Regulator of Social Housing

Sector Risk Profile 2022

October 2022

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Executive summary

The Sector Risk Profile sets out the regulator's view of the most significant sources of risk to providers' ongoing compliance with our standards. It is aimed primarily at boards of private registered providers and, where relevant, governing bodies of local authority registered providers. Though many of the risks highlighted here are multifaceted, the Sector Risk Profile[1] has a particular focus on risks to our economic standards; our Consumer Regulation Review[2] sets out specific case studies and learning from reactive casework related to our consumer standards. It remains the responsibility of board members and councillors to ensure providers meet all of our regulatory standards and to determine how this is done.

The UK has faced a sequence of severe and ongoing macroeconomic shocks over the past three years, including from Brexit, Covid-19, and resulting from Russia's invasion of Ukraine. Providers continue to face an extremely uncertain operating environment. High inflation, a tight labour market, and the residual impact of the pandemic on supply chains have increased costs for providers. Providers are also facing higher borrowing costs, both from substantially rising interest rates and from widening spreads on debt. At the same time, income streams are facing greater than usual uncertainty, with significant headwinds in the housing market and the government consulting on capping social housing rents increases.[3] There remains a possibility of further unexpected shocks.

Against this backdrop, providers are looking to undertake substantial investment in existing stock to deliver against quality, building safety, and decarbonisation commitments, as well as continuing to invest in much needed new housing supply. This planned activity has resulted in a further reduction in providers' forecast interest cover. Reduced financial headroom is likely to reduce some providers' capacity to cope with further financial shock and some boards will need to make difficult decisions to maintain financial resilience while delivering essential services.

Many of the risks that have been highlighted in previous iterations of the Sector Risk Profile are now crystallising and this will test the resilience of many providers and the sector as a whole. An effective risk management framework remains crucial but mitigating the impacts of the current environment will have material consequences for providers' delivery of strategic objectives, key services, and their tenants. Boards will face difficult trade-offs, and these will need to be communicated transparently and appropriately to stakeholders. Boards must ensure that their organisations remain compliant with the requirements set out in legislation and in our regulatory standards, prioritising safety and essential services.

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[1] Sector risk profiles - GOV.UK (www.gov.uk)

[2] Consumer regulation review 2021 to 2022 - GOV.UK (www.gov.uk)

[3] Social housing rents consultation - GOV.UK (www.gov.uk)

Boards must manage and mitigate a wide variety of complex risks in order to achieve continued compliance with our standards. The rest of this document explores some of the considerations in managing these. From these specific risks emerge the following, more general themes that are likely to be key areas of focus for boards and for us as the regulator.

Strategic direction: Boards must set a clear strategic direction and priorities for their organisations, and this is especially important when providers are facing an uncertain operating environment where many mitigation plans have already been deployed. In defining and delivering their strategic objectives, boards will inevitably face a broad range of competing pressures and trade-offs affecting their organisations' financial capacity. Providers are undertaking substantial investment in existing stock to respond to changing quality, safety, and energy efficiency standards. At the same time, providers are investing to develop new homes to serve future tenants and facing the challenge of supporting their tenants at a time of significant cost of living pressure. A provider's purpose, how it makes choices, and its performance will be scrutinised by a wide range of stakeholders. These include current and future tenants, local communities, councillors and MPs, local and national government, lenders, contractors, other regulators, and the media. Boards must be able to clearly articulate their organisation's purpose and transparently communicate performance against this in order to manage the risks inherent to these trade-offs, as they implement mitigations to maintain financial resilience.

Macroeconomic risk and viability: The economic environment remains particularly uncertain, with the risk of further downside shocks. Providers are facing significant cost inflation, resulting from the current tight UK labour market, high energy costs, and continuing supply chain disruption. Providers' cost of borrowing is expected to increase, with interest rates expected to continue to rise over the next year and the potential for impacts to credit ratings. Providers' income could be constrained, with the government currently consulting on a draft direction on the rent standard that includes a number of proposed options for capping rents increases in 2023/24. Declining real household incomes may mean tenants increasingly struggle to pay even capped rents. Rapidly increasing interest rates and declining real household incomes increase the likelihood of a material housing market downturn. These factors will inevitably weaken financial performance and reduce capacity to manage downside risk. Providers are now implementing mitigation plans to ensure continued delivery of strategic objectives as far as possible while maintaining viability. As boards make choices on priorities, they will need to continue to undertake stress testing in order to maintain mitigation plans that remain robust to possible future shocks.

New supply and development: Providers play a key role in delivering much needed new homes for both social rent and low-cost home ownership and this is frequently a crucial strategic objective for both providers and stakeholders. Providers also invest in the development of homes for market sale to cross subsidise strategic objectives. However, both the sale and development of new homes can carry significant financial risks and boards of developing providers will need to manage these carefully. Current high inflation, skills shortages, and supply chain disruption continue to increase costs of development, while decreasing household incomes and rising interest rates increase the risk of falling house prices and slowing sales. Providers will need to consider carefully how to assess and prioritise investment in new development, ensuring that investment appraisal approaches remain up-to-date and projects are tightly managed. It is also imperative that providers understand how the crystallisation of risks arising from participation in joint ventures, leasing arrangements, and other investment vehicles could affect the core social housing business and its finances.

Stock decency and safety: Failing to maintain adequate investment in existing stock can have significant consequences for tenants, as well as potentially leading to deterioration that requires greater expense in the long run. Providers' stock is a long-term asset and boards must ensure that an effective system for repairs and maintenance is in place to meet minimum standards. Boards must ensure they understand how the condition of stock relates to current and evolving requirements, in particular from changing energy efficiency standards and the government's decarbonisation and net zero agenda. Boards must also ensure that they understand the requirements of the Building Safety Act 2022 and the new regulatory regime being introduced by the Building Safety Regulator. Understanding performance against requirements requires a detailed knowledge of stock condition, and boards will need to ensure this is underpinned by accurate, up-to-date, and robust data.

Service delivery and accountability: Our consumer regulation casework continues to highlight the importance of effective engagement with tenants, and upcoming changes to regulation emphasise the importance of tenants being listened to and being able to hold their landlord to account. We have set out our principles and approach as we prepare for the introduction of a proactive consumer regulation regime[4], including the introduction of tenant satisfaction measures from April 2023. It is essential that boards do not wait for the introduction of this new regime. Ensuring that underpinning data is robust and strengthening a culture of tenant engagement and service delivery can take time. Boards should ensure that they are using this period to embed the systems and processes that will allow them to meet new data requirements and deliver improved outcomes for tenants. It is also important that boards ensure providers have robust systems and mitigations in place to manage risks to service delivery. The current tight labour market is likely to continue to put pressure on providers' delivery of key services and programmes.

[4] Reshaping consumer regulation: our principles and approach - GOV.UK (www.gov.uk)

Further, we have recently seen instances where cyber security threats have resulted in significant interruptions to data, systems, and services; we expect boards to actively manage this risk.

Reputation: High profile instances of stock decency problems and service delivery and complaint handling failings have damaged the sector's reputation and increased scrutiny from stakeholders. This is likely to increase the reputational impact from any further failings. Many tenants are likely to face cost of living pressures in the coming year and this is likely to be an aggravating factor for wider failings, including on probity or remuneration. In a context where providers are having to make difficult trade-offs, they should be aware of their stakeholders' expectations and clearly communicate their decisions and rationale for their investment priorities.

1. Introduction

1.1 The 2022 Sector Risk Profile sets out our view of the most significant sources of risk to providers' ongoing compliance with our regulatory standards. This publication draws on submitted regulatory returns and other data provided to us as the regulator where applicable. Detailed analysis of providers' annual accounts (FVA) at a sector level are set out in our annual Global Accounts publications.[5]

1.2 The risks set out in this document have the potential to threaten the successful delivery of providers' strategic objectives, providers' viability, or the safety of tenants. They reflect risks that most providers are likely to face and also those that may only affect a minority of providers. Board members of private registered providers and, where applicable, councillors forming the governing bodies of local authority registered providers (henceforward 'boards') should be alert and responsive to these risks.

1.3 We remain firmly committed to a co-regulatory approach. It is for boards to ensure that providers are managed effectively and that they meet all regulatory requirements. As part of this, we expect boards to have in place an effective risk management and internal controls assurance framework. It is for each board to assess its own risks in the round and satisfy itself that appropriate strategies are in place to mitigate these.

1.4 As the regulator, our focus remains to seek assurance from providers that they are meeting our economic and consumer standards. We have set out specific expectations in relation to risk management in the Governance and Financial Viability Standard and associated Code of Practice.[6] We will continue to challenge individual providers where a risk that has been identified as material through our analytical work, engagement, or referrals is not adequately captured in the provider's risk and control framework.

1.5 Although we currently regulate the consumer standards reactively, this does not mean that the obligation for registered providers to comply with the standards is lessened. We continue to consider referrals made to us in relation to breaches of the consumer standards, signposting to the Housing Ombudsman where a referral appears to be an individual rather than a systemic failing.[7] Following the introduction of draft legislation earlier this year, we continue to prepare for the change to proactive consumer regulation. This includes our recently published decision on the new Tenant Satisfaction Measures Standard which will come into effect on 1 April 2023.[8]

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[5] Global accounts of private registered providers - GOV.UK (www.gov.uk)

[6] Governance and Financial Viability Standard and Code of Practice - GOV.UK (www.gov.uk)

[7] Memorandum of Understanding between the Regulator of Social Housing and the Housing Ombudsman - GOV.UK (www.gov.uk)

[8] Consultation on the introduction of tenant satisfaction measures - GOV.UK (www.gov.uk)

2. Strategic risks

Macroeconomic and financial environment

2.1 The sector is currently facing constrained resources and significantly increased uncertainty from the deteriorating macroeconomic environment. Many of the risks highlighted in this and previous iterations of the Sector Risk Profile are now crystallising. Providers will need to continue to meet their core objectives and deliver in line with their strategic direction, but mitigating the economic, social, and financial impacts of the current environment will test the resilience of the sector. Boards will inevitably face difficult trade-offs as they consider their priorities.

2.2 The UK economy has been exposed to a sequence of severe shocks over the last few years. Having recovered to pre-pandemic levels, the economy is now smaller than it was at the start of 2022. Rapid and increasingly prolonged inflation, a tight labour market, and continuing supply chain disruption are all increasing costs for providers. Rising interest rates are increasing the cost of floating rate and new debt, while sources of debt may need to change if ratings fall. At the same time, providers face more uncertain incomes from potential restrictions to rent indexation and probable increased arrears as tenants experience cost of living pressures and real terms falls in incomes. The potential for further financial market turmoil or unexpected downside shocks remains substantially elevated.

2.3 In this environment, it is essential that boards continue to set a clear strategic direction for their organisations. Delivering their objectives will require difficult trade-offs, and boards will need to consider these carefully to maintain viability while prioritising essential services and safety. Providers must continue to demonstrate that they provide value for money to a range of stakeholders, and boards will need to closely monitor and constructively challenge their organisation's performance to make well informed decisions regarding the effective use of the assets and resources available to them.

Delivering against expectations

2.4 In setting their strategic direction, providers will need to navigate a range of competing demands from stakeholders. Failure to consider competing demands at the outset, or failure to communicate these choices effectively once made, can have serious ramifications for a provider's own reputation and that of the sector as a whole. As organisations with a social purpose, many of which have charitable status, providers' actions will inevitably be scrutinised by a range of stakeholders. These include current and future tenants, local communities, councillors and MPs, local and national government, lenders, contractors, other regulators, and the media. Instances of poor quality or service delivery failures may reach the public domain very quickly and can be shared widely before providers are able to address them.

2.5 The Housing Ombudsman has seen an increase in the number of cases it investigates, with property condition remaining the most common complaint.[9] Complaints provide rich insight into the performance of services and can act as early indicators of wider issues. It is essential that providers seek to learn from tenant complaints and hear the feedback from tenants. High profile cases of severe disrepair have damaged the sector's reputation over the past year. A range of stakeholders, including national media, have publicly criticised the conditions of some properties. Recent criticism of providers has focussed on health and safety non-compliance, poor service quality and issues from outsourced service delivery, disrepair, poor complaint handling, incorrect rent and service charge setting, conflicts of interest, and executive pay.

2.6 As the regulator, we do not have a role in resolving individual disputes between tenants and their landlord, but we do look to consider whether there is evidence of a systemic failing by a registered provider and consider the impact (or potential impact) to tenants. We have regular engagement with the Housing Ombudsman to ensure effective signposting of referrals, including the referral of potential systemic issues to us.[10]

2.7 Boards should be aware of the expectations of tenants and other stakeholders as part of their strategic approach and decision making. They should also proactively seek to understand and respond to the diverse needs of their tenants, especially vulnerable tenants. Boards will need to appropriately set the balance between short term and long-term stock investment and recognise that unexpected delays in regeneration programmes could lead to disrepair. Where difficult trade-offs are required, boards should ensure that they have timely and effective mitigating strategies in place to manage reputational risks, including transparent and effective communication with tenants and stakeholders.

Diversification

2.8 Diversification into non-traditional business streams can allow providers to increase their turnover and supplement their rental income and grant funding, enabling them to invest returns back into their core activities. However, diversification introduces additional risks alongside those from social housing activity. Failure to appropriately manage these can be detrimental financially and can damage a provider's reputation. Poorly managed diversification potentially puts social housing at risk.

[9] https://www.housing-ombudsman.org.uk/2022/06/28/housing-ombudsman-makes-1250-remedies-during-final-quarter-of-financial-year/

[10] https://www.gov.uk/government/publications/memorandum-of-understanding-between-the-regulator-of-social-housing-and-the-housing-ombudsman

2.9 Diversification can include market sales, student housing, portfolios of commercial property, and specialist care. These areas of activity may be in line with a provider's core purpose, but they bring a different profile of risk. Providers forecast that 28% of income over the next five years will be accounted for by activity other than social housing lettings (FFR 2022). Market sales make up the largest proportion of this non-social housing activity, but providers have reduced their reliance on income from this area compared to previous forecasts. Providers are forecasting £12.2bn in outright sales receipts over the next five years (FFR 2022), a decrease from the £13.0bn assumed in 2021 forecasts.

2.10 Boards must ensure that they have the required skills, information and advice to appropriately assess any move into a new business stream and manage this on an ongoing basis. Boards must understand the full range of risks that diverse activity can expose them to and ensure that such activity has a clear strategic role in meeting their organisation's purpose and objectives. Furthermore, boards must understand the potential risks associated with the funding structures and finance of non-social housing activities and must have appropriate governance structures and ring-fencing arrangements in place to ensure that social housing assets are not put at risk by, for example, guarantees or impairment relating to non-social assets.

2.11 Charitable providers must also have regard to charity law when undertaking diverse activity. As the regulator, we will seek assurance from providers that non-social housing activity creates rewards commensurate with its associated risks, that this activity makes a clear contribution to the provider's core purpose, and that social housing is not put at undue risk.

Access to labour and skills

2.12 Providers are reliant on access to skilled workers to deliver development, undertake programmes of major repairs and maintenance, comply with health and safety requirements (including building safety), and deliver key services to tenants. The current tight labour market continues to exacerbate ongoing skills shortages and may threaten providers' ability to deliver these programmes and services.

2.13 There continue to be particular labour shortages in certain industries including construction, building safety, support, and care. Some providers have reported delaying planned maintenance works due to a lack of available staff. Low numbers of retrofit coordinators and qualified fire risk assessors are making it harder to meet energy efficiency and building safety targets. Some providers operating in areas of high-cost homes unaffordable to those on lower wages and where their own staff require access to affordable housing are having to develop innovative employment packages to attract and recruit staff. In the face of substantial shortages in key staff and high staff turnover, providers offering support and care services are frequently increasingly reliant on high numbers of bank staff to deliver services, potentially imperilling high-quality care and delivery of services in line with contractual targets.

2.14 Boards will need to understand their operating environment and how emerging and longer term labour and skills shortages impact the delivery of organisational objectives, safety and quality. Boards will need to have established effective mitigation strategies to ensure essential services continue to be delivered.

Counterparty risk

2.15 Providers enter into contracts with a wide range of third parties, including funders, insurers, auditors, pension providers, construction and maintenance contractors, care providers and through joint ventures. These can represent effective ways for providers to deliver key services and help deliver value for money. However, entering into contracts with third parties exposes providers to counterparty risks and can reduce the control that providers have over the quality of delivered services. Reliance on a limited number of third parties or sources of finance also exposes providers to concentration and reputational risks.

2.16 Contractors frequently operate on tight profit margins and high inflation and a tight labour market have made the environment for contractors particularly challenging. The end of temporary business relief measures implemented during the pandemic has seen large numbers of company insolvencies, with the number of insolvencies in Q2 2022 the highest since Q3 2009. Construction businesses accounted for the largest contribution towards total company insolvencies in England and Wales,[11] and are facing particular pressures from significant increases in the costs of raw materials and a shortage of skilled staff. Some providers have outsourced landlord services to contractors as an option to drive down costs. Contracting out services does not contract out landlord responsibility, and it is essential that providers maintain oversight of service delivery; failure to do so risks damaging the provider’s reputation.

2.17 It is ultimately boards that remain accountable to their tenants and stakeholders. Boards must ensure their organisations conform to all relevant policies, standards, and law when outsourcing to third-party organisations. Boards must have assurance that concentration risk is being managed, including monitoring of counterparty robustness and consideration of protections for breaches or termination of contracts. Due diligence should be undertaken to ensure any potential conflicts are identified that could breach policy, regulation, legislation or cause reputational harm.

[11] Rising business insolvencies and high energy prices - Office for National Statistics (ons.gov.uk)

3. Operational risks – existing stock and service delivery

Existing stock quality

3.1 Failure to ensure homes are maintained at a decent standard or to effectively respond when issues arise can result in significant consequences for tenants, as well as having substantial implications for the trust and confidence that tenants and other stakeholders have in a provider. Many of the disrepair cases we have seen in our consumer regulation role result from the breakdown in the relationship between landlord and tenant. Poor engagement or poor case handling can result in increased disrepair and no-access cases, resulting in higher costs and delaying works. Failure to invest appropriately can also lead to deterioration of stock, potentially leading to greater expense at a later date.

3.2 There has been high profile media interest in cases of severe disrepair across provider housing stock which has damaged the reputation of the sector. Increasing energy efficiency and decarbonisation requirements will require substantial investment in existing stock. On top of this, longer term changes to working patterns and lifestyles following the pandemic are resulting in more wear and tear of homes and greater use of utilities and appliances. Since 2018, major repairs and maintenance expenditure over the first five years of providers' forecasts has increased by 45% in real terms on a per unit basis. Provider's latest five-year forecasts (FFR 2022) show a 16% increase in major repairs and maintenance expenditure when compared with last year's forecasts. This reflects substantial investment in response to increased standards, as well as reprofiling of expenditure delayed during the pandemic and high underlying inflation. Rising interest rates, continued supply chain disruption, and a tight labour market are all likely to further increase costs and delay works.

3.3 Boards must ensure that their organisation provides a repairs and maintenance service to homes and communal areas that represents value for money and which ensures tenants' homes meet minimum standards. Providers' stock is a long-term asset and boards will need to ensure that it continues to be fit for purpose over its lifetime. Crucially, boards will need comprehensive, robust, and up-to-date stock condition data to make informed decisions. This should support understanding of the stock's cyclical maintenance demands and new requirements on energy performance or through potential revisions to the Decent Homes Standard as well as enable identification of investment needs. Boards will need to consider implications from such new requirements on the economic performance of assets. In ensuring their stock remains fit for purpose, providers should also consider the resilience of their stock to the effects of climate change, such as the implications of higher temperatures, more extreme weather events, and indoor air quality.

Delivering services to tenants

3.4 The provision of good quality housing services to their tenants is core to the role of a registered provider. As well as breaching consumer standards, a failure to deliver these services or to engage effectively with tenants could lead to a breakdown in trust in the relationship providers have with their tenants, as well as seriously damaging the reputation of the provider and sector.

3.5 The Social Housing White Paper sets out the government's approach to strengthen providers' engagement with tenants and improve the services that tenants receive. As the regulator, our remit will expand, with changes to legislation due to be introduced to enable a regime of proactive consumer regulation. As part of this, we have consulted on the introduction of a new Tenant Satisfaction Measures Standard. From April 2023 this standard will come into force and providers will need to start collecting data to support these measures.

3.6 Our recently published Consumer Regulation Review identifies key issues and lessons arising from our casework in 2021/22. Our casework highlights the need for clear oversight of service delivery so that boards can be assured of the quality and safety of homes and services they provide for tenants. It also continues to demonstrate the importance of effective communication with tenants and learning from tenant complaints. Providers need to demonstrate an organisational culture that ensures critical issues aren't overlooked and are dealt with when they emerge.

3.7 Boards should already be preparing for the introduction of proactive consumer regulation, ensuring that strong governance arrangements are in place to continue to manage effective delivery of services to tenants and maintain compliance with consumer standards. Providers should ensure all decisions and communications with tenants demonstrate transparency and accountability. Board assurance that tenants are being treated with fairness and respect, and that their diverse needs are considered, should be reinforced by decision-making processes supported by robust data and effective performance management.

Health and safety

3.8 Ensuring that tenants are safe in their homes is a fundamental responsibility of all landlords. Providers must ensure that they comply with statutory health and safety obligations. These requirements apply to both existing stock, and to new build properties. Providers also have wider responsibilities such as fulfilling their legal duty of care to their staff.

3.9 The Building Safety Act came into force in April 2022 bringing improved building safety standards, and the new Building Safety Regulator will enforce the consideration of safety at all stages of construction. Our Consumer Regulation Review highlights the importance of having accurate and reliable data so that boards can be assured that they are meeting all relevant legal health and safety requirements. It also highlights the importance of having effective data reporting and monitoring systems in place to ensure that providers meet all health and safety requirements and that risks are appropriately identified and managed. Providers must ensure that they are prepared to report building safety tenant satisfaction measures for 2023/24. Failure to proactively identify issues and deliver remedial safety action in a timely manner puts tenants at risk. It also has a substantial impact on shared owners who can find themselves unable to sell and trapped in homes that no longer suit their needs.

3.10 Boards must ensure that they adequately understand all legislative and regulatory requirements relating to health and safety compliance, including their duties and responsibilities with regard to fire and building safety under the new regulatory regime. Boards must ensure that they have comprehensive and effective building safety systems and programmes in place to provide assurance that tenants remain safe. This is particularly important when services are provided by third parties such as managing agents or contractors, as ultimate responsibility lies with the landlord.

3.11 Boards will need assurance that their organisations hold good quality data to enable the accurate assessment and management of risks. Boards must understand the costs associated with remediation works and any implications for other planned major repairs, particularly for large and complex buildings and properties with vulnerable tenants. Where remediation works may take time to implement, taking account of industry capacity and risk, boards must ensure that their organisations communicate transparently with tenants and stakeholders.

Costs and inflation

3.12 Providers' costs have increased materially in the last 12 months and are likely to face continuing inflationary pressure. Providers will need to assess the impacts of high inflation and manage their cost base effectively; failure to do so could impact on business resilience, with reductions in free cash flow, margins, and interest cover.

3.13 The UK is currently experiencing consumer price inflation at a level not seen since the early 1980s, with twelve-month CPI inflation reaching 10.1% in September 2022. Latest Bank of England forecasts suggest CPI inflation will reach just under 11% in October 2022, reflecting the dampening effect of the government's Energy Price Guarantee. Inflation is expected to remain elevated. High inflation and a tight labour market will put pressure on providers' wage costs. While supply chain disruption is easing, materials and parts are likely to see continued significant inflation from second-order effects from higher energy costs. There are significant ongoing risks to the outlook for CPI inflation, including from further energy price shocks, the tight labour market, or financial volatility.

3.14 Boards will need to fully understand their cost base and capital requirements and have a clear prioritisation approach to ensure continued delivery of essential services and safety. Boards will also need to consider how decisions taken to mitigate risk in the short term may increase risks in the longer term. Boards will need to ensure that investment appraisal is robust, and that they understand the financial and operational impacts from any changes to strategic investment decisions due to high inflation.

Rent setting

3.15 The government regulates how much most social housing rents can increase each year. The prospect of above inflation permitted social rent increases during the current period of high inflation has attracted significant attention from both the government and media. The government is currently consulting on proposals to cap increases in social rents from April 2023[12] and providers should be reviewing business plans in light of this.

3.16 The government's consultation on the draft direction to the regulator in relation to social rent policy sets out a range of proposals to cap rents increases during rent periods that begin in the 12 months from April 2023. Restrictions to rents increases will materially impact providers' ability to deliver existing business plans, and boards and governing bodies will need to ensure they have a clear strategic approach to the difficult trade-offs that will ensue. In implementing mitigations, providers will need to prioritise statutory obligations on safety and key service delivery while maintaining viability.

3.17 Analysis of providers' 2020/21 Statistical Data Return and 2020/21 Local Authority Data Return data submissions[13] and regulatory engagement suggests most providers set their rents correctly. In March 2020 the regulator published an addendum to the 2019 Sector Risk Profile on setting rents in social housing[14], setting out some of the themes that the regulator has found in its engagement with providers on rent. Rent compliance will continue to be an area of scrutiny for the regulator as any changes to rent policy could potentially increase complexity and result in more instances of non-compliance. Failure to apply rent rules correctly or inappropriately applying exceptions from these can lead to over-charging tenants and cause both reputational and economic damage to the sector at a time of economic difficulty and intensifying media scrutiny. Boards and governing bodies should ensure that they have adequate assurance on the quality of

[12] Social housing rents consultation - GOV.UK (www.gov.uk)
[13] Statistics at RSH - Regulator of Social Housing - GOV.UK (www.gov.uk)
[14] Setting rents for social housing - GOV.UK (www.gov.uk)

their organisation's internal controls on rents, and that these continue to meet any changes to the rent setting regime.

3.18 Boards and governing bodies should ensure that they understand the expectations regarding service charges, including Affordable Rent where rents are inclusive of service charge. There must be appropriate controls in place to ensure compliance with all relevant law, particularly the Landlord and Tenant Act (1985), which sets the principle that service charges should only cover identified costs. Failure to manage service costs can adversely affect affordability and cause reputational damage.

Rental income and arrears

3.19 Rental income accounts for the large majority of the sector's income. High inflation and real terms wage reductions will increase financial pressure on households and could result in an increase in arrears. Frequently this rental income is supported by government benefits such as Housing Benefit or the housing element of Universal Credit. Changes to benefits policy and the administration of benefits can have implications for providers' rent collection. Failure to appropriately manage rent collection and arrears can ultimately impact providers' financial viability.

3.20 Latest quarterly survey data[15] show average (mean) current tenant arrears in Q1 2021/22 at 3.6%, broadly in line with long-term averages. However, there is the potential for pressure on providers' rent collection as tenants and shared owners face increased financial pressure from reduced real terms incomes. There is also the potential for benefit incomes to fail to keep pace with high inflation. Previous levels of hardship funds established to support tenants experiencing the impact of last year's rent increase may be insufficient to mitigate the impact of the 2023 rent increase even if capped.

3.21 Boards will need to continue to ensure rental income risks are appropriately managed. Boards will need to demonstrate that they understand the implications of increased arrears, as well as how each provider's composition of tenures, geography, and stock type will dictate the nature of any potential issues, stress testing against falls in income and establishing mitigations for this.

3.22 Some providers have diversified into the private rented sector (PRS). As with other forms of non-social housing investment, it is important that boards should have assurance that the level of return is commensurate with the level of commercial risk associated with PRS stock rents fluctuating more than social rents. These risks are particularly acute during periods of economic turbulence. Boards will need to understand these risks, stress testing the impact of falling market rents or increasing levels of arrears and current constraints on their ability to recover arrears and

[15] Quarterly survey for Q1 (April to June) 2022 to 2023 - GOV.UK (www.gov.uk)

possession through the courts and ensuring this can be mitigated and that social housing assets are protected. The regulator will seek assurance that boards understand the risks and rewards of entering into this activity, and that these are appropriately balanced.

Data security

3.23 Data is an extremely valuable asset, of which providers gather many types in the course of their activities. Alongside their legal obligations, providers have a duty of care to tenants and staff to protect this data against a backdrop of increasing data security risks. As well as potentially significant penalties, failure to adequately ensure the security of data risks compliance with regulatory standards through damage to key service delivery, harm to tenants, and the breach of trust between the provider and its stakeholders.

3.24 Cyber threats are complex and multifaceted. The National Cyber Security Centre has emphasised UK organisations should prepare for an extended period of heightened threat following Russia’s invasion of Ukraine. In recent months, there have been a number of providers reporting data security issues, resulting in disruption to systems and key service delivery. The widespread move to remote working and increased online service delivery can make organisations more vulnerable to phishing, malware, and ransomware attacks. Some providers might use legacy technology, leaving security holes in their systems, or have easily compromised infrastructure caused by a lack of proactive management. Many providers are also collecting more data on tenants than previously, including using smart technology as a way to improve their service.

3.25 All providers must comply with the Data Protection Act 2018 and other relevant data protection legislation. Boards that appropriate technical and organisational measures are in place to implement the data protection principles effectively and safeguard individual rights and to manage data protection risks. Boards must also ensure that their IT security function is safe and secure and that security vulnerabilities are appropriately identified and mitigated. Boards should ensure their organisations have a proactive cyber incident response plan that is fully aligned with their business continuity and recovery plans, and that prioritises service restoration and communication with tenants. Boards must consider the implications of collecting or processing new data and take steps to prevent personal data breaches. They must also understand the risks of processing personal data with third parties, including the need to undertake due diligence on third parties’ security measures, using standardised contractual clauses where necessary, and documenting where data is located.

Data integrity

3.26 Accurate, up-to-date, complete, and reliable data are fundamental for boards to monitor areas such as rent setting, financial management, stock condition, tenant needs and expectations, health and safety, and meeting consumer standards. Board oversight, control, and decision making is undermined by failure to maintain data integrity or by data isolated in siloed systems.

3.27 Boards must have assurance that data is appropriately managed, ensuring confidentiality, integrity, and availability. This will require adequate quality controls and robust audit trails are in place, identifying critical data and Information Asset Owners, establishing process maps, and implementing appropriate software solutions such as error detection. It is the responsibility of boards to ensure the collection of robust data to support key regulatory returns, including value for money metrics and, from April 2023, the collection and reporting of tenant satisfaction measures data.

3.28 Accurate and timely data underpins our engagement with providers. We consider failure to manage data integrity to be indicative of a poor internal controls assurance framework. Failure to provide accurate and timely data that meet regulatory requirements will be reflected in the judgement of a provider's compliance with regulatory standards.

Supported housing

3.29 The provision of supported housing is a key element of some providers meeting their core purpose. Supported housing accommodation makes up around 13% of the sector's stock, with particular concentrations among small providers. Much supported housing and support services activity, especially where reliant on local authority contract funding, is inherently low-margin and is vulnerable to fluctuating income and costs, or changes in government policy. Failures to provide adequate services can have severe impacts for tenants in need of support, including some of the most vulnerable people housed by providers.

3.30 Supported housing is under increasing cost pressure from high inflation and a tight labour market. Local authorities are experiencing significant cost and income pressure, especially in adult social care, which could place further downward pressure on support contracts. The potential for further deterioration in local authorities' finances as a result of the adverse macroeconomic environment may further increase pressures. Some providers have looked to supplement contract incomes by bidding for support contracts for tenants with complex needs. With the number of vulnerable people relying on supported housing forecast to increase over the coming years, more staff and more homes will be needed.

3.31 Boards of providers with significant supported housing or support contracts must ensure they understand funding risks, including stress testing against increased costs, loss of contracts, and the commissioning of revised or new services. Boards will need to manage staffing and other risks to ensure appropriate service delivery. Boards of providers tendering for contracts in unfamiliar areas of support need to fully understand the wider risks involved, such as increased safeguarding risks, and have robust systems of oversight and effective mitigation strategies in place.

3.32 The addendum to the 2018 Sector Risk Profile highlighted specific risks around specialised supported housing provided on a leased basis.[16] The risks identified in this addendum continue to be a significant concern. Higher inflation is a particular risk for these providers since they tend to have long-term, low-margin inflation-linked leases. Boards of such providers must ensure that they are able to manage the risks inherent to inflation-linked leases, including interruption to their cash flows and potential differential between index-linked liabilities and rental income in the event that rental growth is capped.

[16] Lease-based providers of specialised supported housing - GOV.UK (www.gov.uk)

4. Operational risks – development

Low-cost home ownership and market sales

4.1 The development of new housing – both social and non-social – remains a key priority for government, and providers continue to play an important role in meeting demand. Some providers develop units for sale to meet their strategic objectives, as well as to generate surpluses to cross subsidise other activity. However, exposure to the housing market brings its own set of risks to manage, including inflation or scarcity in material and labour costs, volatility in market prices or slowdowns in sales volumes, mortgage costs and availability, and impairment risks from joint ventures.

4.2 The disruption caused by the Covid-19 pandemic is still being seen in providers' reprofiled development forecasts, with planned increases in major repairs expenditure and the new Affordable Homes Programme[17] also having an impact on plans. However, latest plans date from June 2022 and it is likely that these will be significantly revised in light of the changing outlook for inflation and interest rates. Providers forecast the development of 397,000 units over the next five years across all tenures (FFR 2022), broadly in line with 2021 forecasts.

4.3 Low-cost home ownership and outright market sales continue to make up a significant part of the sector's current development programme, accounting for 39% of units to be developed over the next five years, in line with 2021 forecasts. Providers have reduced their forecast development of market sale units in latest plans, while increasing their development of low-cost home ownership. Development of units for sale remains concentrated in a relatively small number of providers, with the top ten accounting for over a third of the 122,000 low-cost home ownership units (FFR 2021: 116,000) and half of the 34,000 market sales units (FFR 2021: 39,000) developed by the sector. A number of providers undertake further market sale activity through entities in which they hold a non-controlling interest (mainly joint ventures). An additional 32,000 units are forecast to be developed for market sale in this manner.

4.4 The current adverse economic environment is likely to impact on providers' development programmes. The impact of rising interest rates on mortgages has the potential to impact sales prices and volumes, including staircasing of shared ownership properties. Boards must assure themselves that they understand the implications from lower than forecast sales income, stress testing against feasible but severe scenarios for house prices and transactions and establishing mitigation plans for potential stress scenarios. Boards must understand the extent to which impairments of joint venture investments could affect registered providers, for instance through financial covenant

[17] Affordable Homes Programme 2021 to 2026 – GOV.UK (www.gov.uk)

calculations. Boards must understand the risk of default and factor the risk of impairment into their investment decision-making process, stress testing and control framework.

Construction process risks

4.5 The development process itself potentially entails significant risks that require effective oversight and management. Delays to developments may occur as a result of ongoing disruption to supply chains and labour markets and increased costs, which could result in financial impacts or reputational damage. Failure to satisfy statutory safety and quality requirements and stakeholder expectations could result in harm to tenants or reputational damage.

4.6 Policy and legislative changes have increased expectations around the design and construction of new build homes. The Fire Safety Act 2021 and the Building Safety Act 2022 have tightened safety standards, while changes to building regulations earlier this year and the planned implementation of the Future Homes Standard from 2025 will reduce energy use and lower emissions. The establishment of the Building Safety Regulator and the New Homes Ombudsman will increase scrutiny and accountability from failings in safety or in the construction quality of new homes.

4.7 Boards must have sufficient assurance that new properties meet stakeholder expectations and satisfy all legislation regarding building regulations, health and safety requirements, and regulatory standards, whether the development is delivered by the provider itself or acquired from a third-party developer or joint venture. Boards must manage counter party risk for third-party contractor development, considering possible impacts on contractual or planning obligations and establishing appropriate plans to mitigate exposures.

4.8 Boards should also be aware of changing and increasing stakeholder expectations with regard to construction methods as the government looks to drive improvements in decarbonisation, building safety, and design. Where these represent significant differences from providers' current practices, boards should ensure they have sufficient assurance that new properties will meet statutory requirements and they fully understand the implications of any new development approach. Boards must understand the risks inherent to development, including stress testing against increased costs or delays to programmes.

5. Finance and treasury management

Existing debt

5.1 Debt accounts for the majority of financing in the sector. At the end of June 2022, providers had agreed facilities of £119bn.[18] The proportion of bond finance has grown rapidly since 2008 and today the drawn amount (£52bn) currently exceeds the funding drawn from banks. While bonds mostly have more limited covenant suites, providers still need to carefully ensure that these are respected. Failure to manage relationships with lenders or compliance with covenants can threaten financial viability and undermine the achievement of strategic objectives.

5.2 Latest forecasts show a continuation of the decline in providers' interest cover seen over the past five years. The sector's forecast aggregate EBITDA MRI interest cover over the next five years is 147%, down from 161% in 2021 and 190% in 2018 (FFR 2022). A material number of providers are projecting less than 100% interest cover in 2022/23. Reductions in interest cover are particularly driven by widespread forecast increases in spending on maintenance and major repairs. This reflects stock quality improvements – particularly energy efficiency, decarbonisation, and safety – as well as works reprofiled during the pandemic and the effect of high inflation.

5.3 Markets currently expect interest rates to increase significantly over the next year. While providers have taken advantage of the previous low interest rate environment to fix more than 80% of their debt, a substantial number of providers have at least 25% of debt at variable rate in year 1 of forecasts and will face rapidly rising costs in the short term. Providers must also be aware of the implications of capped rents for security valuations. Some provider models, such as lease-based providers of specialised supported housing, make significant use of CPI-linked debt; this model presents particular issues when inflation is high and when rental income growth may be capped.

5.4 Boards must ensure appropriate treasury management and governance processes are in place to effectively monitor existing loan covenants to mitigate the risk of breaches. Providers should act early to communicate with lenders, including seeking waivers where essential safety works might threaten covenant compliance. Boards must also understand the risks to the provider from joint ventures, including impacts to financial covenants from impairments and any restrictions in on-lending. Boards must ensure risks from existing debt are managed, stress testing changes in underlying assumptions to understand and mitigate against unforeseen requirements for financing or increases in interest costs. Boards of providers with index-linked debt must ensure that they are able to manage the risks inherent to inflation-linked leases, including interruption to their

[18] Quarterly survey for Q1 (April to June) 2022 to 2023 - GOV.UK (www.gov.uk)

cash flows and potential differential between index-linked liabilities and rental income in the event that rental growth is capped.

New debt

5.5 Providers' strategic purposes, objectives and risk appetites differ, and therefore suitable funding options also vary. Providers are forecasting greater reliance on debt to deliver increased investment in existing stock and delivering new supply, and this increases exposure to interest rate risks. Failure to maintain investor appetite and manage interest rate exposure would lead to reduced capacity to deliver new developments and capital investment in existing stock.

5.6 Providers' business plans from June 2022 envisaged agreement of £47bn in new debt facilities over the next five years, including refinancing, increasing debt facilities from £116bn in 2021/22 to £129bn by 2026/27 (FFR 2022). It is likely that these plans will change materially as providers implement mitigations in light of the deteriorating external environment. Providers' credit ratings are currently clustered in the low-single A band, but these are vulnerable to downgrades from weakened operating performance or falls in the UK sovereign rating. Credit ratings agencies have highlighted that capping provider rents would be credit negative. Falls in provider ratings, especially below investment grade, will increase the cost of capital and may change the range and capacity of investors, potentially risking the availability of funding. There is also the potential that falls in provider ratings may see debt holdings and supply moving to investors with different expectations and requirements from the current group.

5.7 Boards should understand the sensitivity of business plans to decreases in investor appetite and potential changes to the cost, tenor, and availability of debt. Boards will need to maintain a flexible treasury strategy, considering refinancing risk and the potential for changing counterparties. Communication with lenders and investors will continue to be key. Boards should ensure that decisions around which debt funding option is right for their business stems from their activity, rather than the other way round. It is crucial that boards have the skills and expertise to understand and effectively challenge financial advice, especially when considering innovative and/ or complex funding structures.

5.8 As the regulator, we do not favour one funding approach over another, but we do expect to see evidence that a critical assessment has been undertaken with use of independent, specialist external advice as appropriate, and that boards are able to effectively understand and challenge this.

Alternative funding models

5.9 While debt accounts for the majority of providers' funding, alternative models have become increasingly prevalent in the sector. An increasing number of private investors have looked to invest in social housing products. This investment has been through the establishment of funds providing equity to (usually) for-profit registered providers, by way of lease arrangements, or through direct equity investment in registered providers. These approaches can bring their own risks in addition to those applicable to all providers.

5.10 Private investment has allowed some providers to target rapid growth in units under management, but this funding has the potential to be more expensive than debt. Furthermore, rapid growth can heighten the risk that managerial capacity may not keep pace. Several for-profit providers have recently been established with tightly defined roles within wider corporate structures, with no staff and most business functions outsourced.

5.11 It is for boards to assess the risks associated with any new types of funding they take on. Boards must ensure that there are no potential conflicts from the influence of funders over strategic direction and that the board remains appropriately independent. Boards must also understand how governance and risk flow within wider corporate structures. Boards must bear in mind that they cannot outsource their responsibilities and ensure that they own and manage the risks associated with specific business models.

Pensions

5.12 Employer payments towards pension provision are today a standard part of most sector employees' overall remuneration. All schemes have membership and legal obligations. The balance of financial risk will vary depending on many factors including whether schemes are defined contribution or defined benefit.

5.13 Many providers have exposure to defined benefit schemes. The financial obligations are remeasured on a triennial basis, creating risks of increased provider contribution costs where schemes are found to be in deficit. External events or changes in policy can materially impact such schemes. Changes from 2030 to align the calculation of the Retail Prices Index (RPI) with the Consumer Prices Index including owner-occupiers' housing costs (CPIH) will have a direct effect on funding levels for many schemes.

5.14 Boards of providers should understand the potential for changed contribution levels and the implications of this. Although most providers have taken a proactive approach to managing this risk, where appropriate boards should seek independent advice from relevant professionals to understand their risk exposure.

Fraud

5.15 Providers are exposed to the risk of fraud through their procurement and provision of services. Where fraud occurs, it is reputationally damaging and can have significant implications for providers' financial viability and delivery of strategic objectives, disrupting their services and eroding tenant and stakeholder confidence. Fraud also has the potential for wide-reaching indirect impacts upon other organisations and businesses. Providers are also exposed to the risk of money laundering and terrorist financing risks through their every-day operational activities.

5.16 Providers are vulnerable to many types of corporate fraud, including mandate fraud, supplier fraud, and finance function fraud. The current heightened cyber security threat climate increases the risk of providers falling victim to cyber-attacks.

5.17 Boards must ensure that they have robust internal control procedures in place, and seek appropriate professional advice when fraud is identified. Boards should also understand their responsibilities under anti-money laundering legislation. Anti-fraud policies should be regularly reviewed and well communicated, with employees given regular training. Boards should also ensure that there are processes in place to enable the detection and countering of instances of tenancy and other fraud in their stock. Boards should demonstrate a rigorous attitude to combatting fraud and create a culture where employees are motivated to help in this.

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The Regulator of Social Housing regulates registered providers of social housing to promote a viable, efficient and well-governed social housing sector able to deliver and maintain homes of appropriate quality that meet a range of needs.