



## CIH Briefing

### HCA Consultation on changes to the Regulatory Framework

#### 1. Introduction

- 1.1. Following responses to its April 2013 [discussion paper](#), the HCA has now issued a consultation paper on its proposed changes to the regulatory framework. Changes are limited to what is required to best achieve the aims of ongoing protection of social housing assets and investment. In particular the HCA have replaced the proposal for a ring fence for social housing assets with a stronger risk assessment/ management approach. Measures include requiring a clear and robust recording mechanism of social housing assets and liabilities as part of effective risk management, and to facilitate any action required by the regulator in response to any significant problems in the social housing sector.

#### 2. CIH initial response

- 2.1. CIH's response to the 2013 discussion document acknowledged the changed context in which registered providers are operating and the need for robust processes to identify, manage and mitigate risks. However, we were concerned that the proposed measures such as the ring fence were likely to be overly restrictive and remove the flexibilities of providers to achieve their objectives, and took a blanket approach that did not necessarily work with the range of organisations' structures, sizes and functions.
- 2.2. We are therefore pleased that the HCA has made changes to the proposed framework. We believe that the framework needs to be clear on appropriate actions and levers required to address the different challenges of diversity in the sector, for example, for non-profit registered providers engaging in non-core activities, and for profit-making registered providers with different structures and imperatives.
- 2.3. We are keen to hear from members:
  - Whether the changes identify and address the different types of registered providers and diversity of activities appropriately.
  - If the framework's focus on identifying, managing and mitigating risk is suitable and flexible enough to achieve the aims of protecting social housing assets whilst supporting continued innovation and service development.
  - If the provisions are reasonable and support the regulator's intervention as necessary?
  - If not, what are the particular aspects that cause concerns?
  - And how might the framework be refined to support these objectives?
- 2.4. A more detailed summary is below. **Please give comments and feedback to [sarah.davis@cih.org](mailto:sarah.davis@cih.org) by 21 July.**

### **3. Summary of proposed changes**

- 3.1. The aim of the changes is to protect social housing assets and public investment in those assets in a changing context of reductions in grant levels, changes in housing and financial markets, challenges from welfare reform, and diversification of both the nature of registered providers (for profit and non-profit) and the range of activities they undertake.
- 3.2. The framework is seeking both to drive effective management of risk by organisations, as well as supporting effective intervention when required by the regulator, to ensure that public investment in social housing assets are secured and used for public benefit.
- 3.3. The HCA is also consulting on a draft code of practice. This is not intended as a requirement but to explain and expand on complex issues, to support registered providers to comply with the standard. The regulator will enforce against the standard not the code.

#### *Changes to governance and financial viability standards*

- 3.4. The framework brings together the governance and financial viability standards into one for clarity and to avoid duplication, although the regulator will continue to publish separate judgements.
- 3.5. In keeping with the co-production approach to regulation, the framework and the accompanying code focus on the outcomes required rather than setting out processes.
- 3.6. Required outcomes from governance arrangements are expected to ensure that registered providers:
  - Adhere to all relevant law (expanded from all relevant legislation)
  - Comply with their governing documents and all regulatory requirements
  - Are accountable to tenants, the regulator and relevant stakeholders
  - Have effective risk management and internal controls assurance
  - Safeguard taxpayers' interests and the reputation of the sector
  - Protect social housing assets.
- 3.7. For financial viability the required outcome is that resources are managed effectively to ensure that viability is maintained, while ensuring that social housing assets are not put at undue risk.
- 3.8. Registered providers need to ensure that they have the right skills and capacity to manage risk effectively, across the range of activities undertaken. It will be a formal requirement in the standard for registered providers to adopt and demonstrate compliance with an appropriate code of governance.
- 3.9. The regulator expects boards of registered providers to act independently of parent/ other parts of the organisation, except for other non-profit entities in the same group. The code provides further illustration of how to ensure skills and strong governance, for example through the recruitment of independent board members.
- 3.10. Registered providers must have appropriate mechanisms to ensure that social housing assets are effectively protected and manage risk. This includes:
  - Ensuring sufficient liquidity at all times
  - Appropriate and reasonably based financial forecasts
  - Effective systems to monitor and report on delivery of plans
  - Monitoring, reporting and complying with funders' covenants.

- 3.11. The framework should be reviewed every year.
- 3.12. Registered providers will be required to maintain a thorough and up to date register of their assets and liabilities, including where liabilities have recourse to social housing assets.
- 3.13. This should be broken down by business streams, and ensure social housing assets are separately identified. This will support both effective risk management and any interventions required by the regulator in a failure situation.
- 3.14. Registered providers must apply effective stress testing against identified risks and combinations of risks and cumulative impacts to ensure they have appropriate strategies to mitigate, and to ensure they know and can manage any impacts when taking on new liabilities.
- 3.15. Where registered providers enter into arrangements with third parties, actions should further their own objectives, not those of the third party. This is not intended to restrict benefits to the third party but to ensure social housing assets are not at undue risk.
- 3.16. Registered providers are required to communicate with the regulator in a timely and accurate manner. They should assess and report on how well they are complying with the governance and financial viability standard at least once a year. To ensure transparency, they must certify compliance, or otherwise, in the annual accounts.

#### *Section 2 requirements*

- 3.17. Profit-making registered providers are required to undertake their social housing activities in a legally and operationally separate entity. This lowers risks to social housing assets, and allows boards of the registered provider to manage risks for social housing assets effectively. It enables the regulator to have complete oversight of the relevant functions under its remit and the ability to intervene effectively where necessary, and provides transparency for other stakeholders.
- 3.18. Where other activities are undertaken these must form only a small part of activities – set in the code at 5% of capital or turnover - and must not place their own financial viability at risk nor risk the activities relating to or the provision of social housing.
- 3.19. Where the parent company is not a registered provider, and therefore the regulator does not have oversight, the registered provider should not support the activity of parent or other group member where it might have detrimental impacts on the social housing assets.
- 3.20. Mechanisms must be in place to ensure that the registered provider can comply with the standards, with appropriate support or assistance from non-registered parent company.

#### *Category 6 consent*

- 3.21. This allows non-profit registered providers to grant a security interest over a social housing dwelling to a private finance provider under certain conditions. Proposed changes to this include that:
  - It cannot be used for lending between otherwise unrelated registered providers
  - It is not open to registered providers with a non-registered parent
  - On-lending to profit-making or non-registered bodies within groups can only be for social housing purposes and only to group members operating in England

- It cannot be used to secure finance on an index-linked basis.
- 3.22. The changes do not preclude such activities but require specific consent and enable closer oversight by the regulator.

#### *Changes to disposals*

- 3.23. Changes to this standard are proposed to ensure that the regulator protects social housing assets, including latent value released on disposal.
- 3.24. Diversification within the sector means gains from social housing assets could be used for a wide range of purposes. The regulator aims to ensure that these gains are used to protect social housing assets and their value.
- 3.25. Cross subsidy within non-profit registered providers is usually directed at other social purposes in line with their objectives, and consistent with the consumer objective of the regulator. No further restrictions are therefore planned on use of disposal proceeds by non-profit registered providers.
- 3.26. Restrictions are proposed over the disposal of assets from non-profit or local authority registered providers to profit-making registered providers, to control potential loss of assets.
- 3.27. This is not to intervene in the organisations' ability to generate profits through management efficiencies. It will only apply to stock that originated from non-profit or local authority registered providers, not from stock built by the profit-making registered provider or acquired from outside the social sector.
- 3.28. The regulator will require proceeds from these sales to be placed in a Disposal Proceeds Fund (DPF). This must be done for all subsequent disposals of that property. This includes:
- Disposal of any interest in the property with the exceptions of granting of assured tenancies
  - Disposal to any purchaser, including sitting tenants, is included
  - All net proceeds will be placed in DPF, for simplicity and to ensure transparency
  - Deductions will include only reasonable costs of the transactions such as legal and valuations fees.
- 3.29. Private registered providers will, in agreement with the regulator and investment agencies, plan for spending the proceeds in DPF within a three year time limit.
- 3.30. The aim is that both non-profit and for-profit registered providers will use the monies for building, acquiring or refurbishing properties for social or affordable rent.
- 3.31. Only proceeds from shared ownership sales (by stair-casing or sale of provider's equity onto another party) may be used to build or acquire new shared ownership housing.
- 3.32. Where private registered providers have received stock from local authorities in a transfer, when the preserved right to buy is exercised, proceeds from those sales must be placed into the DPF. Permitted deductions will include net present value of rent forgone as well as transaction costs of sale.

#### *Changes to registration criteria*

- 3.33. The key change proposed to registration criteria is concerned with compliance with the governance and financial viability standard. Previously organisations wishing to register had to comply with the standard on financial viability but could

be on a 'reasonable path' to meeting governance requirements.

3.34. As these are now one standard, an organisation must meet both elements at the point of registration and demonstrate ongoing compliance.

*Changes to the rent standard*

3.35. The proposed changes to this standard are required to reflect the new direction from the Secretary of State in May 2014, specifically:

- The guideline limit for rent increases changed to CPI+1%
- Ending the upward rent convergence (the additional £2 per week previously allowed)
- Permitting higher rents to be charged to social tenants with household incomes above £60,000 ('pay to stay').

3.36. A 5% upward tolerance for individual rents or 10% for supported and sheltered housing rents is allowed subject to the maximum rent levels in guidance (rent caps). Rent caps are to increase annually by CPI +1.5%.

3.37. Affordable rents (inclusive of service charges) are to be set differently, at a level which is no more than 80% of market rent, and increases are to be by an amount that is no more than CPI+1%.

3.38. Where compliance with the rent standard would impact on the ability to comply with other standards, notably financial viability, the regulator may agree to waive the specific requirements of the rent standard for a period of time.