



Regulator of
Social Housing

Setting rents for social housing

Addendum to the
Sector Risk Profile 2019

March 2020



OFFICIAL

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1. Introduction

- 1.1 This document is an addition to the Sector Risk Profile 2019,¹ it supplements the section on rents and reiterates some of the themes set out in the addendum to the Sector Risk Profile 2018 on lease-based providers of specialised supported housing.² The note is primarily aimed at private registered providers (PRPs) of social housing but is also relevant to other stakeholders including local authority registered providers (LARPs) in preparation for the new Rent Standard which will take effect from 1 April 2020.
- 1.2 We are now in the final year of the rent reduction period under the Welfare Reform and Work Act 2016 and regulations made under it (WRWA). As we look back over our engagement over this period, and forward to the forthcoming Rent Standard, this addendum sets out the areas that are most likely to increase the risk of non-compliance with rent and data quality requirements. Boards and councillors must be assured that these risks are being effectively managed when rents for social housing are being set.
- 1.3 The addendum also sets out what the sector can expect from the Regulator of Social Housing (RSH) with regard to regulation of rent requirements in future.

¹ <https://www.gov.uk/government/publications/sector-risk-profile-2019>

² <https://www.gov.uk/government/publications/lease-based-providers-of-specialist-supported-housing>

2. Executive summary

- 2.1 From 1 April 2020, the vast majority of providers³ will have come to the end of the four-year requirement to reduce social housing rents as set out in the WRWA, and there will be a new Rent Standard⁴ in effect. The Standard will apply to both PRPs and LARPs (unlike the Rent Standard in force prior to the commencement of the WRWA). As directed by government, the new Rent Standard is in line with the Ministry of Housing, Communities and Local Government's (MHCLG) policy statement on rents for social housing.⁵ Registered providers need to ensure that they understand the requirements and comply.
- 2.2 The affordability of rents is one of the fundamental benefits of social housing and setting social housing rents in line with requirements is an essential part of being a registered provider. Non-compliance with government policy is a serious issue. Failure to comply with government policy on rents undermines the value of social housing to individual tenants and taxpayers. It also risks damaging the reputation of individual providers and the sector as a whole. Further, since rent and service charge income accounts for the bulk of sector revenue, it is essential that charges are set appropriately to maintain the trust of stakeholders. Finally, complying with regulatory and legal requirements is fundamental to good governance.
- 2.3 Past engagement with PRPs on rents and our preparation for the new Rent Standard have highlighted a range of specific issues that increase the risk of non-compliance. These include:
- failure to take account of changing government policy and corresponding requirements in the provider's rent setting policy and procedures, especially in relation to formula rent
 - incorrectly treating properties as exempt or excepted from elements of rent rules
 - incorrectly calculating or applying Affordable Rent
 - incorrectly calculating or applying service charges e.g. in contravention of the Landlord and Tenant Act 1985
 - new, bespoke rental products with rents that do not comply with requirements
 - poor quality data.

³ This depends on the date on which the 'relevant year' under the WRWA commences (for a majority of providers this is 1 April). Some providers will have a different relevant year, and they should be aware of this.

⁴ <https://www.gov.uk/guidance/regulatory-standards#economic-standards>

⁵ <https://www.gov.uk/government/publications/direction-on-the-rent-standard-from-1-april-2020>

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- 2.4 The risk of non-compliance with rent requirements often stems from a failure to identify rent setting as a strategic risk, as well as from weak internal controls. This results in inadequate assurance at *board level* that rents are set correctly.
- 2.5 Boards and councillors should make sure they are satisfied that robust rent setting controls are in place and should seek appropriate assurance that they are operating effectively.
- 2.6 Most providers appear to set their rents appropriately. However, engagement with PRPs over recent years indicates there is scope for improvement. As a result, we are changing the way we communicate cases of non-compliance in relation to rents compliance and data quality.
- 2.7 For both PRPs and LARPs, where we lack assurance in relation to the rent requirements or data quality (for PRPs this is likely to be across all data submissions, not just rents data) we may issue a regulatory notice outlining the nature of the concerns.⁶ For PRPs we will also consider how these issues affect our view of a provider's overall compliance with the Governance and Financial Viability Standard (this is no change from our current approach). For PRPs with over 1,000 units of social housing, this may mean that we follow up a regulatory notice with a new or revised regulatory judgement which takes the identified rent or data quality issues into account. This approach will be implemented from 1 May this year. Information on our approach to issuing regulatory notices is contained in *Regulating the Standards*⁷.
- 2.8 Rent rules can be complex but adhering to them is a fundamental part of being a registered provider of social housing. It is incumbent on boards and councillors to make sure that they have the required skills, or access to suitably qualified independent advice, so that they can take assurance that organisational internal controls around rent setting are effective.

⁶ We will publish regulatory notices where this is consistent with our duty to exercise our functions in a way that minimises interference and is proportionate and consistent.

⁷ <https://www.gov.uk/government/publications/regulating-the-standards>

3. Background

- 3.1 The control of rent levels and rental increases has long been a feature of the social housing sector, with specific requirements changing over time. Providers must ensure they fully understand and comply with the relevant requirements as these change. Rent and service charge income is the sector's core revenue stream; setting them correctly is fundamental to financial viability. Adhering to all relevant law and complying with regulatory requirements are fundamental to good governance. Indeed, they are key elements of the Governance and Financial Viability Standard⁸ and PRP boards are required to certify compliance with the Standard in their annual accounts.
- 3.2 We expect providers to have robust systems of internal control in place to ensure compliance with rent and service charge requirements. Such systems should be underpinned by high-quality data which providers can use to assure themselves, their tenants, and the regulator that rents are being charged appropriately. Boards and councillors are responsible for ensuring that their organisations are compliant and should seek assurance that this is the case.
- 3.3 Between 2015/16 and 2018/19 we engaged with PRPs in 84 cases because the data submitted in the Statistical Data Return (SDR)⁹ was of poor quality. Although we have seen some improvements over the last few years, there remains scope for further progress. This addendum highlights the areas where providers are most at risk of getting things wrong.

Current requirements

- 3.4 Since 2016/17, registered providers have been subject to legal requirements under the WRWA in relation to the rents they can charge. For most registered providers this has meant reducing rents by 1% each year, with exceptions set out in the regulations under the act. Service charges are governed by specific tenancy agreements and leases, as well as common law and statute in this area, including the Landlord and Tenant Act 1985, in which the definition of 'service charge', as distinct from 'rent', is linked to costs incurred (e.g. for cleaning of communal areas, or grounds maintenance).

⁸ <https://www.gov.uk/guidance/regulatory-standards#economic-standards>

⁹ <https://www.gov.uk/government/collections/statistical-data-return-statistical-releases>

Future requirements

- 3.5 From 1 April 2020, a new Rent Standard will be in effect. The new rules applied by the Rents Standard enable a maximum annual rental increase of Consumer Price Index (CPI) plus 1%. The Rent Standard will apply to both PRPs and LARPs, unlike the Rent Standard that predated the WRWA. It is important that all providers have a comprehensive understanding of the new rent rules and the impact that these will have on their organisation in advance of 1 April 2020. Service charges will continue to be governed by tenancy agreements and leases, as well as relevant common law and statute, including the Landlord and Tenant Act 1985.

4. Common issues that increase the risk of non-compliance

- 4.1 Engagement with PRPs on rent requirements has revealed a range of common issues that providers need to avoid when setting rents. These issues usually stem from a failure to identify rent setting as a strategic risk and weak internal controls around rent setting.
- 4.2 Under our co-regulatory approach we operate as an assurance-based regulator, seeking assurance from providers as to compliance with requirements. On an annual basis, we identify providers which appear to be outliers based upon analysis of the rents data supplied in regulatory returns. We engage with these providers to seek assurance about their compliance with requirements. The onus is on these providers to demonstrate compliance. Where providers cannot supply the requisite assurance we may conclude a breach of standard and reflect this in the judgements and decisions that we reach.
- 4.3 Governing bodies are responsible for ensuring that providers' businesses are managed effectively and in line with regulatory and legal requirements. This includes rent compliance. Accordingly, boards and councillors need to assure themselves that organisational rent-setting processes are robust so that rents are set correctly, both initially and at re-let, and are increased or decreased in line with requirements.

Changing requirements

- 4.4 Rent policy and corresponding requirements for providers have changed over time. If regular reviews of rents and associated processes are not undertaken, even small issues can become compounded, making them difficult and costly to put right, with a cost to individual tenants and public funds and at the expense of the sector's reputation. It is incumbent on providers to ensure that all policy changes are adequately reflected in rent setting processes.

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- 4.5 A specific risk to compliance is in relation to formula rent, which is the foundation for setting the majority of rents.¹⁰ The failure of providers to accurately calculate and record formula rents over time has been the root cause of a number of cases of regulatory non-compliance. This risk is particularly acute now as providers transition from using the social rent rate (which is calculated by applying the WRWA rent reductions to formula rent) under the WRWA back to formula rent under the new Rent Standard.¹¹

Exceptions from rent requirements

- 4.6 Inappropriately applying an exception from rent requirements¹² is a serious matter that can have a significant impact on tenants' bills, public funds and providers' balance sheets. Many exceptions exist so that the needs of some of the most vulnerable members of society can be met. Overcharging rent puts the reputation of the whole sector at risk.
- 4.7 We expect organisations to have internal controls in place to ensure that exceptions are being applied appropriately, and that boards and councillors receive assurance on the adequacy and effectiveness of those controls at intervals that are proportionate to the risk. We have seen evidence of some providers taking an overly simplistic approach to interpreting definitions of excepted stock categories which increases the risk of them being applied inappropriately.

¹⁰ Since 2001, rents for properties let at 'social rent' (which constitute a majority of rented social housing properties) have been set based on a formula set by government. The method for calculating the formula rent under the WRWA is set out in the Schedule to The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016: <http://www.legislation.gov.uk/uksi/2016/390/schedule/made>

¹¹ The method for calculating the formula rent under the forthcoming Rent Standard is set out in paragraphs 2.4 to 2.6 in the government's policy statement: <https://www.gov.uk/government/publications/direction-on-the-rent-standard-from-1-april-2020>

¹² Under the WRWA exceptions are set out in the Act itself and in The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016 and The Social Housing Rents (Exceptions and Miscellaneous Provisions) (Amendment) Regulations 2017. Under the forthcoming Rent Standard see chapter 5 of the government's policy statement.

- 4.8 While providers need to ensure they comprehensively understand all relevant stock definitions, specialised supported housing (SSH) and temporary social housing (TSH) present a particularly high risk of being applied inappropriately. For properties that a provider reports as part of their SSH or TSH provision, boards and councillors need to assure themselves that there are effective controls in place to ensure that each letting meets the relevant definition of SSH or TSH.
- 4.9 One specific issue we have identified that increases the risk of non-compliance is in relation to agreements for rent charges for SSH. If asked, providers should be able to evidence that the rental charge for the SSH has been agreed by the *commissioning body* i.e. the local authority or health service in accordance with the definition. Evidence that a tenant's rent is being met by Housing Benefit or Universal Credit is not sufficient.¹³
- 4.10 Where providers do not fully understand whether stock meets a definition, they should be obtaining appropriate, impartial and suitably qualified legal/professional advice early on in any process of stock categorisation or scheme design.

Affordable Rent

- 4.11 Affordable Rent can only be charged on a property under an explicit agreement with Homes England (the trading name of the Homes and Communities Agency) or the Greater London Authority (and in some cases the Secretary of State).¹⁴
- 4.12 Conversion from social rent to Affordable Rent (or indeed other types of rent) is a specific area of risk of non-compliance for providers. Social rent properties may not be converted to other forms of rent except in very limited circumstances as specified under an agreement with Homes England, the Greater London Authority, or the Secretary of State. Boards and councillors need to be assured that any properties reported and charged as Affordable Rent, whether converted or not, are subject to the requisite agreements as required by the WRWA or the Rent Standard, as applicable.

¹³ Under the WRWA, the definitions of SSH and TSH are set out in The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016 (as amended). Under the forthcoming Rent Standard the definitions are set out in chapter 5 of the government's policy statement.

¹⁴ Under the WRWA the main definition of Affordable Rent can be found in regulation 19 of The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016 (as amended). Under the forthcoming Rent Standard the definition is set out in chapter 3 of the government's policy statement.

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- 4.13 Service charges are a further area of compliance risk in relation to Affordable Rent. Affordable Rent must be set at up to 80% of the market rent for a property *inclusive* of service charges. Providers must assure themselves that this requirement is met. Setting rents at 80% of the market rent for that property and then adding additional service charges would not meet the requirements of the WRWA or the forthcoming Rent Standard.¹⁵

Service charges

- 4.14 Analysis of SDR data over the last few years shows that annual service charge increases have been above inflation for a number of years. For example, last year's SDR data shows service charges increased by 7% on the previous year. As outlined in paragraphs 3.4 and 3.5 above, service charges are governed by individual tenancy agreements and leases, and the common law and legislation in this area. This includes the definition of 'service charge' in the Landlord and Tenant Act 1985, which links service charges to actual costs. In practice this means that service charges can only cover actual costs and must be accounted for to ensure that they are fair and transparent both to tenants and to other stakeholders. As discussed above, adhering to all relevant law is fundamental to good governance and boards must certify compliance in their annual accounts. Boards need to have assurance that they have the necessary policies, procedures and processes in place to manage service charges according to legal requirements.
- 4.15 We consider the impact of service charges when assessing whether property is rented below market rate in order to meet the definition of social housing¹⁶, for example, at registration, or when seeking assurance that rents for excepted social housing properties are being charged appropriately. In making this assessment we generally take the proposed rent *and* housing related service charges and compare this gross weekly rent against the market rent (as market rented property is generally let at a rate inclusive of service charges). It is a misconception held by some in the sector that service charges are discounted for market comparison purposes which increases the risk that excepted properties do not meet relevant definitions (see paragraph 4.8 above). Boards and councillors need to be assured the accommodation they are providing meets the definition of social housing.

¹⁵ Ibid.

¹⁶ Social housing is defined in section 68 of the Housing and Regeneration Act 2008:

<http://www.legislation.gov.uk/ukpga/2008/17/part/2/chapter/1/crossheading/social-housing>

New rental products

4.16 We understand that providers seek to offer rental products that meet the diverse needs of their tenants. Providers need to ensure that any innovation in rent setting is compatible with *relevant* regulatory and legal requirements. For example, we have found that some providers have sought to set social housing rents based on Local Housing Allowance (LHA) rates.¹⁷ While in some parts of the country setting rents at the LHA rate will be compatible with regulatory requirements (e.g. because it falls below formula rent), this is not the case nationally. Boards and councillors must be assured that any bespoke social housing schemes are compliant with all relevant rent requirements. This remains true when agreements have been reached with other public bodies such as local authorities.

Data quality

4.17 While we have seen increasing accuracy of rents data over the past few years, there remains room for improvement. We continue to identify providers with poor quality rents data, both in terms of the data they rely on internally to set rents, and the data submitted to the RSH in the SDR which we use to identify outliers and potential non-compliance (among other things).

4.18 It is difficult to see how providers can assure themselves that rents are set correctly without data which accurately record and track formula rents and the rents charged to tenants over time. Poor-quality data often relate to formula rent. Given that formula rents are the basis upon which the majority of rents charged to tenants should be calculated, it is vital that providers calculate and record them accurately (see paragraph 4.5). Left unresolved, data errors, and the internal control weaknesses that usually lead to them, can result in breaches of both rent and governance requirements.

4.19 There is an additional risk that data submitted to us in the SDR, or for local authorities, in the forthcoming Local Authority Data Return (LADR), are of poor quality. We use these data to identify potential compliance issues as well as to understand trends in the sector; therefore it is important that returns are completed accurately. Further, the submission of incomplete or inaccurate data may be indicative of a weak control environment which could affect our view of a PRP's governance.

¹⁷ LHA rates are determined by the Valuation Office Agency Rent Officers; they are used to calculate housing benefit for tenants renting in the private rented sector.

5. Considerations for providers if rents are non-compliant

- 5.1 Transparency with the regulator is a fundamental pillar of the Governance and Financial Viability Standard and the co-regulatory approach. If providers become aware of material issues that relate to non-compliance or potential non-compliance with the standards, they must communicate with us in a timely manner. This is no different for rents.
- 5.2 If a provider has overcharged rent, there are a number of questions that boards and councillors should be asking themselves. In addition to considering what has gone wrong, providers need to consider what should be done to put it right. Is there adequate assurance that all problems, and root causes of those problems, have been identified so that no such failures occur in future? What action is the provider taking to correct rents retrospectively, and deal with the future impact where rents have been increased from an erroneous base level?
- 5.3 As set out in this addendum, there are potential governance implications that we will consider in cases of PRP rent non-compliance. We will also consider the implications for our view of a provider's governance when looking at how providers address failures. If tenants or the government (where rent is met by Housing Benefit or Universal Credit), have been overcharged, there are implications for a provider's accountability, its efforts to safeguard taxpayers' interests and the wider reputation of the sector. As well as correcting the position going forward (e.g. by reducing the base level to which future rent reductions or increases are applied), repayment of any overcharged rent, whether to tenants or the government, should be factored into corrective actions in the case of a breach.
- 5.4 Finally, setting rents correctly is also important to financial viability. If non-compliance is not identified and addressed at an early stage, remedying it can have an impact on a provider's financial viability.

6. Communicating non-compliance with rent or data quality requirements

- 6.1 As set out earlier, there have been improvements across the sector on rents and data quality issues in recent years but risks of non-compliance remain. As we transition to a new rent policy the risk is likely to grow. As a result, we are changing the way we communicate to the sector and other stakeholders when we lack assurance that rent and related data quality requirements have been met.
- 6.2 Co-regulation remains at the heart of our regulatory approach, with boards and councillors accountable for ensuring rents are compliant and data is accurate. From 1 May, we will begin issuing regulatory notices for any registered provider (whether they are a PRP or a local authority) where we lack sufficient, timely assurance of compliance with rent or data quality requirements.¹⁸
- 6.3 In addition to outlining the specific rents or data quality concerns in the regulatory notice, we will also assess the impact of the PRP's record on these areas on its compliance with the Governance and Financial Viability Standard. This will affect PRPs of all sizes. For PRPs with 1,000 or more units of social housing this may then result in a governance and/or financial viability grade change and a new or updated regulatory judgement to reflect this.
- 6.4 We do not publish regulatory judgements in relation to local authority registered providers because the Governance and Financial Viability Standard is not applicable to them. Therefore, where we lack assurance of compliance with the new Rent Standard, we will only use regulatory notices to communicate this.

¹⁸ We will only publish a regulatory notice where this is consistent with our duty to exercise our functions in a way that minimises interference and is proportionate and consistent.



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