Credit Research Initiative
NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
transforming big data into smart data
Weekly Credit Brief May 26 - Jun 01

UK election result lifts prospects for homebuilders

by Victor Liu

The Conservatives comfortably won the UK general election on May 7, 2015. This result was quite surprising as most pre-election polls were predicting a tighter election result. UK homebuilders breathed a sigh of relief that they could avoid suffering from the unfavorable housing policies proposed by the opposition Labour Party, including rent controls and a mansion tax on homes worth more than GBP 2mn. The Conservative victory also means that the "Help to Buy" scheme, which allows people to buy a home priced up to GBP 600,000 with as little as a 5% deposit, will be extended until 2020. UK homebuilders celebrated the pleasing election result as their stock prices went up. The top 3 players, Barratt Development, Taylor Wimpey PLC and Persimmon PLC, all saw their stocks appreciate by more than 10% since the election. Whereas the election result was a short-term stock price catalyst, the UK's benign mortgage environment and the homebuilders' robust financial profiles should sustain their long-lasting growth momentum.

The mortgage rate and unemployment rate are the two main indicators of a country's mortgage environment as these can assess the house buyers' average costs and their sustained ability to repay their mortgage loans. As the left part of Figure 1 illustrates, the UK has seen a downward trend in both the mortgage rate and the unemployment rate, which created a benign mortgage environment in terms of loan growth and asset quality. According to the Council of Mortgage Lenders, the gross mortgage lending increased to GBP 204bn in 2014 from GBP 145bn in 2012. In addition, the number of home repossessions as well as the mortgages in arrears reached their lowest levels since 2006 on Feb 12 this year. The healthy mortgage environment also boosted the property market. The right part of Figure 1 shows that both housing price and transaction volume have climbed up since 2012, while the election uncertainly over mansion tax and rental cap had caused a slowdown in 2014.

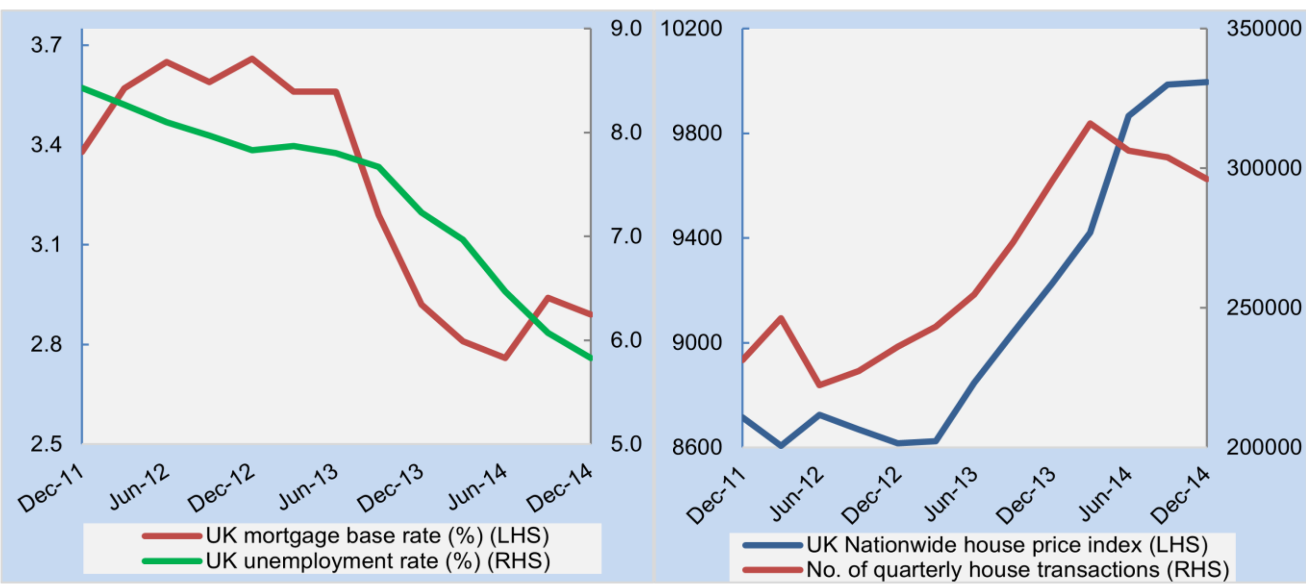

Figure 1: UK mortgage base rate, UK unemployment rate, UK Nationwide house price index and the number of quarterly residential property transaction completions with value GBP 40,000 or above. *Source: Bloomberg, HM Revenue and Customs*

Benefiting from the good mortgage environment, UK homebuilders continue to see sales growth and margin improvement, which was reflected in their stock prices. As Figure 2 shows, the UK homebuilder index increased by nearly 3 times from 2012 to 2014, coinciding with the drop in RMI aggregate 1-year Probability of Default (PD), a simple median of 8 UK homebuilders, during the same period.

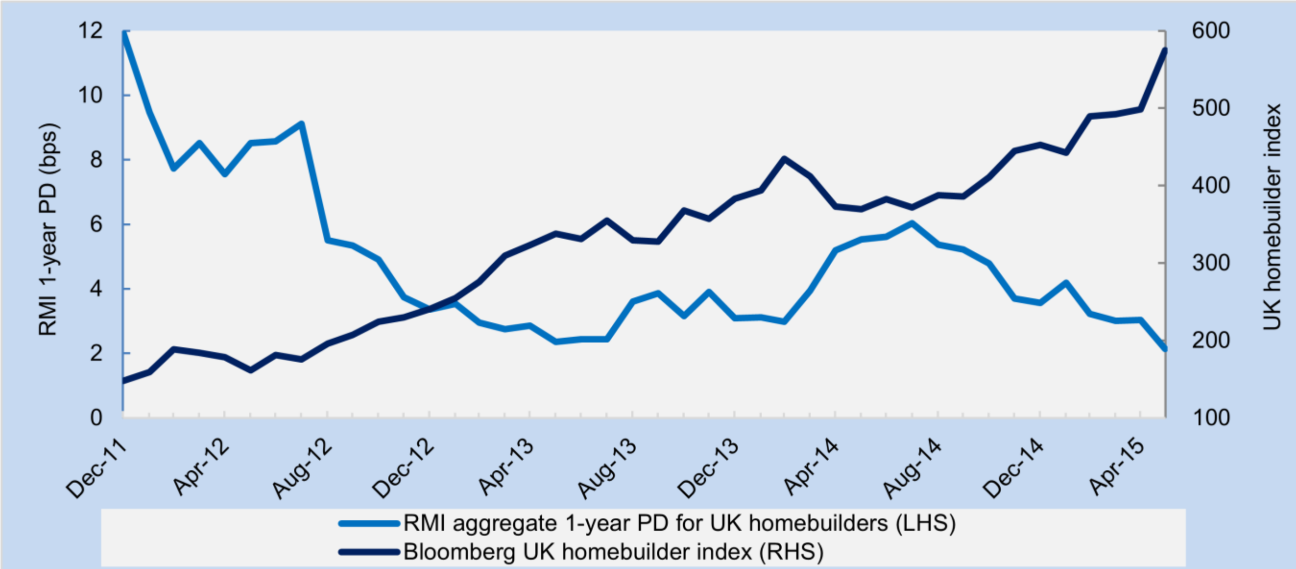

Figure 2: RMI 1-year aggregate PD for 8 UK homebuilders vs. Bloomberg UK homebuilder index. *Source: Risk Management Institute, Bloomberg*

Nurtured by the advantageous macro backdrop, the top 3 homebuilders all possess robust financial fundamentals as tabulated below. The sector-wise rising housing price and transaction volume helped them generate strong sales growth and better margin. The heightened profitability, in turn, improved those firms' liquidity. The net debt, which is the sum of short-term and long-term debts deducted by cash & cash equivalents, decreased in all the 3 firms. For Taylor Wimpey and Persimmon, the net debt to equity ratio even became negative, showing that their cash level was higher than their debt level. As a result, the market cap for all the 3 firms almost doubled in the past two years.

	Barratt Development PLC			Taylor Wimpey PLC			Persimmon PLC		
	2H 2012	2H 2013	2H 2014	2H 2012	2H 2013	2H 2014	2H 2012	2H 2013	2H 2014
Revenue (GBP mn)	951	1,265	1,576	1,113	1,288	1,496	915	1186	1376
Net income margin	3.5%	7.3%	10.6%	8.9%	10.5%	14.7%	10.0%	13.2%	15.2%
Net debt / equity	12.0%	10.0%	5.2%	3.0%	-0.2%	-4.5%	-10.1%	-10.0%	-17.3%
Market cap (GBP mn)	2,032	3,435	4,672	2,130	3,600	4,483	2,423	3,775	4,836

Table 1: Key financials for the top 3 UK homebuilders. *Source: Bloomberg*

On top of the favorable mortgage environment and homebuilders' solid financial profiles, the election result has helped to remove the political uncertainty for UK homebuilders. It is highly likely that the homebuilders would keep delivering strong financial performance unless they encounter a significant rate hike or any unforeseen policy turbulence in the future.

Credit News

RBA, Treasury tell banks to tighten lending amid bubble fear

Jun 2. Members of the Australian Treasury and RBA have expressed concern that the Australian housing market is overheated and asked lenders to increase their capital buffers against a potential housing crash. Regulators were also considering imposing penalties on lenders who increase the proportion of mortgages to their total loan book too quickly. Regulators said that banks should reduce their reliance on foreign funding as lenders could face liquidity problems if the housing market drops significantly. Regulators are also investigating the high spread between the Cash Rate and the banks' credit card interest rate, which has remained at 17% since global financial crisis. (Reuters)

US debtors can't void underwater mortgages in bankruptcy

Jun 1. The US Supreme Court has ruled that bankrupt homeowners may not expect to have their second mortgage loans cancelled, even if their debt amounts are more than what their properties are worth. During the US housing boom, many banks extended multiple mortgage loans to homeowners, who used the value of their homes as loan collateral. After the housing market crashed in 2008, many of these underwater homeowners sought bankruptcy protection as a solution to their housing woes. However, the US Supreme Court ruling will now prevent these homeowners from easily discharging their home equity loans and other types of second mortgages in Chapter 7 bankruptcies. The ruling is a victory for lenders as it closes a legal avenue for debt-laden homeowners to shed their underwater properties. (Forbes)

PBOC provides supplementary lending to select banks

Jun 1. The People's Bank of China is said to allow certain banks to tap into the Pledged Supplementary Lending (PSL) program, a lending tool used to boost liquidity to specific sectors of the economy. Details of the central bank's action were not revealed as such deals were often conducted behind closed doors. The program provides loans to banks at below market rates to extend credit for specific purposes. Last year, the PSL program was used to provide low cost housing through banks in rural areas in line with China's Silk Road economic development campaign. More recently, the program was used to bolster the demand for municipal debt and avoid a credit crunch. (Reuters)

Evergrande raises USD 593mn in offer priced below range

May 29. Evergrande Real Estate Group Ltd., China's third-biggest developer by assets, raised net proceeds of USD 593mn after selling shares below a marketed price range. Hong Kong Stock Exchange stated that the company sold 820 mn shares at HKD 5.67 each, an 18% discount to its last closing price on May 29. The company might be seeking to refinance borrowings by taking advantage of a stock rally that has seen its share price double in the past three months. Its total debt more than tripled over the past three years to USD 25bn at the end of December. (Bloomberg)

China Coca-Cola bottle maker to default on bonds today

May 28. A bottle maker in China for Coca-Cola Co. will be unable to make a full bond payment today. This is the fourth company to default in the onshore debt market. Zhuhai Zhongfu Enterprise will pay all of the RMB 31.52mn of interest, but only repay 35% of the notes' RMB 590mn in principal. The company faces declining demand for its products, as well as a liquidity problem, due to a loan denial by a bank consortium. Zhuhai Zhongfu's shares fell by the daily limit of 5% after trading resumed following an April 30 halt. The company's notes yielded 19.33% in the secondary market on June 27 last year, before being delisted from the exchange. (Bloomberg)

Sunac abandons purchase of troubled Chinese developer Kaisa (Bloomberg)

Indian banks allowed to invest in lenders' infrastructure debt (Economic Times)

Shadow banks grab record US loans share (FT)

Regulatory Updates

Yellen urged to steer global regulators from too-big-to-fail tag

Jun 2. Federal Reserve Chair Janet Yellen and other US officials should push global regulators away from designating individual asset managers and investment funds systemically important, the industry's lobby group said. The Financial Stability Board plans to identify too-big-to-fail investment funds that could face stricter oversight. A chief executive officer of the Investment Company Institute also pointed out US regulators should "use their authority and role within the FSB process to redirect it away from one that seems in a misbegotten way focused on designation of entities." (Bloomberg)

FXCM's Swiss franc losses prompt call for tougher currency rules

May 29. The US derivatives industry's front-line regulator wants retail currency dealers to face higher capital and risk management standards after Swiss franc losses this year left FXCM, a leading brokerage, needing a USD 300mn rescue due to losses at its UK affiliate, which had more lenient oversight for leverage. The National Futures Association proposed that dealers would have to hold more capital in trades with large customers and foreign affiliates under rules. The regulations, which are subject to approval by the CFTC, aim to bolster the resources of US-based currency dealers when they face overseas risks. It would also require currency dealers to have more expansive risk-management programs and reporting requirements. (Bloomberg)

BSP sets stiffer Basel 3 leverage ratio

May 29. The Bangko Sentral ng Pilipinas (BSP) has approved new rules on the leverage ratio of banks in line with the international standards issued by the Basel Committee on Banking Supervision known as the Basel 3 reforms. The policy-making Monetary Board set a minimum ratio of 5% compared with the Basel minimum of 3%. The 5% minimum means that the maximum exposure that a bank takes on must not exceed 20 times its Tier 1 capital. The Monetary Board also set a monitoring period up to end-2016, during which banks will not be sanctioned even if they fall below the 5% minimum. (Manila Times)

Finra chief blasts labor proposal for stricter broker rules (Bloomberg)

UK banks face 65% Hang Seng slump in trading book stress test (Bloomberg)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Dexter Tan