Regulator of Social Housing

Sector risk profile 2023

November 2023

Contents

Executive summary

The Sector risk profile sets out the regulator's view of the most significant sources of risk to providers' ongoing delivery of the outcomes required by our standards. It is aimed primarily at Boards of private registered providers and, where relevant, the councillors forming the governing bodies of local authority registered providers (henceforward 'Boards').

Though many of the risks highlighted here are multifaceted, the Sector risk profile has a particular focus on risks to delivering the outcomes required by our economic standards. The Social Housing (Regulation) Act has given us greater powers to set consumer standards and proactively regulate these from April 2024. The regulator is now considering responses to its consultation on changes to our consumer standards – Boards and councillors will need to ensure they are ready for this new framework. Our Consumer regulation review sets out specific case studies and learning from our reactive consumer casework. It remains the responsibility of board members and councillors to ensure providers meet our regulatory standards.

Providers continue to face a difficult operating environment. There is ongoing fallout from the sequence of severe shocks the UK economy has faced over the past few years, with persistently high inflation, higher cost of borrowing, challenges accessing skilled labour, and a declining housing market all still playing out. There continues to be significant risk of further unexpected shocks from the ongoing war in Ukraine and instability in the Middle East, and as higher interest rates weigh on the UK and global economy.

At the same time, the sector will need to make substantial investment in existing homes to deliver improvements to quality, building safety, and energy efficiency commitments. The sector will also need to continue to deliver new social housing, to serve more than a million households on local authority waiting lists. There will continue to be considerable scrutiny of the sector's performance in providing quality homes and services and ensuring that social housing tenants are listened to and treated with fairness and respect by their landlords.

Some of the risks highlighted in previous iterations of the Sector risk profile are now crystallising, and managing these is already testing the resilience of many individual providers. External pressure continues to weaken the sector's financial capacity and implementing mitigations will leave less margin for error in decision making. Boards will need to exercise skill and judgement to manage risks in order to deliver objectives, identifying pressures and ensuring mitigation plans remain robust against the potential for further shocks. This will inevitably result in difficult trade-offs for Boards.

The rest of this publication demonstrates the wide variety of complex risks that Boards of providers must manage and mitigate to ensure they continue to deliver the outcomes required by the standards. From these more specific risks emerge some general themes that are likely to be key areas of focus for Boards, and for us as the regulator. These are set out below.

Strategic direction

It is crucial that Boards continue to set a clear strategic direction and priorities for their organisations. The macroeconomic headwinds faced by the sector and resulting weakening financial capacity will make it harder for providers to deliver competing objectives, and Boards will inevitably face difficult trade-offs. Providers are undertaking record investment in existing stock to ensure compliance with quality, safety, and energy efficiency standards. At the same time providers are seeking to develop hundreds of thousands of new homes over the next few years.

Providers will also need to focus on delivering quality services to tenants, many of whom will be facing significant cost of living pressures. Value for money will inevitably be a focus in a period of financial constraint for both providers and tenants, and Boards must ensure the activity they undertake effectively achieves strategic objectives. A provider's purpose, how it makes choices, and its performance will be scrutinised by a wide range of stakeholders. As well as the regulator, this will 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 priorities, and transparently communicate performance against these in order to manage the risks inherent to these trade-offs.

Macroeconomic risk and viability

Providers continue to face a difficult and uncertain economic environment. Persistently high cost inflation, a tight labour market, and contractor failures and supply chain issues are delaying works and increasing costs for providers. An ongoing housing market downturn poses risks for development sales income. Rental income has been constrained by the 7% rent cap for 2023/24, while costs for stock investment programmes have continued to rise. Interest rates have risen markedly in response to high inflation, resulting in materially increased provider borrowing costs. These economic factors have weakened the sector's financial position and reduced its capacity to manage downside risk. Sector interest cover has continued to fall and on a social housing lettings basis is already below 100% (financial forecasts returns 2023).

Providers have been 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 undertake stress testing of key assumptions, including rents policy, establishing robust, worked up mitigation strategies to address further possible shocks. Constrained finances reduce a provider's room for manoeuvre and heighten the risk that weak governance results in financial distress. Boards must fully understand their organisation's assets, liabilities, and operating environment to ensure their organisations remain financially viable and that social assets remain inside the social housing sector.

Stock decency

The Social Housing (Regulation) Act gives greater powers to ensure providers are providing homes that are decent, safe and well-maintained, and that tenants receive quality landlord services and are treated with fairness and respect. 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.

Effective management of stock requires a detailed knowledge of stock condition, and Boards will need to ensure this is underpinned by accurate, up-to-date, and robust data from stock condition surveys that adequately assess all four criteria of the Decent Homes Standard. Boards must ensure they understand how the condition of stock relates to current and evolving requirements, in particular understanding how their stock may be affected by any changes which may arise from the government's upcoming review of the Decent Homes Standard and consultation on minimum energy efficiency standards (MEES).

Tenant safety

Keeping tenants safe is a fundamental responsibility for any landlord. Boards must ensure that they comply with all statutory health and safety legislation. The regulator's review of damp and mould following the tragic death of Awaab Ishak highlighted the importance of providers holding accurate, up-to-date, and robust stock data in ensuring tenant safety. Boards must ensure that risks to tenant safety are identified and mitigated, including stock surveys that are sufficiently robust to assess the presence of category 1 hazards under the Housing Health and Safety Rating System.

Boards must ensure they understand the implications of the Social Housing (Regulation) Act, including the consultation on the part of Awaab's Law that ensures tenants understand their rights and that effective processes are in place for tenants to raise concerns about damp and mould. Further requirements relating to the timeframe for repairs and expectations that providers take into account the diverse needs of tenants will be subject to future consultation. Boards should ensure that repairs are completed effectively and that tenant complaints are considered and learned from. Boards must also ensure that they understand the regulatory framework for high-rise buildings introduced by the Building Safety Act 2022, including the requirements for providers to have established tenant engagement strategies and produced building safety cases by April 2024.

Service delivery and accountability

The provision of good quality housing services to their tenants is core to the role of a provider. Boards need to ensure that strong governance is in place to oversee service delivery and maintain compliance with consumer standards. In particular, they must ensure that the organisation has robust and accurate data on performance, including tenant satisfaction measure data for 2023/24.

The Social Housing (Regulation) Act has expanded the regulator's powers and we are considering responses to our consultation on revised standards to come into effect from April 2024. The proposed standards strengthen the expectations on providers to deliver good quality landlord services, provide quality homes, and treat tenants with fairness and respect. The current tight labour market is likely to continue to put pressure on providers' delivery of services and programmes. Moreover, there have been instances where cyber security threats have resulted in significant interruptions to data, systems, and services. We expect Boards to actively manage these risks to ensure continued delivery of essential services.

1. Introduction

1.1 The 2023 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.

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 and well-being of tenants. 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 Our focus remains on seeking assurance from providers that they are meeting our standards. We have set out specific expectations in relation to risk management in the Governance and Financial Viability Standard and associated Code of Practice. 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 The Social Housing (Regulation) Act has added to the statutory objectives of the regulator in regard to its consumer regulation role. The regulator has consulted on the revised standards we are proposing, and which are due to come into effect from April 2024. We intend to publish a Code of Practice on consumer issues alongside these standards to help tenants and landlords understand how compliance may be achieved. We continue to consider referrals made to us in relation to breaches of the current consumer standards, signposting to the Housing Ombudsman where a referral appears to be an individual issue rather than a significant failure of the provider to achieve the outcomes required by our standards.[1]

[1] Memorandum of Understanding between the Regulator of Social Housing and the Housing Ombudsman - (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. 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. These have resulted in persistently high cost inflation, a tight labour market, and rising interest rates. These have continued to increase costs for providers while high interest rates have also contributed to an ongoing housing market decline, potentially reducing income from development. While inflation has likely now peaked, the persistence of inflationary pressures remains uncertain. Interest rates have risen markedly in response to high inflation, increasing the cost of floating rate and new debt, while sources of debt may need to change if provider ratings fall. These factors, alongside increased stock investment requirements have seen in a further weakening of the sector's financial performance. Forecast sector EBITDA MRI interest cover has fallen to 125% in aggregate over the next five years. Sector interest cover is forecast to fall to a low of 106% in 2023/24 (falling to 90% on a social housing lettings basis alone) before recovering in subsequent years (FFR 2023). Providers' income is also currently uncertain, with rent increases capped below inflation in 2023/24 and rent policy from 2025/26 yet to be determined by government. Many tenants are experiencing cost of living pressures and substantial real terms falls in incomes, and this increases the risk of rising arrears.

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. Boards will need to ensure stress testing is undertaken against a range of severe yet feasible scenarios, establishing detailed mitigation plans that are periodically reviewed to ensure these remain robust. 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 while ensuring fundamental requirements such as tenant safety continue to be met. 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 stock 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 saw a 27% increase in the number of complaints it received in 2022/23, with the main complaint types focussed on property condition and complaints handling. Its investigations have seen a steady increase in the proportion of cases with maladministration findings, rising from 48% of cases in Q1 to 61% in Q4 2022/23.[2]

2.6 Boards should be aware of the expectations of tenants and other stakeholders as part of their strategic approach and decision making – engaging with these transparently about the trade-offs providers will inevitably face. They will need to understand their performance against consumer standards and must make sure they are collecting and providing information to support effective scrutiny by tenants and stakeholders. They should also proactively seek to understand and respond to the diverse needs of their 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.

2.7 Our requirements relating to tenant satisfaction measures (TSMs) came into effect in April 2023 in order to support effective scrutiny by tenants of their landlord's performance. This includes landlords sharing information with tenants about how they are spending their income. Providers are required to publish these for tenants, and to submit their first set of results to the regulator in summer 2024. Boards are ultimately responsible for ensuring that reported TSMs have been calculated accurately and in accordance with regulatory requirements.

[2] Annual Complaints Review 2022-23 | Housing Ombudsman (housing-ombudsman.org.uk)

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.

2.9 Diversification can include market sales, student housing, portfolios of commercial property, specialist care, and many other activities. 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 25% of income over the next five years will be accounted for by activity other than social housing lettings, though this represents a slight reduction when compared with previous years' forecasts (Financial forecast return (FFR) 5year aggregate of 28% in 2022 and 29% in 2021). Providers have previously undertaken substantial development of homes for market sale to cross-subsidise social activity. However, as the housing market has continued to decline, providers have substantially reduced their exposure to market sales activity, reducing the forecast number of units to be developed for outright sale over the next five years by 25%. However, the sector still expects to supply a large number of homes for sale over the next five years – in particular for shared ownership – and providers will need to manage development and sales risks carefully.

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. Boards must ensure that such activity provides value for money and that the rewards from this activity are commensurate with its risk profile. 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, cross-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 ongoing tight labour market continues to exacerbate skills shortages and could threaten providers' ability to deliver these programmes and services.

2.13 There continue to be particular labour shortages in construction, building safety, support, and care. Procuring external auditors is also increasingly difficult and we are seeing cases where external auditors are having to be retained beyond their original term. Sourcing insurance is becoming more expensive, with a limited range of insurers for specific risks such as flooding and tower blocks. Providers are finding it difficult to recruit procurement professionals due to increased demand and significantly increased consultancy rates. In the face of substantial shortages in staff and high staff turnover, providers offering support and care services are frequently reliant on high numbers of agency staff to deliver services, with potentially unsustainable increases in costs and potential for poor quality of care. Recruitment and retention challenges are reported by more than nine in ten local authorities, with particular difficulties relating to planning officers.[3]

2.14 Providers' development ambitions are also being constrained by labour shortages and subcontractor insolvency. Providers continue to report delays to major repair works due to lack of available contractors.[4] A lack of fire risk assessors, specialist building surveyors, and contractors are making it harder to meet existing and future building safety requirements. The requirement under the Building Safety Act for landlords of high-risk buildings to establish a building safety case before the deadline of April 2024 is creating significant competition for expertise. Changed standards from the government's upcoming review of the Decent Homes Standard and consultation on MEES are likely to lead to further demand for skilled labour, compound existing issues.

2.15 Boards will need to ensure they 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 that they have the necessary skills and labour to continue to deliver essential services and maintain stock decency.

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[3] Local government workforce summary data - November 2023 | Local Government Association

[4] Quarterly survey for Q1 (April to June) 2023 to 2024 - GOV.UK (www.gov.uk)

Counterparty risk

2.16 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.

2.17 Contractors frequently operate on tight profit margins and high inflation and a tight labour market have made the environment for contractors particularly challenging. Rising interest rates and cost and wage inflation has resulted in company financial distress, with insolvencies in Q2 2023 the highest since 2009.[5] Construction businesses accounted for the largest contribution towards total company insolvencies in England and Wales, and are facing particular pressures from persistent cost inflation, a shortage of skilled staff and a slowdown in housebuilding.[6]

2.18 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 tenants' safety and the quality of their homes, as well as damaging the provider's reputation.

2.19 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 will need to have considered impairment implications from potential counterparty failures and ensure contingency plans are in place. 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.

[5] https://www.gov.uk/government/statistics/company-insolvency-statistics-april-to-june-2023
[6] https://www.gov.uk/government/statistics/monthly-insolvency-statistics-august-2023

3. Operational risks – existing stock and service delivery

Delivering services to tenants

3.1 The provision of good quality housing services to their tenants is core to the role of a registered provider. As well as not meeting 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. This could result in harm to tenants, as well as seriously damaging the reputation of the provider and sector.

3.2 The Social Housing White Paper set out changes to our consumer regulation role to strengthen the accountability of landlords for maintaining good quality homes and services, prioritising safety, treating residents with respect and being transparent organisations. The Social Housing (Regulation) Act enables these commitments by introducing changes to our objectives and powers. We are considering responses to our consultation on changes to our consumer standards due to come into effect from April 2024, and have already published requirements for tenant satisfaction measures which came into effect in April 2023. Boards and councillors will be ultimately responsible for ensuring organisations meet these standards.

3.3 Our Consumer regulation review 2023 identifies key issues and lessons arising from our casework in 2022/23. Our casework highlights the need for robust data that gives a clear and accurate account of performance, so that Boards can be assured of the quality and safety of homes and quality of services to tenants. It continues to demonstrate the importance of effective communication with tenants, treating tenants with fairness and respect, and learning from tenant complaints. Boards are ultimately responsible for ensuring reported performance data is accurate and in line with regulatory requirements.

3.4 Boards must have strong governance arrangements in place to continue managing the delivery of services to tenants and maintaining compliance with current consumer standards. Providers should ensure all decisions and communications with tenants demonstrate transparency and accountability. Robust data and effective performance management should support decision making so that Boards have assurance that providers are effectively delivering high quality services, and that tenants are being treated with fairness and respect, with consideration of their diverse needs. Boards need to have a robust understanding of performance across all areas and ensure that they are receptive to the issues that tenants raise through feedback and complaints.

Existing stock quality

3.5 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. High-profile instances of extremely poor stock quality that have led to severe impacts to tenants have damaged the reputation of the sector. Through our regulatory engagement, we find significant variation in landlords' understanding of the condition of their homes, with our consumer regulation casework highlighting specific issues of poor quality and disrepair. Current sector expenditure on repairs and maintenance is at a record level and providers forecast further large increases, though some of this will reflect the impact of inflation (FFR 2023). Many providers continue to report delays or changes to repairs and maintenance programmes, with limited access to contractors and price inflation leading to repairs and maintenance programmes being reassessed and, in some cases, postponed. A significant number of providers reported being affected by continuing high demand for damp and mould works, either as a result of increased tenant awareness or from carrying out proactive property inspections.[7]

3.6 Boards must ensure that their organisation provides a repairs and maintenance service to homes and communal areas which ensures tenants' homes meet minimum standards and that represents value for money. Providers' stock is a long-term asset and Boards will need to ensure that it continues to be fit for purpose over its lifetime.

3.7 Boards will also need to ensure they have comprehensive, robust, and up-to-date data on stock condition to inform decision making and ensure tenant homes are of good quality. This will necessarily include stock condition surveys that adequately assess all four criteria of the Decent Homes Standard. Data should support understanding of investment needs, as well as the potential implications of the government's upcoming review of the Decent Homes Standard and consultation on MEES. Insurers increasingly also require more detailed information to price risk appropriately. 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.

3.8 The regulator is considering responses to its consultation on the Safety and Quality Standard, which will replace the existing Home Standard. This sets out our proposed expectations on stock quality, decency, repairs, maintenance, and planned improvements, and housing adaptions. Boards must understand the requirements and implications of the proposed new standards, including ensuring providers are prepared to accurately report TSMs for 2023/24 in line with regulatory requirements.

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[7] [Quarterly survey for Q1 (April to June) 2023 to 2024 - GOV.UK (www.gov.uk)]

Health and safety

3.9 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.

3.10 Our Consumer regulation review highlights the importance of having accurate and reliable data on health and safety, 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 statutory health and safety requirements, such as gas safety checks, and that risks are appropriately identified and managed. Failure to proactively identify issues and deliver remedial safety action in a timely manner puts tenants at risk. We have recently seen some examples of poor approaches to gas safety, with poor programming leading to checks falling overdue, and in cases of no access to homes, gas capping is carried out as routine, with little consideration of the needs of tenants living in those homes or the reasons for no access.

3.11 The regulator has written to all registered providers relating to the presence and risks from reinforced autoclaved aerated concrete (RAAC). Our current understanding is that RAAC is not widespread in social housing. However, it may be present in a small number of buildings and providers will need to identify where RAAC components are present and any risks to tenant safety from arising from this. The regulator has also written to all registered providers to seek assurance on health and safety responsibilities for all buildings over 11 metres, including that providers are meeting their responsibilities under the Fire Safety (Regulatory) Order 2005, that risks are identified and understood, and timely remediation plans are in place for buildings with life safety fire risks. From October 2023 the Building Safety Regulator has overseen and enforced the new more stringent regulatory regime for higher-risk buildings. All existing occupied high-risk buildings had to have been registered with the Building Safety Regulator before this date; providers now have until April 2024 to have established a tenant engagement strategy and prepare a building safety case for each building.

3.12 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 also ensure that they have comprehensive and effective building safety systems and programmes in place to provide assurance that tenants remain safe in their homes. This is particularly important when services are provided by third parties such as managing agents or contractors, as ultimate responsibility lies with the landlord.

3.13 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 tenants who may have protected characteristics or additional needs. Boards should also be conscious of the interaction with service delivery risks. Where remediation works could take time to implement, Boards must ensure that their organisations communicate transparently with tenants and stakeholders while taking account of industry capacity and risk. Where necessary, Boards should ensure steps are taken to ensure risks to tenants are mitigated in the period before physical remediation works are complete. Boards should also ensure that no-access policies are robust while remaining mindful of tenants' individual needs.

Costs and inflation

3.14 Providers' costs have once again increased materially in the last 12 months. 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.

3.15 Twelve-month Consumer Prices Index (CPI) inflation was 6.7% in September 2023. CPI inflation peaked in October 2022 at 11.1% and has fallen gradually since. Latest Bank of England forecasts suggest CPI inflation will reach the 2% target in 2025/26. However, persistent inflationary pressure means the path for inflation remains uncertain. Though materials inflation has diminished, continued high inflation and a tight labour market will put pressure on providers' wage costs, with UK wage growth close to record highs. Providers report reassessing or postponing works programmes in light of price inflation and contractor availability.

3.16 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

3.17 Both private registered providers and local authority registered providers must set rents and service charges in accordance with the government's Policy Statement on Rents for Social Housing 2022 and the regulator's 2023 Rent Standard. Failure to set rents correctly can lead to over-charging tenants and calls into question a provider's system of internal controls and board's assurance on this, as well as damaging a provider's reputation with stakeholders.

3.18 In October 2017 the government announced its intention to set a long-term rent deal for registered providers that would permit annual rent increases on both social rent and affordable rent properties of up to CPI+1pp from 2020 for a period of at least five years. In response to high levels of inflation, government acted to limit annual rents increases to a 7% ceiling for rent periods that begin between 1 April 2023 and 31 March 2024, applied to both social and affordable rent homes (though excepting supported housing). The government has committed to undertake a consultation on the rent settlement from 2025/26 onwards.

3.19 Our previous regulatory engagement suggests the majority of providers set their rents correctly. Analysis of providers' Statistical Data Return and Local Authority Data Return submissions show general needs average weekly net rents in England increased by 4.1% in 2022/23, in line with the permitted formula rent increase of 4.1%. Where providers' submitted 2022/23 data suggests we need further assurance on rents, this will be addressed through our regulatory engagement.

3.20 Boards and governing bodies should ensure that they have adequate assurance on the quality of their organisation's internal controls on rents, and that these continue to meet any changes to the rent setting regime. They should further 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 charges can adversely affect affordability and cause reputational damage.

3.21 In its addendum to the 2018 Sector risk profile, the regulator highlighted a lack of assurance around whether appropriate rents are being charged for lease-based specialised supported housing. Boards of providers with such provision must assure themselves that the rents charged are in fact below market rents (which is part of the definition of social housing in the Housing and Regeneration Act 2008), and that the letting meets the definition of specialised supported housing. In March 2020 the regulator published an addendum to the 2019 Sector risk profile on setting rents in social housing, setting out some of the themes that the regulator has found in its engagement with providers on rents. Rent setting compliance will continue to be an area of focus for the regulator.

Rental income and arrears

3.22 Rental income accounts for the large majority of the sector's income. High inflation and real terms wage reductions have increased 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.

3.23 Data from the Quarterly Survey show average (mean) current tenant arrears in Q1 2022/23 at 3.7%, broadly in line with long-term averages. High inflation has resulted in historic falls in real household disposable income, and this will continue to put pressure on tenants and potentially on rent collection. Shared owners coming to the end of fixed rate periods on mortgages in particular are likely to experience a significant financial shock as they look to re-mortgage in an increased interest rate environment while also facing significant rent increases.

3.24 Boards will need to continue to ensure rental income risks are appropriately managed and can demonstrate that they understand the implications of any potential issues, stress testing against falls in income and establishing mitigations for this.

3.25 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 ensuring this can be mitigated and that social housing assets remain 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 and cyber security

3.26 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.

3.27 There have been a number of high-profile instances of cyber-attacks in the sector, and these have had serious consequences for providers' service delivery and resulted in substantial costs to rebuild and recover systems. Ransomware and extortion attacks have grown significantly in recent years, and the National Cyber Security Centre considers these to be the most acute cyber threat for most UK organisations. 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. The proposed requirements in the Transparency, Influence, and Accountability Standard in relation to the diverse needs of tenants due to come into force from April 2024 will put more emphasis on providers making use of information and data to inform their understanding of how they will meet the different needs of tenants. This is likely to involve collecting more data on tenants than previously, including sensitive data on protected characteristics, which will further increase the risk from data breaches.

3.28 All providers must comply with the Data Protection Act 2018 and other relevant data protection legislation. Boards should ensure that data protection risks are managed, and that appropriate technical and organisational measures are in place to implement the data protection principles effectively and safeguard individual rights. 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.

3.29 Boards must ensure that providers have contingency plans in place in the event of unforeseen data incidents and cyber-attacks, considering workarounds to ensure continued critical service delivery.

Data integrity

3.30 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.

3.31 Strengthened requirements for landlords to ensure performance data is accurate, transparent and comparable are at the heart of the proposed Transparency, Influence, and Accountability Standard, including the requirements on TSMs. Our consumer regulation casework continues to demonstrate the importance of robust data, with many areas of non-compliance found to be the result of an incomplete understanding of providers' housing stock. Regulatory engagement has highlighted instances where providers' stock condition survey approach is inadequate to fully assess compliance with the Decent Homes Standard. The Housing Ombudsman has highlighted the reoccurring issues it finds in its casework with aspects of knowledge and information management, with around two-thirds of cases upheld against landlords having an issue with the data and information available.[8]

3.32 Boards must have assurance that decisions are underpinned by robust data that is appropriately managed, ensuring confidentiality, integrity, and availability. This will require adequate quality controls and robust audit trails to be in place. Boards must ensure that stock condition survey approaches produce data that is sufficiently detailed to enable assurance against compliance with health and safety legislation, the Decent Homes Standard, and delivery of repairs, maintenance, and planned improvements to stock. It is the responsibility of Boards to ensure the collection of robust data to support key regulatory returns, including from summer 2024 the accurate reporting of TSM data in line with regulatory requirements.

3.33 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

3.34 Many providers see the provision of supported housing as central to 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. Failing to provide adequate services can have severe impacts for tenants in need of support, including some of the most vulnerable people housed by providers.

[8] KIM-report-v2-100523.pdf (housing-ombudsman.org.uk)

3.35 Supported housing is under increasing cost pressure from high inflation, increases in the national living wage, and a tight labour market, alongside sector-specific recruitment and retention issues. Local authorities are experiencing significant cost and income pressure, especially in adult social care, which could place further downward pressure on support contracts. There has been a gradual decline in supported housing activity operating margins, and this has prompted some providers to look for additional sources of income, supplementing contract incomes by bidding for support contracts for tenants with complex needs.

3.36 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. Boards will also need to ensure they are familiar with the new framework for supported housing introduced by the Supported Housing (Regulatory Oversight) Act 2023.

3.37 The addendum to the 2018 Sector risk profile highlighted specific risks around specialised supported housing where the accommodation is leased to the registered provider on a long-term lease. The risks identified in this addendum remain a significant concern. Higher inflation is a particular risk for these providers since they tend to have long-term, low-margin inflation-linked leases often without break clauses. 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.

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 Providers' plans have been revised in light of the changing outlook for inflation, interest rates, the housing market, and the need to fund increased investment in existing stock. Providers' development programmes are experiencing issues with high cost and wage inflation and access to skills. Providers forecast the development of 333,000 units over the next five years across all tenures (FFR 2023), 16% lower than 2022 forecasts. Outright sale has seen the greatest reduction in forecasts of 23%. The number of new units forecast by for-profit providers submitting FFRs has increased slightly to 33,000 (FFR 2022: 31,000). Further declines in the housing market from the impact of rising interest rates on mortgage affordability has the potential to reduce sales prices and volumes, as well as income from staircasing of shared ownership properties. Government has announced reforms to shared ownership rents for new shared owners, including switching the maximum increase in rents from Retail Prices Index (RPI)+0.5pp to CPI+1pp.

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 41% of units to be developed over the next five years, in line with 2022 forecasts. Development of units for sale remains concentrated in a relatively small number of providers, with the top 10 accounting for over a third of the 107,000 low-cost home ownership units (FFR 2022: 121,000) and over half of the 25,000 market sales units (FFR 2022: 34,000) planned 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 26,000 units are forecast to be developed for market sale in this manner.

4.4 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. They will also need to understand the implications of the reforms to shared ownership rents for their future development programmes.

4.5 Boards must understand the extent to which impairments of joint venture investments could affect registered providers, for instance through financial covenant 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

4.6 The process of development itself can entail significant risks that require effective oversight and management. Ongoing disruption to supply chains and labour markets and increased input costs may risk delays to developments, resulting in potential financial impacts or reputational damage. Failure to satisfy statutory safety and quality requirements and stakeholder expectations could result in reputational damage, or potentially harm to tenants.

4.7 Policy and legislative changes have increased expectations around the design and construction of new build homes. With the enactment of the Fire Safety Act in 2021 and the Building Safety Act in 2022, safety standards have been strengthened. Additionally, alterations to building regulations in 2022, along with the forthcoming integration of the Future Homes Standard in 2025, will contribute to decreased energy consumption and reduced 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.

4.8 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. This is the case regardless of 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.

4.9 Boards should also be aware of changing and increasing stakeholder expectations with regard to construction methods as the government looks to drive improvements in energy efficiency, 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 also 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 2023, providers had agreed facilities of £123.9bn.[9] The proportion of bond finance has grown rapidly since 2008 and the drawn amount has since 2021 exceeded 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 indicate providers' interest cover continues to tighten. The sector's forecast aggregate EBITDA MRI interest cover over the next five years has fallen to 125% (FFR 2023), down from 147% in 2022 and 190% in 2018. Sector interest cover in 2023/24 is forecast to be 106% (90% on a social housing lettings basis). The number of providers projecting less than 100% interest cover in the first year of business plans has increased from 41 to 55 providers. Factors driving this deteriorating include higher inflation, the effect of the 7% rent cap for 2023/24, materially higher interest rate assumptions, and increased investment in existing stock. At £4.6 billion, sector cash balances are at their lowest level in over eight years. These are forecast to reduce further, reaching £3.0 billion by June 2024. However, overall liquidity remains strong, with total cash and undrawn facilities totalling £33.8 billion sufficient to cover forecast expenditure on interest costs (£4.8 billion), loan repayments (£2.0 billion), and net development (£14.5 billion) for the next year.

5.3 Markets currently expect base interest rates to be near their peak, but expectations for inflation persistence mean rates are expected to fall only by a small amount over the next five years. Market data suggest the overall cost of medium and long-term borrowing is unlikely to be lower at the end of 2024. Providers had generally taken advantage of the low interest rate environment to fix a substantial proportion (80%) of their debt and the sector's effective interest rate of 4.2% is now significantly below the Bank Rate. The majority of the sector's existing debt is fixed for more than five years. Nevertheless, a number of providers already have material proportions of debt at variable rate, or face soon needing to refinance at higher rates and with potentially shorter terms. Providers must also be aware of the implications of rents policy uncertainty 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 the interaction between inflation and permitted future rental income growth is uncertain.

[9] Quarterly survey for Q1 (April to June) 2023 to 2024 - GOV.UK (www.gov.uk)

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 cash flows and potential differential between index-linked liabilities and rental income. It is essential that Boards ensure providers maintain sufficient liquidity, particularly during periods of economic uncertainty. The regulator will continue to engage with any provider that has low liquidity indicators.

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. Funder interest and activity in the sector can change. 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 2023 envisaged agreement of £44bn in new debt facilities over the next five years, including refinancing, with expected debt facilities increasing from £120bn in 2022/23 to £125bn by 2027/28 (FFR 2023). 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 future supply move to investors with different expectations and requirements than currently.

5.7 Boards should understand the potential consequences of weaker business plans that reduce investor appetite and consequent 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.

5.8 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.

5.9 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

5.10 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.

5.11 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.

5.12 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

5.13 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.

5.14 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 RPI with the CPI including owner-occupiers' housing costs (CPIH) will have a direct effect on funding levels for many schemes.

5.15 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

5.16 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.

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

5.18 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 appropriate 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.

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