HOUSE OF COMMONS

Levelling Up, Housing and Communities Committee

Oral evidence: Finances and sustainability of the social housing sector, HC 1268

Monday 11 September 2023

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Watch the meeting

Members present: Mr Clive Betts (Chair); Bob Blackman; Ian Byrne; Mrs Natalie Elphicke; Ben Everitt; Kate Hollern; Andrew Lewer; Mary Robinson; Nadia Whittome; Mohammad Yasin.

Questions 134 - 206

Witnesses

I: Steve Collins, Chief Executive, Rentplus-UK Ltd; Neil Brown, CEO, Inclusion Group; Dave Meseck, CEO, DMG Eco; Gemma Bourne, Managing Director, Head of Affordable and Social Housing, Big Society Capital.

II: Felix Ejgel, Senior Director, Sector Lead Sovereign and International Public Finance Ratings, S&P Global Ratings; Simon Century, Managing Director Housing, Legal & General.

Examination of witnesses

Witnesses: Steve Collins, Neil Brown, Dave Meseck and Gemma Bourne.

Chair: Welcome, everyone, to this afternoon's session of the Levelling Up, Housing and Communities Select Committee. This afternoon, we have another session on the finances of the social housing sector, looking at how, with their housing stocks, local councils, housing associations and others in the property sector are managing currently with the requirements on them both to retain their existing stock and to build new homes, of which the country is desperately short.

We have two panels this afternoon. Before I come over to the first panel of witnesses, I will ask Committee members to put on record any interests they have that may be relevant to this inquiry. I am a vice president of the Local Government Association.

Kate Hollern: I employ a councillor in my office.

Nadia Whittome: I am a member of the One Nottingham Board.

Bob Blackman: I am a vice president of the Local Government Association, and I employ councillors in my office.

Mrs Elphicke: I am a vice president of the Local Government Association, and I employ a councillor in the work of my office.

Ben Everitt: I am a VP of the LGA, and I employ a councillor.

Q134 **Chair:** We will move over to our witnesses, and I will just ask everyone just to say your name and the organisation that you are representing today, please.

Gemma Bourne: Good afternoon. I am Gemma Bourne, managing director at Big Society Capital.

Dave Meseck: I am Dave Meseck. I work within an organisation called DMG Eco. I look after remediation, refurbishment and financing projects for local authorities and social housing.

Steve Collins: Good afternoon. I am Steve Collins. I am the chief executive of Rentplus, which is the leading provider of affordable rent-to-buy in the UK.

Neil Brown: Good afternoon. I am Neil Brown. I am the chief executive of Inclusion Group. I provide about 4,000 units of specialist supported housing across the country.

Q135 **Chair:** Thank you all for coming this afternoon to give the Committee your understanding of the current situation. We take evidence in writing, then the oral sessions, and eventually come to our conclusions based on the evidence that we have.

There are traditional ways of funding social housing. However, in recent years, there have been some perhaps different and more innovative

ways. Some may challenge the existing model; some may be in addition to it. As a first question, would you like to explain what you know about what you are involved with in terms of new ways of funding and what impact they are having on the provision of social and affordable housing?

Gemma Bourne: Big Society Capital is the leading social impact investor in the UK. Along with our co-investors, we have committed £1.4 billion to social and affordable housing, which is projected to deliver homes for 15,000 people.

I will put our role in context, which will explain the vision that we have of private impact capital coming into the market. Big Society Capital's role is twofold: first, to grow the social impact investing market in the UK and, secondly, to make our own investments that signal to that market what good impact practice and good impact investment looks like.

That, therefore, has given us a really good vision of the overall shape and size of private impact capital coming into the market. It is a market that is still relatively nascent, but it has grown significantly. In 2011-12, it was valued at zero. Our recent market sizing shows that that market is now worth £5 billion.

It started with very impact-first, boutique investment managers entering the market, particularly establishing homelessness funds, but we have, latterly, really seen it grow as a result of two things. One is more mainstream fund managers and real estate houses pivoting their expertise towards social and affordable housing. Some names you might recognise include Columbia Threadneedle, CBRE and Man Group, for example.

Secondly, it is increasingly becoming a really interactive sector in terms of institutional capital, particularly local government pension schemes, for a couple of reasons. One is that they want to deliver on their ambition to deploy 5% of their assets locally. Housing is a really local, tangible asset that can have significant impact for local communities. They are also really attracted by some of the cash flow or financial characteristics. The long-term, high-quality nature of the cashflows that are derived from the rent is really attractive to them.

Housing is a real asset. For example, it has particularly performed well over the long term. Going back to those cashflows, in many degrees, there is an element of underpinning of Government revenue to those, which reduces overall risk for them, so it is really attractive to long-term investors. The market needs lots of capital. Private impact capital can be one part of that solution and that toolkit, which is why we are really pleased to submit evidence to the Committee to represent that.

Q136 **Chair:** Maybe it is me who is not getting it, but I suspect lots of other people hear the words "impact investment". What is the difference between impact investment and other investment?

Gemma Bourne: That is a great question. It is making investments to optimise financial outcomes, as well as either social outcomes for people or environmental outcomes. I often think that a helpful acronym to remember is ABC when it comes to impact investing, A being "avoid harm" and B being "benefit stakeholders". That is typically where you see ESG—going about your normal course of business and how you are avoiding harm. Impact investing is the C, which is "contributing to solutions", so you intentionally use capital to design a solution that could help solve a local, national or global problem.

Dave Meseck: I have been working with JP Morgan, and our view on capital investment into the marketplace is based on three areas. The first area is existing housing stock, because people seem to think that we have a new problem. It is already there and has always been there. The second area is the challenge for net zero to bring any housing stock—new and existing—into the relevant policy grounds.

The third part is how capital investment is portrayed as being a balance sheet asset to a local authority. Local authorities sometimes seem to see investment as a threat, and what we seem to be getting at the moment is local authorities saying to us, "We do not really want you to come and invest with us. We would rather go and do it with a smaller, recognised investment organisation, because we know that that works."

However, the models that currently work are based on a 10 to 15-year span, which means capital investment is high. In debt to equity terms, it costs you more money, so there is going to be more expenditure on the capital side. Then you end up with a problem that does not enable you to manage your yearly commitments to keep housing stock at the level that it should be kept to.

The final part of that is net zero, which is down to making all housing stock in the UK to a standard by 2030 to 2032. That is the policy area that it is going for. There is a substantial sum of money that is required to bring all social housing and local authority stock up to a standard, and people are hiding from that number. It is not a small number; it is in the billions. I concur that there is capital available to be invested, but there just seems to be a lack of will to adopt a new approach.

People have been tethered to this PFI approach, whereby an organisation will come along and confirm that it is going to refurbish your properties for you. The organisation will probably go forward and say, "We want a return on the asset that we have helped refurbish for you," but the model today is much simpler. JP Morgan is working on that model. There is a £1 peppercorn rent to take the property on and refurbish it, and then you pass it back to the local authority, which guarantees the return on the investment that has been made.

You have a programme to refurb every 10 to 15 years and, at the end of the period, you take the property back at £1. The investor has not gained, other than the risk reward that they wanted for that model.

Currently, everybody seems to want a little bit more than is available, but they are not looking at the real underlying problem.

Steve Collins: I come from a slightly different perspective. We deliver an affordable rent-to-buy product nationally that is reliant upon institutional investment funds. It is a targeted product that gives lower and middle-income working families a route to home ownership. We utilise pension funds to deliver that particular product in the market. We have a national portfolio currently and have the ability to expand the delivery of that product and gear it specifically around lower and middle-income earners.

In terms of accessibility to cash, we have a proven, tested product that is suitable for institutional investment funds, and we believe that there is several billion available to help facilitate the delivery of the Rentplus product across the country.

Neil Brown: My colleagues on the panel are from the finance side. Inclusion Group is the entity that delivers. It really provides the ability for funds to get their money working. We provide about 4,000 units right across England, from the Scottish border all the way down to Devon and Cornwall, into Dorset, into Wales and into Scotland. We are growing at about 450 to 500 units a year, so we are talking about £90 million to £100 million worth of development coming through Inclusion Group on an annual basis. One of our entities is a registered entity—Inclusion Housing—regulated by the Regulator of Social Housing.

The accommodation that we are providing is all funded through institutional investment. There is no housing grant or grant from Homes England, and nor would we want any grant in terms of the model that we have.

We are getting investment because of some of the things that have already been said. It is the long-term nature of the accommodation. It is the revenue stream. It is the fact that there is excess demand. It is in the UK care sector, so there is a great deal of demand felt for this type of accommodation.

Because of that, the investment is increasing. It is increasing from abroad. We have UK and international investors coming forward, and we are seeing that the product we are providing is of high quality. We operate across about 126 local authorities and 99% of our referrals are from local authorities, fully funded with their support plans. Because of that, we are seeing increasing demand.

Despite the opposition to the model, we can prove it to be successful. It is successful, because every scheme that we undertake is backed by commissioners, who have seen that traditional procurement routes have not been working. The social housing investment model in this country has been locked in and really has not moved for a number of decades, and institutional investment sees the benefits of this.

We measure the social impact of what we are providing, and what we know is that we are saving about £3 million to £4 million a year in terms of comparable accommodation costs for somebody in a registered care environment or in unsuitable accommodation, so it is successful. It is commission-backed. It is about giving individuals long-term tenancies. We are doing it despite the opposition of the sector and the regulator in that regard.

Q137 **Chair:** Thank you for all of those contributions. You are all very optimistic and forward-looking. You all think that you have real solutions, so there is nothing not to like there. Why are we not solving all of our housing problems with the offer that you are making to the Committee today? What are the challenges, the problems and the obstacles?

Neil Brown: From our point of view, we are delivering some of the solutions. As I say, everything that we do is commissioner-led. It is backed by local demand. Because the traditional model has abandoned this particular market, there is a vacuum. Inclusion Group is a well-performing organisation, and that is why institutional investors like to invest in that regard.

In terms of the market, we have been swimming against the tide, but when you look at the UK housing sector, it is sitting on assets of £186 billion. It has a turnover of about £20 billion and makes a profit before tax of about £5 billion and pays virtually no tax. The potential and the capacity there are significant, but the model just will not allow for what I would call unlocking the value of the sector.

This is not public sector in terms of the sector that I am working in. It is regulated social housing and it is private sector, but there is no real market operating. We need to unlock the value of the organisations to bring institutional investment into them, not just through lending, through bonds or through setting up their own organisations.

Alongside that, we need to look at the sector adapting. Inherently, in the way it is regulated, it is about risk mitigation. Because of the changing environment in terms of demands and of the institutional investors who are coming in from home and abroad, the sector needs to adapt much more quickly, and it is not really doing that.

Q138 **Chair:** Are the not-for-profit providers trying to reform the whole sector, or are you meant to provide something separate to them?

Neil Brown: In terms of the model, it would take primary legislation, which is not your role, and I get that. In terms of how it would potentially look for a tenant, if we are serious about delivering genuine social housing—not affordable housing or shared ownership, which can be delivered without grant—it can be achieved, but it will take a sea change in order to do that. There needs to be greater focus in terms of the moneys being deployed for social housing. The model needs to be changed and we need to see how we can move rent levels from what are

primarily affordable rents back towards social rents. That can be achieved, but it means that you need institutional investors holding assets. You need some housing associations primarily focused on development rather than social service provision. Then you need to look at the service itself in terms of the tenants and the service offer.

Steve Collins: I am probably going to break this down into something a bit more simplified, in that the key challenges we face in delivering institutional impact products in the market come principally from local authorities not accepting that institutional investment-backed models are financially sound. That is a really big issue that can be rectified relatively simply through correspondence from Government to those local authorities to make it abundantly clear that these products are acceptable.

The second thing is redividing the policy system to account for the different segments of the market. Everybody talks about social housing as a catch-all, but social housing does not catch everything. It goes from social housing right the way through shared ownership and into high-dependency supported living products. Some of those products do indeed require grant to make them stack up, and I would argue that social rented properties and high-dependency, supported living-type accommodation are paramount and should be receiving high levels of grant.

Affordable rent, rent-to-buy and shared ownership do not need grants. We have demonstrated that we can deliver an affordable rented product for up to 20 years and convert people into home ownership without the need for Government grant whatsoever. That is deliverable across the country, and that is predicated based on an affordable rent rate. What the current policy says is 80% or less within the market.

Local authorities should be encouraged to think more about need, but not just social-rented need or the most deprived and their need in society. There is a growing requirement for lower and middle-income working families. I know that we are taking action around section 21 notices as an example, but if somebody is evicted through no fault of their own from private rented and ends up on the doorstep of the local authority saying, "I now need some form of temporary accommodation," that costs the local authority an absolute fortune.

What you can deliver is a policy that enables a preventive product, which, effectively, prevents people getting into that "most in need" category in the first instance. I am suggesting that that should be something like rent-to-buy as a generic sector. It should be noted that there are some nuances and differences in the rent-to-buy market, which offer different opportunities for different types or groups of people, and that should be explored further and made very clear to local authorities.

At the moment, we have £11.5 billion-worth of grant allocated to affordable housing in the 2021 to 2026 programme. If you were to

advocate for a policy change and divert that funding to a social rented product or high-dependent living, you would be able to deliver anywhere between 200 and 300 socially rented properties. In addition, you have also now created an environment that is attractive to, and a level playing field for, institutionally backed products to come in and deliver additional institutionally backed housing products to meet other forms of need within those local communities.

Chair: You said 200 to 300, but do you mean 200,000 to 300,000?

Neil Brown: That is what I mean, sorry, depending on the grant level, of course.

Dave Meseck: We have been trying to say to local authorities, "You have value in your portfolio—social housing combined, etc." Going back to the point about local pensions investing in local authority portfolios, they set a mark. The mark for investment comes back over a 10 to 15-year period, if an institutional investor comes in on the traditional model.

We are suggesting a 30-year or 40-year model, which gives you a better yield in terms of cost of capital—back to the debt-to-equity ratio—and enables you to run a programme of works through the whole life of the investment. Instead of people coming in flightily and saying to the local authority, "You do this work"—and we know that they do not manage finances well, because of the pressures that they have—there would be a programme of work dedicated to supplying local authorities with the ability to continue doing the maintenance but to provide the right level of infrastructure to deliver worthwhile living for their tenants and their customers.

The problem that we have at the moment is net zero and the LAD scheme that is trying to bring in decarbonisation programmes, which are all coming in and confusing people as to where they can get capital from to support it. Our suggestion is a one-stop solution, which we provide over the whole period. As I have said before, we look at the property. We take the property for £1. We do a leaseback to the local authority. They take the rental. They pay back on the investment. They then have the property back at the end of the 30-year or 40-year period for £1, so they have gained value in their property. That is a win for them.

We have given them a programme that enables the building to evolve in the envelope that the policy wants it to evolve in. Today, net zero is the number one challenge. In 15 years' time, we may say that we want a refurb back to hydrogen gas coming into household boilers. There is a lot of work to be done, but if you think about that as a return on investment over a longer period, with more options to be able to evolve the property instead of locking people in at the start, that is our approach.

Q139 **Chair:** Is there any flexibility during that period in terms of what needs to be done, or do you agree the programme at the beginning and you are fixed into it?

Dave Meseck: It is a partnership in terms of that aspect of the programme. We say what we think needs to be delivered. They have surveyors who come along, their building operations agree with us on what we need to do, and we do that work. However, every so often, there will be a review or a refresh of products that needs to be done.

When we talk about refurbishing a property, we are talking about everything from bathroom to kitchen level, because everything has to be aligned with net zero coming through. We cannot do just one part of it and then say, "We have achieved something really great." We have to do everything in balance.

We have been talking to a local authority. They have a 21,000-home portfolio and capex of £60 million a year. That £60 million divided between 21,000 homes does not give you anything that you can do to that property of any value, so they are picking at where they want to be doing the right things. Local authorities are in a bit of a pickle at the moment, purely because of the way that historical policymaking and funding has been provided, and they are trying to catch up. The gap is that they do not have the time and the resource to hit the net zero element of it. You cannot deal with net zero as just one thing on its own. It has an impact on everything that has to be done to a property, and that is where our starting point is.

Gemma Bourne: Speaking from the perspective of the market that we see, which is impact-investing long-term capital that is aligned with the need of the sector, like local government pension schemes that I spoke about, and noting that it is also one part of the overall solution, because billions of pounds of capital is needed, one of the challenges that we hear and see working with them is the certainty required over rent-setting policy, for example. Particularly long-term investors really like certainty over rent-setting, because the less volatility or uncertainty there is in the rents, the more their costs of capital come down, since it enables them to plan for the future, noting that they are investing a lot of people's pension funds.

Inflation has been a really difficult challenge in the sector. Because impact investors take a long-term view, they have not passed on the full extent of inflationary increases to tenants. They know that they are already struggling with the cost of living crisis. They are aligned to their impact objectives, but this capital also thinks long-term. It does not serve anyone's returns for there to be rental arrears or unoccupied buildings, for example.

Certainty over rent-setting policy is a real key challenge that could inhibit more capital potentially coming into the sector, but it is also worth noting another challenge in the sector of the market that we see from impact investing, which is when it comes to supporting vulnerable people, for example. Some of those models are local housing allowance-based and

do not yet meet the returns for which private capital would come into that market.

We have a really great example where we have worked with DLUHC in terms of making grant go further. That is a real option in this part of the toolkit of overall funding for the sector. Since 2020, DLUHC has granted Big Society Capital £25 million to support rough sleepers, those at risk of homelessness and families in temporary accommodation. We have matched that with investment capital.

Whereas a grant would typically be used once, it is being recycled at the end of each investment term, plus, because it has reduced the overall capital risk to investors, it has leveraged in £80 million of pension fund money. This is one part of the toolkit that can be used to respond to the challenges in the market that investors see.

Chair: We are going to move on to colleagues' questions. I will just say that I have allowed everyone a bit of dispensation to make introductory comments about what you do as an organisation and what you have to offer. I would just ask you now to be a bit briefer in answers; otherwise we will be here for a very long time. There are four of you on the panel and we have a number of questions that we need to get through, so just remember that when we come on to further questions.

Q140 **Nadia Whittome:** My questions are for Steve Collins and Neil Brown. First, do your organisations have the capacity and the funding to deliver a significant number of new additional homes?

Steve Collins: Our current business plan provides for only 1,500 homes per annum across the spectrum, but it is absolutely scalable. We have the ability to raise funds within the institutional market, as I said earlier, in the form of several billion. I would like to say that we can do that almost immediately, but that is not quite true. We have to, of course, go through a process, but I suspect that we would be able to scale that up and deliver 10 times that over the next 12 to 18 months, providing that policy change is performed.

Neil Brown: In terms of the funding and the capital side, that really is down to the markets and whether the investors are there. At the moment, we know that the underlying principles and attraction of investing in the sector are high. It just depends on the environment that it exists in. If the funding is there, we can deliver. As I said, we are delivering about 400 to 500 units of accommodation, which we could double in terms of our capacity. Going forward, we envisage that we will be doubling the size of the organisation within the next five to 10 years. It is possible. We have the blueprint, we have the capability, and we have this supply chain.

Q141 **Nadia Whittome:** What do you see as your role in the sector? Do you consider your organisations to be an important part of affordable housing delivery in the long term?

Neil Brown: We are a disruptor business. It is as simple as that. We lease accommodation. That is not normal in the sector. There are leases, but not at the scale at which we do it. That has meant that we have been able to deliver significant institutional investment into the sector. It means that we have also been able to deliver accommodation for particular needs. We are very good at that and will continue to deliver that going forward.

What was the other part of that, sorry?

Q142 **Nadia Whittome:** Do you consider your organisation to be an important part of the wider sector effort in building affordable new homes in the long term?

Neil Brown: In terms of being an influencer, we are going against the grain. We are showing that this model can work and will continue to do so. Through that, hopefully we will build confidence that new models can work within the social housing market; they can be successful; but, more importantly, they can deliver much needed new accommodation across the country.

Steve Collins: We are an essential part of the affordable housing mix. As I alluded to earlier on, this is because there is no other product in the market that is currently looking at that lower and middle-income, key and essential working group. There are no other real products that have access or have a facility to enable people who are not wealthy enough to access the market but are too wealthy to access traditional forms of social housing. Sadly, that is a growing trend across the country, particularly in a high interest rate and mortgage cost environment.

Q143 **Nadia Whittome:** So you are not going to come in, extract profit and then leave when the going gets tough. That is the concern that a lot of people have raised about for-profit social housing providers whose motive, among other things, is to return a dividend to shareholders.

Steve Collins: I can answer that very quickly. When we enter or engage in a site delivering affordable provision, we do it under a 20-year term, so we are here for 20 years. Because of the unique nature of our model, each five years we take the cash from that initial investment and recycle it in more. We are currently recycling the investment that we have initially made through the system. The more money that we can get in, the more money that we can then recycle through the system. We are definitely in it for the long term.

Neil Brown: Just to come back on that one, we enter into long-term leases. This is a long-term business strategy. We are not paying out dividends. There are two important indicators here that are reported on a public basis. In terms of return on capital employed, we are delivering capital employed into the social housing market. The average for the sector is 3%. We are delivering 10%, so we are driving more and more value.

In terms of investment in social housing, the sector delivers only about 1.4% of new accommodation within social housing. We are delivering 10% year on year, so that is our commitment. The market that we are in is about reputation. We and the funds do not want to be associated with bad practice. We know that there are bad actors out there. We know that there are bad service providers. In terms of what we are delivering with the partners that we are working with, reputation is key. We do not want to damage that, because this is long-term investment for particularly vulnerable clients.

Q144 **Nadia Whittome:** I have a couple of follow-up questions for the whole panel. Are for-profit providers able to deliver housing at true social rent rates, as well as other forms of affordable housing that we know are not affordable at all for households in the lowest income bracket, since that can be up to 80% of market rents?

Steve Collins: The answer is a bit complicated, because there are a number of things that impact on rent levels locally. Within the social housing sector, we are currently seeing issues around damp, mould, the quality of management of stock, and all of those sorts of things. It is the rents that are paying for that through traditional, longer-term housing stock.

The other point to mention is that, while institutional investment funds are in it for the long term, that does not necessarily mean long-term accommodation in that particular home. For instance, I can make reference only to our product, and I apologise for that, but we have a situation where traditional affordable housing providers and local authorities look for affordable housing to be delivered in perpetuity. As a consequence of that, it increases costs as your stock becomes much older. The cost of retrofitting, environmental standards and all of those things increases the management costs of those particular properties.

With something like Rentplus, we do it over a 20-year cycle. Our stock is never any older than 20 years, so we always have modern stock available to us.

Q145 **Nadia Whittome:** Could you clarify that? I think you said that you are in it for the long term, but that not everybody is in it for the long term in one particular house.

Steve Collins: What I meant was the comparison of in-perpetuity provisions—long-term traditional forms of affordable housing, which then costs an awful lot of money. If you are talking about a financial investment strategy, we are absolutely in it for the long term, but that means that we sell those houses to tenants over each five-year cycle. If we have four properties, say, on a development, one would be sold at year five, year 10, year 15 and year 20 to the tenants.

Just to be clear, we have a 94.8% success rate of achieving home ownership in our product compared with, say, shared ownership. One of

the previous witnesses mentioned 6% in shared ownership managing to cascade out to full ownership, so there are significant differences. The reason why it is short-term is that we own that stock for a short period of time. It is then sold to the tenant. We then take that money and reinvest it in new stock, so it is a two-pronged attack. We have long-term investment, but a short-term asset ownership strategy that enables people to buy their home over a period of time, and we then reinvest that money into more affordable homes.

Neil Brown: We do not receive any Government grant in terms of the accommodation. In terms of the gross level of rent that we charge, we know, because the analysis has been done by the National Housing Federation, that our gross rents are 15% lower than traditional housing associations that have received grant. That is significant, given that we have not received any grant, and that is on the gross level. We know that, if we had received a grant, we would probably be about 30% cheaper.

Would we be able to deliver social housing rent? No, not really, because the fact is that the average social housing rent in the country is about £106. You can double that for affordable housing rent, and £106 would barely cover the lending. You can move more towards social rents and away from affordable rents. As I said earlier, affordable rents can be delivered without grant.

If you put your focus on social housing, you can really push those numbers down towards social housing rent levels, but it will take a re-emphasis on institutional investment and the terms on which they invest around the leasing of accommodation, as well as a competitive environment in terms of housing associations and registered providers that would compete for and provide that accommodation to people who are genuinely in need. I cannot not go through all the detail, but there is potential there to provide more social housing at lower rents, although achieving social rent would be extremely difficult.

Gemma Bourne: Specifically for for-profits, we do not have particularly deep insight, because we tend to invest in models that are working with the existing for-profit sector. Ultimately, we are talking about people's homes. There is a reason why that is at the bottom of the pyramid when it comes to the hierarchy of needs. If that is not right, it has knock-on effects elsewhere for people's life chances, the NHS and the economy, etc. Given that we are talking about that, it is not just a financial solution that is needed. Any private capital coming into the sector would benefit from a more impact-focused approach.

If I boil that down into the simplest terms, ignoring that there are many frameworks and things out there that align to that, do the investor and the fund manager really understand the area that they are going into? Especially if it is an area of people who are vulnerable, are they working with expert partners to design a solution, given that, typically, sometimes

they are just coming from a financial perspective and lens? Is that built into the terms of that finance?

Ultimately, given that this is about good outcomes for people and providing their homes, is impact embedded in the whole investment decision-making process? Is that elevated to the same level as you would when managing financial KPIs, etc? All capital coming into the sector should be impact-focused, because we are talking about people's lives and homes.

Q146 **Nadia Whittome:** The Affordable Housing Commission found that affordable rent was diverting resources from providing social rented homes, for example through social landlords re-letting properties that were previously let at social rent rates at affordable rent rates. Do you agree with that? Could an increase in the proportion of social housing owned by for-profit providers accelerate that trend?

Neil Brown: It is certainly true that there has been flipping of rents within the sector in terms of the supported housing side and the general needs side. I do not know the extent of that. That would need some further research through the regulator, but that has been happening. Affordable rented accommodation and key worker type accommodation is needed and can be provided.

As I have said, it can be provided without the need for grant, so the grant should be on the social aspect. It is about getting the maximum value from that investment, maximising the number of units and lowering rents, but that takes a completely different model to what is in place at the moment. That is as far as I can go at this stage, but it is doable in terms of providing more social housing units. Affordable housing rents will still be there if there is a demand, which there is.

Q147 **Nadia Whittome:** We are already seeing the trend of social rent houses being re-let at affordable rent rates. Will that be accelerated by the increase that we are seeing in for-profit social housing providers?

Neil Brown: I do not think it has anything to do with for-profit providers. These are existing not-for-profit providers who are increasing their rents. The for-profit providers will come forward with the individual units and schemes, and they will set the rent and agree that rent at that level. Within there, there will potentially be a rent increase mechanism—it could be CPI—and that will be fully transparent and will operate throughout the terms of the contract, the lease or the financial arrangements. It is not about for-profits. What has been happening has been not-for-profits.

Nadia Whittome: No, not not-for-profits. Social landlords are not-for-profit organisations.

Steve Collins: I was going to agree, because it probably is existing affordable housing providers with old stock. With the regulatory rent cap at 7%, that has recently exacerbated the situation where there is now a shortfall in revenue compared with if you were able to increase rents by

CPI plus 1%, which is the normal formula. It is a consequence of existing affordable housing providers, not limited to for-profit providers, that are looking to do or have done that to try to cover that particular gap in terms of current rents.

It is not necessarily setting a trend to do that. I would go back to what I said earlier on. We need to create an environment that makes it clear that there are particular parts of the affordable housing market that each product or provider provides for. Therefore, if you redivert your grant funding to provide social rent delivered under the regulatory framework, they may be subject to rent constraints and so on, because they are dealing with the most vulnerable in society.

Affordable rent is something very different. Affordable rent is now geared towards those lower and middle-income families that do have an income and do not rely on the state for benefit provision or housing cover. They are people who have only an option of high-cost private rented at the moment, or section 21 notices and so on.

There is an absolute need to have an affordable rent-type product that is accessible to certain groups to meet needs within local communities. There is an absolute need to have a different type of programme that delivers what I would call true social housing. That gives you the ability to direct what that minimum rent would be to accommodate social housing and reduce things like the benefits bill, and so on and so forth.

Nadia Whittome: We are straying a little bit from the question. Dave and Gemma, do you have anything to add?

Gemma Bourne: I do not have specific insights to share with you in terms of that specifically. In some cases, there are elements of new builds and new schemes where there is affordable rent, but impact investors are also taking ordinary homes in ordinary streets and repurposing them for social use. They are working with those local housing allowance-based models that we spoke about before. We do see less social rent in new propositions and would like to see more. I do not quite have the insight for you into whether that is an ongoing trend.

Dave Meseck: The circumstances that have been created are just through this inflationary pressure that is currently in the marketplace. People are trying to balance their balance sheets to make the income model work for them. People are trying to, let us say, bring new models that have no real meaning. They just show a higher entity to themselves. To the public, it seems like they are money grabbing, but they are not. They are trying to stay alive to keep people in the homes in which they need to stay. That is the way I see it.

Nadia Whittome: Tenants are also trying to stay alive, but thanks very much.

Q148 **Bob Blackman:** Steve, could I just follow up on your model that you work on? When you sell the properties after, say, five years, what price

do you put on them? Is it full market price as when they were built, or is there a sliding scale that you operate?

Steve Collins: When the tenant purchases, they buy at, effectively, 100% market value at the time that they purchase, less the cash deposit that we provide. That is all built into our financial model. We use section 106 to buy at a discount. We then build in the 10% deposit. We build in the operating and delivery costs. Then we sell at, effectively, 100%. The revenue income stream then generates a yield return back to the institutional investment fund.

Chair: We will now move to the issue of rent and grant levels. If questions have already been answered, you do not need to repeat yourselves. Again, I am conscious of time. If you could give reasonably concise answers, that would be helpful.

Q149 **Kate Hollern:** I promise that I will be very quick and straight to the point. Neil, you quoted £106 for social rent. What did you say affordable rent was?

Neil Brown: Generally, we are looking at double that. It depends on the region and the locality, but on average it is about £200.

Q150 **Kate Hollern:** Gemma, do your financial models require grant or rent levels to be maintained or increased?

Gemma Bourne: It is really a combination. Investors that we co-invest alongside appreciate the inflation increases and the certainty on the rent that I spoke about earlier. Also in the example I gave earlier, they are quite mindful that these investments have a dual aim: to keep tenants in good-quality, safe and affordable homes and to make a financial return. In the macroeconomic environment that we have found ourselves in of late, they have not passed on full inflationary increases, for example, but that is attractive.

In the local housing allowance models that I spoke about—and I gave the DLUHC example—grant is really important at the moment to be able to scale those, particularly when it comes to vulnerable people and those mechanisms. A rent-setting policy or framework that takes into account the differing needs of tenant groups, noting that sometimes grant might just be needed, is really important.

Dave Meseck: We are looking at just doing the incremental increases on the LHA, because we believe that the value that we are putting into the property brings the property up as a sustainable, usable asset.

Steve Collins: We have looked at setting different rent levels, irrespective of whether it is 80% market or LHA. In some local authority areas, we have looked at setting a rent at 70% of market rent, and then running that through our respective models. The trick here is twofold, really. The first is recognising that there has to be a yield that is being

driven from that rent to repay the debt investment that has provided for the asset.

The second is that you have to generate sufficient income to be able to provide good-quality management services. This is why I am supporting the social-rented, grant-funded-type basis. The level of rent that comes through, because of the debt that has been deployed to purchase those properties, is not sufficient to generate enough return to be able to continue an investment strategy in those properties for their day-to-day operation and maintenance. Therefore, if the grant comes in, the capital value that you purchase it for reduces. You can still drive that yield and then return sufficient revenue income stream to pay for things like that day-to-day management operation.

Neil Brown: Current rent that is set in guidance is normally CPI plus 1%. In terms of the particular schemes that we are bringing into management, they are all CPI only, so there is no 1% inflator. In real terms, our rents will be worth less than the CPI plus 1%, so it can and should be done.

In terms of the CPI indexation, what Dave said in terms of linking it to LHA is very interesting. We have certainly thought about whether CPI is really necessary on an annual basis. I am not that smart, but I work with people who could look at that and see whether there is a better formula that gives reassurance to the financial investor while also making sure that rents are affordable as they can be.

Q151 **Kate Hollern:** On that basis, everyone is saying that there should be an increase in grant; otherwise there is going to have to be a big increase in rent to maintain your dividends. Is that right?

Gemma Bourne: There should be grant where grant is needed. It should be made really hard by working in partnership, for example as we have done with DLUHC before, to allow private impact capital to do the best job it can where it can. That tends to be in housing tenures where there are fewer vulnerable people. The sector overall supports a wide range of people, so we need a flexible or differing approach for all those different groups.

Dave Meseck: There are enough mechanisms in play at this moment in time that can be utilised when they are needed, but nobody is really putting them to play when they are needed.

Steve Collins: I have nothing to add other than just reinforcing my position. You can deliver a vast quantity of affordable provision without the need for grants.

Neil Brown: I have a similar response in that regard. For social housing, yes, grant. For affordable housing, that is not required.

Q152 **Kate Hollern:** Everyone has spoken about LHAs. Given inflation and the hike in interest rates, how are each of you going to manage that?

Gemma Bourne: Just like the inflation example I gave earlier, the impact fund managers that are currently in our portfolio are also taking quite a long-term view. They made these investments for the longer term and also want to come out the other side with an investment intact.

Where there have been interest rate increases that have impacted them—although they have not done so yet to a certain degree, because people were on fixed terms, etc. before—they are not passing on the full extent of those increases down the chain to tenants because they know that it is tough for tenants at the moment, and it would not be aligned with their impact aims, so we are perhaps a bit different in that sense.

Dave Meseck: For us, the LHA is the marker to follow. In our opinion, it is a blip on the landscape. It will turn and come back to where it needs to be. It is just an imbalance. That is why the long-term view has to be there in order to cover all of the areas that are required.

Steve Collins: We deliver our product on both 80% market and LHA level, depending upon what the local requirement is in terms of the local authority.

Neil Brown: We do not use a borrowing model, so we are not exposed to interest rates. We have taken that risk out and brought forward a model that is more adaptive. Through our lease model, we are able, first of all, to set the rents in advance. We do consultation with local authorities around that. In terms of rent increases going forward, it is CPI only. We are not so exposed to that interest rate hike putting pressure on our finances. As long as we have a secure income stream for high-quality accommodation in demand, that is sufficient.

Q153 **Chair:** So you are not exposed to interest rate increases.

Neil Brown: No. We do not have borrowing. We lease our accommodation.

Q154 **Chair:** Are leases not affected by changing rates?

Neil Brown: It is for the investor, because they have made an investment. If interest rates go up, they probably could have made an investment in another area, but because our rents are fixed and are agreed in advance, and are increasing annually by CPI only, it does not matter if interest rates go up. Okay, inflation has an impact on the CPI figure, but the interest that we are paying is negligible or nil.

Q155 **Chair:** Eventually, if they are impacting investors, they are going to get a little bit less enthusiastic about putting money into leases, are they not, if we get increases in interest rates as we have recently?

Neil Brown: Yes, because investors see the return on investment that they will get if they put accommodation into Inclusion Group and the return that they will get on that rent. If the market has moved on, they will look at whether they can invest in something that has a higher

return. Some investors will, but during this period of high interest rates I am still seeing institutional investment coming forward, because they want to have the long-term income in the UK property market for tenants, where there is significant demand and under-supply. All the traits for investment are there, and they take a longer-term view for those investors.

Q156 **Mary Robinson:** I will address my questions to Dave Meseck and Gemma Bourne. As we know, the sector is facing challenges. It may be around net zero, as has been mentioned, or other challenges to do with the stock. How can private financing of remediation and repair generate a return on investment? How is that working?

Dave Meseck: We are trying to look at the overall problem that people have. The driver behind net zero is the EPC rating of the property. You can do anything you like, but if you cannot get the EPC rating up, you are not going to get to where you need to be with any money that you invest. Ours is a one-solution approach, but working in partnership, as I have explained before, by managing to get the stock up to a standard that can then be maintained by the local authority. When it needs a refurb, we would refurb it as part of the investment portfolio.

We are not a provider. We are literally the financiers who go in, provide the build programmes and the work programmes, and let the local authorities manage the tenants and everything to do with the maintenance of those properties.

You have to be very innovative in your approach. People would mention things like underfloor heating, and there is a big advocacy programme by the local authority. You cannot underfloor heat certain properties. It is not viable and does not make sense, so we have looked for alternatives that provide the standards required under BRE and the EPC programme to enable people to have a better standard of living while lowering their energy costs to hit the NRZ. By the fact of doing that, we have recreated the fabric of the building.

Where we are having problems is that some policies allow tenants to buy. Once you have an investment portfolio going ahead at 20, 30 or 40 years, and a tenant wants to buy, there is a challenge there. There is certain stock that will not be included and certain stock that will.

Furthermore, we have people who have expressed to us, through local authorities, that they want to live in a certain area. Local authorities are currently selling properties on the open market instead of refurbishing and maintaining them at a standard that could be kept for the tenant.

For us, the challenges are engaging with the local authorities at the right level, making sure that policy works, and applying the right technologies to provide the efficiency measures to enable the EPC standard to be met. That is our approach.

Q157 **Mary Robinson:** How high do you set that standard? It can be a bit of a moveable feast, can it not? The standards that we are requiring today might be higher in a year's time. If the maintenance is going to be through the local authority, where do you intervene? Do you say, "We could do more now," or, "Those units could be replaced and enhanced"?

Dave Meseck: I am going to go through the impact of heating on people's homes. In an average semi-detached home in the UK in a local authority catchment area, people would want two radiators in a room. The gas boiler has to be fired up to give the temperature that you require. Underfloor heating would normally be provided to provide rising heat, whereas we have come up with innovative ways of creating the same amount of heat for less electrical and gas input, and given people the choice of where they want heat to be generated at any one point.

That lessens the amount of energy that that home is using. You could put double or triple glazing in, or you could change the bathroom or kitchen and create the right ventilation. People's equipment is old. The impact of those measures is quite high in the first instance, so you get 90% or 100%, which is where we want to be, so you get to EPC C.

Our ideal is to get to EPC B, which means that we do not have to go back to that property for many years until somebody says, "An appliance has a 10-year life" and, in 10 years, you need to change the appliance. That is how we are trying to measure it, because that is the only way that we can. We cannot look at individual electricity and fuel bills. However, we can educate people in how they try to use energy in their home.

Q158 **Mary Robinson:** Nevertheless, it does sound like a bespoke arrangement as you are looking at the tenancies. That has, in itself, an intrinsically higher cost, so I am wondering how you are making a profit on this. Where is the profit in this?

Dave Meseck: The profit is over the 30 to 40-year period for the institutional investors—the 3% to 4% yield. The profit is not about us taking money out of the works that we are doing. The profit is in the return on the investment being created by the local authority getting value in its properties, so its balance sheet goes up. We get money back through the rental, through the LHA mechanism, and the works are completed to a standard that is acceptable and required by the policy for net zero. We are not in it to take out high numbers like 25% or 30%. The long-term investment model is better for us, because it returns a better yield.

Q159 **Mary Robinson:** Does it work for fire safety remediation and the whole range of remediation that may need to take place?

Dave Meseck: It is everything to do with the building fabric.

Gemma Bourne: It is a really tough nut to crack. I have not seen it done at scale to any degree yet, because there is a whole range of challenges associated with it. I really hope that private impact capital can

step up and help be part of the solution here as well. Among the challenges is supply chain. It is going to take a significantly upskilled supply chain to be able to retrofit all these homes to net zero, etc. in addition to all the tech and it not being quite bespoke.

If private capital is part of that solution, it requires the best of everyone to come to the table and have a collaborative effort with it—the best of Government, the best of private impact capital and the best of the housing association sector—in order to try to crack it, because it is really difficult, and I have not seen it done at scale.

Q160 **Mary Robinson:** How would you bring the best of everybody to the table? What would it require?

Gemma Bourne: A great starting point would be perhaps to explore it with DLUHC as a Department, as well as DESNZ. We could bring ourselves, some of our co-investors and some of the housing associations to really start exploring what that would look like. That would be a great first step to get us moving, because, as I said, speaking to the housing association sector, it is not just one thing. It is the supply chain. It is the finance offering. It is the fact that they do not have a homogeneous housing stock, so you cannot apply one solution to everything. It is really challenging. Therefore, collaboration is the only way forward with that. Private impact capital—or private capital alone—would be remiss to think that it was not.

Q161 **Mary Robinson:** How amenable are local authorities to working in that way?

Gemma Bourne: We do not engage that closely with local authorities. It is more the not-for-profit housing associations that I know are very amenable.

Q162 **Chair:** Energy efficiency measures cost the landlord but benefit the tenant in terms of reduced bills. Should the landlord be able to put the rents up to some degree to reflect some of that cost?

Gemma Bourne: That is one of the challenges to some of the models at the moment, because, even when it comes to impact investing, there needs to be a revenue source that will generate some returns to investors, no matter how long or patient that capital is. From speaking to housing association colleagues, for example, one of the things that they also struggle with in trying to make this stack up financially is that the benefit goes to the tenant and does not necessarily get accrued to them as a landlord. Some great minds and innovative thinking about how that could be done would be really welcome, because it is one of the challenges, in addition to supply chain and the other areas that I spoke about.

Dave Meseck: We speak to a number of local authorities. We spoke to one with stock of 60,000 to 80,000, so it is quite big in what it does. We went with some innovative models with an 80% refund or a

refurbishment on the property, so 20% would be paid by the local authority. We try to manage the meter readings and then take the 20% saving off the energy that we had saved them. It becomes very difficult, because individual tenants have to sign individual agreements, since the local authorities will not support the agreement that is being signed, even though the benefit to the tenant and to the local authority is far outweighed by the costs. It is a difficult one to try to express to individuals.

The example that I will give you is homes and insulation. You can insulate a home all day long. You cannot tell somebody to turn their radiator off. That is as simple as it gets. Individuals always have an individual approach, and that is what we are finding at the moment. We have organisations that do that monitoring. Sero is an organisation in Wales that monitors platforms and works with Octopus Energy, which is very innovative. They are getting people on board, but it is taking a long time to get them to understand how the savings can be meaningful to them.

Q163 **Andrew Lewer:** This is a question for Neil, Dave and Gemma. Does the Regulator of Social Housing effectively assess the governance and financial stability of for-profit housing providers? Is the regulator's use of its value for money standard adequate?

Neil Brown: I would respond in terms of all providers rather than specifically for-profit providers. In terms of governance and viability, it is not adequate or sufficient at the moment. There have been changes in that regard, and I am sure that there will be future changes. Certainly, the historic approach has been very much about ticking boxes. It is like a regulatory bingo type of approach. At the same time, we have had new investors coming into the market, as well as new models and providers.

Not-for-profit providers are making a gross surplus of 25% on average. It used to be 28% operating surplus, so it depends on what you determine to be for-profits and what are not-for-profits. As a group, we do not make that element of return, and we are a for-profit group.

Regulation should be appropriate for all entities. My argument would be that it is had too much of an emphasis on, "The asset-based model is the only one that really has any credence and will work, and let us not adapt to the new models coming forward." Regulation and businesses have to adapt, and the regulation around that is very much around looking at all the information and the intelligence coming forward. The regulator is very good in terms of information gathering and data analysis, but it is not being applied appropriately. It really has to be about outcomes.

Q164 **Andrew Lewer:** Is their analysis good?

Neil Brown: No. Their research is good, but their analysis is insufficient and inadequate. For example, in terms of the customer offer, was the analysis there around bad actors in the market not delivering great services? Yes, it has been there for a long time. The housing ombudsman

has been involved in that element of regulation, but nothing was done until it was highlighted on "News at 10" and it blew up.

In terms of what is happening in the market now with regard to the downgrade of organisations around financial viability, all of this could be foreseen. Business plans were put in place on the basis of very low interest rates. It was very likely that interest rates were going to increase in the future. If organisations have overextended themselves, it really should not have taken too much analysis to foresee that, unless the information that was being provided was incorrect. They need to get smarter and to be more adaptive, but what has gone on in the past really has not been sufficient.

Dave Meseck: I have no interaction with the regulator, so I have nothing that I can comment on.

Andrew Lewer: Thank you very much for that—the best answer of the day.

Gemma Bourne: Very similarly, in terms of insights into regulatory power in relation to for-profits, we have very little interaction on that basis. My comment previously about any private capital coming to the sector having an impact lens on it really stands. Whether it is the regulator and/or another organisation that delivers on that, I am agnostic.

Q165 **Andrew Lewer:** Is there a concern that, having been a regulator for a very traditional and static model for quite a long time, and not having to do in-depth analysis into complex capital markets in quite the same way, it may struggle to cope with new models within the market?

Gemma Bourne: I do not have enough insight into the regulator's culture, the people it employs or their expertise in order to be able to comment on that.

Q166 **Ian Byrne:** I just want to touch on the element of risk and to put a scenario to you. If we look at what happened in Berlin in the early 2000s, €42 billion was spent on real estate investment, with smaller landlords and state-owned social housing being taken over by the large institutional players that you are talking about here as a vehicle for the management of global funds. It resulted in skyrocketing rents, huge displacements and dismantling of local communities. That is the model that we use and that we are talking about here. Without removing that model completely of for-profit equity structures, how do we ensure that Berlin does not happen here?

Gemma Bourne: That goes to all my previous comments and the impact capital being really aligned with the needs of the sector. Investors want that dual benefit of having social impact. That is what social affordable housing is about. Having a home is something that everyone can understand.

Q167 **Ian Byrne:** Not in a perfect world, though. There are a lot of investors that would not have that worldview, are there not?

Gemma Bourne: To be clear, it is part of the solution, not all. There are other elements of regulation that come into play and other guardrails for capital, but it can definitely play a significant role in the sector.

Dave Meseck: I have already outlined the fact that it would be a partnership and a long-term arrangement, and that would be managed through LHA. That is the mark. We believe that an aggregation vehicle may be of use through central Government. That would be a good vehicle to provide momentum for backing finance into the arena and giving people confidence.

The Government today are currently bailing out local authorities, which causes a concern. Going back to one of the points that Gemma made, investors like certainty. If certainty can come from and be controlled by Government through the aggregation vehicle, with the rules and the conditions that need to be set in place to stop Berlin happening, that would be of benefit to what we are talking about.

Steve Collins: For me, the risk analysis of institutional investment funds comes down to how you exercise, for example, leasing arrangements. There are leases and then there are leases. Some give funders step-in rights at the point that there is a failure and enable them to exercise the Berlin scenario. There are other leases that do not. For me, it is about how that corporate structure works. There are mechanisms where you can create long-term leasing arrangements in SPVs that safeguard the tenancies.

Q168 **Ian Byrne:** Does that need strong legislation from here to protect that framework that you are talking about?

Steve Collins: It does not require strong legislation from here. It is already in place. It comes down to the earlier regulation question about how the regulator does or does not accept certain types of leases. There is nothing wrong in lease-run businesses. They work for warehouse distribution and in all sorts of sectors. The same is true within housing. You have some leases that will give step-in rights for investors, so that, if it all goes pear-shaped, that is fine, but we have to think about how you can exercise a leasing arrangement that safeguards the tenant or the end user in the context of social housing.

Q169 **Ian Byrne:** I am glad that you said that, because we have not heard much about tenants. We have heard a lot today about investors.

Steve Collins: It is about the tenant. Again, I can only talk about our business, but we operate what is known as a bankruptcy-remote SPV structure. There is nothing unusual in that at all. You have investment that comes in and you have a 20-year lease that is attached to a housing provider.

The relationship between the housing provider and the tenant is through a standard fixed-term, five-year AST. Nothing can happen to that asset until the termination of that fixed-term AST. The way the Rentplus model works is that that gets renewed up to four times throughout that structure.

I genuinely believe that there are leasing structures and corporate structures that can be applied that would reduce the risk of catastrophic failure in terms of that institutional investment fund. They are the sorts of things we should be making sure the regulator is aligned with when it comes to regulatory status or the assessment of innovative business models.

Neil Brown: It is about that certainty and stability. If institutional investors are coming forward and they want to invest in this type of accommodation, long-term leases will provide them with that long-term yield of 3% to 4%. It is in their best interests to make sure that succeeds because the last thing investors want is disruption, lower values, uncertainty and a bad reputation.

Certainly, from what I have seen, where there have been issues in the sector with regard to leases going wrong, institutional investors have on the whole been very responsible, stepped in and made sure tenants were protected even if they have had to change the lease arrangements or move accommodation on. Inherently, this is about providing accommodation for vulnerable individuals, whether it is social housing or supported housing.

In terms of the assets—you mentioned social housing assets—there should be protection. If the accommodation was provided and registered for that purpose, if something happens to the managing entity, if the housing association goes wrong, somebody else can step in, but the asset should be protected. The tenant stays there, irrespective of the fact that they might be switching from one landlord to another. Tenancy rights should be covered in that regard and all existing arrangements around rent should hold.

That is the basis of the institutional investment, unless you have bad actors in the market who want a short-term return, and who want to get in and get out, where there will be disruption. Some of that has happened, but certainly institutional investors have learned from that. They understand that this is a long-term investment.

Q170 **Ian Byrne:** There will be people watching this who are trying to get into the housing market and who have seen the disaster that has been made of the private landlord housing sector. We are facing a humanitarian crisis. People do not have good enough housing. They are looking at the social housing element as a lifesaver. As I was talking about, the same people who were responsible for that disaster are now entering this market. There will be real fear about what we are potentially letting out of the bottle here.

There are so many unknowns. I highlighted Berlin, but where we are now within the housing sector is pretty terrifying, where these big corporations want to come in and do this. How are we going to assuage that fear?

Dave Meseck: We are not trying to disrupt what is happening out there; we are trying to support and bolster it. We cannot go in and change the people who run the organisations. Ultimately, the decision-makers are the decision-makers. We are just a support function. We are providing the enabling for the enablers to deliver what their tenants require.

Q171 **Ian Byrne:** Is that for profit or social good? It just seems to be feeding into everything you are saying. It is all profit, profit, profit. I just do not hear enough about social good.

Dave Meseck: From our perspective, we have talked about net zero; we have talked about providing the right environment in the accommodation. The social good that everybody wants is based on the society we are living in today. Everybody wants an answer tomorrow because we are in a fast-moving society. When a problem occurs, everybody is looking for somebody else to blame.

The institutional investors are trying to do the right thing. The terms of their investment before, off the last model, were the right terms. They just now need to look at refreshing and recycling it over a longer period. The impact will be lessened.

Q172 **Ian Byrne:** I want to bring Gemma in for the second part of the question. Are there any sorts of investment that should be discouraged? Within the evidence we got, Big Society Capital touched on Home REIT and that model, which has come to light lately. Is there anything you would like to talk about in terms of models that we should potentially be discouraging?

Gemma Bourne: First of all, we are not invested in the model you spoke about there, the Home REIT model. We can only talk from the information that is publicly available. It appears to show poor outcomes for tenants, counterparties in lease arrears and poor-quality housing stock on the promise of a lot of financial return for investors.

Speaking from our experience of investing in social and affordable housing, particularly housing for vulnerable people, which is what that was targeted at for the last 10 years, all of those scenarios are pretty atypical. We have not seen any of that in our portfolio.

One of the key differences is that the fund managers that are impact-minded have worked with really experienced counterparties around that. Resonance is a great example. They set up their fund 10 years ago. They partnered with St Mungo’s, the homelessness charity, which really understands what it takes to support someone who is vulnerable. Lately, they have partnered with Notting Hill Genesis, which is really experienced in that space. We should encourage the people coming into the sector,

particularly if they are working with the most vulnerable, to have an impact mindset.

We worked with The Good Economy to produce something called the Equity Impact Reporting Project, which is essentially a standardised and transparent framework around KPIs and reporting. It is not good enough to say, "Yes, this is an impact fund," and to produce an impact report at the end. It is about how you design the finance to meet the needs of the people, ultimately, on the front end and work with expert partners.

Any way we can proliferate that throughout all the private capital coming into this sector is a really good thing. To be clear, we developed that as part of our market-building role. I talked about the dual roles we have at the beginning. We would like that to apply to all capital entering the market.

Steve Collins: I just want to make a very brief comment. We have been going for nearly 10 years. We completed our first scheme in 2016. It was funded by institutional investment funds. As an individual, you cannot just rock up and say, "I want to borrow however many millions of pounds to invest." You tend to go through credible brokers, who then scale the market. There is a huge amount of due diligence and assessment around those funds before you even get to have a meeting with them about the potential of funding your particular business.

You also have other financial regulatory positions. The FCA or whatever would have some form of say in terms of the investment funds that are coming into the UK. We tend to do a really good job of making sure the people operating in the UK market have credible sources of funding.

Neil Brown: I would like to make a few points here. In terms of the for-profits, as we said, the yields are probably about 3% to 4% on a 30 to 40-year lease; they are longer, 5% to 6%, on a 20-year lease year. They are not making massive profits. When you look at the social housing sector, the not-for-profits are making a gross surplus of 25%.

Ian Byrne: It has not been invested back in.

Neil Brown: The other aspect is really where the investment is going in. I will speak about my particular sector, which is supported housing. We are delivering accommodation in that sector. One of the primary reasons for that is that traditional housing associations have walked away from that sector. They disposed of their supported housing assets. They would not invest in supported housing assets unless there was a significant amount of grant.

Q173 **Ian Byrne:** Is that a failing of the Government?

Neil Brown: No, this is a failure of housing associations in terms of the purpose for which they were set up.

Q174 **Ian Byrne:** Is it not a failure of the Government to offer grants that let

the sector wash its face?

Neil Brown: It is not a failure of the Government. I will tell you why. We have been able to come into the market—we are a very important provider in this market—without any grant. We are providing commissioned accommodation, primarily new-built or refurbished. We are providing good-quality accommodation and the gross rents are lower than you would pay to organisations that have received grant.

Q175 **Ian Byrne:** They are affordable rents; they are not social rents.

Neil Brown: They are not social rents. As I have said and as everybody has said on the panel, if you want social rents, yes, the grant has to be there. As a panel, we would say we need more money being diverted away from affordable rents and that grant needs to go into social housing. If you want social housing at that rent, you need to put grant in. The more grant you put in, the more you will get.

In actual fact, this sector has been replacing the traditional housing associations, which have walked away from elements of provision. We have done it to a very high standard with a lower cost.

Q176 **Ian Byrne:** You have doubled the rent.

Neil Brown: No, we are lower than the comparable rents where you have had grant.

Q177 **Ian Byrne:** So you are lower than a social housing association with grant funding.

Neil Brown: We are specialist supported housing. We are 15% lower and we have no grant.

Q178 **Chair:** Does housing benefit take any of the strain of your model?

Neil Brown: Housing benefit takes the strain right across the sector, does it not? Whether it is general needs, supported housing or whatever, housing benefit takes the strain. We are no different in that regard.

Q179 **Chair:** If your rent is higher for this sort of housing, you get people claiming more housing benefit.

Neil Brown: The rents are higher because of the type of accommodation, the services that are going in and the specialist nature of the accommodation. Our costs are about 30% to 40% lower than traditional housing associations. When you look at the data, like for like, our costs are much lower. Our rents are lower by 15%. Those figures are transparent. We can demonstrate those.

Q180 **Ben Everitt:** I have two really quick ones. The first is about regulation. Steve touched on this. It is rather a cheeky question. If anyone wants to take a punt on it, go for it.

Is the Regulator of Social Housing the right regulator to look at it from the angle from which we have been discussing it today? Should it not be

one of the City-based regulators like the FCA due to the level of complexity in the governance and the type of SPVs involved in the models that are set up? If anybody wants to have a go at that, have a go.

The second question is really just to wrap up. There is this huge opportunity to bring in private capital for the affordable end of the sector and therefore free up the Government to focus on and fund the social end. What are the barriers to stopping that happening on a grander scale?

Steve Collins: In terms of your first question on the regulator and whether it is really fit for purpose to analyse these models, I am going to refrain from answering that question because I have an application that is currently in with the regulator. It is important to acknowledge that.

Sorry, I have forgotten the second question.

Ben Everitt: What are the barriers to rolling out this model on a grander scale?

Steve Collins: I covered this a little bit earlier on. The legislative framework is there to recognise that there are alternative products and mechanisms that can come into play here, supported by institutional investors.

First, local authorities are a barrier in many ways, but principally they do not trust institutional investment funds because they do not really understand these models.

Secondly, there is a question mark around affordable housing being provided in perpetuity. I spoke a little bit about that earlier on. That is partly the reason why we are in the disastrous situation we are in around repairs, maintenance and aged stock.

Thirdly, there seems to be little acknowledgment in any local policies of the growing space of the forgotten middle, as I describe it. These are the lower and middle-income workers who do not quite fit the mould, and there is nowhere else for them to go.

The resolution is quite simple: a letter from Government to local authorities, giving them confidence that institutional investments are okay and confirming that these innovative models, if they can demonstrate that they are compliant with the National Planning Policy Framework, should be delivered to meet the needs of a growing and variable demographic within that local area.

Gemma Bourne: In terms of the regulator, I would defer to the comments I made earlier.

In terms of the second question, how can we unlock more of this? From the perspective of the market that we see, we need more impact-based

capital over the longer term that is more aligned with the needs of local government pension schemes in particular. Bearing in mind that they also have a fiduciary duty to pension holders, which is in all of our interests, we need certainty on rent-setting and we need that to be quite stable over a long period of time. The more uncertainty there is, the higher the return they will want in compensation for that risk.

The other element, as we have spoken about before, is really about recognising where grant is required and making the best use of it that we can. We also need to look at the solutions—I mentioned the collaboration we have done with DLUHC—to make it go further and not just be used once.

Neil Brown: On the regulation side, yes, the regulation on the financial viability side should be undertaken by the FCA. It has oversight of community benefit societies in any case. It has a greater understanding of institutional investment and the models that are coming forward. Certainly, experience has shown that the regulator has not kept abreast or up the date. Whether that is to do with capability or whatever it might be, it is still trying to catch up. On the financial viability side, the FCA certainly has a role.

In actual fact, there are not that many barriers at the moment. If you look at the amount of investment that is coming into the sector, whether it is from investors in America, in the south-east, or in south-east Asia, or from institutional investors, that is swallowing up an immense amount of social housing assets, in the widest sense. That will continue. All the projections are there.

It is happening. Are the Government and the Select Committee confident and happy with that, and with seeing how things work out, or is there a role for regulation to have some influence on that? The money is coming in. The investment is going in. Their influence and growth in this particular sector are increasing and will continue to increase.

Q181 **Kate Hollern:** I would just like a bit of clarification from Neil. A few times, you have said that your rents are much cheaper and you do supported housing. Are you just basing that on the rent? Is there funding coming from another stream for the additional support that supported housing needs?

Neil Brown: It is based on the gross rent, which is the rent and service charge. The element of care is not paid through housing benefit, and we do not have any of that income. That is paid to the care provider based on the individual they are providing support to. It is very much like for like. You are looking at the rent and the service charge, and we are lower.

Kate Hollern: The rent could be fairly cheap, but the support costs could be quite expensive. I just wanted clarity on that.

Chair: Thank you all very much for coming to this afternoon and giving us a wide range of information about different ways of trying to tackle the challenges that the country has in dealing with what is an accepted shortage of accommodation that people can afford. That has been really helpful to the Committee. We will consider what you have said to us and reflect on it when we come to produce our report. Thank you very much indeed for coming this afternoon. We will now move on to our second panel.

Examination of witnesses

Witnesses: Felix Ejgel and Simon Century.

Q182 **Chair:** Thank you both for coming this afternoon to our second panel looking at the issues of the finance of the social housing sector. Could I ask you both to introduce yourself: who you are and the organisation you are here on behalf of this afternoon?

Felix Ejgel: Good afternoon. Thank you very much for your invitation. I am Felix Ejgel. I am sector lead on the international public finance team at S&P Global Ratings.

Simon Century: Good afternoon. I am Simon Century. I am managing director of housing at Legal & General.

I will just give you 10 seconds of background and context, which might be relevant to some of the pre-discussion and the forward discussion. I have previously acted as a financial adviser to many of the largest housing associations in the sector. I have acted as an operator within a housing association. In the last five or six years, I have acted directly as an investor into the sector.

Q183 **Chair:** Simon, first of all, on the issue of your current role in Legal & General as opposed to the issue of credit ratings and regulation, Legal & General is also an investor in social housing. You are an institutional investor. Do you have anything you would like to add to what we heard before about the potential for institutional investment, the challenges and the obstacles? Is there anything we should reflect on as a Committee and ought to be thinking about to move things forward?

Simon Century: Thank you very much for inviting me to respond. The conversation reminded me quite a lot of the conversation over probably the last five or 10 years when it comes to the core economics of the sector.

To that extent, just over a year ago I pulled together a report, which a few Committee members here have seen, that tried to talk about the holistic economics and the reality of the sector in terms of where those financial constraints are, where the customer constraints are at the

moment and what the options are going forward. I will just give you a few brief reflections, if that is okay.

First, by way of holistic background, as we have heard over not just the panel just now but the previous few panels, there is a huge financial gap that exists in the sector today. Just to throw out a few numbers to give you a feel for this, in the White Paper that we wrote last year looking at the holistic position of the sector, we said that housing associations alone could deliver about 60,000 to 65,000 homes a year, realistically, off the back of higher interest rates and higher inflation flowing through over the last 12 or 18 months.

We now believe that that figure has come down. It has come down to about 40,000 to 45,000 homes a year. It is a significant drop. We saw a report from Octopus in the last couple of weeks that talked about a 20% to 25% fall in affordable housing delivery from the housing association sector. That is what the traditional players—the only players that have been delivering affordable housing at scale for the last 20 or 30 years—can do today.

The other number to bear in mind, compared to that 40,000 or 45,000, is the ongoing requirement. We believe that figure is about 100,000 to 145,000 homes a year. That is nearly four times the amount that is delivered today.

That is the backdrop. That is the gap that we believe needs to be filled by someone. At that point, we have a number of choices. How do you fill that gap? One way would be to squeeze housing associations further. We do not believe that is viable. They have been pushed very hard since the rent cut in 2015. With the drive to net zero, the high interest rates at the moment and the drive for building safety, the pressures on the sector today are immense. We believe that is not a realistic option.

Another option is that local government tries to do an awful lot more. There is probably some reality in that. While there are lots of good ideas kicking around that sector, at the moment they are delivering something like 1,000 or 2,000 homes a year. The skillsets really do not exist in local authorities to scale that up at the moment, but we would implore them to try to do more.

Then we are into the third option, which is to have some kind of private capital at play. Over the last three to five years, we have seen some very good stuff in private capital. I am thinking of the likes of Legal & General, where I come from.

I started L&G Affordable Homes, which is now one of the largest developers and operators of affordable housing in the country. We are trying to bring long-term patient capital, which is looking for rather boring and sticky long-term returns that last 20, 30, 40 or 50 years, to be invested directly into sectors where we see a deep need for long-term capital to come in.

I can think of few examples that have such a deep requirement as the social affordable housing sector. What is great to see is that, off the back of us and a number of others coming in, we are now seeing more long-term investors coming in that match our and the wider sector's viewpoint around the right and just way to do this sort of investing.

My final comment is that it is right that we are careful, as a sector, about the types of investors that should be playing in the sector and those that probably should not. A lot of that does come down to regulation. The sector is blessed to have a very good regulator, but I would suggest that it is very sensible to create a distinction between the new investors that have entered the sector in the last three or four years, which sit squarely within the regulatory framework and are regulated by the Regulator of Social Housing, and those that are not. They have very different risk profiles and there are very different sorts of models at play.

Q184 **Chair:** I just want to pick up on one point before I move on to other questions from colleagues. You talked about social and affordable. Often these things get interchanged, although they are not the same. In terms of the investment you do, what sort of percentages do you do and what percentages are you looking at for the future? Affordable housing clearly has a market, but there are other people who need social housing as well.

Simon Century: You are absolutely right. The words are used interchangeably all the time. What we do is probably exactly the same as any housing association in the country. If you look at any of the larger housing associations, or even the smaller ones, they tend to be the recipients of the subsidy that is coming in.

What do I mean by that? The old analogy very much rings true today. You cannot provide subsidised housing without subsidy. Housing associations do not tend to do that. We do not tend to do that as an investor. Government tend to, in some shape or form, in lots of different ways.

At the moment, subsidy provision, both under section 106 agreements and via the grant programme utilised by Homes England and the GLA, is far more weighted towards affordable rent and shared ownership than social rent. That has really been the case since 2010.

Our model is a direct mirror of that. Of the roughly 3,000 homes we have under management that we have built up over the last couple of years—we have grown pretty quickly—about 10% is social rent, about 40% to 50% is affordable rent and the other 40% to 50% is shared ownership. That is broadly the same mix you get, like I say, with any of the other housing associations.

I will maybe answer one aspect of the follow-up question. I would love to do more social rent, but there is an economic truth there: that just requires far deeper levels of subsidy. That is ultimately a policy decision.

If you want to have more social rent, more subsidy needs to enter the system.

Q185 **Chair:** Thank you for that. That was a really clear explanation. There is sometimes a lot of blurring and confusion. It is really helpful to understand that.

Can I just move on to credit ratings? How important are good credit ratings for housing associations? What are the main factors that the organisations that give credit ratings look at when deciding what those credit ratings should be?

Felix Ejgel: Our credit ratings consist of three main components. The first one is the assessment of so-called enterprise risk profile, where we look at the cyclicality and competitiveness of the sector, the predictability and supportiveness of the regulatory framework, the demand for service and the quality of financial management and governance. These are the fundamental factors that we include in the enterprise risk profile.

The second component is the so-called financial risk profile, where we look at the financial performance, debt burden and liquidity. Normally, these financial indicators are just a reflection of management decisions within the regulatory framework and certain market economic conditions.

The third component is the probability of extraordinary Government support that an entity may receive. We assess for this third component based on the closeness of the entity to the Government and its role in providing public policy.

These are the three main elements here. Again, I would say that the key components are definitely the regulatory framework and how it functions, in the broadest sense, and the decisions taken by the management within the constraints of this framework.

Q186 **Chair:** What has been mentioned to us—I will ask Simon to come in on this point as well—is the uncertainty about the future revenue streams that an association can get. Everyone looks back to the sudden rent freeze in 2015, which changed the business model of every housing association.

Is the certainty of the income stream and the certainty of rent going forward, or maybe index-linking rent, a key issue that is considered in terms of credit ratings?

Felix Ejgel: Yes. The predictability and supportiveness of the framework is fundamental to the long-term risk. The providers normally build their development plans for the next few decades and borrow for decades as well. It is very important for investors and for the providers themselves to understand how the revenue stream will evolve over time.

If there is some unpredictability here, the response is a reduction of development plans or an increase of savings versus spending. The

providers start increasing headroom over their fiscal targets and slow down their development and investment in existing stock. That is how they respond. Effectively, that is the price the sector may pay if the revenue stream is unpredictable going forward.

Simon Century: I want to bring this back to what that will mean day to day. If you have less sight of what your revenues will do through time, if you are a finance director in a housing association or the exact same in an investor, you will just apply a risk margin; you will add a buffer on top. The way that plays through to this sector specifically is that Government have to step in and provide more subsidy.

There is a very clear point here. We have to make sure the left hand talks to the right hand when we are making these decisions. It requires more subsidy. It also has lots of knock-on impacts, exactly as Felix has said. It reduces development programmes through time; you need to have larger buffers at play; your investment into new housing goes down; and your investment in existing stock tends to be under far more pressure through time. There are lots of knock-on impacts.

While it may be hard to have a very long-term rent settlement, I would not underplay its importance. There is an element about exactly what that rent settlement looks like in terms of the numbers and an element about the duration. Clearly, for any kind of investor, housing association or otherwise, the longer you have sight of that, the more you can plan, the smaller the risk buffers have to be and, ultimately, the more you can do.

Q187 **Chair:** Does it affect credit ratings, or is it simply assumed that housing associations will adjust their development plans to take account of a reduced amount of money?

Simon Century: Yes. That is the simple answer. I say that having spoken to pretty much all the lenders and ratings agencies in the sector over the years. Certainly, as an investor, we take a very strong view on it.

Ultimately, if a rent settlement is either drastically not what people expected or not what Government had previously said it would be, as was the case in 2015, it leads to an undermining of confidence. Lower levels of confidence lead to less certainty around what the future looks like. That leads to a higher range of possible outcomes, and therefore ultimately the probability, if you are a lender in the sector, that your capital will be repaid goes down. It has a very direct impact.

Felix Ejgel: I would just say that it is probably not only about the rent-setting regime; it is also about the grants provided. We are talking about the ability to balance spending with revenue stream. How the model works is very important.

What the latest episode shows us and the lesson we can learn from it is that how the rent regime will evolve in the future is very important. This ceiling was introduced quite abruptly. It was not expected by the sector, but we probably understand why the decision was taken.

What is missing is how the situation will evolve in the future. Social housing providers accumulated losses in the previous financial year when the rent increase was well below the CPI index throughout the year. Since then, this loss has not been compensated. It is not clear how or whether it will be compensated. It is a lot more important than what happened in the past because it has already gone.

The question is how this situation will evolve in the future. That is the main question mark for us and for the sector. This is what may encourage providers to delay decisions and to save more than they spend.

Q188 **Mohammad Yasin:** When a social housing provider fails, for example through bankruptcy or by defaulting on debts, how much impact can this have on the credit ratings of other providers?

Felix Ejgel: It remains to be seen what would happen to other ratings if there were a default because the sector has not recorded any noticeable defaults so far.

As we understand it, if a social housing provider finds itself in financial difficulty, the regulator and other players in the sector will get involved and resolve the situation through mergers in most cases. A large and financially strong housing provider will take over a small one in distress. That is how the financial difficulties in the sector have been resolved at least until now.

There is then a question about what would happen if a big provider were to get into trouble, but we have not seen that yet. We are talking about this scenario very much in theory.

The impact will depend on why the entity is in distress or default. I can envisage a situation in which a small provider is in distress because of its small size, financial mismanagement or anything like that. That may happen. The biggest concern would be a big provider, without any sign of distress, getting into this situation fairly quickly. That would mean that the safety net in the sector was failing. That situation would be a lot more concerning because it would mean that the sector was collectively missing something very important.

Q189 **Mohammad Yasin:** I understand that. If, for example, a smaller provider goes bankrupt or is in financial difficulties and fails, and a bigger provider takes over or merges with it, will that affect the credit rating of the bigger provider?

Felix Ejgel: It may, if the smaller entity is in such distress that the consolidated indicators of the group turn out to be much weaker than this white knight or stronger provider had in the past.

Simon Century: I would very much agree that the context is extremely important. From my experience, the first question you tend to ask is, "Is something systemic going on with an entity? Is it entity-specific or is it something wider?" If a housing association or any entity starts to go into default for some reason, is it likely to be just this entity or are several others likely to come over time? As always, looking at that context is important.

It is probably worth taking a little bit of a step back from the question, if that is okay, and bearing in mind some of the wider context here. We talked earlier about what to look at from a credit rating perspective. Before you get to a stage of default, let alone loss, which has never happened in this sector, there are a lot of things that have to take place. Some of those happen at the operating level. If you are sat around the board, you feel it and you see it. Your finance director comes in and is talking about warning signs.

The one thing I would focus on most is the role of the regulator in this. We believe the regulator is always on a journey, as with any regulator, but is very strong. Over several decades now, the regulator's toolkit, which keeps getting perfected, has been extremely powerful. That toolkit is a vast array of things. It ultimately ends up with a quiet conversation in the background to try to lead to a white knight type situation. Before that, it starts off with things like your quarterly returns and your KPIs. "What is going on?" It is then your annual reports. It is a whole swathe of things.

What the regulator can do, and it does this very well, is to use that toolkit accordingly, rather than getting to the stage where, a year down the line, you find that something has gone really wrong. We take a lot of comfort from that. A lot of investors and lenders in the sector take that comfort as well.

Q190 **Mohammad Yasin:** Can this situation affect their ability to attract further investment?

Simon Century: If there is a default, yes, it absolutely can do. Hence why regulation is so important. It is so important for any registered provider to have good, sound governance. That zero loss point is extremely important.

Despite its huge financial strains, this is a high-credit-quality sector. It tends to be rated at A or sometimes BBB level. That is investment grade. That means a very low probability of default through time. That is a very good thing.

Clearly, if that risk profile goes up, ratings come down. That has a direct impact, which ultimately has an effect in the real world. It leads to a higher cost of borrowing and lower financial capacity, which means less work on existing stock, less work with existing customers and less new build.

Q191 **Mohammad Yasin:** In your view, would the failure of a social housing provider that was not registered with the regulator impact the credit ratings of those social housing providers that are regulated?

Simon Century: The context is always extremely important. I will talk in very general terms, but the impact of a non-regulated entity going into default is a very different proposition to a regulated entity going into default.

We have been through this at Legal & General, which is a regulated entity. It is a hard task to become regulated. There are high standards of financial viability, customer service and governance to be met. If you are outside that framework, you do not necessarily have the benefit that comes with being inside it, which is that investors tend to think that you have better credit quality.

Again, it depends on the context, but, if you are outside of that regulatory framework, I suspect the impact will be far smaller than the impact of a regulated entity facing the same situation.

Felix Ejgel: I agree that the narrative or scenario is very important. Investors normally see registered status as a strength. Effectively, non-registered providers have to build higher buffers to convince investors that they are of the same credit quality as registered ones. That is the practice; that is what is happening.

Q192 **Bob Blackman:** We have received a variety of evidence on the credit ratings of different organisations. Sometimes you get diametrically opposite views on this. I know that during your evidence here you have spoken about how some of this is theoretical. We have seen a lot of major suppliers merging and becoming big organisations; others are standing independently and alone.

I just wonder whether the credit rating varies across the social housing sector by location and by type of provider. Are there other factors involved?

Felix Ejgel: They differ. There are practical and theoretical answers to your question. All other things being equal, bigger housing providers have more flexibility in managing the spending side, in particular. They can rearrange or delay things and can find savings here and there.

When I am talking about large ones, I mean providers with more than 50,000 units. These ones are considered to be large from our point of view. Smaller ones may find themselves in difficulty in the case of financial stress. At the same time, because they know they have

flexibility, the larger providers tend to be involved in larger schemes and riskier activities. That is why we may find examples of relatively risky large providers and relatively safe small providers.

Q193 **Bob Blackman:** Just to give you an example, the larger providers in cities, where they often have quite tall buildings, have had to deal with the impact of fire safety remediation, which often is very expensive. Does that have an impact on their credit rating?

Felix Ejgel: It depends on how costly the remediation will be.

Q194 **Bob Blackman:** A lot of this is quite expensive remediation, which they have to carry out.

Felix Ejgel: It still depends on how much they have to pay. It depends on how it will impact their performance indicators and debt burden indicators. That is why I am saying that it depends on the circumstances.

If there was a small provider with large tower blocks and it needed to invest in fire safety, I believe it would have a much stronger impact on their performance than it would on a provider that has a number of tower blocks, some of which may need additional investments. It depends on the circumstances.

Q195 **Bob Blackman:** What about organisations that become too big to fail? If no one can step in and take them over, they might have to be broken up and end up as individual suppliers. Do you see that happening as a potential risk?

Felix Ejgel: It is a potential risk. In the case that a very large and noticeable social housing provider gets into trouble, our assumption is that central Government will provide support one way or another, maybe through the Treasury. There is no certainty about that because it has never happened, but the importance of large providers to the sector and their visibility for investors is such that central Government will have an incentive to somehow assist this provider.

Q196 **Bob Blackman:** Finally, are you seeing any trends about credit ratings for smaller or larger organisations in the marketplace? Is there a trend there? Are their credit ratings increasing or reducing? Are you seeing anything in that field?

Felix Ejgel: There is no particular trend based on size, no. At the moment, many of the large and visible providers have lower ratings than the small and medium-sized providers, which are focusing exclusively on general needs business and are not involved very much in market development or in large-scale schemes.

Simon Century: It is not just this sector, but there is always bias when it comes to things like mergers that lead to large organisations. People get very excited when you do a merger, but the reality can be different.

I forget the figures, but normally less than half end up delivering what they have said they will do. It normally comes down to the quality of the teams doing it and whether they can do what they have said. A point to bear in mind is that having large organisations does not lead to a better financial position. That big health warning always has to be very clearly put there.

It is my view that mergers are no silver bullet. If I go back to the big picture that I talked about earlier, 40,000 to 45,000 homes a year are being delivered by the housing association sector, with another 100,000 plus to go and find. That will not come via the mergers of housing associations. It probably will not come via increasing risk and things like development for sale.

There are just some absolute truths around the total capacity that exists in the sector. You can maybe tweak around the edges, but there is a big picture question that needs to be answered about how we fill that gap through time.

Q197 **Ben Everitt:** I have a quick follow-up on Bob's point about the risks of providers being too big to fail. Felix, if I heard you rightly, you said that the assumption from a credit rating point of view is that the Government would step in if those risks were to crystallise. I wonder whether there is any precedent for that. Has that been observed elsewhere? Indeed, is there any documentation that shows that the Government have taken that policy decision?

Felix Ejgel: No, there is no precedent. Country models differ a lot. In continental Europe, for instance, a lot of the providers are owned by municipalities or regional governments directly. In the event of financial troubles, we expect local authorities to step in as the owners. That is not the case in the UK or England specifically.

We are always talking in terms of probability. We do not expect the probability of the Government stepping in to be 100%, but we still assume that the importance of the sector—ultimately, it is providing public policy—is such that the Government would have an incentive to support a provider that got into trouble because of sector-wide stress.

This comes back to what we were talking about with the example of a default. That is the same question. How would the default of a large provider affect the willingness of investors to continue lending to others? It is difficult to test. It is difficult to draw a practical conclusion because past experience is not always a good reflection of how things will evolve in the future.

Q198 **Ben Everitt:** You have talked us through the impact of this risk, and we are well aware of the catastrophic consequences of it. What is your view on the likelihood and the velocity of this occurring? What is the likelihood of a big player going under and how quickly would things go wrong?

Felix Ejgel: Where the ratings are allocated now, at least for the public ratings, as Simon mentioned, it is the deep investment grade. They are somewhere in the middle of the so-called investment grade area. That means the probability of default is roughly 1% to 1.5% over the next 10 years. Effectively, one in 100 providers may default over the next 10 years. That would be in line with our assessment.

It may happen. It is not a risk-free sector from our point of view, but the likelihood of default is still low; 1% to 1.5% is a fairly low probability of default over 10 years.

Q199 **Ben Everitt:** On the velocity point, given the circumstances at the moment, with all the pressures on the sector, how quickly will this happen, if it occurs?

Felix Ejgel: It is difficult to say. In ideal circumstances, financial quality weakens over time, and everybody can prepare for it. If there is a shift across the sector and the whole sector weakens, investors and regulators will adjust to that reality. Then the eventual financial stress is not viewed as dramatic.

Indeed, if one high-profile entity were to get into trouble overnight, it would probably send some shockwaves and investors would start reassessing the risk across the board. It takes some time to adjust to the new reality and understand what has happened.

Q200 **Kate Hollern:** How important is the Regulator of Social Housing to credit ratings in the sector as a whole?

Felix Ejgel: The role of the regulator is very important in the model we observe now in England. Among other things, we look first at its role in improving disclosure standards. That is very important, so that everybody can access the information needed to assess credit quality across the board.

Secondly, the regulator also sends early warning indicators and sets up best practice across the sector. That is also very important.

Thirdly, the regulator brokers mergers among entities, especially when one of them is in financial distress. That is very important because in the end it prevents defaults in the sector. That is why it maintains the overall ratings where they are.

Simon Century: I fully agree. The standards we are held to as both an equity investor and a lender to the sector are extremely important. Certainly as a lender, a lot of comfort is taken from the regulator's overall framework and the way in which it can intervene.

I would join together the previous two questions slightly. There was a question about what happens when a big entity gets to a default-type stage. Again, people take a lot of comfort from the sector because of the regulator's role in ensuring that there is a long period of time before you

get to that position, through the multiple interventions that can and do take place over time.

The regulator is very aware of what problems typically exist. They are also very aware of the things they do not yet know. They are trying to build up the right members of staff to deal with those new issues as and when they come about. Generally speaking, to answer the question, yes, the regulator is incredibly important. Ultimately, it de-risks entities through time.

Q201 **Kate Hollern:** Are you confident that the regulator has the necessary expertise to adequately manage systemic failure?

Simon Century: Broadly, yes. From my and colleagues' conversations with the regulator, it is very much on the front foot, as different models enter the sector and as different risk profiles come about, in how it focuses its existing resource and what new resources it will need beyond that.

Inevitably, there will be things that get missed through time. That is human nature. Generally speaking, pretty much everyone who operates within the regulatory framework would follow the same broad view. Like any regulator, it can sometimes be a little bit annoying, but on the whole the framework is a very good thing, and it acts very well with us.

Felix Ejgel: It is difficult for me to comment on whether they have enough resources. I can look at the outcome of what they are doing. What they are doing is very important for the sector. They do manage to deliver. It is difficult for me to comment on whether they have enough resources. They might like to have more.

Q202 **Kate Hollern:** It was interesting that on the last panel we heard that there was very little interaction from the regulator with for-profit providers. Is that a concern?

Simon Century: A bit of clarity is required in terms of the previous panellists. Not everyone on that previous panel is from a for-profit or sits in the regulatory framework. Those that sit within it will be speaking to the regulator all the time. They have all the benefits and other things attached to the regulation.

Some of the models that were talked about sit, in one way or another, outside the regulatory framework and therefore are not necessarily blessed by the same level of oversight that is attached to the framework. That is a really important distinction to make.

Felix Ejgel: I cannot complain about the level of communication with the regulator.

Kate Hollern: That is good. Thank you.

Q203 **Chair:** Does the regulator have the skills to deal with new models that

fall within the regulatory framework?

Simon Century: I can talk only from my own experience. Legal & General has been through an in-depth assessment over the last year. It is very in depth. As new capital or new forms of investment have entered the sector, the regulator has been very aware of what it does and does not know. It is very quickly trying to build up the skillsets to deal with that.

You are always chasing something because there is always something new and ahead of you. Generally speaking, they are asking the sorts of questions I would be asking if I was in their shoes. They are exactly the right ones. It is about understanding the individual or idiosyncratic risks attached to those new entities, as opposed to what they have seen before. On the whole, my general view is that, yes, they are doing a very good job of getting up to speed.

Felix Ejgel: It is difficult for me to comment on whether they have enough expertise. Again, just judged by the outcome, they have been successful so far in doing what they are supposed to do. Whether it will continue remains to be seen.

Q204 **Ben Everitt:** I cannot remember a group of witnesses that have been so overwhelmingly positive about their regulatory body. That is probably true not just for this Select Committee but probably all the Select Committees in this House. It does make me wonder what this particular regulator might be missing.

I will just ask a very quick one on risk. Again, it is a specific one, Felix, on market sale. Can you explain why market sale is categorised as a risk to credit quality?

Felix Ejgel: It is because the revenue stream is a lot less predictable. Cyclicality and competitiveness are a lot higher in the area of real estate development than in the social housing sector. That is why the predictability of the revenue stream is completely different and why the entities that are dependent on unpredictable revenue streams may find themselves in difficulties, if they rely too much on that type of business.

Q205 **Ben Everitt:** Is that widespread across the sector? Are you seeing that as a trend? Again, going back to the pressures that housing associations are feeling, is that something you are tracking as a trend that is going up?

Felix Ejgel: It is becoming less attractive in the sector. We have 43 public ratings in the UK. Out of the 43, only six, from our point of view, have a large dependence on revenues from development for sale, meaning that revenues from this type of activity exceed one third of their total revenue, including joint ventures. It is a risk related to a particular group of entities, and it is probably decreasing in the sector.

Q206 **Ben Everitt:** Is it decreasing because those entities are poorly managed

and they are getting brought up by bigger entities?

Felix Ejgel: It is because the attractiveness of this business is going down and so the margins from this activity are going down. They see in practice how unpredictable the revenue stream can be. I guess they are reconsidering the risk related to these schemes.

Chair: Thank you both very much for coming in. You have helped clarify a number of important issues for the Committee. That has been really helpful to us.