House of Commons

Housing, Communities and Local Government Committee

The finances and sustainability of the social housing sector: Regulator of Social Housing response

First Special Report of Session 2024–25

HC 457

Housing, Communities and Local Government Committee

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Committee reports are published on the Committee's website at www.parliament.uk/hclg and in print by Order of the House.

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First Special Report

Our predecessor Levelling Up, Housing and Communities Committee published its Sixth Report of Session 2023–24, The Finances and Sustainability of the Social Housing Sector (HC 60), on 8 May 2024. The Regulator of Social Housing response was received on 14 November 2024 and is appended below.

Appendix: Regulator of Social Housing response

Introduction

1. We regulate for a viable, efficient, and well governed social housing sector able to deliver quality homes and services for current and future tenants. We regulate at the landlord level to drive improvement in how landlords operate. We are co-regulatory ensuring that boards and councillors continue to be responsible for their organisations. And we are risk based focusing our resources where they are most needed.

2. In this response, unless otherwise stated, where we refer to landlords or providers we are referring to private registered providers, such as housing associations, and their respective boards. This is because they are subject to our Governance and Financial Viability Standard and Value for Money Standard while local authorities are not.

3. We welcome the publication of Committee's report on the finances and sustainability of the social housing sector. We thank those involved for their work on the inquiry.

4. In our response, we have included details of the specific recommendations we are responding to alongside the relevant paragraph number in the Committee's report.

Sector capacity

5. As noted by the committee, the sector continues to retain many sources of financial strength and resilience, including a strong liquidity position, secure income streams backed by government benefit payments and relatively low gearing.

6. However, the sector also faces significant financial pressures, as the committee notes in its report. These include necessary expenditure on existing stock to ensure this meets safety, quality and energy efficiency expectations and the increasing cost of capital as a result of higher interest rates which impacts the sector's ability to build new homes for future tenants. London and other urban areas, where large numbers of flats need building safety works, are seeing the strongest financial pressures.

7. This pressure has resulted in a continued trend since 2018 of reducing financial performance in the sector. This has intensified recently resulting in the cost of servicing debt exceeding net earnings in 2023/24, for the first time since 2009. In aggregate terms, forecast sector interest cover over the next five years is just 111%.[1] Higher than expected interest rates, building and fire safety remediation costs, the increased volume and cost of repairs, and the impact of the rent cap mean that previously projected recovery in interest cover in landlords' business plans has consistently failed to materialise.

8. Registered providers are taking action to manage viability risks, including deferring uncommitted development and renegotiating covenants. However, reduced financial headroom reduces the capacity to manage downside risk and increases the risk that a governance failure leads to financial distress. We will continue to engage closely with providers where our analysis suggests that financial performance is weak and reflect this in regulatory judgements. Where a provider identifies a potential problem with, or threat to, its viability we expect it to give us early warning.

Use of provider resources

Recommendation: where registered housing providers have homes that require major improvements and significant reserves, the Regulator of Social Housing should encourage them to deploy their reserves to remediate and regenerate their existing properties, or to replace them with new ones if necessary. In response to this Report, the Regulator should set out what steps it is doing to achieve this and its assessment of how successful it believes the steps that it has taken have been. (paragraph 57)

1 Financial Forecast Return 2024 data from Sector risk profile 2024 - GOV.UK

Response:

9. As outlined in the Committee's report registered providers are faced with significant financial challenges, as well as multiple and competing pressures on their resources. We agree with the Committee that providers need to manage these difficult trade-offs and make best use of their resources, so they can continue to deliver their core objectives of providing safe, well-maintained homes for their tenants and invest in new homes.

10. Investment by the sector in repairs and maintenance is at record levels with further significant increases forecast.[2] Over the next five years, repairs and maintenance expenditure is forecast to amount to £50bn, 43% of social housing lettings turnover.[3] However individual provider business models and their stock profile affect the levels of investment they need to make and their capacity to do so. Increasing expenditure on repairs at the same time that rents have been capped below inflation and interest rates have risen is the main reason that interest cover (ratio of surplus to debt repayment costs) has gone down and recently fell to its lowest level. The increased investment in existing stock is impacting on providers' capacity to invest in new supply which is being reined in to meet the demand for spend on existing stock.

11. We are confident in our ability and capacity to regulate the sector's financial position to enable them to invest in existing and new stock. We expect landlords to deliver the outcomes of our standards that apply to them, deciding for themselves the best way to do this for their organisation and their tenants. Our standards require them to understand their stock condition and make adequate financial allowance for the work in their business plan.[4] Through our regulatory engagement we look at the processes and controls a provider has in place to deliver this outcome and seek evidence which gives us assurance that they are taking appropriate action if there are failures to deliver this. Where it is not cost effective to invest in stock to meet expectations we seek assurance that providers have plans in place to remedy this.

12. There are a number of examples of recent regulatory casework where failure to maintain stock has been a factor. For example, a case in which the regulator had concerns about the integrity of stock condition data which then adversely impacted on decision making and scrutiny of risks. In another, a provider failed to manage its affairs appropriately in relation to risk management, fire safety, and the decency of homes. In both these examples we downgraded the providers' governance judgements and worked closely with them to address the issues identified.

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2 Financial Forecast Return 2024 data from Sector risk profile 2024 - GOV.UK

3 Financial Forecast Return 2024 data from Sector risk profile 2024 - GOV.UK

4 Governance and Financial Viability Standard and Code of Practice - GOV.UK

Recommendation: The Regulator should proactively assess how registered providers use their reserves not only as an indication of financial viability, but also as an indication of providers' governance, value for money and responsiveness to tenants. (paragraph 79)

Response:

13. We agree with the committee that the effective use of provider resources is an important element of their governance, value for money and responsiveness for tenants. Landlords must deliver the right outcomes for tenants. It is their responsibility to put in place governance arrangements that will achieve this. The Value for Money Standard requires providers to ensure that optimal benefit is derived from their resources and assets and to optimise economy, efficiency and effectiveness in the delivery of their strategic objectives. Our new consumer standards set out our expectations of meaningful scrutiny by tenants and the provision of information relating to how income is spent. These aspects are all explored thoroughly as part of our regulatory engagement with the sector.

14. The challenging economic climate in which providers are operating, along with greater focus on the quality of their homes and services, makes value for money increasingly important. Providers are required to report each year on their performance against a suite of value for money measures set by the regulator.[5] Individual provider information is published by the regulator alongside a report summarising the findings at sector level. Our most recent report highlights how the difficult decisions made by many Boards regarding their strategic priorities have collectively had a significant impact on the sector's value for money performance.[6] We produce a value for money benchmarking tool[7] which enables providers to assess their performance against our metrics and have seen evidence of its use by the sector when we do inspections. This work forms part of our continuing activity to help the sector contextualise the performance of individual providers more easily and enabling a wide range of stakeholders, including tenants, to assess their landlord's performance against the rest of the sector. Where we have concerns about providers meeting the requirements of the Value for Money Standard this is reflected in their published governance judgement.

5 Value for money reports and guidance - GOV.UK (www.gov.uk)
6 Value for money metrics and reporting 2023 - GOV.UK (www.gov.uk)
7 Value for money 2023 benchmarking tool - GOV.UK (www.gov.uk)

Impact of regeneration on tenants

Recommendation: When the Government, Homes England or the Regulator of Social Housing are involved in regeneration projects, they should insist that the regeneration takes full account of and meets existing tenants' needs wherever possible. (paragraph 61)

Response:

15. In setting standards the regulator must have regard to the desirability of registered providers being free to choose how to provide services and conduct business.[8] Therefore our standards do not detail how providers should deliver our requirements or set out specific scenarios or groups of tenants on which the standards are focused. This is because the prescription necessary to examine all potential situations would lead to a significantly increased regulatory burden on providers. We therefore do not identify specific expectations of providers around their engagement in regeneration projects. However, we believe that our new consumer standards do set out, in general terms, expectations of providers that would align with the committee's aspiration for tenants' experience during regeneration projects. For example, our Transparency, Influence and Accountability Standard requires landlords to treat tenants with fairness and respect, take their views into account in decision-making about how landlord services are delivered, and where considering a significant change in management arrangements consult affected tenants on proposals at a formative stage and take those views into account in reaching a decision.

16. Providers are also expected to take reasonable steps to assist tenants wishing to implement tenant-led activities to influence and scrutinise their landlord's strategies, policies and services. We have issued Regulatory Notices under our previous Tenant Involvement and Empowerment Standard where landlords' engagement with tenants has not met our expectations.[9] We recognise the potential impact that relocation during and potentially after a regeneration project might have on the affected tenants. Within our Tenancy Standard we outline expectations that providers grant tenants who have been moved into alternative accommodation during any redevelopment or other works a tenancy with no less security of tenure on their return to settled accommodation.

Recommendation: We welcome the Regulator's efforts to ensure that regeneration projects are properly explained to tenants, and that tenants have had some opportunity to share their views. However, we believe the Regulator must go further to ensure registered providers not only listen to,

8 S198, Housing and Regeneration Act 2008

9 See, for example, case study 10 (Westmoreland Supported Housing Limited) in Consumer regulation review 2019 to 2020 - GOV.UK (www.gov.uk)

but appropriately act on, tenants' views, by considering the level of input tenants have in any regeneration projects as part of its consumer standards and requiring that the developers take on board priorities that have been agreed with existing tenants as part of the standard. (paragraph 62)

Response:

17. We agree with the committee about the importance of providers explaining regeneration projects to tenants, listening to and taking account of their views, and ensuring appropriate information is provided about what has been done with this feedback. Our Governance and Financial Viability Standard requires landlords to have governance arrangements in place that ensure they are accountable to tenants. We believe that this, coupled with our requirements relating to meaningful influence and scrutiny in the Transparency, Influence and Accountability Standard, sets out clear expectations of providers. Whether landlords are telling tenants what they have done with their feedback is an area that we seek assurance on in our inspections. In addition, the Tenant Satisfaction Measures (TSMs) specifically ask tenants about their satisfaction that the landlord listens to their views and acts on them.

The Regulator's understanding of for-profit investments

Recommendation: we recommend that the Regulator must regularly conduct reviews of its own understanding of and ability to scrutinise new financing models in the social housing sector. These reviews must be published biannually in order to provide reassurance and transparently share some of the key challenges that the Regulator faces. (paragraph 100)

Response:

18. We agree with the committee that it is important we ensure that we can understand and scrutinise the for-profit part of the sector. To support this we have recruited staff with experience of banking, financial markets, consultancy, and corporate law/legal structures to for-profit providers and corporate finance in our regulatory engagement, strategy and legal teams and we train and develop our staff. We have regular engagement with advisors to the sector which enables us to keep abreast of the latest developments in the sector in relation to equity investment and new structures and models.

19. We use a variety of ways to keep our regulation under review including through our audit function. The Government Internal Audit Agency (GIAA) recently carried out an internal audit of our regulation of for-profits which

received a substantial assurance rating. We have in our 2024–25 priorities a review of our current knowledge and future development of for-profit providers. As with all our internal audit activity this work was reported to our Audit and Risk Assurance Committee the minutes of which are published on our website.[10] We also provide details on our performance in our annual report.

Recommendation: the Regulator must ensure that, as part of its governance ratings, it examines whether registered providers' boards and executive teams have individuals with sufficient expertise in the financial models the provider is using. Registered providers must demonstrate that they properly understand any capital markets and financial products they are exposed to. (paragraph 101)

Response:

20. We welcome the committee's recognition of the importance of providers having individuals with sufficient expertise in the financial models the provider is using. Our Governance and Financial Viability Standard sets out our expectations that providers manage their affairs with appropriate skill and foresight and the assurance we seek on board capability takes account of the level of complexity in the business that the board needs to have oversight of. Our Code of Practice expands on the standard to outline our expectation that providers regularly assess whether boards and management have the right competencies, experience, and technical knowledge appropriate to the size, scale and risk profile of the organisation. We use a variety of mechanisms to gather assurance on this. Our inspections (and previously In Depth Assessments), which cover large for-profit providers, explore this when considering a provider's governance grading. Our responsive work has also uncovered examples where providers have not demonstrated this and this has been reflected in external publications.

The role of the Regulator if a housing provider defaulted

Recommendation: We are pleased that the Regulator is already engaging more regularly with larger housing associations. However, the Regulator must specifically set out what early measures it would be able to take and by when in the event that this engagement identified any notable problems. (paragraph 168)

Response:

10 RSH Board and committee minutes - GOV.UK

21. We explicitly seek information on large private registered providers' financial position quarterly, including their covenant compliance and liquidity position. We undertake detailed annual reviews of provider finances, including their closing covenant position and covenant forecast, and publish our conclusions in a regulatory judgement. We also examine this during inspections and previously during In-Depth Assessments. As the committee noted there has been a significant increase in the proportion of providers graded V2, and a small increase in the number at V3 and V4, in recent years which reflects the challenging economic circumstances facing the sector.

22. Where our regulatory engagement identifies the possible risk of default we will investigate to quickly understand the relevant issues and underlying causes and may add the landlord to our gradings under review list. Where appropriate, we work collaboratively with other regulators and organisations. We aim to work with landlords so that they make self-improvements and address relevant failures. If a registered provider takes responsibility for self-improvement and we conclude that it has the capacity, capability and willingness to respond to the problems, we will generally work with it to achieve the necessary corrective actions.

23. Last year we consulted on statutory guidance relating to the use of our statutory regulatory and enforcement powers and published new guidance in February 2024. This includes, for example, guidance on insolvency and moratorium powers which are in the Housing and Regeneration Act 2008 specifically to allow the regulator to have some control and make proposals when certain insolvency events occur. This, together with the special administration regime (Housing and Planning Act 2016), form a backstop to protect tenants' homes, keep social housing in the sector, and maintain the confidence of secured creditors.

24. Working with a registered provider may include instances where the regulator will deem it appropriate to use its powers, in order to support the improvement. In circumstances where we use our enforcement or other powers, our approach is to apply what we consider to be the most appropriate power, or combination of powers available. The scenarios in which a provider might experience financial difficulty and the potential avenues for resolving such a situation are varied. We therefore would not want fetter our discretion to react to specific situations as they arise. We are confident we have the approaches and powers in place to engage landlords at an early stage and to resolve issues should they arise and have a track record of successfully doing so. RSH has a dedicated team to deal with those cases where there are material problems who are experienced at considering resolution strategies and utilising the powers available. We

share details from past cases where we can,[11] for example a recent sector trade press interview regarding the financial failures at Rapport Housing and Care.[12]

25. We thank the Committee again for their work on the Inquiry.

11 See, for example With the benefit of hindsight - Learning from problem cases: volume 4 - GOV.UK (www.gov.uk)

12 Social Housing - Insight - Why the English regulator made a payment to a failing provider