14 October 2021

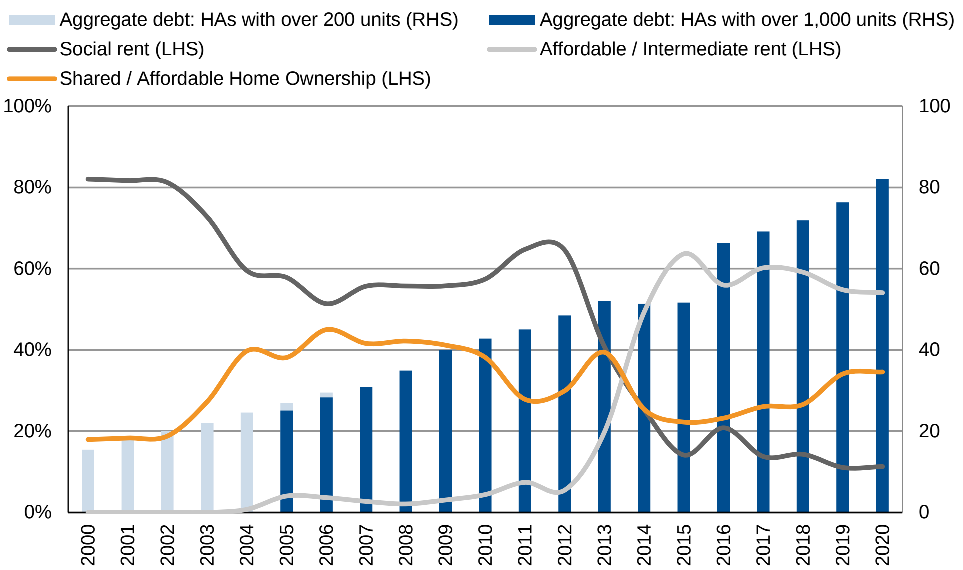
England's social housing: a resilient sector to Covid, Brexit and rising costs

England's social housing sector has undergone a remarkable transformation over recent decades. The sector now plays an increasing role in policy debates over the rising unaffordability of housing. Changes to the institutional framework have also altered risk profiles in the sector. We deem housing associations (HAs) to be in a strong position to meet today's most pressing challenges, including Covid-related disruptions, upwards pressure on costs and sustained reliance on debt finance.

England's social housing sector has undergone important changes over past decades, with the rise of HAs as the main providers of social housing. Changes in government policies and support schemes have also shaped HA business models and risk profiles to move away from traditional social activities and rely on debt funding (**Figure 1**).

The need to manage the transition to new funding regimes has underpinned HAs' operational and financial sophistication and fostered their preparedness to shocks. This highlights the strong interplay between the institutional framework and the stand-alone credit profiles of HAs. The changing business models have also led to a more complex operating and regulatory environment, including strong stress-testing requirements for providers, which have strengthened their ability to respond to shocks.

Figure 1. New affordable homes by tenure and aggregate HA debt in England
% of total additional affordable housing supply (LHS); GBP bn (RHS)



Note: The figures presented above are based on consolidated financial data.
Source: Ministry of Housing, Communities & Local Government, UK Housing Review 2021, Scope Ratings GmbH

Even with increased public funding and higher rent levels, the HA sector will mostly finance investments with debt. Increased government and regulatory focus on the safety and quality of homes following the Grenfell Tower fire as well as energy efficiency targets are putting upwards pressures on costs, though at the same time supporting asset quality.

Overall, the sector remains resilient in the face of a broad range of short- and long-term challenges. HAs' comfortable profitability, robust financial positions, strong governance and predictable cash flows for their core activities, combined with increased government support, underpin credit quality across the sector.

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Related Research

UK Social Housing Providers Rating Methodology
17 June 2021

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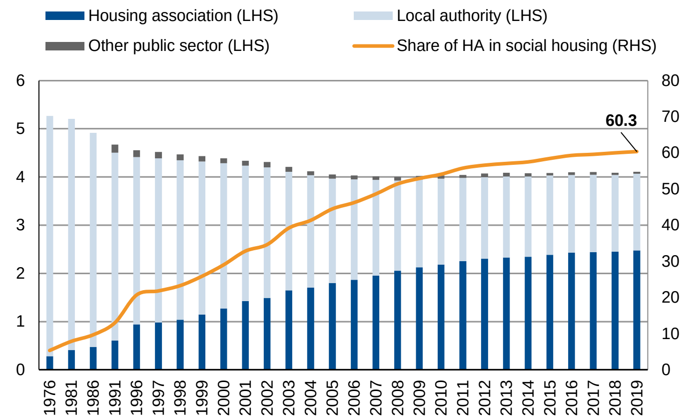
Shift of key providers: from public landlords to housing associations

Private housing associations have become the dominant providers of social housing

England's social housing sector has undergone a remarkable transformation over recent decades. At the start of the 1980, social housing represented around a third of all housing, with local authorities providing 95% of the stock. The last 40 years has seen government housing policy promoting home ownership including a 'right to buy' for tenants of local authority properties. The Conservative government led by Margaret Thatcher was instrumental in transforming the social housing sector, incentivising people to buy their rented council homes while favouring privately run HAs over public-sector landlords, expecting higher efficiency and effectiveness from the former. HAs at the time could not distribute surpluses and were expected to re-invest surpluses for such purposes as improving the quality of existing stock and building new homes.

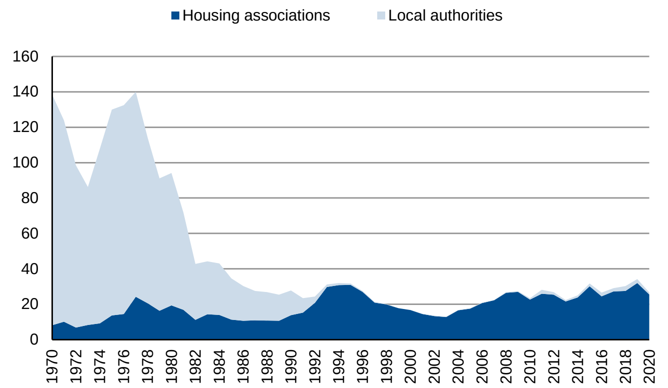
HAs' regulated status and generally robust balance sheets have enabled them to raise debt at a multiple of their reserves and receive grants to deliver new social homes. In 2008, the HA sector overtook local authorities as the main provider and owner of social housing, accounting for over 60% of the country's existing stock (**Figure 2**) and 95% of new supply (**Figure 3**).

Figure 2. Social housing stock in England
Million units (LHS); % of total (RHS)



Source: UK Housing Review 2021, Scope Ratings GmbH

Figure 3. Social housing completions in England
Thousand units



Source: Ministry of Housing, Communities & Local Government, Scope Ratings GmbH

Shift of funding: from government grants to debt

Progressive shift towards bond financing

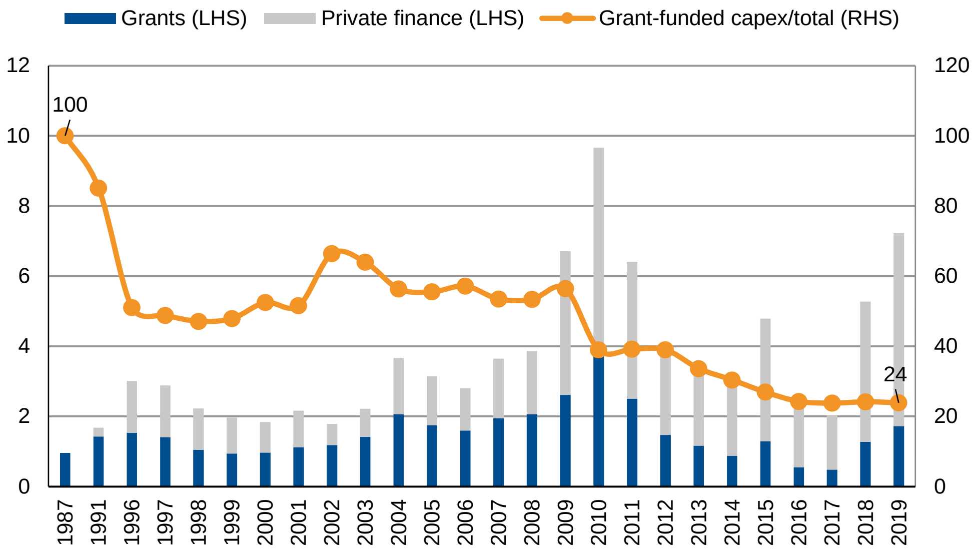
Government social housing policies and support schemes have shaped HAs' strategic direction and sustainability of their business models as well as influenced their reliance on debt. Private financing has increased substantially since 1998 when the mixed private-public funding regime was introduced.

This trend accelerated in recent years with cutbacks in government capital grants following the 2008 financial crisis, combined with the pressure to build more homes. The share of grant-funded HA investment has gradually declined, from 57% on average over 2000-09 to 24% in 2019 (**Figure 4**). As a result, total HA debt in England increased steadily over recent decades to GBP 82bn in 2020 (**Figure 1**, first page). Before 2008, long-term lending to HAs was dominated by UK banks. There has since been a progressive shift towards bond financing, with several providers and bond aggregators tapping capital markets or raising funds through private placements.

Evolving credit profiles, driven by changing policy and regulatory frameworks

Government rent policies play a central role in HAs' business planning and revenue predictability and have therefore strongly affected their business models and risk profiles. A recent example is the unexpected revision in 2016 of the 10-year plan for rent increases agreed in 2013, requiring rents to fall by 1% each year to 2020[1]. HA's were, however, able to adjust their operations and business plans to ensure financial covenants were still achieved.

Figure 4. HA investment expenditure by funding source
GBP bn (LHS); % of total (RHS)



Source: UK Housing Review 2021, Scope Ratings GmbH

Business models increasingly exposed to market risks

The funding shift towards debt has also prompted HAs to move away from their traditional business models, albeit concentrated on the larger HA's. Declining grant funding alongside welfare reforms such as rent cuts has underpinned the need among providers to save costs, improve efficiency and widen operating margins. It has also underpinned the expansion of HAs into non-social housing activities such as market sales and private rentals to diversify revenue streams and cross-subsidise social housing development. HAs receiving a greater share of revenues from non-social-housing activities are more sensitive to business cycles.

Regulatory framework does not stand still

Responding framework has become more complex

HAs' changing business models have also led to a more complex operating and regulatory environment. The transition to new funding regimes has underpinned the operational and financial sophistication of HAs and fostered their preparedness to cope with shocks, which highlights the strong interplay between changes in the institutional framework and the stand-alone credit profiles of HAs.

Robust regulatory standards support sector resilience

The regulatory framework for social housing providers is important in ensuring the sector's viability by supporting the provision of good-quality and well-managed social housing. The Regulator of Social Housing in England has adopted a proactive, risk-based approach to enforcing its comprehensive economic and governance standards (**Figure 5**). Monitoring includes collection of programmed data returns and 'in depth assessments', which examines in detail the financial and operations of HA's including the way in which they are stress testing and scenario planning. A strong regulatory framework with comprehensive standards and robust oversight mechanisms are critical for the financial resilience, good governance and risk containment across England's social housing sector.

[1] See the Welfare Reform and Work Act 2016.

Figure 5. Overview of the Regulator of Social Housing's regulatory standards

Name of standard	Type	Requirement
Governance and Financial Viability	Economic	Effective organisational governance and resource management
Value for Money	Economic	Ensure assets and resources deliver best value
Rent	Economic	Setting and charging rent in line with government regulations
Tenant Involvement and Empowerment	Consumer	Landlords should provide choice and effective communication to tenants, including complaint handling
Home	Consumer	Ensure homes are safe, decent and in good repair
Tenancy	Consumer	Letting homes in a fair, transparent and efficient way
Neighbourhood and Community	Consumer	Keeping the wider area clean and safe, promoting wellbeing and tackling anti-social behaviour

Source: Regulator of Social Housing, Scope Ratings GmbH

Strong statutory powers and record of proactive intervention

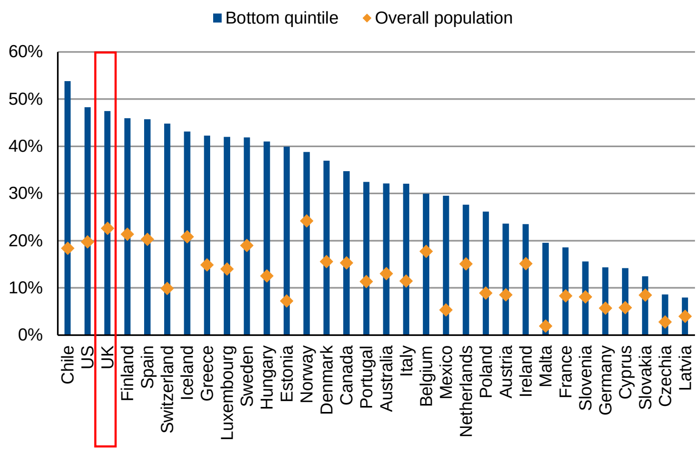
The statutory powers of the Regulator of Social Housing, combined with its record of early and proactive intervention upon a standards breach, provide an important backstop in avoiding severe financial distress and consequent reputational damage for the sector. The regulator will work with the HA to resolve problems, but if that fails, it does have the powers to appoint board and/or managers. Sometimes finding a partner HA is the answer and, we note that no funder has faced a loss to date. More recently a Special Administration regime has been enacted to aid HA's in the worst financial circumstances and as part of that regime emergency funding can be sourced.

England's institutional framework today

Social housing is a critical policy topic in England

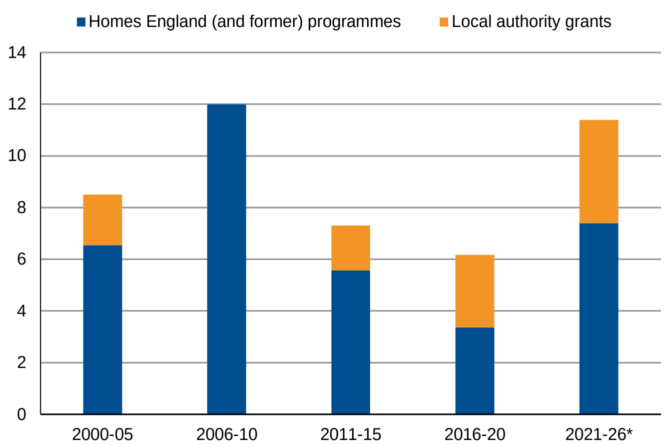
Social housing is increasingly prominent in policy debates around the rising unaffordability of housing in England. This is a result of: i) declining government investment over the last decade; ii) demographic trends that have increased housing demand, such as population growth and longer life expectancy; and iii) the rapidly rising prices of land and ownership compared with the moderate growth in wages, with the cost of land pushing up the cost of building new homes. The UK is among the OECD countries with the largest affordability challenges in the private rental market (**Figure 6**). The Covid-19 pandemic reinforced the critical role of social housing in providing stable, safe and affordable accommodation.

Figure 6. Housing cost overburden rate for private rents
% of total population



Note: The housing cost overburden rate is equal to the share of the population spending more than 40% of disposable income on rent
Source: OECD, Scope Ratings GmbH

Figure 7. Capital grant funding for English HAs
GBP bn



Note: 2021-26 figures also include funding made available to non-HA providers
Source: Housing Review 2021, Homes England, MHCLG, Scope Ratings GmbH

Rising housing affordability and availability challenges…

In the past four decades, house prices in the UK have grown faster than in any other G7 country. Home ownership has fallen for more than a decade after rising for most of the past century. In the UK, average house prices have risen by more than 250% in real terms over the last 20 years compared with 60% for wages. New entrants to the property market, whether buying or renting, face escalating affordability issues and in response the Government has instigated schemes to help people onto the property ladder. Over the coming decade up to 145,000 new social homes yearly will be needed to meet housing needs and lower housing costs.

…translate into greater support for the sector

In this context, popular and political support for the sector has grown. In 2018, a UK government green paper outlined its ambitions for social housing. Targets include the construction of 300,000 new homes yearly by the mid-2020s, the empowerment of tenants, and improvements in the quality and safety of social housing. In 2020, the government pledged GBP 11.4bn towards the Affordable Homes Programme over 2021-26, up from the GBP 6.2bn disbursed over 2016-20 (**Figure 7**) and reversing the declining trend in funding since 2009. In addition, the government announced an additional GBP 3bn for the Affordable Homes Guarantee Scheme, supporting HAs' access to low-cost funding. Finally, HAs' revenues and business planning will get a boost from a new policy allowing rent increases to be linked to the consumer price inflation plus 1% for at least five years.

English social housing sector challenges

Covid-19 a near-term challenge…

HAs are facing a wide range of challenges (**Figure 8**). HA's have mobilised efforts to deal with the consequences of Covid 19, with a focus on ensuring gas safety checks were kept on schedule and delivering emergency repairs while containing an increase in arrears and voids. The sector demonstrated its resilience, with the long-term impact on financial sustainability being limited thus far (see **next section**). Though the government has lifted restrictions, new virus variants could result in the pandemic's fallout being more severe and longer than currently anticipated.

Figure 8. Important challenges faced by English social housing sector

Challenge	Analytical rationale
Covid-19	Emergence of new variants could delay the transition to regular operations (e.g. property maintenance), continue to constrain market sale activity and worsen arrears.
Politics and regulation	Increased government and regulatory focus on the safety, quality and energy efficiency of housing is putting upwards pressure on costs though also supporting asset quality.
Development risks	Competing priorities such as fire safety and decarbonisation costs further impact development budgets.
Debt finance	Higher-than expected debt increases could lead to falling liquidity and weaker debt metrics.
Brexit	Risk of increasing worker shortages and labour costs and additional checks of materials coming from Europe could lead to delays in developments.

…longer-term pressures due to institutional framework…

The institutional framework also puts pressure on HAs. Even with increased public funding and higher rents, debt financing of investments is set to remain a key feature of the sector. Increased government and regulatory focus on the safety and quality of housing following the Grenfell Tower fire, as well as energy efficiency considerations, is putting upwards pressure on costs. On the other hand, it also supports asset quality, reduces operating and reputation risks, and underpins the sector's credentials regarding environmental, social and governance (ESG) aspects. In any case, the increased costs are constraining development priorities: several providers have either scaled back development plans to allocate more resources to existing stock or increased projected debt funding.

…and Brexit-related bottlenecks

Social housing providers are also facing increased maintenance and development costs.

Brexit is expected to result in a reduced labour force for construction plus an additional administrative burden on imports, combined with volatile prices on key commodities, such as timber, which is expected to squeeze margins and delay construction.

England's social housing sector remains resilient

HAs benefit from stable and predictable cash flows

HAs benefit from strong and predictable cash flow from their social rented properties, which are largely secured by state-provided housing benefits. This limits any rise in unpaid rents in an economic downturn, as seen throughout the pandemic. In addition, the sector benefits from the countercyclical nature of its services, with demand for social housing increasing when economic conditions worsen. This, combined with the substantial backlog for affordable housing, results in stable and predictable cash flows on HAs' core business.

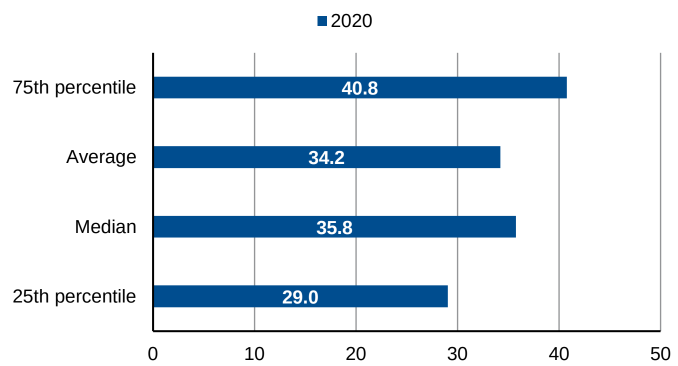
Comfortable profitability

A weaker economic climate has led to a slight uptick in arrears, voids and lower market sales, but general needs housing give HA's a foundation of comfortable profitability and high underlying demand for social housing will support consistently strong operating cash flows. Inflation-linked rent increases should provide a natural hedge against increased maintenance and development costs, thus keeping sector margins comfortable. EBITDA margins averaged 34% in 2019/20 and stood at over 29% for three of the four HAs (**Figure 9**).

Proven resilience to Covid-19 shock

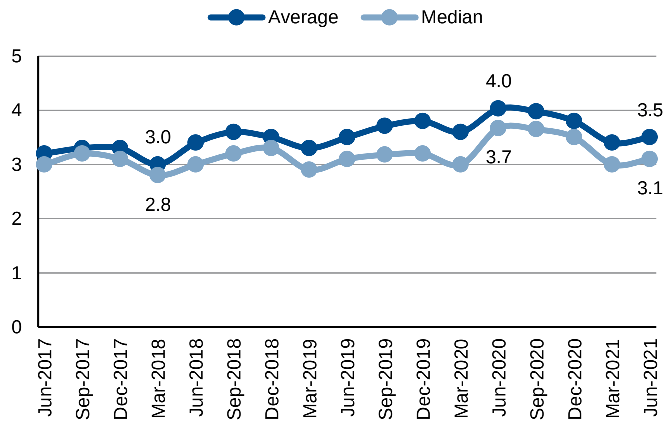
The Covid-19 crisis constituted an important stress test. Models assumed dire economic conditions including a rapid growth in unemployment which was expected to put extreme strain the UK social benefit system resulting in escalating arrears, while HA's still bleed cash for property under development combined with a cessation of property market. The sector remained resilient despite the adverse economic conditions thanks to strong government support and proactive action by providers. Arrears did see a minor uptick at the beginning of the pandemic, but they have since returned to pre-pandemic levels, averaging 3.5% of rental income in June 2021 (**Figure 10**).

Figure 9. EBITDA margins
% of total turnover



Source: UK Regulator of Social Housing, Scope Ratings GmbH

Figure 10. Current tenant arrears
% of rental income



Source: UK Regulator of Social Housing, Scope Ratings GmbH

The UK Government instituted a furlough scheme to support employment through the crisis, which aided social welfare system in coping with those who did lose their jobs early on. Delays in instigating benefit payments was thus ameliorated and reduced the pressure on rents arrears.

The crisis also demonstrated the proactivity and reactivity of the Regulator for Social Housing through its close monitoring of the sector. In addition to its usual quarterly financial reports, the regulator conducted monthly Covid-19-related surveys to better understand the sector's operational challenges in key areas such as staffing, emergency repairs, and gas and fire checks. Feedback led to a temporary reduction in the regulatory burden on registered providers, through deadline extensions or increased flexibility in reporting requirements. It also allowed the regulator to provide guidance to HAs throughout the pandemic.

Regular stress testing crucial in ability to respond to shocks

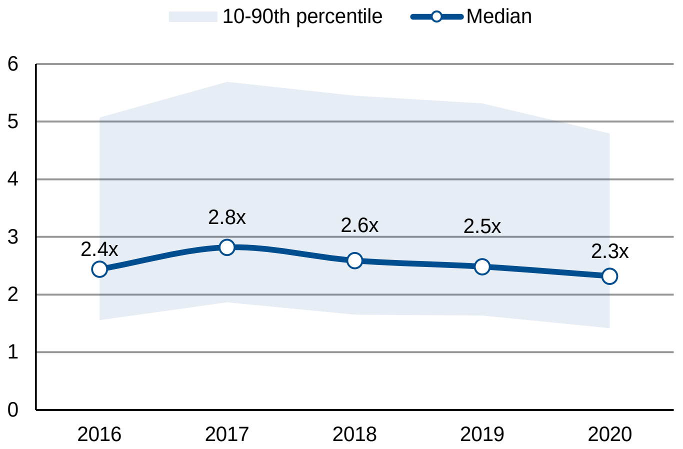
The English regulator sets out strong stress-testing requirements for providers. Boards must design scenarios that allow them to assess the resilience of their business plans and financial position as part of its risk management policy. This requirement was reinforced in the lead up to Brexit, with providers having to consider the Bank of England's EU withdrawal scenarios when conducting stress tests. Though Brexit's immediate impact on the sector was moderate, this exercise gave providers clear visibility on their risk exposure and prepared them well for adverse conditions, such as the one relating to the pandemic. Regulatory requirements proved critical in underpinning the sector's robustness to the Covid-19 crisis and have improved the ability of providers to respond to future shocks.

Fluid access to private finances and robust liquidity positions

The Covid-19 crisis has also confirmed the resilience of the sector's access to funding. New credit facilities agreed in 2020 peaked at GBP 14.5bn, from GBP 12.4bn in 2019, reflecting robust investor demand for HA debt. Access to external borrowing will remain fluid for the sector overall, with the investor base to increasingly diversify on the back of strong and rising demand for HA debt and the sector's strong ESG credentials.

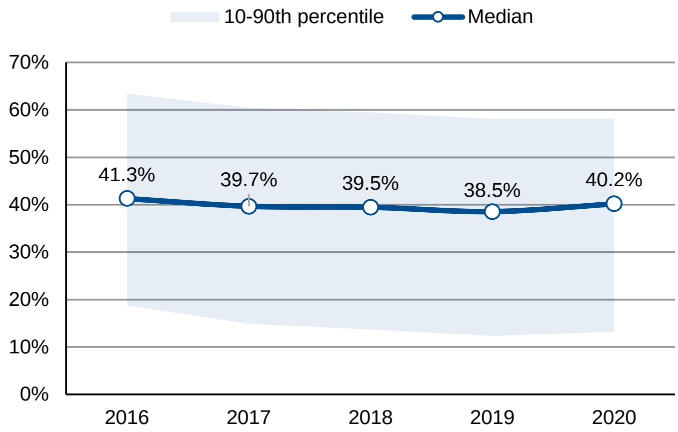
The sector maintains comfortable liquidity buffers, supported by prudent liquidity management and good access to private financing. Total cash and undrawn facilities available within the sector totalled GBP 35bn, enough to cover interest payments, loan repayments and net development costs for the next year, even in the absence of new debt facilities or sales income.

Figure 11. EBITDA-interest cover ratio



Source: UK Regulator of Social Housing, Scope Ratings GmbH

Figure 12. Debt-to-adjusted assets
% of adjusted assets



Source: UK Regulator of Social Housing, Scope Ratings GmbH

Low-risk debt profiles overall

Though the sector's average debt profile has deteriorated during the crisis, mostly due to the maturity of the Covid Corporate Financing Facility loans, but the overall maturity profile remains favourable, with 80% of debt maturing in more than five years' time. In addition, 77% of the sector's outstanding debt is fixed rate, with 57% fixed maturities over 10 years, providing HAs with good visibility over future borrowing costs.

Moderate debt burdens and low interest costs give room for additional borrowing

The sector's debt levels remain moderate and pose no affordability problems overall thanks to comfortable albeit declining EBITDA-interest cover ratios (**Figure 11**). Steady surpluses from core activities including social housing lettings and favourable funding rates will support a stabilisation of interest cover ratios moving forward. At the same time, leverage, measured by Scope's debt-to-adjusted assets ratio, is set to remain at manageable levels (median of around 40%, **Figure 12**). This should give HAs room to absorb the additional debt needed to finance important capitalised repairs and rising maintenance costs over the coming years.

Strong governance a critical driver of credit resilience

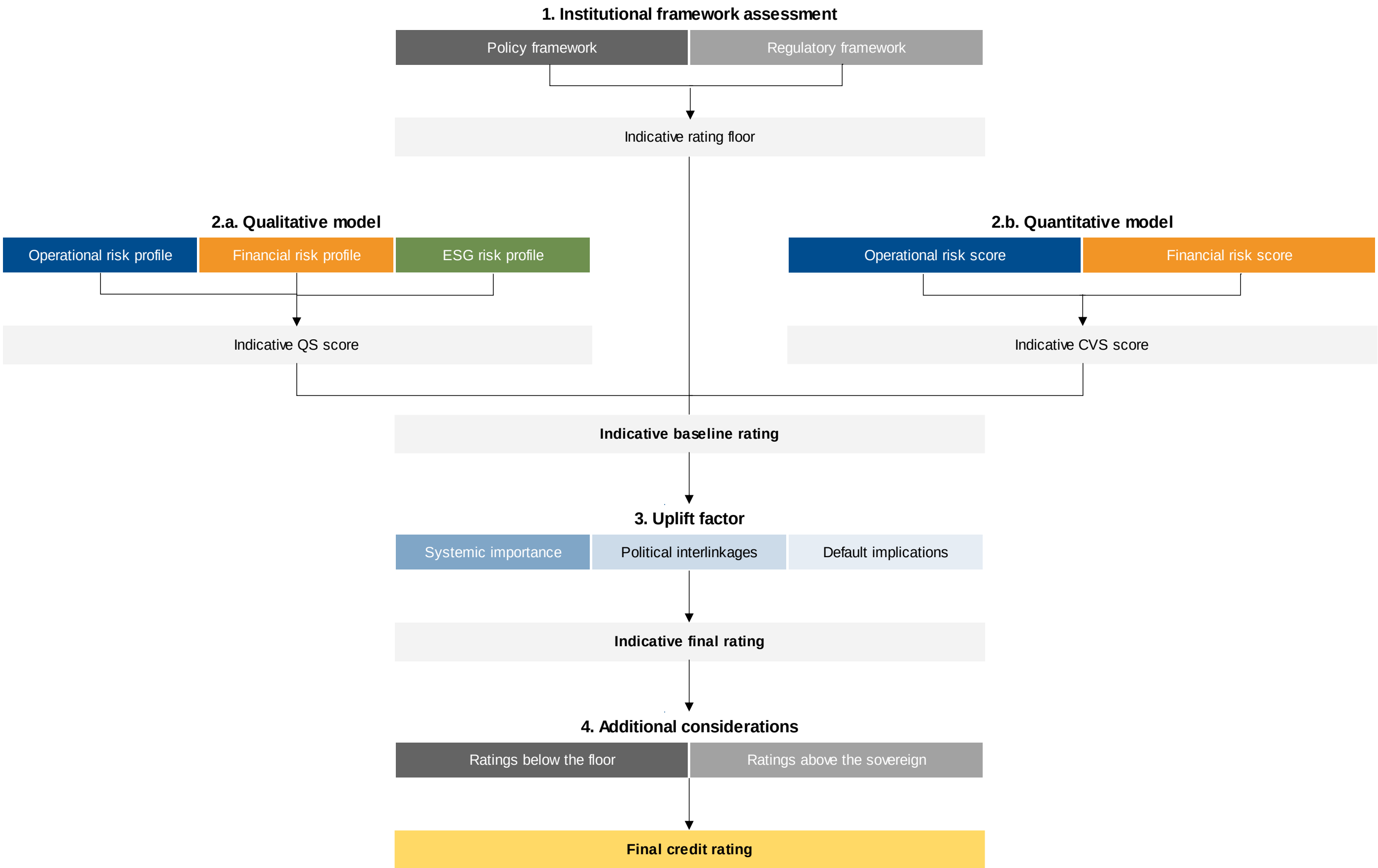
The sector's proven ability to react to changes in the operating environment is a key credit strength, as demonstrated by the HAs' capacity to mitigate the operational disruptions caused by the Covid-19 crisis and adapt their strategies to changing government policies. In addition, HAs' strong governance, supported by the regulatory framework, underpins our view of the sector's resilient credit quality despite notable short- and long-term challenges.

Appendix I. Overview of Scope's UK Social Housing Providers Rating Methodology

Our rating approach under our UK Social Housing Providers Rating Methodology is split into four fundamental steps:

- As the first step, we assess the supportiveness of the policy and regulatory frameworks under which social housing providers operate, recognising that both can evolve over time. This determines an indicative rating floor, which can differ across the four countries in the UK given that housing is a devolved function.
- The second step, which includes a dual quantitative-qualitative analysis of a non-profit social housing provider's stand-alone credit profile combined with the indicative rating floor, results in an indicative baseline rating.
- The third step is an uplift factor used to derive the final credit rating, which accounts for the UK sovereign's capacity and willingness to support individual providers.
- The last step considers additional factors such as those that could adjust the credit rating lower should a provider face acute distress as well as exceptional conditions under which a provider could be rated above the UK sovereign.

Figure 13. Overview of Scope's UK social housing approach



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