Regulator of Social Housing

Value for Money metrics

Technical note feedback and response

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1. Introduction

1.1 Alongside the Consultation on the revised changes to the Value for Money (VfM) Standard[1], the Regulator of Social Housing published a technical note[2] that set out proposals on seven metrics with which to measure economy, efficiency and effectiveness on a comparable basis across the sector. It also asked for feedback on the selection of metrics and their measurement.

1.2 We received 84 responses to the metrics technical note. These were broadly favourable to the proposed set of metrics. A number of common themes in the responses echoed those in the replies to the statutory consultation on the VfM Standard and Code which have been addressed in the accompanying Decision Statement on the VfM Standard and Code.

2. Feedback received on the VfM metrics

2.1 Overall, the regulator has concluded that the proposed metrics remain broadly the most appropriate set of measures to capture performance across the sector in a fair and comparable way. However, we received a wide range of valuable feedback on the detailed design of the measures and have made a number of changes to our proposals in order to reflect some of the refinements suggested by respondents. We have also made a small number of additional changes to reflect the latest FRS102 reporting requirements.

2.2 In reviewing responses to the technical note, the regulator has been guided by the need to ensure that the final measures permit meaningful comparison across the sector as a whole, and with the aim of minimising regulatory burdens on providers.

3. The changes to the metrics suite

3.1 Four VfM Metrics have been refined. They are as follows:

- New Supply Delivered %
- Gearing %
- Headline social housing cost per unit
- Operating Margin %.

[1] https://www.gov.uk/government/consultations/consultation-on-the-value-for-money-standard
[2] https://www.gov.uk/government/publications/value-for-money-metrics-technical-note

New Supply Delivered %

3.2 The regulator originally proposed that the New Supply metric should set out the number of new social housing and non-social housing units that have been acquired or developed in the year as a proportion of total social housing units and non-social housing units managed at period end. The denominator of the New Supply metric has now been changed to **Units owned** so that the outputs provide a fairer reflection of a provider’s delivery in the context of their existing asset base. To facilitate this change, from 2018 onwards the regulator has changed the FVA template so that providers identify owned and managed stock separately.

New Supply Delivered – (Non-social housing units)

3.3 We have made a minor amendment to the denominator of the New Supply (non-social housing) metric which now captures new supply non-social housing (in-year) – the numerator – as a percentage of the total asset base (units owned) – the denominator. We have changed the denominator in this metric from the previously published version. The denominator will not include the outright sale period end data given that this stock is held for sale and therefore does not constitute a long term part of the provider’s asset base. New supply for outright sale will still feature in the numerator. This change will make the metric more consistent with the calculation of the New Supply Delivered (Social Housing units) version of this metric, with the distinction that the denominator of the non-social housing version will also include non-social housing units (other than those for outright sale) held at period end (e.g. market rent properties).

Gearing %

3.4 We recognise that there is a wide variety of different gearing measures in use across the sector; different organisations will use different metrics to reflect the nature of their business and their existing loan covenants. This variety was reflected in the range of feedback that the regulator received on this metric. In order to reflect the growing number of providers who operate through the capital markets in which to access funding, the regulator intends to change the measure of gearing that we originally proposed so that gearing will be measured on a **net debt** basis. This will provide a more meaningful measure of the financial position of the significant minority of providers who have recently raised funding from the capital markets and therefore hold a significant amount of cash, in preparation for a range of investment programmes.

Headline social housing cost per unit

3.5 The headline social housing cost per unit was previously calculated on the basis of units in management at period end. The denominator of headline social housing cost per unit metric has now changed and will be based on a measure of **Units owned and/or managed**. This will mean a closer alignment between the costs that a provider incurs and the number of properties to which these costs relate. It should produce a more relevant measure for the minority of providers where there is a big mismatch between the number of units that they own and those that they manage. Associated with the change to the denominator, **leasehold units** (non-Low Cost Home Ownership leasehold units which include Right to Buy (RTB) and fully stair-cased shared ownership units, where the provider retains the freehold, will be excluded from the denominator.

Operating Margin %

3.6 In line with the reporting requirements to FRS102, the Operating Margin metric will now include an adjustment that requires providers to deduct the gain/(loss) on disposal of fixed assets from the operating surplus. By excluding potential volatile income from fixed asset sales, the adjustment will help identify more clearly the ‘core’ profitability and efficiency of an organisation.

4. Reporting expectations

4.1 In line with the principles of the revised VfM Standard, providers are expected to report their performance against these metrics in their annual accounts. We have selected the metrics that feedback suggests would work for the majority of providers. However, we acknowledge that any metric, however calculated, will inevitably be more appropriate for some providers than others, and there may be a minority of cases where reporting on a particular basis is difficult, or inappropriate, given the unusual nature of a given organisation’s business or differences in accounting practice.

4.2 We cannot change the required metrics on this basis, where it works for the majority of the sector. However, where a provider’s reported data is affected by a factor particular to that organisation they should clarify this in the commentary accompanying the publication of their data.

4.3 More detail of the regulator’s approach to regulating VfM, including use of the metrics, is set out in Regulating the Standards[3].

[3] https://www.gov.uk/government/publications/social-housing-regulation-regulating-the-standards

5. The Value for Money metrics

(Value codes[4]: Negative, Positive, Either)

Metric 1 – Reinvestment %

5.1 This metric looks at the investment in properties (existing stock as well as New Supply) as a percentage of the value of total properties held[5].

Measurement of VfM Cost Chain – Efficiency

[Properties Acquired (total housing properties)

+ Development of new properties (total housing properties)

+ Works to Existing (total housing properties)

+ Capitalised Interest (total housing properties)

+ Schemes completed (total housing properties)]

Divided by

[Tangible fixed assets: Housing properties at cost (Period end)

/ Tangible fixed assets: Housing properties at valuation (Period end)]

[4] Codes indicate where values are anticipated to be entered as positive, negative or of either value in the FVA. For some fields the FVA will allow users to enter a different value to that anticipated.

[5] This metric is not based on cashflow data given the limitations on data collected as part of the FVA regulatory return.

Metric 2 – New supply delivered %

5.2 The New supply metric sets out the number of new social housing and non-social housing units that have been acquired or developed in the year as a proportion of total social housing units and non-social housing units owned at period end.

5.3 Registered providers will report on two New supply delivered ratios:

A. New supply delivered (Social housing units)
B. New supply delivered (Non-social housing units)

Measurement of VfM Cost Chain – Effectiveness

A. New supply delivered (Social housing units)

[Total social housing units developed or newly built units acquired in-year (owned)

(Social rent general needs housing (excluding Affordable Rent), Affordable Rent general needs housing, social rent supported housing and housing for older people (excluding Affordable Rent), Affordable Rent supported housing and housing for older people, Low Cost Home Ownership, care homes, other social housing units, Social leasehold)]

Divided by

Total social housing units owned at period end ('social units' as defined in numerator)

Measurement of VfM Cost Chain – Effectiveness

B. New supply delivered (Non-social housing units)

[Total non-social units developed or newly built units acquired in-year (owned)

(Total non-social rental housing units owned, non-social leasehold units owned, New outright sale units developed or acquired)]

Divided by

[Total social housing units owned (period end)

+ Total non-social rental housing units owned (period end)

+ Social leasehold units owned (period end)

+ Non-social leasehold units owned (period end)]

Metric 3 – Gearing %

5.4 This metric assesses how much of the adjusted assets are made up of debt and the degree of dependence on debt finance. It is often a key indicator of a registered provider's appetite for growth.

5.5 **Note:** Registered providers can be restricted by lenders' covenants and therefore may not have the ability in which to increase the loan portfolio despite showing a relatively average gearing result.

Measurement of VfM Cost Chain – Efficiency

[Short-term loans

+ Long term loans

- Cash and cash equivalents

+ Amounts owed to group undertakings

+ Finance lease obligations]

Divided by

[Tangible fixed assets: Housing properties at cost (Period end)

/Tangible fixed assets: Housing properties at valuation (Period end)]

Metric 4 – Earnings Before Interest, Tax, Depreciation, Amortisation, Major Repairs Included (EBITDA MRI) Interest Cover %

5.6 The EBITDA MRI interest cover measure is a key indicator for liquidity and investment capacity. It seeks to measure the level of surplus that a registered provider generates compared to interest payable; the measure avoids any distortions stemming from the depreciation charge.

Measurement of VfM Cost Chain – Efficiency

[Operating surplus / (deficit) - (overall)

- Gain/(loss) on disposal of fixed assets (housing properties)

- Amortised government grant

- Grant taken to income

+ Interest receivable and other income

- Capitalised major repairs expenditure for period

+ Total depreciation charge]

Divided by

[Capitalised interest in housing properties

+ Interest payable and financing costs]

Metric 5 – Headline social housing cost per unit

5.7 The unit cost metric assesses the headline social housing cost per unit as defined by the regulator. The cost measures set out in the metric are unchanged from the metric used in the regulator's 2016 publication Delivering better value for money[6] However, the denominator has been changed **from units managed to units owned and/or managed.**

Measurement of VfM Cost Chain – Economy

[Management costs

+ Service charge costs

+ Routine maintenance costs

+ Planned maintenance costs

+ Major repairs expenditure

+ Capitalised major repairs expenditure for period

+ Other (social housing letting) costs

+ Development services[7]

+ Community / neighbourhood services

+ Other social housing activities: Other (operating expenditure)

+ Other social housing activities: charges for support services (operating expenditure)]

Divided by

Total social housing units owned and/ or managed at period end[8]

(Social rent general needs housing (excluding Affordable Rent), Affordable Rent general needs housing, social rent supported housing and housing for older people (excluding Affordable Rent), Affordable Rent supported housing and housing for older people, Low Cost Home Ownership , care homes, other social housing units)

6 https://www.gov.uk/government/publications/delivering-better-value-for-money-understanding-differences-in-unit-costs

7 Accounting Direction 2015 requires material items of social housing activity to be separately identified. Since we published the Headline social housing cost per unit definition, the 'Other social housing activities - Other' line included within the measurement, has been disaggregated. This will enable stakeholders to distinguish costs incurred for activities such as Development services and Community services while maintaining a comparable headline social housing cost.

8 Leasehold units which for example include Right to Buy and fully stair-cased shared ownership units where the provider retains the freehold are excluded from this definition.

Metric 6 – Operating Margin %

5.8 The Operating Margin demonstrates the profitability of operating assets before exceptional expenses are taken into account. Increasing margins are one way to improve the financial efficiency of a business. In assessing this ratio, it is important that consideration is given to registered providers' purpose and objectives (including their social objectives). Further consideration should also be given to specialist providers who tend to have lower margins than average.

Registered providers will report on two Operating Margin ratios:

A. Operating Margin (social housing lettings only)

B. Operating Margin (overall)

Measurement of VfM Cost Chain – Efficiency

A. Operating Margin (social housing lettings only)

[Operating surplus / (deficit) from social housing lettings– Gain/(loss) on disposal of fixed assets (housing properties)]

Divided by

Turnover from social housing lettings

Measurement of VfM Cost Chain – Efficiency

B. Operating Margin (overall)

[Operating surplus / (deficit) - (overall)

– Gain/(loss) on disposal of fixed assets (housing properties)]

Divided by

Turnover (overall)

Metric 7 – Return on capital employed (ROCE)

5.9 This metric compares the operating surplus to total assets less current liabilities and is a common measure in the commercial sector to assess the efficient investment of capital resources. The ROCE metric would support registered providers with a wide range of capital investment programmes.

Measurement of VfM Cost Chain – Efficiency

[Operating surplus / (deficit) - (overall)

(including gain / (loss) on disposal of fixed assets (housing properties)

+ Share of operating surplus/(deficit) in joint ventures or associates]

Divided by

Total assets less current liabilities

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