REPORT

Welsh Government

Consultation on Residential Park Homes Commission Rate

13 March 2018

MHA Broomfield Alexander

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1 Introduction

1.1 Terms of Reference

We have been engaged by Welsh Government (WG) to carry out a review of the financial information of selected residential park home owners, with a view to identifying how important the commission rate income received on the resale of park homes is to their business's continued viability.

In light of our findings we have further been asked to critically analyse the evidence commissioned in August 2017 and provided by the British Holiday & Home Parks Association (BH&HPA) to support their member's assertions that some businesses would become unviable if the commission rate were reduced or abolished.

This report has been prepared solely for the confidential use of the Welsh Ministers on behalf of the Welsh Government (WG), Cathays Park, Cardiff, CF10 3NQ.

1.2 Conflict of Interest

We draw attention to the fact that MHA Broomfield Alexander act as accountants and taxation advisers in respect of one of the residential park home owners whose financial information is included in our review. The team who were involved in undertaking this consultation however have no involvement in working with the residential park home owners in question. We believe that there is no conflict of interest for MHA Broomfield Alexander in relation to our work in this instance or in our work for others.

2 **Background**

In October 2016 the findings of a Welsh Government commissioned review entitled “Understanding the Economics of the Park Home Industry Wales” were published.

The purpose of the study was to undertake a comprehensive assessment of the economics of the park home industry in Wales.

Previous studies into the economics of the industry have identified that there are three established main sources of income for residential park home owners. These are:

1. Profit earned when a park home owner develops a new pitch and sells a home on it, or re-sells a home which they have repurchased on an existing pitch.

2. Pitch fees, being the amount paid by a resident in return for being allowed to keep their park home on the pitch, as set out in the agreement between the park home owner and the resident.

3. Commissions earned when a resident sells their home to a third party.

This third category was the primary focus of the Welsh Government consultation undertaken between 25 May and 17 August 2017, namely to understand the necessity, or otherwise, of maintaining the commission rate to ensuring the viability of the residential park homes industry.

2.1 **Legislative context of the commission**

Up until 1975 residents on park home sites had no legal right to sell their park home on the pitch on which it was located, but some park home owners would allow them to do so in return for a commission. Under the Mobile Homes Act 1975 this position was formalised and gave all residents the statutory right to sell their home on the park pitch on which it was located, and in return the park home owners were given a statutory right to a commission which was initially capped at 15%. This was reduced under the Mobile Homes Act 1983 to 10%.

The Mobile Homes (Wales) Act 2013 provided for Welsh Ministers to set the level of commission by regulation, which they did in 2014, retaining the commission rate at the previous capped 10%, where it has remained to date.

2.2 **Historical justification for the commissions**

A number of arguments exist to justify the commission when a park home changes hands. These reasons, when taken together, form the basis of why a commission payable to the park home owner where a sale took place was introduced. The reasons, which have to be viewed together and not in isolation, are:

1. A compensation payment to the park owner for the continued loss of the use of the land on which the home sits. In other words it is the price for security of tenure given to the park home resident.

2. The value of the home sold is an amalgam of the value of the park home and the value of the site on which it is placed. Without the pitch/site location, the park home in isolation would be valued at a lower price for re-sale.

3. The commission payment is payable on the sale of the home, and therefore site owners are able to offer lower on-going pitch fees to residents, with a one off payment being made to match an inflow of income for those residents at the point of sale. This particularly suits older residents who are often on a fixed low income on an on-going basis. This position has now been formalised by the fact that the Mobile Homes (Wales) Act 2013 has now restricted the ability of park owners to increase these pitch fees, by indexing any annual increase at CPI.

The income received from this commission is now seen by park home owners as an important part of their businesses on-going finance. However there has been discussion from some residents in the sector about whether these commissions remain fair and appropriate.

2.3 **Welsh Government consultation exercise**

The review commissioned by the Welsh Government and published in October 2016 sought to undertake a comprehensive assessment of the economics of the park home industry in Wales, including whether the commission rate remained appropriate and, if so, at what level the rate should be set.

If the loss of the commission income were to undermine the continued viability of a park, or undermine investment in the park and its infrastructure, this could impact on residents' quality of life and value of their homes. In the extreme, there is a risk that the park owner may decide to close the park entirely if it is deemed unviable.

The findings did not support any change to the commission rate for existing residents due to the perceived risk to the continued viability and sustainability of some sites. However this was supported by limited financial information and therefore a separate consultation was launched by the Cabinet Secretary for Communities and Children with the aim of establishing robust financial data to determine whether the 10% commission rate should be retained, reduced or abolished.

As part of their response to this exercise the BH&HPA commissioned GVA, a company of Chartered Surveyors, to undertake an exercise to consider how a variation of the maximum commission rate would affect the viability of Welsh park businesses, the results of which were submitted to the Welsh Government consultation in August 2017.

2.4 **The objective of this consultation**

The responses to the consultation launched by the Cabinet Secretary for Communities and Children identified a number of parks which would be willing to share their financial records for scrutiny.

We have been engaged by Welsh Government to undertake a review of this financial information with a view to identifying how important the commission rate income received on the resale of park homes is to their business's continued viability.

In light of our findings we have further been asked to critically analyse the evidence commissioned in August 2017 and provided by the BH&HPA to support their member's assertions that some businesses would become unviable if the commission rate were reduced or abolished.

2.5 **Scope and our responsibilities**

Our responsibility is to review the financial information provided by the parks in order to undertake the assessments for which we were engaged.

The parks which consented to provide their financial information operate under different legal statuses (company, sole trade, partnership). Further many of the businesses had multiple activities on-going within the single reporting entity. For the purposes of this report we have worked with park owners to extract from the underlying financial records of each business the component results of the residential park business for analysis.

The financial information provided by the park owners is unaudited information as the businesses in question are not required to have a statutory audit. Whilst in undertaking this work we have been reliant on the accuracy of the financial information provided by the park home owners, we are under an obligation to perform our work with reasonable skill and care and in accordance with good industry practice.

If we considered that we had not received the information and explanations necessary to perform our work we would highlight this in our report and therefore to Welsh Government. We have no matters to report in this regard.

3 Our Approach

3.1 Identifying relevant income and expenditure

The GVA report, as commission by BH&HPA, included only two of the income streams earned by parks when undertaking the assessment of the fairness of changing the rate of commission. They were:

1. Pitch fees, being the amount paid by a resident in return for being allowed to keep their park home on the pitch, as set out in the agreement between the park home owner and the resident.

2. Commissions earned when resident sells their home to a third party.

The income streams relating to any profits earned when a park home owner sells a home were excluded. In undertaking our review we have considered whether it is appropriate to include or exclude this income from our financial analysis. Our key considerations in respect of this matter were as follows:

- Most parks only generate significant profits from selling a home during the initial phase of establishing their park, or where they are able to expand their park, either through the acquisition of vacant land or through the utilisation of existing land utilised for another purpose currently within their park (both of which would be reliant on the granting of planning permission). Such income streams would not therefore generally form a significant on-going part of the income stream of an established park.

- In order to fund the establishment of the parks and their subsequent development and expansion, most parks take out substantial loan finance, with the profits generated on the sale of the park homes being required to finance the debt repayments. The financial information of those park sites which are in the establishment/development phase show significant levels of debt finance. However the loans often fund wider developments or activities being undertaken by the businesses, not purely residential park build. Therefore whilst we cannot specifically confirm the reliance on the profits from selling a home to service related debt repayments, the available management information does support a significant debt service requirement for the parks during these phases.

Based on these considerations we believe that by including the profits on selling a home this would distort the conclusions drawn on the on-going financial position of an established park business should commission be withdrawn or reduced. We therefore concur with the approach adopted by GVA, and where specific sales and costs are included in relation to home sales we will exclude these from our analysis.

Further, some parks have diversified operations with multiple business activities taking place through one set of accounts. It is important that any analysis and conclusions drawn thereon are not distorted by any profits or a loss generated by these activities, the residential park has to be viewed as a business in its own right. With that in mind, we have worked with the park home owners to identify where these exist and, based on management information, exclude any related income and costs from our analysis.

3.2 Determining a "typical" year

Commission income can vary greatly over a number of years, as it is linked to the number of residents who sell their homes, a rate over which the park home owners have no control. To ensure that we establish an average position which would provide a meaningful basis for analysis we have taken a five year period for each business (or shorter if the park is newly established) and gathered the data on the annual number of private sales and the average selling prices.

Similarly, expenditure can vary widely from year to year within a park business, particularly in relation to repairs and maintenance spend which will fluctuate dependent upon specific work requirements. Again we have taken for analysis a five year period for each business (or shorter if the park is newly established). Further to ensure completeness of this assessment of cost we have also considered two further factors:

- Capitalisation of cost. Some businesses will have purchased capital equipment over time to undertake the maintenance works which would not form part of its trading results for the relevant year. We have therefore reviewed the capital spend of the businesses over the five years and included an allowance for this cost in arriving at the underlying profitability.

- Park owner's time. The accounting treatment undertaken by parks often differs, with some parks not accounting for the owners' time in managing the park or undertaking repairs. This time is effectively included when assessing the equity return or profit share of each owner. However, in assessing the sustainability of businesses we need to take this time spent into account. We discuss the mechanism we have used to value this time further in section 4.

3.3 Assessing the BH&HPA commissioned report

The BH&HPA commissioned report took the approach of creating a model through which to consider how a variation of the maximum commission rate would affect the viability of Welsh park businesses. This included making an allowance for repairs costs in the model based on an average maintenance programme position, which was determined by undertaking a building survey at a selection of parks.

Our approach as set out in 3.1 and 3.2 above is to base our assessment on the financial information of the parks over the last five years, inclusive of actual expenditure undertaken on repairs and maintenance activities. Based on this we have formed an independent conclusion, which can then be compared to BH&HPA commissioned report conclusion that some businesses would become unviable if the commission rate were reduced or abolished.

4 Our Findings

4.1 Background to the parks involved

The park owners who responded to the request for information had parks which would be classified as being Micro (around 15 pitches) and small (up to around 50 pitches). These park sizes we understand make up around 80% of the parks in Wales.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Number of pitches	15	16	30	31	32	37	39	55	32	29
Average pitch fee (£ pcm)	88	76	146	166	85	141	52	110	105	106
% average annual churn	6.67%	6.25%	-%	5.41%	3.13%	-%	5.64%	1.69%	3.33%	2.21%
Average sales price of units (£)	48,200	59,400	-	77,188	41,224	-	49,182	100,500	£97,000	£73,333
Commission rate	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%

Important points to note from the above parks:

- Parks 3 and 6 to date have not received any commission income. These parks are relatively new parks which are still establishing their resident population and therefore currently they are not experiencing any onward selling of homes. However both parks will shortly be moving out of this position and with their site capacities being reached their available income streams will move to match those of the established parks. It is therefore relevant to understand their underlying financial position as part of this exercise.

- Both the average pitch fees and average resale values of the homes on each park vary significantly. This reflects the diversity of the parks in the sector and demonstrates the potential complexity in trying to apply a one-size fits approach to understanding this issue.

- The average % of existing park home owners on a park who sell their home in an average year is referenced above as % average annual churn.

Appendix 1 sets out the summary analysis of the financial results for an average year for each of these residential parks, based on the financial information provided.

A summary of the key findings/matters for consideration is set out below.

4.2 Financial analysis inclusive of commission income

4.2.1 Relative importance of the commission income

Whilst the average annual churn of existing park home owners who sell their homes is relatively low, the income derived from those sales forms a not insignificant part of the on-going operational income of the parks themselves.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Annual income (£)										
Pitch fee income	15,752	14,638	52,428	61,593	32,659	62,752	24,476	72,369	40,305	36,900
Commission fee	4,820	5,940	-	12,934	4,122	-	10,820	9,369	10,347	4,691
Total income	**20,572**	**20,578**	**52,428**	**74,527**	**36,781**	**62,752**	**35,296**	**81,738**	**50,652**	**41,591**
Commission fee as a % of total income	23%	29%	0%	17%	11%	0%	31%	11%	20%	11%

The park owners we spoke to all commonly identified that the pitch fee was often originally set at a lower level than possibly would otherwise be charged, in order firstly to attract purchasers to a site and secondly in the knowledge that additional income would be made through commission.

Excluding parks 3 and 6 who do not at this point have any park home resales, the commission income can be further viewed as follows:

	Park 1	Park 2	Park 4	Park 5	Park 7	Park 8	Park 9	Park 10
Average commission per sale (£)	4,820	5,940	7,719	4,122	4,918	10,050	9,700	7,333
Number of months rent to equate to one commission sale	55.08	77.91	46.62	48.47	94.04	91.66	92.42	69.16
Increase in monthly pitch fee for all owners to equate to annual commission (£)	26.78	30.94	34.77	10.74	23.12	14.19	26.94	13.48
% Increase	30.60%	40.58%	21.00%	12.62%	44.21%	12.95%	25.67%	12.71%

It is over-simplistic to state that if the commission were removed that it would need to be replaced by a pitch fee increase. However, the above analysis demonstrates that if it were assumed that the current income levels were required, then a significant increase in the pitch fee for all residents on the park would be required to maintain income levels. This is considered further below in section 4.3 in light of profitability of the parks.

4.2.2 **Profitability based on reported financial information**

Based on the reported financial information provided by the park owners, all but one of the parks (highlighted in red below) are currently profitable from its average level of operations.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Average profit for the year after capital expenditure (£)	11,541	12,043	18,065	23,367	(8,813)	5,031	5,002	14,426	8,794	19,466
Profit as % of income	56%	59%	34%	31%	(24%)	8%	14%	18%	17%	47%

Park 5 however is the only park which incurs a significant employment cost. In its management accounts the park has made allowance for the cost of works conducted by the owners, whether it be in the form of the owners' time in managing the park or time in undertaking repairs. The other parks have not taken into consideration any such costs.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Employment costs (£)	-	3,254	-	13,034	18,720	-	6,231	-	15,468	9,750
As a % of income	-%	16%	-%	17%	51%	-%	18%	-%	31%	23%
Number of park owners active but not remunerated	2	3	2	2	2	2	2	2	2	2
Profit available/(loss to fund) after capital expenditure per owner (£)	5,770	4,014	9,033	11,683	(4,406)	2,515	2,501	7,213	4,397	9,733

In the other parks the owners time is effectively included when assessing the equity return or profit share of each owner. All parks included above have more than one owner involved in the business and based on the reported results the profit available to each is shown.

The profit available per partner as return on investment is not significant when taking into account their input into the on-going operations of the park or the risk of investment in being a park owner.

However to determine what is a reasonable return on investment can be subjective, and therefore we have derived an alternative method of valuation below.

4.2.3 **Profitability valuing an owners time**

We have looked to view the results or return on investment for the owners by valuing their time on an input basis and deducting this from the average profitability for each park to arrive at an adjusted level of profitability. This of course takes no consideration of the need to provide a return on investment but it does provide a more accurate view of the underlying profitability.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Park owners time										
Value of 20 hours per week (£)	9,600	9,600	9,600	9,600	-	9,600	9,600	9,600	9,600	9,600
Profit/(loss) after capital expenditure and 20 hours (£)	1,941	2,443	8,465	13,767	(8,813)	(4,570)	(4,598)	4,826	(806)	9,866
Value of 30 hours per week (£)	14,400	14,400	14,400	14,400	-	14,400	14,400	14,400	14,400	14,400
Profit/(loss) after capital expenditure and 30 hours (£)	(2,859)	(2,357)	3,665	8,967	(8,813)	(9,370)	(9,398)	26	(5,606)	5,066
Value of 40 hours per week (£)	19,200	19,200	19,200	19,200	-	19,200	19,200	19,200	19,200	19,200
Profit/(loss) after capital expenditure and 40 hours (£)	(7,659)	(7,157)	(1,135)	4,167	(8,813)	(14,170)	(14,198)	(4,774)	(10,406)	266

We set out above three alternative scenarios for the number of hours worked by the owner managers. Applied to each is an assumed £10 per hour rate of pay which may be a little conservative for the skilled element of the tasks undertaken by the owners. However for illustrative purposes this rate is not deemed unreasonable. We have also assumed a 48 week year, making allowance for 4 weeks annual leave.

Our discussions with the owners identified a significant list of tasks that they complete on an on-going weekly basis, and many of these are conducted over a seven day week given the nature of the business. Further as there are multiple owners in the business these tasks are often shared between them over the course of the seven days.

We are unable to specifically support an exact value for the number of hours worked by a park owner as the parks do not maintain the detailed records that would allow such an analysis. Our discussions have identified that a combined 40 hours per week on average for the owners would not be unusual but to sensitise this we have looked at three scenarios, where shared hours by the owners are 20, 30 and 40 per week on average respectively.

The impact of the inclusion of this valued time on the profitability of each park is clear. Whilst we cannot say with certainty which of the time values should be applied to each park, it is illustrated that even when a reasonably low level of combined input into park operations by the owners is valued, the financial performance of the parks deteriorates, with either losses being incurred or significantly reduced profits being generated, which when viewed from a return on investment perspective may does not generate an attractive return.

4.3 Financial analysis excluding commission income

4.3.1 Impact on financial results

The financial performance of the businesses deteriorates further where the commission income is removed as illustrated below, with in all cases losses being incurred at the valued 40 hours work suggested as representative by park owners. Indeed even at 20 and 30 hours losses are made or returns on investment negligible.

Excluding commission income (£)	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Average profit for the year after capital expenditure	6,721	6,103	18,065	10,433	(12,935)	5,031	(5,818)	6,932	(1,553)	14,775
Profit/(loss) after 20 hours of owners time	(2,879)	(3,497)	8,465	833	(12,935)	(4,570)	(15,418)	(2,669)	(11,153)	5,175
Profit/(loss) after 30 hours of owners time	(7,679)	(8,297)	3,665	(3,967)	(12,935)	(9,370)	(20,218)	(7,469)	(15,953)	375
Profit/(loss) after 40 hours of owners time	(12,479)	(13,097)	(1,135)	(8,767)	(12,935)	(14,170)	(25,018)	(12,269)	(20,753)	(4,425)

Further it is of interest to consider the financial position of the parks should the commission be removed, by reference to the impact on their balance sheet and liquidity positions.

4.3.2 Impact on financial strength of a business

As identified previously many parks have a diverse business and their financial records do not allow for their balance sheets to be split in order to identify the assets and liabilities that wholly relate to the residential park business. However, three of the parks who provided their financial records to us are wholly residential park businesses and therefore we have considered their positions are follows:

Pure Residential Parks Only	Park 1	Park 4	Park 7
Per last accounting period provided (£)			
- Cash balances	28,761	55,896	31,763
- Net current assets/(liabilities)	15,134	(16,041)	38,627
- Net assets/(liabilities)	16,887	35,362	101,363

Position if commission income was removed over the 5 year period provided (£)			
- Cash balances	4,661	(5,854)	(22,337)
- Net current assets/(liabilities)	(8,966)	(77,791)	(15,473)
- Net assets/(liabilities)	(7,213)	(26,388)	47,263

The analysis of course can only be used as an indication of the impact on the financial strength of these businesses, as if such a deterioration in their financial positions occurred, the respective businesses would likely have taken different decisions on its on-going operations and activities. This analysis of course assumes that all other income and spend remained constant. However it does show that over a 5 year period each of the businesses reviewed would have seen a significant deterioration in its financial position if the commissions were removed. This indicates that the businesses do not have significant levels of headroom within their balance sheets to absorb any significant changes in income streams or one-off costs.

4.3.3 Return on capital and pitch fees

In the event that the ability to raise income from the commission were removed, then in order to remain viable an increase in pitch fee is likely to be required. We understand that such a change is allowed for under the Mobile Home (Wales) Act 2013 if there are legislative changes which directly affect the cost of management or maintenance, which we believe the abolition of the commission would represent.

The level that the pitch fees would need to be raised to is subjective and difficult to quantify, as each park home owner will have a view on what level of profitability or return on their investment is required to make the long term business worthwhile. As we have seen through discussions with the owners, they on an on-going basis fund one-off costs through cross-subsidy from their other businesses or through injections of finance, however a long term scenario where losses had to be funded would be a more difficult proposition.

The GVA report, as commission by BH&HPA, included an assessment to try and determine an appropriate allowance for return on capital. The report identified that over the last decade parks in Wales have changed hands for in excess of £20,000 per pitch. They applied a level of discount to this and used £12,000 per pitch to underpin their measure. They then allowed a 5% annual return on this, which they equated to an annual allowance of £600 per pitch.

To determine whether this valuation is appropriate in assessing the required return on capital per pitch is problematic as this was used in the report as a guide only. We have therefore looked at this from a different angle.

Firstly we determined the current return on capital per pitch being achieved by each park based on the reported results. Note for this analysis the owners costs included in park 5 (the only park to value this input in their accounting) have been excluded so that we have consistency when comparing the parks.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Number of pitches	15	16	30	31	32	37	39	55	32	29
Average profit for the year after capital expenditure (£)	11,541	12,043	18,065	23,367	9,907	5,031	5,002	14,426	8,794	19,466
Current return on capital per pitch (£)	**769**	**753**	**602**	**754**	**310**	**136**	**128**	**262**	**275**	**671**

On the basis that these parks remain operational then, on an average basis over the time period being examined, it is a reasonable assumption that this level of return on capital per pitch must at least be deemed sufficient by the owners for the parks to be viable. Further as we have identified in our analyses above the profitability in these parks is not significant and a relatively small change in income and/or costs can have a significant impact on profit. Therefore these returns should not be viewed as in any way excessive.

If the commissions were removed, in order to achieve this level of return the following increases in pitch fees would be required.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Increase in monthly pitch fee to achieve return on capital (£)	26.78	30.94	0.00	34.77	10.74	0.00	23.12	11.36	26.94	13.48
% Increase	**30.60%**	**40.58%**	**0.00%**	**21.00%**	**12.62%**	**0.00%**	**44.21%**	**10.36%**	**25.67%**	**12.71%**

This analysis of course does not include any allowance for valuing the owners time in working at the parks as previously discussed.

It could be argued that as the majority of park owners did not include a value in their management accounts for their time, they are assessing their profitability without this cost when considering their return on investment.

However our sample of park respondents is small when compared to the whole sector in Wales and therefore it is appropriate to consider this effect as such a value may be included for certain businesses. If we just include the minimum time consideration we identified previously of 20 hours, this would have the following impact.

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Return on capital per pitch including commission (£)	**129**	**153**	**282**	**444**	**310**	**(124)**	**(118)**	**88**	**(25)**	**340**
Return on capital per pitch excluding commission (£)	**(192)**	**(219)**	**282**	**27**	**(119)**	**(124)**	**(395)**	**(49)**	**(349)**	**178**
Increase in monthly pitch fee to achieve return on capital (£)	80.11	80.94	26.67	60.58	35.74	21.62	43.63	25.90	51.94	41.07
% Increase	**91.54%**	**106.16%**	**18.31%**	**36.59%**	**42.02%**	**15.30%**	**83.43%**	**23.62%**	**49.49%**	**38.73%**

To include further variants of time values would only serve to illustrate that any increased inclusion of owners time would further reduce the current return being earned and would increase the required level of pitch fee required.

These analyses cannot demonstrate the exact impacts on pitch fees which will be felt if commissions were to be removed. What they illustrate is the following:

- The GVA report, as commission by BH&HPA, identified a return on investment to be achieved of £600 per pitch, inclusive of an allowance for the value of owner's time.

- Based on the parks we have reviewed this is only being achieved by some parks before such an allowance is made and by none after a minimum reasonable allowance is made.

- When a reduction in commission is then included parks are returning either a minimal or negative return on investment, which cannot be sustained as a business model in the long term without a significant increase in pitch fees.

We feel it important to note however that from our discussions with park owners they are reticent to see pitch fee increases as a viable option as they believe that the on-going additional monthly costs this would represent for their existing home owners may make this housing option unsustainable. Further they consider that higher pitch fees may make the homes more difficult to sell due to the higher on-going costs for any acquirer, putting the current homeowners in a difficult situation.

Further we note in the above analysis that we have not considered the option to reduce costs to offset any commission income loss. The reasons for this are twofold. Firstly we have not from our review identified a significant cost base for the businesses in which realistic savings could be incurred. Secondly the most likely area of saving would be in the form of less time investment by the owners (which is not currently valued) or a reduction in the level of maintenance works undertaken, which would of course impact on the experience and quality of service which the residents receive.

5 **Conclusions**

We were engaged by Welsh Government (WG) to carry out a review of the financial information of selected residential park home owners, with a view to identifying how important the commission rate income received on the resale of park homes is to their business's continued viability.

In light of our findings we were further asked to critically analyse the evidence commissioned in August 2017 and provided by the BH&HPA to support their member's assertions that some businesses would become unviable if the commission rate were reduced or abolished.

5.1 **Key assumptions**

In undertaking this review, and as detailed in the body of the report, we made certain assumptions in reviewing the financial information of these parks which have shaped our analysis. These assumptions can be summarised as follows:

- The parks in many cases had diversified operations, with the financial information therefore supplied to us containing the results of multiple business activities. For this review to be meaningful it was important to focus on the residential park business in its own right. Therefore we have worked with park home owners to identify where these other activities exist and, based on management information and assumptions made by management, have excluded any related income and costs from our analysis.

- There are three established main sources of income for residential park home owners. This report, in common with the report commissioned by BH&HPA, focusses on the two income streams which are currently prevalent in all on-going residential park businesses, being pitch fees and commissions earned on the resale of park homes. The third main income source relates to profit earned when a park home owner sells a home directly to a new resident. This income is principally only received with any regularity when the park is being established and does not form a significant on-going part of the income stream of an established park. Therefore, where specific sales and costs are included in relation to home sales we have excluded these from our analysis.

- Both commission income and park expenditure levels, particularly in relation to repairs and maintenance spend can vary greatly from year to year. To ensure that we established an average position which would provide a meaningful basis for analysis, we have taken a five year period average for each business (or shorter if the park is newly established)

- Most parks do not account for the owners' time in managing the park or undertaking repairs. However, in assessing the sustainability of the businesses we believe that this time spent needs to be taken into account. In assessing the cost involved we have assumed a £10 per hour rate of pay, which may be a little conservative for the skilled element of the tasks undertaken by the owners but is not deemed unreasonable, and a 48 week year, making allowance for 4 weeks annual leave.

5.2 **Findings**

5.2.1 **Illustrative results**

In summarising our findings we have determined an “average established park” based on the financial data of the park respondents. The purpose of this is to illustrate our overall findings:

	Average Established Park
Number of pitches	31
Average pitch fee (pcm)	£98
% average annual churn of homes resold	4.25%
Average annual value of commission contributed to income	£7,646
Commission fee as a % of total income	17.00%
Profitability based on reported financial information	
Average profit for the year after capital expenditure	£10,728
Average number of park owners active but not remunerated	2
Profit available per owner	£5,364
Current return on capital per pitch	£345
Profitability valuing an owners time	
Profit after 20 hours of owners time	£1,128
Profitability if commissions then removed	
Loss after 20 hours of owners time	(£6,518)
Increase in monthly pitch fee to achieve current return on capital (£)	£46
As a % of current pitch fee	46.92%
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£20
As a % of current pitch fee	20.80%

Therefore for an average park:

- Whilst the percentage of existing park home owners who sold their home was relatively low at 4.25% the resale commission earned from those sales formed 17.00% of their annual income levels.

- Based on their financial information, an average park, which did not value their owners' time, reported an average annual profit of £10,728, which represented an average profit available per owner of £5,364. Such a profit level is not deemed as excessive when being viewed as an annual return on investment, particularly when taking into account their input into the on-going operations of the park and their risk of investment in being a park owner.

- Park owners have identified that it would be not be unusual for them to work a combined 40 hours per week on their respective parks, but even if a level of 20 hours per week was included (which based on our assumptions would be valued at £9,600 per annum) this results in a significant deterioration in the returns achieved to £1,128.

- Indeed, where commission income is then also removed from the results, a loss of £6,518 is then incurred.

- In the event that the ability to raise income from the commission were removed, then in order to remain viable an increase in pitch fee is likely to be required. Whilst current reported profitability levels are not significant, the businesses are still operational. Therefore it is reasonable to assume that on an average basis over the time period being examined, the current level of return on capital per pitch must at least be deemed sufficient by the owners for the parks to be viable. If the commissions were removed, in order to achieve this level of return an increase in pitch fees of 20.80% would be required.

- If you then include an allowance for valuing the owners time in working at the parks of 20 hours per week, the increase in pitch fees required would be 46.92%.

5.2.2 **Results for all parks**

Our detailed review as documented in section 4 of this report has analysed the financial data of the parks individually, and the findings in relation to the average park as illustrated above are representative of the findings for the individual parks.

Further, where the financial records of the parks allow, we have identified that with all other factors being consistent, over a 5 year period each of the businesses reviewed would have seen a significant deterioration in their financial position and liquidity if the commissions were removed. Indeed those parks for which this analysis was possible would have reported either a liquidity issue (overdrawn cash position), or a going concern issues (net current liabilities) or both. This indicates that the businesses do not have significant levels of headroom within their balance sheets to absorb any significant changes in income streams or one-off costs.

5.3 **Conclusion**

In conclusion, based on the evidence from the financial information of the parks provided, and when including a reasonable allowance for the time worked by the park owners, if the commission income were removed the parks would be returning either a minimal or negative return on investment, which cannot be sustained as a business model in the long term without a significant increase in pitch fees, a rise in which would impact all home owners in the sector.

Appendix 1: Summary Financial Data

	Park 1	Park 2	Park 3	Park 4	Park 5	Park 6	Park 7	Park 8	Park 9	Park 10
Number of pitches	15	16	30	31	32	37	39	55	32	29
Average pitch fee (pcm)	88	76	146	166	85	141	52	110	105	106
% average annual churn	6.67%	6.25%	0.00%	5.41%	3.13%	0.00%	5.64%	1.36%	3.33%	2.21%
Average sales price of units	£48,200	£59,400	-	£77,188	£41,224	-	£49,182	£100,500	£97,000	£73,333
Commission rate	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Annual income										
Pitch fee income	£15,752	£14,638	£52,428	£61,593	£32,659	£62,752	£24,476	£72,369	£40,305	£36,900
Commission fee	£4,820	£5,940	£0	£12,934	£4,122	£0	£10,820	£7,495	£10,347	£4,691
Total income	**£20,572**	**£20,578**	**£52,428**	**£74,527**	**£36,781**	**£62,752**	**£35,296**	**£79,864**	**£50,652**	**£41,591**
Less annual expenditure										
Employment costs	£0	£3,254	£0	£13,034	£18,720	£0	£6,231	£0	£15,468	£9,750
Repairs and maintenance	£1,408	£2,747	£14,660	£9,795	£15,702	£24,362	£10,155	£32,348	£20,019	£5,975
Insurance	£1,074	£206	£2,696	£2,587	£1,845	£4,453	£1,430	£2,900	£840	£750
Motor expenses	£431	£500	£6,214	£2,289	£3,325	£7,406	£5,554	£5,500	£1,082	£200
Accountancy and legal fees	£1,615	£100	£925	£1,154	£3,770	£4,443	£746	£1,500	£445	£2,750
Other overheads	£4,253	£1,728	£9,869	£4,780	£2,232	£10,804	£5,695	£23,190	£4,005	£2,700
	£8,781	**£8,535**	**£34,363**	**£33,639**	**£45,594**	**£51,468**	**£29,811**	**£65,438**	**£41,858**	**£22,125**
EBITDA	**£11,791**	**£12,043**	**£18,065**	**£40,888**	**-£8,813**	**£11,285**	**£5,485**	**£14,426**	**£8,794**	**£19,466**
Average annual capital expenditure	£250	£0	£0	£17,521	£0	£6,254	£483	£0	£0	£0
Average profit for the year after capital expenditure (£)	**11,541**	**12,043**	**18,065**	**23,367**	**(8,813)**	**5,031**	**5,002**	**14,426**	**8,794**	**19,466**