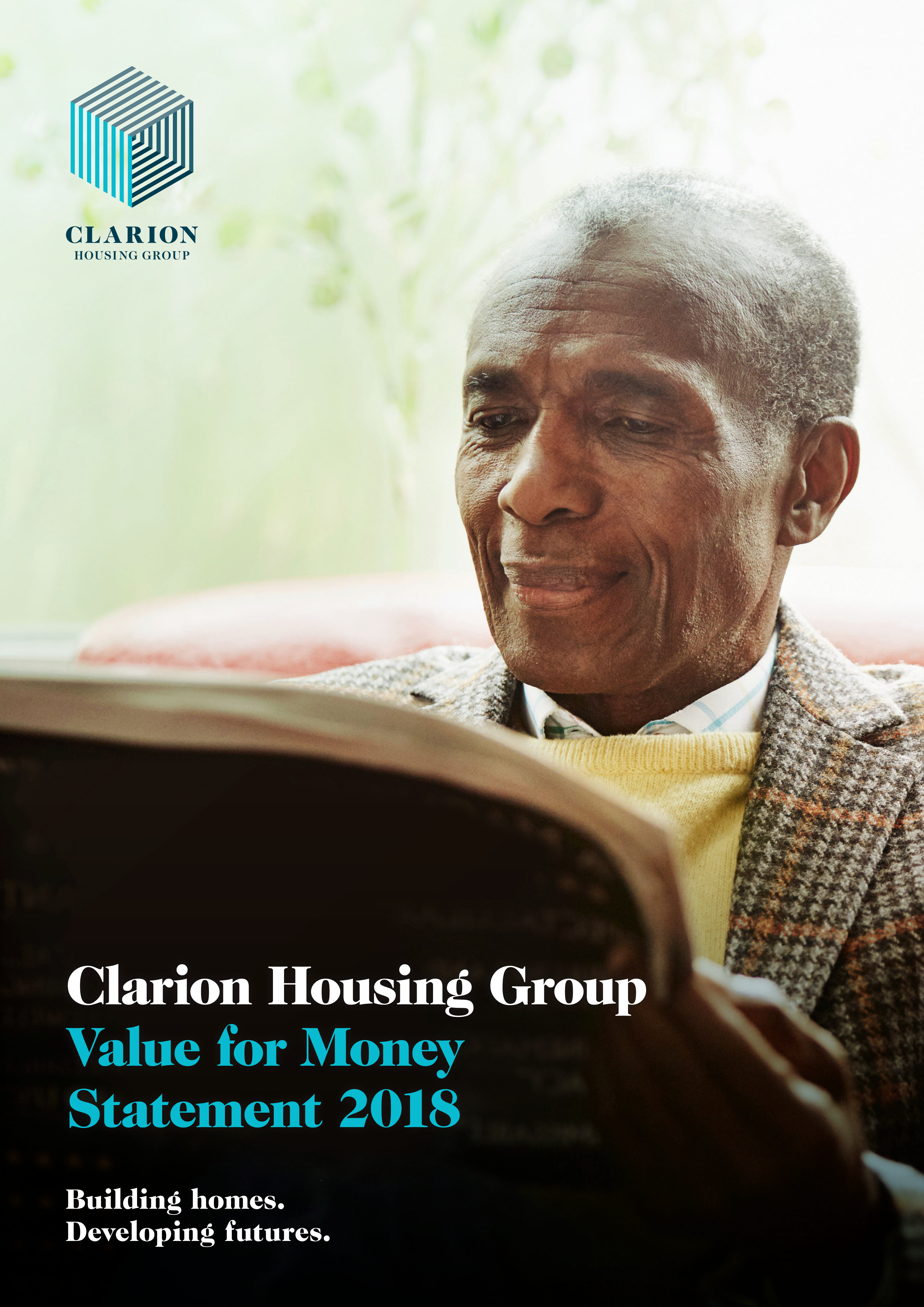


CLARION
HOUSING GROUP

Clarion Housing Group
Value for Money Statement 2018

**Building homes.
Developing futures.**

Highlights

Clarion Housing Group is a business for social purpose. First and foremost we are a social landlord and our charitable aims are to house people who cannot meet their housing needs in the market. We build new affordable homes and we invest in maintaining our estate. Being efficient and effective is critically important. We do not distribute profits, so every penny we earn is reinvested in the business to deliver our charitable aims.

This is the first full reporting year for Clarion Housing Group following the completion of the merger of Circle Housing and Affinity Sutton in November 2016 creating the largest social housing group in England. Our merger created an organisation with the capacity to deliver a significant programme of new homes, however our first priority has been to restore effective and efficient services to our customers. We have made significant progress over the year culminating in the restoration of our regulatory gradings in March 2018, confirming G1 and V1, but we are not complacent. We know that in parts of Clarion the service pre and post merger was poor, and that this has left a legacy of issues which we must work hard to resolve. We are committed to addressing a legacy of underinvestment in some homes and we have embarked on a significant transformational programme of change which will deliver long lasting benefits for our residents.

This report outlines the performance of the organisation in 2018 and the journey we have commenced to establish a fully integrated Clarion Housing Group:

£15m

We expect to complete the integration of Circle Housing and Affinity Sutton releasing savings by year three of c. £80 millon compared to our pre merger costs, and bringing the Clarion operating cost per unit down below that of the former Affinity Sutton cost. In the last 12 months, excluding one-off costs of merger and taking account of inflation, operating costs have reduced by £15 million.

2%

We have set a three-year budget which will see operating costs reduce by 2% in 2018/19.

5,000 homes

We expect to be building 5,000 homes a year by 2022 and to sustain this level of output in the future. We will maximise the amount of affordable homes we build with a minimum ambition that two thirds of our programme will be at below market prices. At the end of this year we had more than 14,000 homes in our development pipeline with anticipated completion dates over the next three years.

£426m

This year we invested £426 million in new homes and £119 million in existing homes. That represents 347% of our annual surplus.

£11m

We invested £11 million in community investment programmes to benefit our residents and this is planned to continue next year. We expect to help 4,000 people each year into employment, and 1,500 youngsters to sustain their education and training.

One

We completed the simplification of the Group's legal structures creating a single asset owning housing association, to replace the 10 legacy associations we inherited at merger.

70,000

We have consolidated our in-house repairs providers creating Clarion Response which delivers responsive repairs and services to 70,000 of our homes.

ERP

We launched the first phase of our new enterprise resource planning (ERP) systems with further investment in new and streamlined processes and ways of working, in time this will lead to reducing costs and redirecting resources to create added value.

£15m

We spent over £15 million on safety work to our homes including electrical compliance testing and fire safety measures.

Our Financial Golden Rules create a solid risk framework to balance essential financial strength with maximum investment in new and existing homes.

Introduction

Both Affinity Sutton and Circle Housing before the merger had embarked on transformational change programmes. The driving force behind these programmes was to enable our customer offer to be as good as some of the leading customer service businesses in the country. We know from our customer insights that our customers increasingly want to access services digitally. Our legacy systems did not support that ambition. We also know that investing in new ways of working and new systems will deliver longer lasting efficiencies, which will benefit our current and future residents.

Given our commitment to providing a blend of excellent service and value for money we are investing in a major programme of business change that will transform the way we do business and further reduce our operating costs.

This Value for Money report sets out our ongoing commitment to achieve value for money for residents, stakeholders and investors. The report highlights a number of measures we have taken to drive further efficiencies, despite ongoing uncertainties in our operating environment.

Our financial strength

This year the Group made a net surplus of £157 million on a turnover of £829 million generating an operating margin (excluding disposals) of 33.3% which demonstrates a strong financial performance in a year of great change for the business.

79% of our turnover is derived from our core business of social rents and service charges which delivered Social Housing Interest Cover of 167%, demonstrating strong underlying performance and showing that we place no reliance on asset sales or build for sale - just 13% is derived from development sales. As a business we have been keen to limit our diversification to what is required to support our core social mission given limited government support in recent years for rented housing. Our plans for the next decade will see us develop a greater proportion of homes for sale, double our current programme, but we are committed only to doing what we need to be able to deliver our social housing ambitions.

At 33.3% (2016/17: 31.7%) the operating margin (excluding disposals) of the Group at year end remains strong despite some very real cost pressures during the year, principally arising from additional repairs and maintenance spend on former Circle Housing owned properties to rectify historic underspend, and fire safety work in the aftermath of the terrible tragedy at Grenfell Tower.

EBITDA MRI which measures the headroom the business has from which to meet its long term interest costs is 152.1% at year end, the reduction in this indicator reflects the additional £44 million capital expenditure on homes this year compared to the previous year. Despite that, the indicator demonstrates the robustness of the Group's overall financial position. Our 10 year forecast anticipates that EBITDA MRI will be at or above 160%.

This year the Group invested £119 million in capital major works, which represents a long-term investment in our existing housing stock with an additional £426 million invested in new homes for a range of tenures. We completed 1,263 new homes during the year and these homes were delivered with limited grant funding. For every £1 generated from operations we spent £1.07 on new homes, this is money generated from our own resources and demonstrates our commitment to investing in new homes in line with our charitable mission to provide homes for those excluded from the market. Running the business as efficiently as we can enables us to maximise this investment. During the year we started construction on 1,428 new homes, and at the year end we had c. 14,000 new homes in the development pipeline.

Our investment in new and existing homes at £545 million, was 3.5 times greater than our annual surplus.

Our year on year focus continues to be to keep operating costs under control and to forecast no growth in underlying costs. At the year end the Group had a headline social housing operating costs of £4,510 per home. This is higher than previous years and reflects the significant effort during the year to tackle previous service performance issues. Our clear ambition is to achieve costs which are lower than the operating costs of the former Affinity Sutton, which we expect to deliver within 3 years.

We have made a start in agreeing a three year budget which will reduce our operating costs by 12% below current costs by 2021 in real terms. Each year we maintain a savings register and we validate all entries at the year end. This year specific efficiency initiatives across the Group resulted in savings of more than £16 million.

Delivering social value in our communities

We run our business on commercial lines, with a keen eye on both effectiveness and delivering value for money, and clear distinction between commercial and charitable activity. It is because of this that we are able to channel so much of the money we make into delivering social benefits for the communities in which we operate.

The work we have produced with HACT to develop a set of financial values which can be attributed to particular interventions is increasingly being adopted by other landlords in the sector. Being able to quantify the impact of our investment on people's wellbeing has proved invaluable, not only in helping us to understand the return on our investment, but also as we refine and develop our community investment programmes.

This year we have achieved a social benefit of £96 million, this compares to £85 million in the previous year, and reflects our increased emphasis on this work post merger. We want all our residents to benefit from the investment we make.

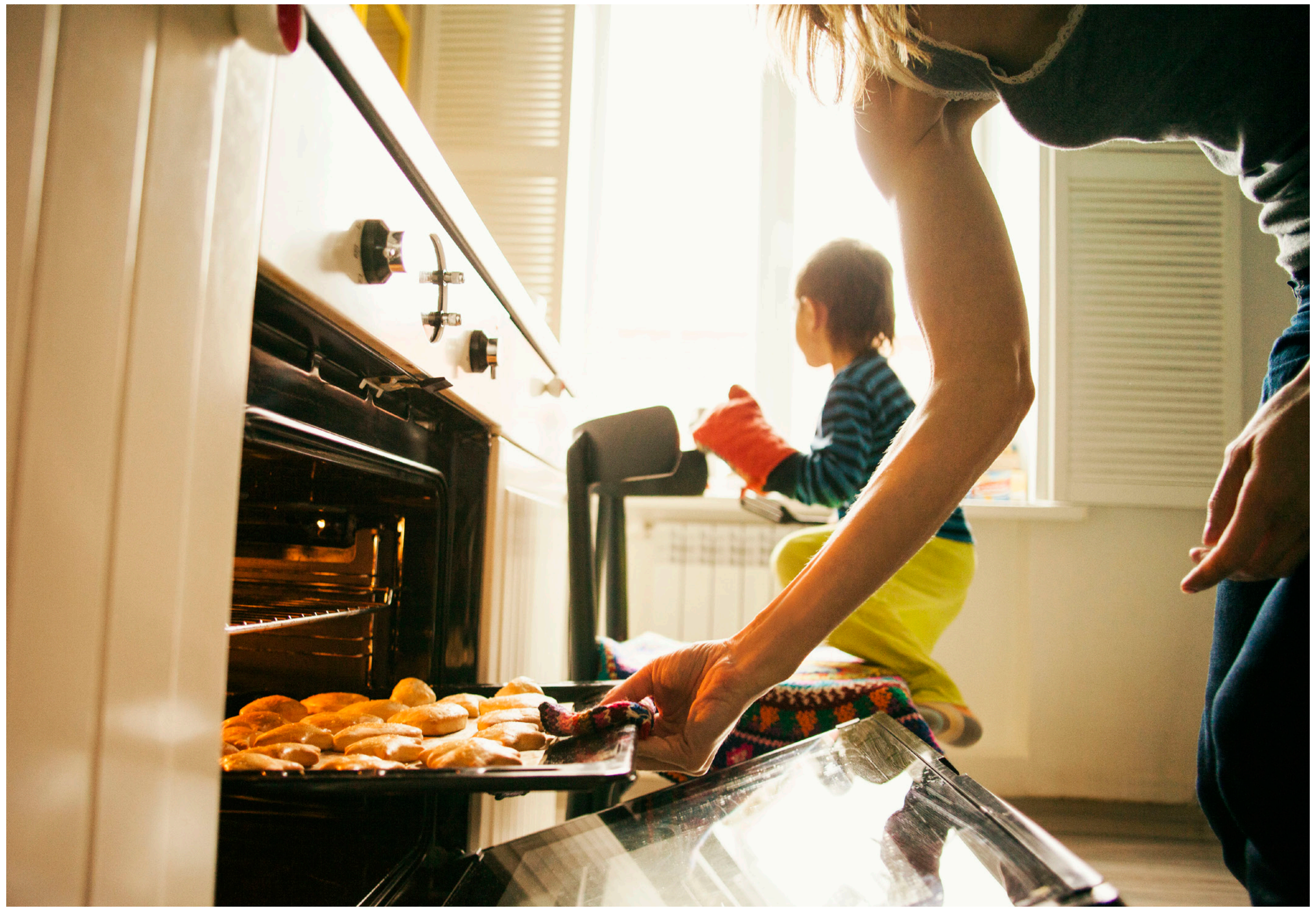
Clarion's investment has a significant direct impact on improving the lives of our residents and their communities. Post merger the Board agreed to prioritise a significant increase in our spending on communities from just under £7 million of our own resources growing to £10 million this year and to continue at that level. This will enable the Group to offer a comprehensive service for all our residents wherever they live.

An important element of our community investment programme is our employment service. We believe that finding our residents work is the best route we can offer to financial independence and reduced dependency on welfare. Over the last year we have also been the lead agent for a group of housing associations who have rolled out employment services across London with funding from the Greater London Authority and the European Social Fund. This year the service helped a record 3,035 people to find work. In addition to this, we also achieved another record by providing 218 apprenticeships, helping those young people to learn vital work skills.

Our community foundation, Clarion Futures, has prioritised future investment in young people who are residents and the children of residents. Over the next few years we expect to be helping 15,000 young people annually to fulfil their potential through apprenticeships, training support and bursaries.

The Group continues to prioritise financial inclusion work and debt advice services which are more in demand than ever. Helping our residents to access affordable loans saved an estimated £16 million in reduced payments and debt write-offs.

We have also continued to invest in Welfare Advice Services for our residents helping them to claim benefits which they are entitled to. This work alone has benefitted our residents by securing an extra £7 million in income they would otherwise have foregone.



Our assets

The Group has nearly 125,000 properties across England. Some of these homes date back to the turn of the last century while others, for example those from local authority stock transfers were built in the 1950s, 60s and 70s.

It is incumbent on all housing associations to make the best use of their assets and we continue to improve on our approach. We have two main tools by which we inform our future investment and disposal decisions:

1. The first is a qualitative scoring system for our estates based on a range of management and customer indicators, helping us understand how much effort an estate takes to manage and the desirability of the estate to current and prospective tenants. This is informed by tenant turnover, current tenant average stay, re-let times, contact volumes, account balances, void loss and repairs volumes. It can be used to compare estates and can then be used to measure impact gained due to any interventions we make.
2. The second is a discounted cashflow model that provides net present values, yields and vacant possession values for our properties, helping us understand how much our properties will make (or cost) us over the coming 30 years in today's money. Our reinvestment team use the model to identify poorly performing estates based on their financial performance and carry out an options appraisal looking at the fabric of the buildings and wider environmental works involving a number of different departments in the organisation.

It is critically important that we manage our assets carefully in order to derive the most value from them. Our total maintenance spend in 2017/18 was £313 million, which reflects day to day maintenance spend, investment in replacement components such as kitchens, bathroom, boilers and windows as well as energy efficiency, environmental and estate improvement works. We have worked hard this year to tackle some of the historic under investment in the homes previously owned by Circle Housing. It will take time to bring all our homes up to the same standard but a key priority this year has been on safety works and in particular fire safety measures.

Last year the Group carried out 294,560 responsive repairs. At the year end we delivered 67% of all repairs service in-house through Clarion Response. The remaining services were provided through contracts awarded to long term partner contractors. 90,000 heating repairs were undertaken, reflecting heightened demand during the cold period but also influenced by a legacy of under investment in some homes. Post merger there has been a significant amount of work to do to integrate both legacy services and to ensure the arrangements provide a good service for residents. We have taken several initiatives this year to improve the efficiency of our in-house service including reducing the use of sub contractors, absorbing the impact of inflation on running costs and improving our void and empty property turnaround times. We are developing a 'Clarion Homes' standard which all our homes will meet, and which will set the benchmark for our future investment plans.

Each year we dispose of housing stock which is no longer suitable for the provision of social rented accommodation. In 2017/18 year we generated a surplus from disposals of £29.2 million. Our long term financial plan anticipates a programme of sales of social housing to other registered social landlords which will generate money we can use to develop new homes, whilst keeping those we sell in social housing. We will begin to pilot work in this area shortly to test the market appetite for disposals in sector and to work with our residents to identify suitable landlords.

New homes

Clarion aims to be a developer of homes at a significant scale. Over the last year we have built 1,263 new homes across a range of tenures. Central to our development programme is ensuring we are able to focus on those who are failed by the market. Those homes were developed with just 4.4% of public subsidy. Supporting a programme of this scale has required us to undertake commercial activities to generate returns to fill the gap left by shrinking public funds.

This year's financial surplus of £157 million should be seen in the context of the £439 million long-term investment we made in social housing over the last twelve months. We invested £320 million into the construction of new social housing properties. More than twice our annual surplus was applied to our core social housing activity through a programme of planned improvements, as well as the development of new social housing.

Procurement

The Group maintains a savings register which is independently verified and lists all savings achieved through procurement. We strive to consistently realise savings in procurement on a year on year basis delivering value through both tender processes and contract management.

Procuring long-term suppliers to deliver better core services has been a focus of our work since merger. This has involved bringing together different legacy arrangements to deliver consistent services across our homes. Total savings achieved in 2017/18 which offer significant levels of savings in future years stand at £7.8 million compared to existing costs. Procurement aims to ensure value for money and is achieved at the awarding of contracts and extends to strategic delivery. We expect to deliver additional value from the tender process as well as ongoing contract management.

Transparency and scrutiny

Our Group is committed to transparency. We publish detailed information about our spending, both on our website and in financial statements. This year we have taken the opportunity to include in our Value for Money Statement the metrics developed by the sector led Efficiency Working Group which we think helps illustrate the outcomes we achieve.

Our website contains details of payments to top suppliers, action taken to combat tenancy fraud, delivery performance on our affordable homes programme, our current regulatory rating, our code of conduct and the results of resident scrutiny. Our Annual Report and Accounts show details of the pay and reward offered to our staff and board, as well as key statistics and performance information.

Our residents remain at the heart of everything we do. Regional Scrutiny Boards (RSBs) and Service Improvement Panels, for example, are engaged in examining our performance in core areas of the business and making service improvement recommendations to the Board. This has included recommendations on door entry systems, communal lighting, untidy gardens, measuring success, and the roles of estate based staff.

Transforming the way we do business

The Group recognises that simply driving cost savings will ultimately result in diminishing returns and also runs the risk of reducing levels of service. In order to mitigate this we have invested in a major programme of transformational activity that goes beyond traditional continuous change processes and will deliver ongoing benefits to residents and a significant return on investment.

This group-wide change programme, 'FF2' will result in a transformation of service provision, working practices and customer experience. We launched the first phase of this work in April 2018 and we expect to have the whole business working on fully integrated common systems by early 2019, just over two years post the largest merger in the social housing sector. These changes will ensure that the business is equipped for future growth in line with the Group's ambitious growth strategy as well as providing a step change in the level of service to our customers, staff and business partners.

This programme is ambitious and timely, and it is unique in the sector. It will provide an integrated solution which is scalable for the business and which we can use as a platform to grow.

Clarion Housing Group - Sector Scorecard

	2017/18	2016/17
Operating margin (excluding disposals)	33.3%	31.7%
Operating margin (social housing lettings)	36.2%	34.5%
Interest cover – EBITDA (MRI)	152.1%	173.3%
New supply delivered: absolute (social and non-social)	1,263	1,340
New supply % (social and non-social)	1.07%	1.14%
Gearing	50.4%	48.7%
Customer satisfaction	80.0%	76.7%
Reinvestment	8.0%	5.4%
Investment in communities*	£10.8m	£7.9m
Return on capital employed (ROCE)	4.0%	4.0%
Occupancy	98.5%	98.4%
Ratio of responsive repairs to planned maintenance	63.6%	84.7%
Headline social housing cost per unit	£4,510	£4,371
Management cost per unit	£750	£758
Service charge cost per unit	£530	£558
Maintenance cost per unit	£1,558	£1,657
Major repairs cost per unit	£229	£225
Capitalised major repairs cost per unit	£1,089	£696
Other social housing costs cost per unit	£355	£478
Rent collected	99.8%	99.8%
Overheads as a percentage of adjusted turnover	10.5%	11.8%

*This includes external funding

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