



## Regulatory Notice April 2019

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### Registered Provider

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Encircle Housing Limited (formerly known as HH Residential Care Limited) (4784) was registered in January 2014, and designated as a for-profit provider. Encircle Housing Limited (Encircle) was registered as a private company limited by shares (company number 07573815) on 22 March 2011. It subsequently converted into a registered society (number 8071) with effect from 11 March 2019.

The regulator is required to maintain the register of social housing providers and to designate each registered body as either a non-profit organisation, or a profit-making organisation. Encircle are currently registered as a profit-making organisation. The regulator is considering whether this remains the appropriate designation for Encircle.

Encircle's growth strategy following a change in control in December 2017 has been to acquire properties under long term leases to let them to tenants.

The March 2018 Statistical Data Return (SDR) stated Encircle owned and managed 92 units of social housing.

### Regulatory Finding

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The regulator has concluded that:

- a) Encircle is non-compliant with the governance and viability elements of the Governance and Financial Viability Standard. Encircle has not managed its resources effectively to ensure its viability can be

maintained, and has not ensured its governance arrangements deliver an effective risk management and control framework.

- b) Encircle has not been able to demonstrate that it has managed its affairs with an appropriate degree of skill, independence, diligence, effectiveness, prudence and foresight.
- c) Encircle has failed to ensure that it has an appropriate, robust and prudent business planning, risk and control framework that ensures sufficient liquidity at all times.

## The Case

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The regulator has concluded that it lacks assurance and evidence that Encircle is compliant with the governance and viability elements of the Governance and Financial Viability Standard. Investigations undertaken by the regulator obtained inadequate assurance over Encircle's on-going viability, the effectiveness of its risk management and internal controls and that the board has managed Encircle's affairs with an appropriate degree of skill, independence, diligence, effectiveness, prudence and foresight.

Encircle enters into long term indexed linked lease arrangements with the private sector to acquire homes which are then used to provide accommodation to tenants. The properties it acquires are leased on 'Full Repairing and Insurance' (FRI) terms which means that income collection, maintenance and repair and operating costs risks are transferred to Encircle.

High vacancy levels within its stock and delays in agreeing rent and housing benefit levels with local authorities combined with its expansion has placed stress on Encircle's cashflow.

As a result Encircle is heavily reliant on achieving future growth and the facilitation fee income that generates, as well as on financial support from third parties for a fixed period whilst properties are void. The evidence provided to the regulator demonstrates that Encircle can currently only continue to meet its lease obligations with the continuation of growth, third party support and a substantial improvement in occupancy levels. This places Encircle in a position where third parties could exert significant influence over the operations of the provider. This does not meet the regulator's standards. In addition the regulator's investigations have revealed a series of relationships in relation to which Encircle has been unable to demonstrate that it has effectively managed potential conflicts of

interest and influence in entering into housing management contracts and new lease arrangements.

To ensure its medium to long term viability Encircle's business plan is predicated on its material income source (rent) being 'excepted' from the requirements of the Welfare Reform and Work Act 2016 by meeting the specialised supporting housing criteria. The regulator will explore the deliverability of Encircle's business plan, including the appropriateness of underpinning key financial assumptions in the course of on-going engagement.

A required outcome of the governance element of the Governance and Financial Viability Standard is that a registered provider shall ensure it has an effective risk management and internal controls assurance framework. We lack assurance that Encircle has an appropriate risk management and control framework. Encircle continues to enter into new long term index linked leases, thereby layering additional risk onto the business, despite it not being successful in agreeing and receiving the required rental levels from relevant local authorities for its existing properties, or evidence of having appropriate void agreements in place. While these risks were identified by Encircle they have not been managed effectively. Further, Encircle has identified that third parties have been allocating tenants to its properties without first notifying and agreeing the allocation with Encircle. As a result of this fundamental and basic control weakness the board lacked assurance that the individuals housed in its properties were placed in accordance with its allocation policies and that appropriate tenancy agreements were in place. Encircle has acknowledged that this situation exposed tenants to health and safety risks and has investigated the matter.

These outcomes mean we lack assurance that Encircle is managing its affairs with an appropriate degree of skill, independence, diligence, effectiveness, prudence and foresight.

Encircle is currently designated as a 'for profit' provider and this presented an additional risk for Encircle in agreeing higher levels of Housing Benefit (HB) with relevant local authorities, due to the requirements of HB legislation. We lack assurance that the risk and implications of its designation status as a 'for profit' provider in its operating environment at the time it was engaging with local authorities were duly considered; the outcomes (as described above) being that Encircle entered into new leases without adequate assurance of rent payments thereby increasing its risk of operating with insufficient liquidity, and also placing vulnerable tenants at risk of significant rent arrears.

In response to the regulator's engagement Encircle is intending to further strengthen the governance arrangements. It has also recently converted to a registered society. The Encircle board has committed to work with the regulator to address the issues outlined in this Regulatory Notice.

Based on its most recent statistical data return, Encircle had fewer than 1,000 units and is classed as a small provider. The regulator does not publish regulatory judgements for providers which fall into this category. Instead, in the interests of transparency, the regulator publishes a Regulatory Notice where it has evidence that a small registered provider is not meeting the regulatory standards. This notice is published under those arrangements.

Section 220 of the Housing and Regeneration Act 2008 states that the regulator's regulatory and enforcement powers may be used if a registered provider has failed to meet a standard under section 194 of the Act. The regulator is considering what further action should be taken, including whether to exercise any of its powers.