Knowsley Housing Trust Limited
Value for Money Summary Statement
for the year ended 31st March 2019

Our Strategic Approach to Value For Money

KHT's mission, together with colleagues in the wider First Ark Group, is to deliver first class homes and services that help people and organisations to flourish.

KHT is in the final year of its current strategic 5 year plan. This will be updated and refreshed by the new Board and Executive team, and form the basis of our budgeting and planning for the financial year commencing in April 2020. Its priority will be to return to full regulatory compliance, refocus the business on its core housing operation and prudently expand on our development programme. As a Group we have undergone a period of significant change and our new strategy will underpin the next stage of our journey.

KHT retains an ambition for significant property development over the next 5 years with 610 new properties planned, being a mixture of shared ownership and affordable rental properties. We will also invest in existing homes, guided by our Asset Performance Evaluation Model and the outcome of our comprehensive stock condition survey. Our investment will be funded by a combination of a refreshed Value for Money strategy, which will drive improvements in operating margins, and an increase in gearing in the short term, utilising our revolving credit facility. We will continue with our prudent approach to the management of debt and cash, whilst investing in internal process improvements, leadership and training to reduce risk.

Our core social housing business and our mission to deliver for our tenants remain at the heart of our strategic vision, and our approach will build on our current strategic objectives with a balanced approach across the four strategic areas of focus. The strategic objectives for this final year of our current Group Strategic Plan are set out in our Financial Statements and are as follows:

- Targeted Sustainable investment in Property and Place
    - A more attractive home and service offer to customers, with more choice
    - Higher occupancy rates
    - Faster turnaround times for empty homes
    - Sustainable social impact and investment designed to benefit our tenants through employment, enterprise and education opportunities.

- Improved Financial Performance and Value for Money
    - An excellent customer experience with a renewed focus on efficient service delivery to tenants
    - A focus on efficiency and productivity
    - Greater returns on our assets

- A culture of compliance and performance
    - Returning to a compliant rating of G2 or above
    - Strong stakeholder engagement
    - Simplified internal structures and processes

- Employee and Leadership Development
    - Company-wide training to foster consistency of approach
    - Policies to attract and retain an engaged motivated workforce

Our **"Customer-Led"** approach aims to ensure we can deliver an offer that will meet the changing needs of our customers and that can attract and retain a diverse customer base from young people to families with general needs through to supported living, such that we will be regarded as a home provider of choice in the areas where we operate. In addition to our homes we will continue to provide services to support our customers and underpin sustainable tenancies.

Our priority in the short-term remains embedding the improvements delivered to address our governance issues and continuing to satisfy our undertakings to the Regulator. This will enable us to restore the Trust to full compliance with the Governance and Financial Viability standard.

Our Strategic Principles

In recent years the strategy and financial plans of the KHT and the wider First Ark Group, were designed primarily to allow an expansive growth and social investment agenda to be pursued. Surpluses have been historically used to fund a combination of investment in existing property and services and organic growth in addition to diversification activity.

The currently emerging strategic principles – aligned to increasing the credit strength of the Group – will initially see a move towards bringing the underlying gross margin and financial metrics of KHT into line with sector median levels, with a further strengthening where attainable in subsequent years. This will enable a more balanced reinvestment of surpluses back into core housing services, the funding of a multi-tenure development programme and continuing investment in core systems and process improvements.

This approach to improving performance and investment is embedded in our approach to Value For Money. The resource allocation in the past financial year and in the short-term future is broadly reflective of a continuation of existing levels of investment in staffing across the Group (subject to some inflation and pension cost increases), the finalisation of various strategic initiatives and projects that were commenced in 2018/19, the resourcing of legacy asset compliance issues that are planned to be delivered in year, the continuation and run-off of a number of strategic plans and committed projects e.g. the HE 2016-21 contract, and legacy social investment reserve backed commitments.

The principles of returning to strong and consistent margins, and the containment of indebtedness and gearing, are prerequisite guiding principles to ensure that we maintain our V1 viability rating and enhance our ability to borrow competitively to maintain a supply of affordable homes and investment in existing homes. The base financial plan has strong headroom against covenants, with the tightest covenant being future interest cover.

The Group has established clear targets across the VFM metrics which are used consistently to measure performance. In addition to the core metrics we have a scorecard of 20 performance metrics and 8 compliance metrics that are used throughout the business to monitor and communicate performance. Updated action plans to achieve higher stable margins are being produced and implemented across KHT. All entities in the First Ark Group are adopting a consistent approach to investment and risk appraisal. Each entity explicitly considers the impact of its strategic decisions on KHT as a registered provider of social housing.

2018/19 Results

Development Capacity & Supply

Category	KPI	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Target	Benchmark [1]
Development (Capacity & Supply)	New Supply % (social)	0.13%	1.17%	0.88%	0.80%	1.60%
	New Supply % (non-social)	0.00%	0.00%	0.00%	0.00%	0.00%
	Gearing [2]	72.30%	70.50%	66.53%	67.29%	48.50%

The KHT Group invested in 116 new social housing units during the year, a decline on 2017/18 when Watch Factory Phase 1 was completed. In 2018/19 the business acquired 39 rental units and 17 properties for shared ownership. In addition 60 units were developed for shared ownership, with a return to focusing on development in Knowsley and the surrounding boroughs.

Our unit growth target for 2019/20 is similar to 2018/19 with expected new supply of 0.8%. The business is however planning 337 new starts on site as Phase 2 of Watch Factory gets underway, being a 190 unit development of both shared ownership and rental units.

Gearing reduced in the period as the business did not utilise its Revolving Credit Facility during the period, due to the lower development expenditure. Gearing for KHT appears relatively high on this gearing calculation due to the age and mix of its housing stock, but KHT has significant levels of stock that are unencumbered by debt (Approximately 36% by number).

Outcomes delivered

Category	KPI	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Target	Benchmark [1]
Outcomes delivered	Reinvestment %	8.97%	7.84%	6.72%	6.67%	6.70%

The level of reinvestment is being achieved by KHT due to its historically prudent approach to debt and cash management, but the Group will need to improve its margin position to consistently deliver above average levels of investment.

KHT continues to invest in social programmes, primarily via its sister company, One Ark. The First Ark Group as a whole continues to work with partners to deliver a sustainable model of returnable investments with a dual financial and social purpose. This enables KHT and the First Ark Group to achieve compounding returns on its social investment.

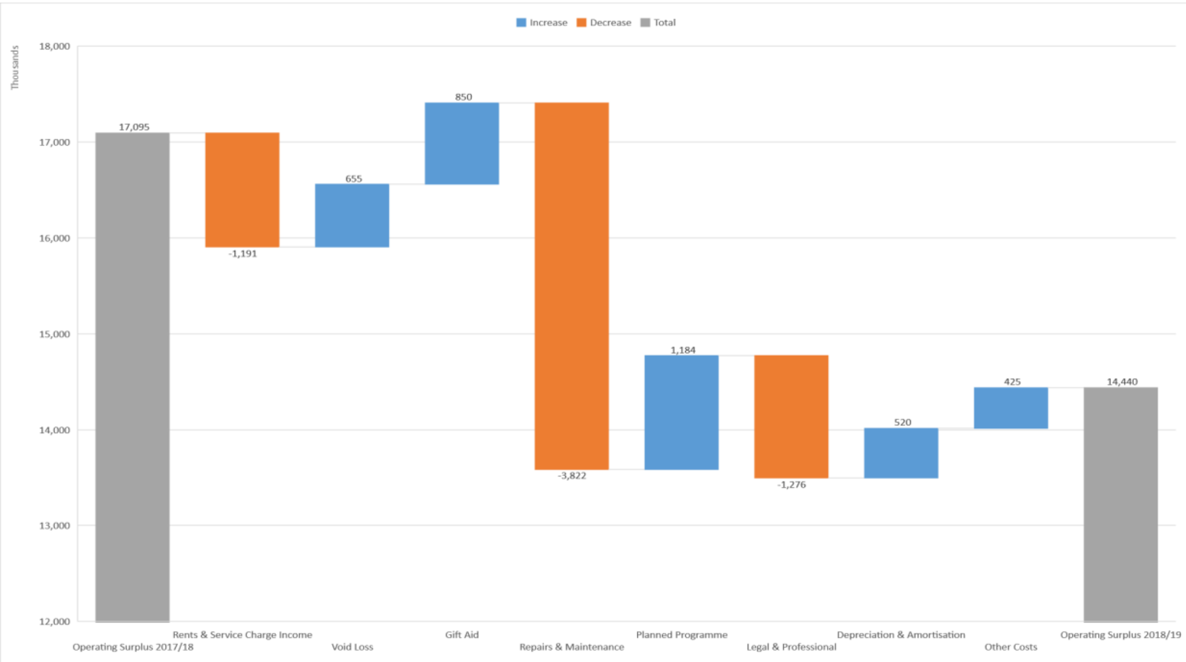
Business Health

Category	KPI	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Target	Benchmark [1]
Business Health	Operating margin (%)	32.08%	22.60%	16.31%	20.07%	29.50%
	Operating margin (%) (social housing lettings)	33.47%	23.71%	18.52%	20.88%	34.60%
	EBITDA MRI Interest Cover (%)	275.00%	249.00%	185.00%	189.00%	187.00%

As outlined above 2018/19 has been another challenging year for our operation and this is reflected in our lower than average operating margin. The costs of compliance, repairs and improving our Governance structures has weighed heavily on the bottom line. The business is engaged in detailed analysis of every cost centre to ensure that one-off costs are removed permanently from the business and the benefits of streamlining and efficiency are driven through into our results.

Despite the reduction in margins KHT still has a good level of interest cover as measured by EBITDA MRI, and our stress testing indicates that our financial plan is robust, but greater headroom is required in this key measure if KHT is to fulfil its ambition to develop a greater number of homes.

Operating Margin 2017/18 to 2018/19



- Despite this third year of rent reductions KHT Group turnover grew to £68.2m (2017/18 £61.4m) as a result of shared ownership sales of £7.6m (2017/18 £0.2m) and Gift Aid of £850k (2017/18 £NIL) from Vivark, a fellow subsidiary in the First Ark Group The reduction in rent and service charges was £1.2m

- KHT Group operating surplus fell to £14.4m (2017/18 £17.1m). The surplus covers our interest costs by 1.85 times (2017/18 2.09 times)
- Operating surplus was impacted by the following variations in the year:
  - Rents and service charge income fell by £1.2m, but void loss improved by £0.7m as the Group focused on bringing long term voids back into use. The void loss continues to be a key priority for the Group.
  - Repairs and maintenance costs increased year on year by £3.8m, as KHT undertook additional works in respect of Fire Safety and accelerated Electrical testing to a 5 year frequency. This had a consequential impact on electrical installations that were earmarked for replacement and repair earlier than they might have been under a standard test frequency. KHT also increased void repair activity as mentioned above to bring long-term voids back into use.
  - The planned investment programme was scaled back in year pending a comprehensive stock condition survey which is intended to ensure that KHT has greater certainty regarding future investment plans and can plan more effectively to achieve value for money.
  - High legal and professional costs were incurred as a consequence of changes to the Group's governance framework, with the majority of the costs being attributable to changes in KHT. The costs included finalising our conversion to a CBS, the creation a common Board structure and the recruitment of a new Board and Executive team. Consultancy costs were also incurred in upgrading our compliance systems, and undertaking the stock condition surveys.

Effective Asset Management

Category	KPI	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Target	Benchmark [1]
Effective Asset Management	Return on capital employed (ROCE)	9.90%	6.91%	5.67%	5.70%	4.60%

Our Return on Capital Employed (ROCE) is above the benchmark, but has declined on previous years due to the lower operating margin. In 2019/20, whilst underlying performance is budgeted to improve profits from property sales and disposals of fixed assets are expected to be lower, so returns will not change significantly. Asset disposals increased ROCE by approximately 1.2% in 2018/19.

The business recognises that our key-to-key times for void properties continue to be too long despite improvements during the year. Long term voids have been brought back into the rental portfolio and a revised management structure, encompassing both Asset management and repairs, has improved accountability. Our new approach is delivering a dual benefit of reducing both costs and rental losses and will contribute to our margin improvement in 2019/20.

Operating Efficiencies

Category	KPI	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Target	Benchmark [1]
Operating Efficiencies	Headline social housing cost per unit	£ 2,868	£ 3,211	£ 3,457	£ 3,200	£ 3,340

KHT is committed to improving the management of income as well as reducing its cost base. Additional rent and service charge resources in the finance team are now embedded and have streamlined activity. Our new approach to management of rent arrears will complement this change, with additional senior resource being recruited to our income management team. A step change in data management and analysis has been a key enabler in our project to improve the level of rent collected (both arrears and current rents) and reduce bad debt and legal costs.

In our report last year we outlined our investment in project management and consultancy to assist us in addressing the operational challenges we face. The drive to embed best practice in our day-to-day operations has continued and we remain on course to remove any marginal project resource within two years to assist in our cost reduction drive.

We continue to invest in our employees with Group wide training initiatives for managers and leaders. Our restructure of the Learning and Development team together with the relaunch of our e-learning platform, has enabled us to do this in a manner that is cost effective, using a variety of resources and external funding where possible. This investment in engagement and leadership is critical to reducing the costs of absence, staff turnover and recruitment.

Note 1
Benchmark data source
2018 Global Accounts Annex – Value for Money Metrics, published by the Regulator of Social Housing
Social Housing Units Owned (10,000 – 19,999)
Note 2
Gearing is calculated as a % of assets at depreciated cost. Gearing for covenant purposes is as a % of valuation (EUV – SH) and equates to 42% against a covenant maximum of 80%.