Regulator of Social Housing

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Dear Chief Executive

Preparation for a no deal Brexit

It remains the Government's priority that the UK should leave the EU in an orderly fashion on 29 March 2019. However, government has accelerated no-deal preparations to ensure the country is prepared for every eventuality. Many of you will be aware that at the end of last year that the Chair of the Regulator of Social Housing (RSH) and I re-emphasised at meetings and conferences the importance of stress testing and effective mitigations in the context of current uncertainty about the terms on which we will leave the EU.

I am writing now to ensure that all providers are clear about the Regulator's expectations of them during this period of uncertainty, and to share examples of what providers should consider when stress testing their businesses. The Regulator is not requesting systematic information from providers at this time. However, where individual providers have identified specific exposures or risks which threaten their compliance with the Regulatory standards, our expectation is that they will inform us of these in line with the co-regulatory settlement.

Regulatory expectations

Under the Governance and Financial Viability Standard, providers are expected to

- have in place an appropriate, robust and prudent business planning, risk and control framework and
- carry out detailed and robust stress testing against identified risks and combinations of risks across a range of scenarios, and put appropriate mitigation strategies in place as a result.

In the current context, the Regulator expects registered providers to have: identified the risks to which their businesses would be exposed; stress tested their business plans to reflect these; and identified specific, deliverable and timely mitigations, to ensure viability is maintained and tenants and social housing assets are protected. Our experience through the IDA process is that board attention needs to be focussed on the identification and planning of effective mitigations as these are often more challenging than the process of identifying key exposures.

The Bank of England's (BoE) EU withdrawal scenarios document provides suggestions of the potential macroeconomic effects of a disorderly Brexit. It should be noted that these are possibilities rather than forecasts.

The scenarios, which are available here: [www.bankofengland.co.uk/-/media/boe/files/report/2018/eu-withdrawal-scenarios-and-monetary-and-financial-stability.pdf,](www.bankofengland.co.uk/-/media/boe/files/report/2018/eu-withdrawal-scenarios-and-monetary-and-financial-stability.pdf) cover withdrawal, both with and without a deal and a range of severities depending on the circumstances of withdrawal. However, we would expect providers to consider their own specific exposures, including non-financial exposures and stress, for a range of scenarios.

Providers are reminded of the requirement in the Governance and Financial Viability Standard to communicate with the Regulator in a timely manner on material issues that relate to non-compliance or potential non-compliance with the Standards. Where a provider identifies such issues that are sufficiently serious either to threaten its compliance with the Standards or its ability to meet its strategic objectives, they should inform the Regulator as soon as possible.

Considerations

Registered providers are domestically-focused organisations with limited direct trading exposures to the European Union and may be less directly affected than other sectors of the economy. Nevertheless, the final terms of the exit from the EU could affect them as a result of their place in the UK economy, their reliance on the financing and housing markets, and their labour and supply chains. Some of the possible exposures the Regulator has identified based on its analysis and contacts with registered providers and sector stakeholders are set out below. Providers may have identified other risks to their businesses.

I. Deteriorating housing market conditions

The BoE's suggestions include a fall in house and land prices of between 14 and 33%, and a further decrease in the volume of transactions. As the Regulator has been flagging for some time, larger providers are increasingly exposed to the housing market to provide cross-subsidy for social development and as part of multi-tenure developments.

Falling house and land values would reduce profitability and potentially crystallise impairments, while lower transaction volumes would increase working capital requirements and decrease cashflow. Valuations for security purposes could also be adversely affected, though these are more closely tied to ongoing rent levels than the market.

II. Interest, inflation and currency risk

The BoE's no-deal scenarios include an increase in inflation to a peak of 4.25 to 6.25 per cent, largely as a result of weaker sterling. This could be accompanied by an increase in the base rate to a peak of 1.25 to 5.5 per cent. New, refinanced and floating rate debt would all be adversely affected by an increase in LIBOR or gilt rates. Inflation is broadly mitigated by the resumption of rent indexation in 2020/21.

III. Access to finance

While the BoE considers a no-deal Brexit is unlikely to precipitate a financial crisis such as that seen in 2008, and the sector currently has substantial cash and undrawn facilities, there is potential for credit availability to become tighter if banks and institutions become more risk-averse. In the short term this could have severe effects on individual providers looking to draw or arrange new facilities, while a long-term tightening of the market could restrict providers' ability to develop.

IV. Availability of labour

Areas identified as potentially being impacted by labour shortages in the short to medium term, should those materialise, are in construction and care with over 10 per cent of the current workforce being EEA nationals. Labour shortages would probably create differential inflation, with labour costs rising more quickly than rental income, and reduce development. In a more severe scenario, ongoing maintenance and care standards could also be affected. Arrangements are in place for current EU nationals to apply for settled status, allowing them to continue to work in the UK after EU withdrawal.

V. Access to materials and components

The UK has a net deficit in building materials with the EU. While most basic building materials are available on the UK market, there may be some reduction in availability. However, some engineered products (providers suggest boilers, lift components and parts for district heating systems) are sourced from EU suppliers and are not readily stockpiled. This could result in some major repairs taking longer than usual to complete. Providers should also be aware of the need for appropriate, UK-recognised safety certifications to be in place to maintain insurance cover, in line with the MHCLG guidance available here: www.gov.uk/guidance/construction-products-regulation-if-there-is-no-brexit-deal.

VI. Access to data

There is potential for providers to find that they are unable to access their own data (which may be business-critical) if it is located outside the UK. This might be because they are using cloud-based data storage, or because the third parties with whom they contract, hold their data outside the UK. As part of their stress testing and scenario planning, it may be necessary for providers to establish where all key data is held. Further information is available from the Information Commissioner here: https://ico.org.uk/for-organisations/data-protection-and-brexit/data-protection-if-there-s-no-brexit-deal/.

Exposure to these risks varies largely depending on the scale of individual providers' development commitments and financing requirements; the greatest financial impact would be from a sudden housing market downturn. Mitigations of a no-deal Brexit scenario would primarily involve provider Boards identifying the crystallisation of their risk exposures and taking timely corrective action. Key mitigations in larger providers might include controlling development commitments, liquidity monitoring and supply chain management.

It is important to note however, that overall, the regulator's assessment is that, with appropriate preparation and effective mitigations in place, providers can successfully manage the potential impact of leaving the EU even if that is not on terms which government is seeking to achieve. Providers should contact the Regulator in the event that they identify material risks that exceed their mitigation strategies and could cause non-compliance with the Standards. We continue to monitor the sector's financial position through the quarterly survey and the level of risk in the operating environment. We will issue further communication as necessary.

Yours faithfully

Fiona MacGregor
Chief Executive