REPORT

Welsh Government

Supplementary Analysis on Residential Park Homes Commission Rate

10 May 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.

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

On 28 January 2018 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 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.

Our findings from this exercise were set out to WG in our report of 13 March 2018 entitled "Consultation on Residential Park Homes Commission Rate" (the consultation report).

2.1 The consultation report methodology

In reviewing the financial information of the parks in order to formulate the analyses set out in the consultation report, a number of assumptions were made. These assumptions shaped our analysis and the detail of these is set out in the main body of the consultation report. To understand the full context and relevance of the assumptions we made, it is important to read the consultation report in full. However, for reference and in summary only, they were:

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

- There are three established main sources of income for residential park home owners. The consultation report, in common with the report commissioned by BH&HPA, focussed 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 were included in relation to home sales we 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 took 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 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.

2.2 The findings of the consultation report

In summarising and illustrating our findings in the consultation report, we determined an "average established park" based on the financial data of the park respondents. The details of this average park were as follows:

	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

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 was 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 identified that it would 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 resulted in a significant deterioration in the returns achieved to £1,128.

We then looked at the impact on this average park if the commission income were removed:

	Average Established Park
Profitability if commissions were removed	
Loss after 20 hours of owners time included	(£6,518)
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£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%

Key findings:

- Where commission income is removed from the results, a loss of £6,518 is 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%.

Please note that the consultation report analysed the financial data of the selected parks individually, and the findings in relation to the average park as illustrated above were representative of the findings for the individual parks.

Further, where the financial records of the parks allowed, we 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 indicated that the businesses did not have significant levels of headroom within their balance sheets to absorb any significant changes in income streams or one-off costs.

In conclusion, we identified that 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, that if the commission income were removed the parks would be returning either a minimal or negative return on investment. This 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.

2.3 The objective of this report

The consultation report focussed on the impact on an average established park business, should the commission income be removed in its entirety.

Following submission of our report to WG, and in light of our findings, we have further been engaged by WG to look at a range of alternative commission rate scenarios, as specified by WG, and the potential impact of these on the financial viability of an average established park business.

2.4 Scope and our responsibilities

Using the average established park as determined in the consultation report, our responsibility is to apply the WG specified commission rate scenarios to the financial information in order to undertake the financial analyses for which we were engaged.

The financial information provided by the park owners which was utilised in determining the average established park is unaudited information, as the businesses in question are not required to have a statutory audit. As set out in the consultation report, in identifying the average established park we have been reliant on the accuracy of the financial information provided by the park home owners, and this reliance remains for the purposes of this report. However we were and 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 The scenarios

The commission rate scenarios which we have been asked to consider by WG are as follows:

- An immediate reduction from 10% to 7.5%, 5% or 2.5% respectively
- A reduction over 3 years from 10% to 7.5% to 5% then 2.5%
- A reduction over 5 years of 1% each year from 10% to 5%
- A reduction from 10% to 7% in the first year then a reduction of 1% per year until 5% is reached
- A reduction from 10% to 8% in the first year then a reduction of 1% per year until 5% is reached

In order to understand the impact of these scenarios we have utilised the average established park financial data as concluded upon in the consultation report as our base data. We have then applied the above scenarios individually to this data.

3.2 Cost base

A number of the scenarios identified for consideration by WG look at a reduction in the commission rate over a number of years. To properly reflect the time value in each scenario we have therefore included an assumption for inflation in our analysis. .

The "Forecasts for the UK economy: a comparison of independent forecasts" published by HM Treasury in May 2018 identifies that the average independent forecast for CPI between 2019 and 2022 is between 2.0% and 2.1%, and the average independent forecast for RPI for the same period is between 3.0% and 3.2%. Individual increases in the constituent elements of the cost base of the park will be linked to each measure differently. For the purposes of this analysis we have included an assumed annual inflation rate of 2.25% applied to the whole cost base of the park.

We have not considered any further changes in the cost base over time, particularly the option to reduce costs to offset any commission income loss. The reasons for this are twofold. Firstly we did not from our consultation identify 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.

4 The Scenarios

4.1 An immediate reduction in commission rate from 10% to 7.5%, 5% or 2.5% respectively

	Reduction to 7.5%	Reduction to 5.0%	Reduction to 2.5%
Profitability currently with 10% commission rate			
Average profit for the year after capital expenditure	£10,728	£10,728	£10,728
Profit/(Loss) after 20 hours of owners time	£1,128	£1,128	£1,128
Impact of the reduction in commission rate to:	**7.5%**	**5.0%**	**2.5%**
Average profit for the year after capital expenditure	£8,817	£6,905	£4,994
Average number of park owners active but not remunerated	2	2	2
Profit available per owner	£4,408	£3,453	£2,497
Return on capital per pitch	£283	£222	£160
Profit/(Loss) after 20 hours of owners time	£(783)	£(2,695)	£(4,606)
Potential impact on pitch fees			
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£31	£36	£41
As a % of current pitch fee	31.32%	36.52%	41.72%
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£5	£10	£15
As a % of current pitch fee	5.20%	10.40%	15.60%

Individual park respondents:

Number of individual park respondents who are **loss making** following the reduction in commission rate (out of 8 established parks)			
- Including 20 hours of owners time	3	5	6
- % of established park respondents	37.5%	62.5%	75%

4.2 **A reduction over 3 years from 10% to 7.5% to 5% then 2.5%**

	Year 1	**Year 2**	**Year 3**
	Reduction to 7.5%	**Reduction to 5%**	**Reduction to 2.5%**
Impact of the reduction in commission rate			
Average profit for the year after capital expenditure	£8,175	£5,520	£2,761
Average number of park owners active but not remunerated	2	2	2
Profit available per owner	£4,087	£2,760	£1,380
Return on capital per pitch	£263	£177	£89
Profit/(Loss) after 20 hours of owners time	(£1,641)	(£4,517)	(£7,502)
Potential impact on pitch fees			
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£32	£6	£6
As a % of current pitch fee	32.02%	6.16%	6.42%
Cumulative monthly increase over 3 years		**£44 (44.60%)**	
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£5	£5	£6
As a % of current pitch fee	5.32%	5.56%	5.80%
Cumulative monthly increase over 3 years		**£16 (16.68%)**	

Individual park respondents:

	Year 1	Year 2	Year 3
Number of individual park respondents who are **loss making** in each year following the reduction in commission rate (out of 8 established parks)			
- Including 20 hours of owners time	3	6	7
- % of established park respondents	37.5%	75%	87.5%

4.3 A reduction over 5 years of 1% each year from 10% to 5%

	Year 1	Year 2	Year 3	Year 4	Year 5
	Reduce to 9%	**Reduce to 8%**	**Reduce to 7%**	**Reduce to 6%**	**Reduce to 5%**
Impact of the reduction in commission rate					
Average profit for the year after capital expenditure	£9,348	£7,919	£6,439	£4,908	£3,324
Average number of park owners active but not remunerated	2	2	2	2	2
Profit available per owner	£4,674	£3,959	£3,220	£2,454	£1,662
Return on capital per pitch	£300	£254	£207	£158	£107
Profit/(Loss) after 20 hours of owners time	(£468)	(£2,118)	(£3,823)	(£5,585)	(£7,406)
Potential impact on pitch fees					
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£28	£3	£3	£3	£3
As a % of current pitch fee	28.83%	2.82%	2.94%	3.05%	3.17%
Cumulative monthly increase over 5 years			**£40 (40.81%)**		
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£2	£2	£2	£2	£2
As a % of current pitch fee	2.13%	2.22%	2.32%	2.42%	2.53%
Cumulative monthly increase over 5 years			**£11 (11.62%)**		

Individual park respondents:

	Year 1	Year 2	Year 3	Year 4	Year 5
Number of individual park respondents who are **loss making** in each year following the reduction in commission rate (out of 8 established parks)					
- Including 20 hours of owners time	3	3	6	6	6
- % of established park respondents	37.5%	37.5%	75.0%	75.0%	75.0%

4.4 **A reduction from 10% to 7% in the first year then a reduction of 1% per year until 5% is reached**

	Year 1	Year 2	Year 3
	Reduction to 7%	**Reduction to 6%**	**Reduction to 5%**
Impact of the reduction in commission rate			
Average profit for the year after capital expenditure	£7,784	£6,320	£4,804
Average number of park owners active but not remunerated	2	2	2
Profit available per owner	£4,674	£3,160	£2,402
Return on capital per pitch	£300	£203	£154
Profit/(Loss) after 20 hours of owners time	(£2,032)	(£3,717)	(£5,458)
Potential impact on pitch fees			
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£33	£3	£3
As a % of current pitch fee	33.09%	2.92%	3.03%
Cumulative monthly increase over 3 years		**£39 (39.04%)**	
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£6	£2	£3
As a % of current pitch fee	6.38%	2.32%	2.42%
Cumulative monthly increase over 3 years		**£11 (11.12%)**	

Individual park respondents:

Number of individual park respondents who are **loss making** in each year following the reduction in commission rate (out of 8 established parks)

	Year 1	Year 2	Year 3
- Including 20 hours of owners time	3	6	6
- % of established park respondents	37.5%	75.0%	75.0%

4.5 **A reduction from 10% to 8% in the first year then a reduction of 1% per year until 5% is reached**

	Year 1	**Year 2**	**Year 3**	**Year 4**
	Reduction to 8%	**Reduction to 7%**	**Reduction to 6%**	**Reduction to 5%**
Impact of the reduction in commission rate				
Average profit for the year after capital expenditure	£8,566	£7,119	£5,622	£4,072
Average number of park owners active but not remunerated	2	2	2	2
Profit available per owner	£4,283	£3,560	£2,811	£2,036
Return on capital per pitch	£275	£229	£181	£131
Profit/(Loss) after 20 hours of owners time	(£1,250)	(£2,918)	(£4,641)	(£6,421)
Potential impact on pitch fees				
Increase in monthly pitch fee to achieve current return on capital, inclusive of 20 hours of owners time (£)	£30	£3	£3	£3
As a % of current pitch fee	30.96%	2.87%	2.98%	3.10%
Cumulative monthly increase over 4 years		**£39 (39.92%)**		
Increase in monthly pitch fee to achieve current return on capital if no value of owners time included (£)	£4	£2	£2	£2
As a % of current pitch fee	4.25%	2.27%	2.37%	2.47%
Cumulative monthly increase over 4 years		**£11 (11.37%)**		

Individual park respondents:

Number of individual park respondents who are **loss making** in each year following the reduction in commission rate (out of 8 established parks)				
- Including 20 hours of owners time	3	5	6	6
- % of established park respondents	37.5%	62.5%	75.0%	75.0%

5 **Conclusions**

Our report to Welsh Government (WG) of 13 March 2018 entitled “Consultation on Residential Park Homes Commission Rate” (the consultation report) concluded that should the commission income be removed, the average established park would be returning either a minimal or negative return on investment, which could not be sustained as a business model in the long term without a significant increase in pitch fees.

The consultation report further identified that whilst current reported profitability levels at the parks are not significant, the businesses are still operational. Therefore it would be reasonable to assume that on an average basis over the time period being examined, the current level of return on capital per pitch being earned by these parks must as a minimum be deemed sufficient by the owners for the parks to be viable. Our analysis of each scenario has therefore included a consideration of the increase in pitch fees required for the average established park to achieve the current return on capital should the commission be reduced.

Each scenario identifies that over the time period for which the change in commissions would occur; the increase required in annual pitch fee to achieve the current return on capital is greater than the currently forecast CPI rate, the index which, since The Mobile Homes (Wales) Act 2013, any increases in pitch fees are indexed against. The “Forecasts for the UK economy: a comparison of independent forecasts” published by HM Treasury in May 2018 identifies that the average independent forecast for CPI between 2019 and 2022 is between 2.0% and 2.1%

Further, if you included an allowance for valuing the owners time in working at the parks of 20 hours per week, which as we set out in section 2.1 we believe needs to be taken into consideration in assessing the sustainability of the businesses, then in each scenario a significantly higher increase in pitch fee is required to provide the required returns (between 31% and 45% dependent on the relevant scenario).

Indeed, when looking at the results of the individual parks whose data was included in the consultation, and when including the value for owners time, in all of the scenarios the reduction in commission would result in between 37.5% and 87.5% of the park respondents becoming loss making. If the increase in pitch fees could not be achieved to offset the lost commission income, these losses could not be sustained as a business model in the long term.