Explanatory note for making a formal application for an exemption to the rent reductions in the Welfare Reform and Work Act 2016

Updated April 2016
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Background

Under the Rent Standard which came into effect in April 2015, the regulator had the power to grant a waiver to organisations that were at risk of breaching other standards (especially the Governance and Financial Viability Standard) if they implemented the Rent Standard in full. A waiver could also be given where a provider had existing contractual commitments which meant the Rent Standard could not be met. Such a waiver was agreed between the regulator and the provider and enabled providers to set rents outside of the Rent Standard, for a period of time, to alleviate the difficulties they were facing.

The Welfare Reform and Work Act 2016 (the Act) has introduced a new rent regime for registered providers of social housing. The detail of this new regime is set out the Act and in regulations made under it, rather than in the Rent Standard and Rent Standard Guidance. Waivers granted under the previous regime will no longer be valid.

The Act makes provision for the regulator to grant exemptions in certain circumstances. This guidance deals with the regulator’s power to grant exemptions under sections 25(1) and (4) of, and paragraphs 6(1) and (4) of Schedule 2 to, the Act, and under paragraphs 15(1) and (3) of The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016. Such exemptions are much narrower in scope than waivers under the Rent Standard. They will only be given where the financial viability of the organisation would be jeopardised by (as appropriate):

(a) compliance with the legislative rent reduction requirement, or

(b) compliance with the legislative rent setting regime, or

(c) compliance with the alternative provision regulations.

No exemption can be granted without the consent of the Secretary of State.

Since exemptions can only be given where the financial viability of the private registered provider is at risk even following implementation of a range of mitigating actions, the regulator would expect that the number of applications for exemptions should be limited.

The regulator will consider granting an exemption in situations where compliance with:

- section 23 of the Act (the 1% annual rent reduction), or
- Part 1 of Schedule 2 to the Act (the rent setting regime), or
- the alternative provision regulations in The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016

would jeopardise the provider’s financial viability.

If it is decided that an exemption should be given, this will take the form of a direction to the registered provider as to the extent to which the relevant provision will apply to them. The direction may dis-apply the requirement completely, or may vary the provider’s position in one of the other ways prescribed the legislation.
The direction given may apply to the whole of the provider’s stock, or to part only. The direction will specify the period during which it will apply and the social housing in relation to which it is to have effect.

**Process for obtaining an exemption**

The formal process for obtaining an exemption involves two stages:

1. In the first instance the regulator will assess whether the provider’s financial viability would be jeopardised by compliance with the legislation, and if it considers that it would, what direction it is minded to make.

2. The second stage is a referral by the regulator to the Secretary of State. The Secretary of State will then consider whether to consent to the regulator issuing its proposed direction. Providers should not apply directly to the Secretary of State for consent.

At the first stage, the regulator will consider the following question:

*In a scenario where the legislation applies to the provider, will the rent collected for the stock be sufficient to cover the costs associated with carrying out basic functions and generating a minimal margin (i.e. the minimum needed to allow the organisation to cope with downside risk) such as to allow it to continue to be let as social housing?*

In considering the above question, the regulator will apply the following criteria:

- Any further reductions in expenditure would jeopardise the ability of the private registered provider (PRP) to maintain the stock at a level sufficient to allow it to continue to be used as social housing;
- The PRP has considered all options for reducing expenditure, including looking at all contractual commitments and providing assurance and evidence of advice around the feasibility of getting out of any commitments where to do so would improve the financial viability of the organisation;
- The PRP has considered all possible options to ensure continued financial viability.

What the regulator will consider under each criterion will differ according to the specific circumstances of the registered provider and the evidence the regulator is being asked to consider.

If the Regulator is satisfied that the criteria above are met, it will consider whether the provider’s financial viability would be jeopardised by compliance with the legislation, and if it considers that it would, what direction it is minded to make. In this scenario, the regulator would refer the case to the Secretary of State. The Secretary of State would then consider the application.

In any other scenario, the regulator will notify the provider that its application has been unsuccessful.

**Applying for an exemption**

There is no prescribed format for applications. It is the responsibility of the applicant to demonstrate the need for an exemption and to present a robust and detailed business case in support. The regulator would expect that this will set out in detail (with supporting
evidence) how the provider has satisfied itself that it meets the criteria above, including (without limitation):

- The financial and non-financial effects on the business of implementing the rent reduction
- The conclusions of a detailed and comprehensive review of its cost base and all activity undertaken or proposed to mitigate the effect of the rent reduction and maintain financial viability without the need of an exemption
- Full details of the Board’s financial viability concerns after all possible mitigating action has been undertaken and/or fully reflected in financial forecasts
- Full details of the key underlying assumptions, including inflation and interest rates, impact on covenant performance, sales, re-lets etc. that the business case is based on

The application should also be supported by financial forecasts and accompanying narrative based on each of the following scenarios:

1. A base line forecast for implementing a CPI +1% rent increase
2. A scenario implementing the 1% rent reduction to establish the income shortfall resulting from full compliance with the legislation
3. A revised scenario incorporating the applicant’s proposals to mitigate the income shortfall. This assessment should demonstrate how the provider has attempted to meet the income shortfall themselves and will establish the residual income shortfall. This scenario should be supported by narrative outlining the alternative strategies considered to mitigate the income shortfall.
4. A proposed resolution scenario incorporating both the applicant’s proposals to mitigate the income shortfall and the exemption request necessary for financial viability. This will demonstrate the provider’s financial viability under the proposed resolution arrangements, should the exemption be granted.

The provider should also also consider partial compliance with the rent reduction.

The results of all scenarios should be shown with reference to the minimum performance requirement under loan covenants.

The overarching requirement is that the provider must demonstrate and evidence that full compliance with the legislation would jeopardise the provider’s financial viability. If the regulator considers that the provider has not evidenced this, the applicant will be notified that it has not been successful.

Other exemptions

There are also powers for the regulator to grant directions under paragraphs 15(1) and (4), and paragraph 17, of The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016. These powers are available in circumstances where a provider has taken a transfer of stock which already had the benefit of a direction. The regulator will consider any applications made under these paragraphs on a case by case basis, and will not be bound by the criteria around financial viability as set out in this explanatory note when making a decision in these cases.
The Homes and Communities Agency is committed to providing accessible information where possible and we will consider providing information in alternative formats such as large print, audio and Braille upon request.

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