



Aedis-Homes

Scenario and requirement



Industry background

The private house-building industry has been the major provider of new homes in the United Kingdom (UK) since the 1950's. House builders range from very large companies operating nationally to very small businesses serving local markets.

In the UK, the most important constraint on housing supply at the present time is the shortage of land suitable for building. Plans for proposed building need to be submitted to the local government planning division/department and needs to be approved by the local government's elected council. Local residents and other parties with vested interests can object to the local government department giving approval to particular house-building proposals, for example, on environmental, political or other grounds. House-builders can appeal against any rejected proposals, but this can be costly and lead to time-delays.

House-builders are required to comply with building regulations, health and safety policies and sustainability policies – all of which add to the cost of building. The UK Government has introduced regulations to tackle global warming through the reduction of greenhouse-gas

emissions. Arising from this new industry regulation the house-building industry has been tasked with achieving zero carbon emissions by 2019 for all newly built houses.

House-builders have sought to reduce costs through efficiency. For example, the use of standardised drawings and building specifications enables costs to be reduced. It also allows efficient sequencing of trades and allows sub-contractors to make use of relatively low cost, semi-skilled labour. Materials can also be purchased in bulk, at a discount. Through efficient internal design, builders can also maximise the use of limited floor-space. Pre-fabricated building components allow for semi-skilled staff to be used on sub-contracted basis, avoiding full-time employment of a large labour force.

"Modern Methods of Construction" (MMC) are increasingly favoured by house builders to reduce costs and build more energy efficient houses. MMC involves the prefabrication of parts of the house off-site (e.g. walls, floors and roofs). These are transported to the site and assembled in a very short time. Plumbing, electrical wiring and other fittings may already be fitted within the wall and floor panels, further reducing build-time. Critics of MMC suggest that some home-buyers prefer houses that do not have a standardised look and layout.

What the company does

Aedis-Homes plc, is one of UK's top ten house-builders. It was originally established by Don Roby in 1969. It has gradually grown by acquisition of other small house-building businesses and is now quoted on the London Stock Exchange. Aedis-Homes primary objective is to remain as one of the leading national house-builders. It currently builds houses in the UK only, using traditional designs and construction techniques which compare well with its competitors in terms of quality and service, but lags behind in the use of MMC.

It operates through three regional Divisions: Central, Northern and Southern. The Divisions operate with considerable autonomy and have diverse IT systems and practices which have been inherited from the smaller companies that Aedis-Homes acquired. The localised systems and practices make little difference to the work of the individual Divisions but affect centralised co-ordination, for example, when joint projects are carried out.



Current considerations

A) Zero-carbon homes

The sluggish economic climate in the UK means that Aedis-Homes plc's predicted sales will be 10% lower than the planned forecast of 9500 houses per annum. Deteriorating market conditions, partly due to lack of available mortgage loans to potential house buyers, will mean that only 8500 houses per annum being sold in the period 2016/17. This will reduce forecast gross profit margin by £37.4 million per year and result in forecast operating profit of £217.7 million for the year 2017 (based on existing strategy).

The 8500 houses are likely to sell at an average selling price of £170,000.

The principal institutional investors have not received a dividend payment for 2016 and are unlikely to receive payment for 2017. Most of the Board members of the Aedis-Homes are hopeful that business will improve when the national economic climate improves. However, the Finance Director is aware that the current situation could lead to a possible takeover of the company by cash-rich investors, if it is allowed to continue.

One of Aedis-Homes' major competitors, Ziggurat plc, has just completed a first full scale development of 'Green Homes' that meets the UK Government's target for energy-efficient homes. Despite the current difficulty faced by customers of obtaining finance to buy houses, demand for these houses is high, as buyers see longer-term savings in energy-costs. Ziggurat plc is planning to build more homes of this type. Ziggurat has also gained further advantage as a result of being awarded the prestigious "House Builder of the Year Award" for outstanding quality of its homes.

The Financial Director estimates that if Aedis-Homes does not include zero-carbon homes in its building portfolio then it can expect to lose 6% of its sales annually.

However, changing to building zero-carbon homes will rewa once-only initial investment of £21 million.

B) Proposed Overseas Joint Venture

Aedis-Homes is seriously considering investing in a country called Uropia and to this end the Sales Director has asked you to help with the feasibility study. It is evident that the best way forward would be to have a joint-venture with a suitable company in Uropia. A joint-venture is being considered with either a company called Corniche Estates, or another called Realto Homes.

The cost of the land would be recouped by the joint-venture when sales take place (included in direct costs below). 6000 houses would be built on the acquired land and Aedis-Homes would have a 50% stake in the joint-venture. Uropia is currently offering tax incentives to attract overseas investors, which exempt Aedis-Homes from all taxes charged in Uropia.

Corniche Estates is proposing to use MMC to construct the houses. It is anticipated that this will result in a faster build time of 2 years rather than 3 years.

Whilst considering the joint-venture partnerships, Aedis-Homes was pleased to hear that Realto Homes had won a contract to build medium-sized houses in a prestigious suburb of the capital city of Uropia. Aedis-Homes subsequently discovered that the contract had been won by Realto Homes through a series of secret payments made to the contract-awarding organisation.

If Aedis-Homes decides to go ahead with a joint-venture with Corniche or Realto an initial payment of £25 million is payable by Aedis.

	Corniche Estates	Realto Homes
Direct costs (per house)	36,000	34,400
Sales value (per house)	60,000	63,000
Profit margin (per house)	24,000	28,000
50% of total sales value from joint-venture	£180 million	£189 million



C) New Opportunity in the UK (New Town project)

Recent changes to the planning system in the UK has resulted in more relaxed planning rules. Land which previously would not have been allowed to be built on is now easier to gain planning permission for. An opportunity has arisen for Aedis-Homes to bid for land which is likely to gain planning permission for the building of 1500 houses in this "New Town Project".

To date this land has been used for agricultural purposes and surrounds three villages and the plans to build on such land has provoked a strong reaction – not only from the villagers, but also from a range of special interest groups concerned with the protection of the countryside. They have formed a joint alliance called CLASH which actively uses social media channels to promote its views.

However, the local District Council, which is the planning authority in the area is supportive of any planning application as it considers that the development will provide much needed housing in the area, as well as jobs.

If Aedis-Homes decides to bid and go ahead with this project then it will need to pay £110 million in initial costs for land, building materials and other costs. Aedis-Homes' finances allow it to pay these initial costs, as long as the remainder of the building costs can be funded through operating cash-flows and a bank finance loan at an interest rate of 10%. If Aedis-Homes goes ahead with this project then it can be confident that the sales value of the 1500 houses on this site would be £163,000 per house, realisable in 2 years in 2019.

D) Rationalising the Organisational Structure of Aedis-Homes

Aedis-Homes plc has grown through a series of acquisitions and mergers over many years. The acquired businesses have been allowed to operate semi-autonomously, with each Division having its own Marketing and Sales, Operations and Finance functions; and also their own systems and practises.

The CEO, under pressure to increase profitability has asked the Finance Director (FD) to advise him on the implications of rationalising the organisation. The FD's initial analysis shows that if all functions were to be centralised at Aedis-Homes' headquarters and an updated IT system was introduced it would realise in a saving of 40% of the operating expenses, **but it would need an initial investment of £75 million and would take two years to be fully effective.**

The centralising of functions will result in redundancies in the regional Divisions but recruitment of more staff at the Head Office. This rationalising could potentially lead to loss of expertise of experienced staff and this could delay other projects.

Financial data

Financials at the end of 2016:

	£'000,000
Opening balance	112.8
Gross profit	317.9
	430.7
Operating expenses	(94.3)
	336.4
Finance costs	(31.9)
	304.5
Tax (b/f)	(27.9)
	276.6
Depreciation	4.7
Closing balance before investments	281.3

Consultancy advice for Aedis-Homes

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Notes about the case-study:

Proposed activity priority order: