



Homes &
Communities
Agency

CONSULTATION ON CHANGES TO THE REGULATORY FRAMEWORK

May 2014

Contents

	Chair's foreword	2
	Consultation statement	4
1	Introduction	6
2	Executive summary	8
3	Changes to the Governance and Financial Viability Standard	12
4	Changes to the disposals regime	28
5	Changes to the registration criteria	33
6	Changes to the Rent Standard	36

Annexes

1	Governance and Financial Viability Standard
2	Code of practice
3	Rent Standard guidance
4	General Consent
5	Other changes to the registration criteria
6	Consultation questions
7	List of statutory consultees

Chair's foreword

The social housing sector is changing rapidly. Before the credit crunch, registered providers could base their plans on substantial levels of government grant for new development, housing benefit underwriting rental income in full, and banks providing long term debt on low margins. None of those conditions apply now, and the sector is changing as a result.

Even before the credit crunch, registered providers increasingly looked at new business opportunities. For example, some built for sale on the open market to help cross-subsidise new affordable homes and to diversify tenure in neighbourhoods with high concentrations of social housing. Some organisations have a long history in care and student accommodation.

Inevitably, in a world of lower public subsidy but continuing demand for affordable housing, registered providers are increasingly looking at new opportunities for development and new ways of raising money. It is not our intention to stand in the way of independent organisations that want to be innovative in delivering their objectives, or that want to enter the market to be long term providers of new social housing.

However, as set out in our September 2013 *Sector Risk Profile*¹ document, commercial activities and new entrants also bring new risks, which need to be managed effectively. From our perspective, this must be done in a way that is consistent with our statutory objectives given to us by Parliament. We are therefore consulting on proposals to:

- **Ensure that social housing assets are not put at risk.** It is not acceptable that tenants – including some of the most vulnerable members of society – could lose the protection of being in a regulated sector as a result of poor risk management or risks from commercial parts of the business.
- **Protect the public value in the assets,** so that the subsidy provided by taxpayers is used for the purposes intended.

This consultation document follows the discussion document published in April 2013. The proposals presented in this consultation have been developed in light of the feedback received. This consultation includes proposals to revise the Governance and Financial Viability Standard to ensure that registered providers effectively manage the risks within their businesses, and have the appropriate skills and capabilities as demanded by their business. We are proposing to introduce a code of practice for the first time to give registered providers a greater understanding of what is required by the Standard. This consultation also includes proposals for changes to the consents regime to enable transactions between not-for-profit and for-profit providers in a way that protects the taxpayer and changes to the registration criteria.

¹ http://www.homesandcommunities.co.uk/sites/default/files/our-work/sector_risk_profile_2013_full.pdf

We are clear that there needs to be a step change in both our approach and the approach of providers. We are determined to ensure that the sector is on a firm footing to face the many challenges and opportunities ahead.

A handwritten signature in black ink, reading "Julian Ashby". The signature is written in a cursive style with a large initial 'J' and 'A'.

Julian Ashby

Chair, Regulation Committee

Consultation statement

Please respond by	19 August 2014
Please respond to	<p>Tim Sullivan Regulatory Framework Manager Homes and Communities Agency - The Social Housing Regulator Maple House 149 Tottenham Court Road London W1T 7BN</p> <p>Email: statutoryconsultation@hca.gsi.gov.uk</p> <p>If you would like to discuss any issue raised in this document before sending your response, please contact our Referrals and Regulatory Enquiries Team on 0300 1234 500 (option 2) who will be pleased to help.</p>
Why we are asking for views	<p>The environment in which registered providers are operating is changing. Changes to the economy and reduced availability of public funding means that the sector is having to change its business model. At the same time profit making providers have been registered. The Regulator is proposing changes to the Regulatory Framework in order that it continues to meet its statutory objectives and the Regulation Committee's aim of protecting social housing assets.</p> <p>The Regulator is also consulting on a change to the Rent Standard and guidance as a result of Direction by the Department of Communities and Local Government.</p>
What it means for you	<p>For landlords, tenants, lenders and other stakeholders who have an interest in the social housing sector, this consultation is an opportunity to influence how the Regulator will amend the Regulatory Framework.</p>
Who is being consulted	<p>Views are welcome from everyone who has an interest in the future of social housing in England. The Regulator is required to consult certain statutory organisations, which are listed in Annex 7.</p>
How we are consulting	<p>Alongside the publication of this consultation document the Regulator will continue to engage in discussions with</p>

	<p>stakeholders, including through its sounding board and advisory panels comprising providers and sector advisors respectively.</p>
<p>Taking account of your views and what happens next</p>	<p>Once the consultation has closed, the Regulator will review its proposed changes in light of the responses received from stakeholders. The Regulator will then publish a decision statement before implementing the new framework to commence in April 2015.</p>
<p>Publication of responses</p>	<p>We intend to publish all formal written responses shortly after the closing date of this consultation.</p>
<p>Freedom of Information Act 2000/Environmental Information Regulations 2004</p> <p>Data Protection Act 1998</p>	<p>The HCA is subject to the Freedom of Information Act (FOIA) and the Environmental Information Regulations 2004 (EIR). Therefore, information provided in response to this consultation may be made available in accordance with either statute.</p> <p>The HCA has a statutory obligation to respond to all requests for information. To inform our responses, we consult with third parties where applicable and appropriate. Additionally, you should indicate any areas of information that you believe are particularly sensitive when submitting your consultation response.</p> <p>Confidentiality agreements are not binding under FOIA or EIR.</p> <p>The HCA will process your personal data in accordance with the Data Protection Act 1998 and the Data Protection Principles.</p>
<p>Equalities Statement</p>	<p>The HCA is mindful of its statutory equality duties under section 149 of the Equality Act 2010. The HCA has published its equalities strategy which sets out 9 equality objectives that we are working on to deliver. This includes work to ensure that we pay due regard to equality when undertaking our Regulatory functions involving matters of serious detriment.</p> <p>The Regulator will take a proportionate approach to its equality obligations and has identified no specific equalities implications for this consultation. However, based on responses to this consultation, the HCA reserves the right to revisit these matters if new information comes to light.</p>

1. Introduction

- 1.1 In April 2013 the Social Housing Regulator (the Regulator) launched a discussion document on 'Protecting social housing assets in a more diverse sector'. The document explored whether the current Regulatory Framework needed strengthening for a sector experiencing significant changes in its core business model and diversifying into new areas, whilst at the same time new types of profit making registered provider² were emerging. The debate that followed that publication was very helpful in scoping out the range of challenges facing private registered providers of social housing. It highlighted the need for the Regulator to update its framework to ensure it delivers its statutory objectives in the changing environment.
- 1.2 In October 2013 the Regulator published the responses to the discussion document and set out the Regulator's proposed direction of travel. There was a consensus around the need for the Regulatory Framework to develop and for it to place greater emphasis on managing risks and on ensuring the protection of the social housing assets.
- 1.3 This statutory consultation, the first under the auspices of the HCA Regulation Committee, sets out the Regulator's formal proposals in the light of the responses to the discussion document. The Regulator's revised proposals attempt to strike a balance between strengthening the Regulatory Framework while minimising burdens on the sector.
- 1.4 This consultation covers the elements of the Regulatory Framework which are subject to statutory consultation. Following this consultation, the wider Regulatory Framework document will be reviewed and revised where appropriate.
- 1.5 The chapters that follow are structured as follows:
 - Chapter 2 provides an executive summary which describes the outcomes the Regulator aims to achieve through the changes proposed in this consultation.
 - Chapter 3 sets out proposed changes to the Governance and Financial Viability Standard and the Regulator's intention to introduce a code of practice. This reflects a greater regulatory focus on risk management with certain additional requirements for profit making registered providers and those whose parent is not a registered provider.
 - Chapter 4 sets out changes to the Disposal Proceeds Fund requirements to ensure that all profit making registered providers' sale proceeds derived from non-profit social housing stock are reinvested in the sector.
 - Chapter 5 sets out changes to the registration criteria to bring these into line with the proposed changes to the Governance and Financial Viability Standard.

² This document uses throughout the terms "profit making registered provider" and "non-profit registered provider" to refer to the two types of private registered provider designated in the 2008 Housing and Regeneration Act. For brevity the term "registered providers" is used where the reference is to both types of private registered providers. Where used, this term excludes local authority registered providers. Where the document uses the term "the non-profit sector" this indicates both non-profit private registered providers and local authority registered providers.

- Chapter 6 sets out revisions to the Rent Standard to reflect the Government's 2014 direction on rents arising from changes in rent policy.
- 1.6. The Regulator has a range of statutory objectives that need to be balanced when considering any changes to the Regulatory Framework. The Housing and Regeneration Act 2008 (the Act) states that the Regulator must perform its functions with a view to achieving (as far as is possible), the economic regulation objective and the consumer regulation objective. It is to do so in a way that minimises interference and (so far as is possible), is proportionate, consistent, transparent and accountable. This consultation focuses on meeting both the Regulator's objectives but with specific reference to the economic objective. This is set out below:
- to ensure that registered providers of social housing are financially viable, properly managed, and perform their functions efficiently and economically
 - to support the provision of social housing sufficient to meet reasonable demands (including by encouraging and promoting private investment in social housing)
 - to ensure that value for money is obtained from public investment in social housing
 - to ensure that an unreasonable burden is not imposed (directly or indirectly) on public funds
 - to guard against the misuse of public funds
- 1.7. The Regulator considers that protecting social housing assets and the value within it is an important part of its task in meeting these objectives. Protecting social housing assets will help safeguard the investment made by taxpayers in these assets, and means that tenants will continue to be protected by regulatory requirements. It will underpin the pre-conditions for ongoing private sector investment in providers on terms that enable providers to deliver new homes.
- 1.8. Threats to social housing assets can take a number of forms. If providers fail, lenders may enforce their security and the assets may be lost to the sector. There are also 'slow burn' risks, such as chronic under-investment in assets. By protecting public value, we mean protecting the totality of public expenditure or benefits in kind that have been involved in the development of social housing on the assumption that the resultant units would be used for social purposes.
- 1.9. A number of the proposals outlined in this consultation are put forward with the specific aim of ensuring that social housing assets are protected in order that reasonable demands for social housing can continue to be met.

2. Executive summary

Summary: In this chapter the Regulator sets out a brief summary of the proposals covered by this consultation document which are designed to ensure that social housing assets are protected. This includes changes to: the Governance and Financial Viability Standard and corresponding code of practice, the disposals regime, registration criteria and a revised Rent Standard as a result of directions from the Department for Communities and Local Government. Full details can be found in each chapter of this consultation document.

- 2.1. The Regulator is consulting on changes to parts of its Regulatory Framework in order to ensure that it continues to meet its fundamental objectives and achieves the Regulator's aim of protecting social housing assets and encouraging investment and new supply in the sector.
- 2.2. In September 2013 the Regulator published its Sector Risk Profile³. This identified key risks facing the social housing sector and concluded that the sector is facing an increasing and more diverse range of risks than ever before. These risks included welfare reform, diversification of the activities undertaken by registered providers, exposure to changes in the housing market, reduction in grant levels and changes in the financial market.
- 2.3. Changes and increased risks in the social housing market have prompted registered providers to consider entering into a wider range of activities than those that are core to managing their social housing assets.
- 2.4. Many businesses seek new opportunities through diversification. In the context of a non-profit sector, these opportunities can be an important way in which registered providers cross subsidise their main social housing purposes to encourage new supply. In addition, diversification may be a way of mitigating some of the risks facing the sector. It may also be a way for a registered provider to deliver its core objectives in areas such as regeneration or the provision of care services.
- 2.5. However, commercial activities, new and more complex financing arrangements, and new business structures require new skills. Commercial activities mean commercial risks, and registered providers need to ensure that they have the skills to manage these different risks. This brings new challenges for both registered providers and the Regulator.
- 2.6. Under previous legislation, the sector was made up exclusively of non-profit private registered providers. These registered providers take a variety of constitutional forms (e.g. companies, industrial and provident societies, charitable and non-charitable) and the activities they can participate in are limited to a degree by their objects. Where registered providers formed groups, the Regulator obtained its oversight at the group level, as the legislation required that parent to be on the register as well. Predecessor regulators were therefore able to take a degree of comfort from the constitutional status of providers and group level oversight.

³ Sector Risk Profile 2013, HCA, September 2013, link here:
https://www.homesandcommunities.co.uk/sites/default/files/our-work/sector_risk_profile_2013_full.pdf

- 2.7. The Housing and Regeneration Act 2008 (HRA08) changed the Regulator's controls on new entrants and existing providers in two important respects. Firstly, it allowed new profit making providers to enter the sector. Opening up the register in this way was seen as one tool for introducing competition and driving efficiency in the sector. The Regulator's role is different in relation to profit making registered providers. It only extends to their social housing, meaning that the Regulator does not have oversight over the whole of the business. Secondly, it allowed new types of structure in the traditional sector including those where group parents who satisfy certain criteria are no longer required to be registered⁴. This means that for certain registered providers the Regulator cannot obtain assurance at a group level, and it means that we are regulating providers that can distribute profits and have obligations to their shareholders.
- 2.8. Risks to social housing assets can take a number of forms. The failure of a registered provider can ultimately result in lenders enforcing their security and assets being lost from the sector; and risks of value being extracted or leaked out of the sector through, for example, underinvestment (which may result in a reduction in property value). The Regulator is concerned that:
- at an organisational level, registered providers are managing the particular risks to their own asset base
 - at a sector wide level, the Regulator's resources and tools can be used effectively where potential threats to the asset base exist
 - the public value embedded in the sector's assets (be that from grant or other forms of subsidy) is used for public benefit
- 2.9. Registered providers are largely asset based businesses. It is these properties that provide homes to tenants, as well as providing security for the funding of new development and the rents that pay for repairs and services. Managing the risks to these assets is key to ensuring on going future supply and sustainability of the social housing sector. The Regulator is consulting on changes to aspects of our Regulatory Framework in order that we continue to be able to meet our objectives set out in statute and social housing assets continue to be protected in light of changes to the operating environment.

Changes to the Governance and Financial Viability Standard

Requirements for all registered providers

(Para 1.1 – 1.8 of the Standard and C1.1-C1.8 of Code)

- 2.10 The requirements applicable to all registered providers are designed to ensure that registered providers are able to effectively manage their businesses including the activities they undertake and associated risks that those activities may bring.
- 2.11 As the challenges of operating the business changes, registered providers need to make sure that their boards and executive teams are capable of operating in the changed environment. To achieve this, registered providers need to ensure they have the appropriate skills for the type of activity they undertake. They are also expected to conduct their affairs with an appropriate degree of independence in order to ensure that they act in their own best interests and not those of another party.

⁴ Originally it was intended that all non-asset holding parents would be removed from the register but, during the passage of the Localism Act, it was confirmed that transitional arrangements that allowed non-asset holding parents to stay on the register would remain in place indefinitely. No new non-asset holding parents can be registered.

- 2.12. Effective risk management is a central part of the proposed Standard. Registered providers need to have a full understanding of all aspects of their business, including a thorough and documented understanding of their assets and any liabilities on those assets. Registered providers are expected to consider liabilities in the widest context. It should include not only those that have direct recourse to the social housing assets, but also those that could have an indirect claim on the assets such as guarantees, or joint ventures.
- 2.13. As part of their risk management approach, registered providers are required to stress test their businesses. This should involve testing what would happen to the business under a range of different scenarios and if multiple risks were to crystallise. Registered providers should have a clear understanding of what would cause their business significant financial distress and plan mitigating strategies to deal with any exposures.
- 2.14. The proposed standard strengthens the requirements on accurate reporting and transparency. Boards are required to certify on an annual basis that they continue to meet the Regulator's Standards.

Requirements for profit making registered providers

Legal Entity (Para 2.1 of Standard and C2.1 of Code)

- 2.15. Profit making registered providers must undertake any activities that relate to the provision of social housing separately from those that don't. This requirement ensures that there is greater protection of the social housing assets from the non-social housing parts of the business and will assist the Regulator in being able to effectively regulate the part of the business it is required to regulate. A small amount of non-social housing will be permitted within the entity of no more than 5% of capital or turnover.

Requirements for registered group parents

Assistance (Para 2.2 of Standard and C2.2 of Code)

- 2.16. Where the parent company of a group is a registered provider, it should look to maintain compliance with regulatory requirements of all the registered members within the group.

Requirements for registered providers whose parents are not registered (Paras 2.3 and 2.4 of the Standard and C2.3 and C2.4 of Code)

- 2.17. The Regulator does not have oversight of the activities of the group parent, but decisions or actions by the group parent or other parts of the group may have an impact on the social housing assets. We are therefore introducing requirements to help mitigate that risk by setting out our expectations on the role of the parent. This is specifically in respect of agreements they enter into and having in place effective mechanisms. The mechanisms should be designed to ensure that the parent company will assist the registered provider to comply with regulatory requirements and that the parent company does not do anything that compromises the registered provider's ability to meet regulatory requirements.

Category 6 consents

- 2.18. Changes are proposed to category 6 of the General Consent for all non-profit registered providers. Removing category 6 of the General Consent for non-profit

registered providers whose parent is not registered allows the Regulator to scrutinise individual consent proposals prior to a security interest being granted.

Code of Practice

- 2.19 The Regulator is proposing to introduce a code of practice (Code) to explain and elaborate on the content of the Standard, where appropriate with illustrative examples. The Code helps registered providers to understand how compliance with the Standard may be achieved.
- 2.20 The Regulator is committed to a co-regulatory approach to regulation. The Code is not a tick list to ensure compliance. When assessing compliance with the Standard, the Regulator will have regard to the Code.

Changes to the disposals regime

- 2.21 Profit making providers can grow by purchasing existing stock from non-profit registered providers or local authority registered providers. It is an effective means to achieve scale quickly. However, the Regulator wishes to ensure that the considerable public investment that has gone into developing and maintaining those assets is captured on disposal. It is proposed that this is done through the use of the Disposals Proceeds Fund (DPF), capturing the sales proceeds and directing their reinvestment into social housing. The Regulator aims to give confidence to profit making registered providers to develop business plans and approaches to working in the social housing sector.

Changes to the registration criteria

- 2.22 In order to reflect the proposed changes to the Governance and Financial Viability Standard, it is proposed that the criteria applicants have to meet when they are applying to join the register of social housing providers is changed. Applicants are required to meet both the governance and financial viability aspects of the Standard at the point of registration. In addition, the opportunity has been taken to consult on changes to cater for the possible registration of charitable incorporated organisations and also to alter the constitutional requirements for applicants that are charitable.

Changes to the Rent Standard

- 2.23 The Spending Review 2013 and subsequent consultation by the Department for Communities and Local Government (DCLG) on rent setting policy has resulted in a rent direction. The new rent policy changes the indexation basis from RPI to CPI and removes the ability to increase rent relative to the formula level by up to £2 a week. Registered providers will be permitted to charge up to market rent levels to those tenants earning high incomes.

3. Changes to the Governance and Financial Viability Standard

Summary: In this chapter the Regulator sets out proposed amendments to the Governance and Financial Viability Standard which will better protect social housing assets in a sector where risks are becoming more complex and come from diverse sources. The proposals will see the Regulatory Framework become sharply focused on the management of the risk of social housing assets being lost to the sector through financial and governance failings. The core proposals are for enhanced requirements for registered providers to understand and analyse their risks across a range of scenarios and put in place effective strategies to manage those risks. The proposals also contain certain specific requirements for particular types of registered provider where the structure of the organisation or the level or regulatory oversight permitted in the Act means that additional requirements are necessary to better protect social housing assets.

Overview

- 3.1 The social housing sector is changing and the Regulator needs to respond to that change in order to ensure that the Regulatory Framework remains fit for purpose and that social housing assets continue to be protected. In April 2013, the Regulator published a discussion document which set out the challenges and sparked a debate on how best to ensure that social housing assets are protected.
- 3.2 Ideas reflected in the discussion paper included proposals to help insulate social housing assets from commercial risks through ring fencing. Responses agreed with the Regulator's analysis of the problem, but there were a range of views about the most appropriate solutions. In October 2013 the Regulator published a response to the discussion document which took on board feedback from the sector and proposed that social housing assets be protected through more focused risk management. This consultation document builds on those proposals and this chapter sets out changes that are proposed to the Governance and Financial Viability Standard (the Standard) in order to ensure social housing assets are protected.
- 3.3 Introducing specific requirements on managing risks will help to ensure that registered providers have a better grasp of the risks that they face and a more thorough understanding of how these may crystallise. Registered providers should also have a full understanding of how these risks can be managed and mitigated in a way that protects the social housing assets. It will therefore contribute to the Regulator meeting its statutory objective to "ensure that registered providers of social housing are financially viable and properly managed, and perform their functions efficiently and economically". By better protecting social housing assets it will also help to ensure that the Regulator "support[s] the provision of social housing sufficient to meet reasonable demands (including by encouraging and promoting private investment in social housing)" and "guard[s] against the misuse of public funds". Risk management is a key part of any well governed organisation. Whilst the proposals set out below are additional Regulatory requirements the Regulator is of the view that they are reasonable requirements for any well run registered provider.
- 3.4 The Regulator's co-regulatory approach continues. Registered providers are responsible and accountable for delivering their organisation's social housing objectives and in meeting the requirements of law.

- 3.5 The Regulator has identified particular groups of registered provider where it considers the risks to social housing assets to be increased due to the way in which these registered providers are structured and the Regulator's limited regulatory remit in relation to them. The proposals below set out specific requirements for these groups of registered provider. They aim to provide additional protections to ensure that social housing assets are protected.
- 3.6 This consultation does not include a wholesale re-writing of the Standard. Instead, it focuses on changes required to ensure that social housing assets are protected. A version of the existing standard showing proposed changes is provided in Annex 1.
- 3.7 In addition to proposed changes to the Standard, the Regulator proposes to introduce a code of practice (the Code). The aim of the Code is to amplify requirements in the standard, making it easier for registered providers to understand what is expected of them. It is not the Regulator's intention to go back to previous eras of best practice guidance notes. The regulatory model is one of co-regulation. Therefore the Code is not intended to be a set of rules, rather it is designed to help registered providers understand how compliance with the Standard can be achieved, with examples where appropriate. It is for registered providers to determine how best to meet the requirements in the Standard.
- 3.8 One key presentational change proposed is to have one set of specific expectations for governance and financial viability. This is proposed for clarity and to avoid duplication. A number of the requirements in the Standard, in particular those on risk management and business planning, relate to both financial viability and good governance. The Regulator will still publish separate regulatory judgements on financial viability and governance⁵. The separate judgements reflect two different aspects of a registered provider and it is important, in order to be clear about the performance of a registered provider, that these two judgements remain separate. It is perfectly possible that a poorly governed registered provider is financially viable, resulting in a higher viability judgement than that for governance, or that a provider may be well governed but have material exposures in respect of their financial viability. A number of the outcomes required in the Standard, for example the requirements on risk, may inform both the governance and financial viability judgements. How this is translated into the Regulator's two regulatory judgements is set out in *Regulating the Standards*⁶.
- 3.9 In addition to this, the Regulator is proposing some changes to category 6 of the General Consent. This is explored at the end of this chapter.
- 3.10 This consultation document focuses on the changes to the Regulatory Framework that are subject to statutory consultation. There will also be consequential changes required to the overarching narrative of the Regulatory Framework document. These will be published alongside the Regulator's decision statement as part of the outcome of the consultation on these proposals.

⁵ <http://www.homesandcommunities.co.uk/ourwork/regulatory-judgements>

⁶ *Regulating the Standards* 2014, HCA, January 2014, link here:

http://www.homesandcommunities.co.uk/sites/default/files/our-work/regulating_the_standards_2014.pdf

Governance required outcomes

A Registered providers shall ensure effective governance arrangements that deliver their aims, objectives and intended outcomes for tenants and potential tenants in an effective, transparent and accountable manner. Governance arrangements shall ensure registered providers:

- adhere to all relevant law
- comply with their governing documents and all regulatory requirements
- are accountable to tenants, the Regulator and relevant stakeholders
- safeguard taxpayers' interests and the reputation of the sector
- have an effective risk management and internal controls assurance framework
- protect social housing assets

3.11 This section of the consultation refers to paragraph A of the required outcomes of the Standard and para A.1 to A.2 of the Code.

3.12 There are two proposed changes to the governance required outcomes. The requirement to adhere to all relevant legislation has been widened to all relevant law. This is to ensure that it is fully inclusive and takes into account not only legislation but also common law and statutory guidance, such as Charity Commission guidance.

3.13 An additional requirement to protect social housing assets has also been incorporated. This reflects the role of registered providers as custodians of social housing assets and is directed towards ensuring the ongoing viability of social housing providers.

Financial viability required outcome

B Registered providers shall manage their resources effectively to ensure their viability is maintained while ensuring that social housing assets are not put at undue risk.

3.14 This section of the consultation refers to paragraph B of the required outcomes of the Standard and para B.1 to B.3 of the Code.

3.15 The proposed Standard introduces an additional focus on registered providers to ensure that social housing assets are not put at undue risk alongside ensuring their ongoing viability. The Code provides examples of what the Regulator considers to be unacceptable outcomes resulting from social housing assets being put at undue risk. They focus on social housing being lost from the sector. This could be for example, where lenders enforce their security or where assets are sold to prevent potential insolvency due to poor business planning and decisions. The Regulator is concerned with ensuring that it is able to meet its fundamental objectives, and ensuring that social housing assets are not put at undue risk is key to achieving this.

Skills and capability

1.2 Registered providers shall ensure that they manage their affairs with an appropriate degree of skill, independence, diligence, effectiveness, prudence and foresight.

- 3.16 This section refers to paragraph 1.2 of the Standard and paragraphs C1.2 in the code of practice.
- 3.17 The Regulator considers that having suitable skills and capability is a key element of a well governed organisation that is managing its risks effectively. This requirement contributes to the Regulator’s objective of “ensur[ing] that registered providers of social housing are financially viable and properly managed, and perform their functions efficiently and economically”. Organisations that have the appropriate mix of skills and capability and are suitably independent will be run more effectively and are better able to protect the social housing assets.
- 3.18 Paragraph 1.1 of the existing Standard requires that registered providers adopt and comply with an appropriate code of governance. The Regulator considers that, given the importance of having appropriate skills and capability within an organisation, it is reasonable that there is a formal requirement in the Standard. Registered providers need to ensure that they have suitable skills to reflect the range of activities they undertake as well as the diversity of their structures. By proposing the inclusion of this requirement in the Standard expectations will be standardised across all registered providers.
- 3.19 The above proposal builds on requirements used in other regulated sectors and on the National Housing Federation Excellence in Governance code. It is designed to make sure that registered providers have access to the right skills and capability and are suitably independent to carry out their existing and planned business. It recognises that that skill and capability may well come from outside their organisation.
- 3.20 The proposed Code provides examples of how the requirement could be met. Registered providers are required to manage their affairs with a suitable degree of independence to enable them to act in their own interests and to meet regulatory requirements. The Code provides an example of how this might be achieved: by having independent board members. Independent board members help to ensure that the registered provider is able to act effectively in its own best interest without undue influence from the parent or other parts of the organisation. This is especially important given that the parents of registered providers are no longer required to be registered. In considering this, the Code makes clear that the Regulator does not expect boards of non-profit registered providers where the parent is registered to remove co-terminous boards that are common practice in the sector. This is because the Regulator does not expect independence from other non-profit registered entities within the same group.
- 3.21 The Regulator considered whether the number of independent board members required should be stipulated. However, the Regulator concluded that this would challenge the co-regulatory model and the Regulator’s duty to minimise interference and regulate in a way that is proportionate. With such a diverse regulated sector, a one size fits all approach to the number of board members is not appropriate. It would run the risk of putting a requirement on the sector that could have perverse

outcomes and not achieve the aim it set out to achieve. In the proposed Standard it is therefore for registered providers to determine how best to meet regulatory requirements on independence.

Risk and protecting social housing assets

1.4	Registered providers shall ensure that they have an appropriate, robust and prudent business planning, risk and control framework.
1.4.1	The framework shall ensure: <ul style="list-style-type: none">(a) there is access to sufficient liquidity at all times(b) financial forecasts are based on appropriate and reasonable assumptions(c) effective systems are in place to monitor and accurately report delivery of the registered provider's plans(d) the financial and other implications of risks to the delivery of plans are considered(e) registered providers monitor, report on and comply with their funders' covenants
1.4.2	The framework shall be approved ⁷ by the registered provider's board ⁷ and its effectiveness in achieving the required outcomes shall be reviewed at least once a year.
1.5	In addition to the above registered providers shall assess, manage and where appropriate address risks to ensure the long term viability of the registered provider, including ensuring that social housing assets are protected. Registered providers shall do so by: <ul style="list-style-type: none">(a) maintaining a thorough, accurate and up to date record of their assets and liabilities and particularly those liabilities that may have recourse to social housing assets(b) carrying out detailed and robust stress testing against identified risks and combinations of risks across a range of scenarios and putting appropriate mitigation strategies in place as a result(c) before taking on new liabilities, ensuring that they understand and manage the likely impact on current and future business and regulatory compliance

3.22 This section of the consultation refers to paragraphs 1.4 and 1.5 of the Standard and paragraphs C1.4 – C1.5 in the Code.

⁷ Where a registered provider does not have a board, it should be taken to include an equivalent management body as appropriate

- 3.23 Paragraph 1.4 of the proposed Standard places a strong emphasis on the expectations of registered providers in effectively managing risks. It is logical that a requirement to have an appropriate risk framework sits alongside business planning and control frameworks.
- 3.24 Paragraph 1.5 of the proposed Standard builds on the requirements in paragraph 1.4 to effectively manage risks. It introduces a specific set of outcomes that registered providers must achieve to ensure that social housing assets are protected.
- 3.25 The Regulator already requires registered providers to effectively manage risks. However, given the changes to the operating environment and the increasing diversity of activities of registered providers, the Regulator considers that more specific requirements are necessary to protect social housing assets. The proposed Standard increases the regulatory focus on effective risk management within the sector to help ensure that registered providers, as custodians of social housing assets, fully understand their businesses, the environment in which they operate, the risks to the business and the recourse funders might have to social housing assets. All well governed registered providers will see investments in activities priced at such a level and with a rate of return which is commensurate to the level of risk presented. The proposed requirements on risk as a package help the Regulator to meet its fundamental objectives and particularly to “ensure registered providers of social housing are financially viable and properly managed” and to “guard against the misuse of public funds”. Risk management is a core business activity. The Regulator considers that this focus on managing risks to social housing assets is reasonable and proportionate in a regulated market and that it is aligned to the practices of well-managed providers.

Records of assets and liabilities

- 3.26 Para 1.5(a) sets out the proposed requirements on registered providers keeping accurate and up to date records of their assets and liabilities. Registered providers need to have a clear understanding of their assets, and the liabilities that may put those assets at risk in order that they can effectively manage the risks to the organisation and the assets, and have an effective asset management strategy as required by the Value for Money Standard. The quality of records on assets and liabilities varies considerably across the sector and the proposed Standard and Code aim to bring the whole sector up to the required standard. In addition to businesses being able to effectively manage their risks, having a clear record of assets and liabilities will also help to ensure that in a failure situation the Regulator and any other appropriate party can immediately access data on the business’s assets and liabilities such that a potential purchaser can price the assets.
- 3.27 The Code articulates what is expected of an asset register. The register should break down the assets by business stream and clearly and separately identify social housing assets.
- 3.28 A registered provider should understand which of their assets are encumbered and to whom. This is vital management information that helps inform the registered provider’s risk profile and should be actively used to help manage the assets and any debt. In addition, the Code makes clear that the Regulator expects registered providers to consider any liabilities in the widest context. Registered providers should consider the overall security position of the assets including not just those liabilities with direct recourse but also those which may impact through problems elsewhere in the business. For example, through insolvency of another entity in the group or impairment of investments made by the registered provider.

3.29 Understanding its assets and liabilities is a key part of the effective operation of any business. In addition, the Regulator also has to be able to carry out its role in the event of a potential or actual business failure. In the event of the failure of a registered provider, the Regulator has a power to protect the social housing assets and consequently the tenants in them. If key information on assets and liabilities is not available in a timely manner then the Regulator is not able to perform this role effectively and efficiently. The Regulator is therefore of the view that this proposed requirement is reasonable and proportionate for a registered provider operating in a regulated sector. The Regulator considered whether the format for such records should be specified. This could make it easier should a rescue of the organisation be required. However on balance, the Regulator felt that this goes against the principle of co-regulation and its duty to ensure its functions are performed in a way that minimises interference and in so far as possible is proportionate. Also, registered providers differ considerably in size and complexity, so a one size fits all approach is not appropriate. The proposed Standard and Code therefore do not specify the format or way in which these records are kept and recognises that this will vary according to the business practices of each provider.

Stress testing

3.30 Paragraph 1.5 (b) sets out the proposed requirements for stress testing. Under the proposals registered providers are expected to consider what stress testing is appropriate given the size, type and structure of the organisation. The Code states that registered providers should ensure that their stress testing is multi-variate analysis that considers potential downside economic and business risks across significant and realistic scenarios. It is intended that this stress testing be a key business tool that registered providers use in order to test whether their current and future business strategy is appropriate and the necessary risk mitigations are in place. Registered providers should be testing under a range of different scenarios and therefore have a full understanding of what would happen to the business in each case and how they could mitigate those effects. It should include answering the question 'what could bring the business down or significantly weaken it and what would the mitigating action be'?

3.31 Stress testing of the type described here is something that the Regulator considers all well run organisations should be doing. The Regulator therefore considers this requirement to be proportionate and consistent with the other approaches being taken to protect social housing assets. What those scenarios look like will differ according to the size and complexities of the organisation. For those that are small and not developing, the stress testing may be relatively simplistic. For those with more diverse activities it is likely to be appropriate that a more complex approach is taken. In recognition of this, the proposed Standard and Code do not set out the detail of what or how stress testing should be carried out. Rather, the Code makes clear through the use of examples the types of scenarios that should be considered. It is for registered providers to satisfy themselves on what is appropriate for their organisation. The Regulator considers that this approach is consistent with co-regulation and the Regulator's duty to minimise interference and be proportionate.

Impact on decision making

3.32 The Regulator wants to ensure that boards are thinking seriously about how the results of their stress testing inform how they structure business decisions and risk mitigations they put in place. Registered providers would be expected to use the stress testing as a live tool and if appropriate, business plans should be reviewed and revised to ensure that the business remains within acceptable levels of risk. Registered providers should ensure they have effective mitigation strategies and

controls in place. For example, a developing registered provider should plan at what point they would stop developments or reduce/stop uncommitted expenditures. In order to be able to carry this out effectively, registered providers will need to have a firm understanding of what they consider to be an unacceptable level of risk and what that means for their business.

Requirements on entering arrangements with third parties

1.6 Registered providers shall ensure that any arrangements they enter into do not inappropriately advance the interests of third parties, or are arrangements which the Regulator could reasonably assume were for such purposes.

- 3.33 This section of the consultation relates to paragraph 1.6 of the Standard and C1.6 of the Code.
- 3.34 The proposed requirement in the Standard makes clear that registered providers are expected to act to further their own objectives and interests, not of those of third parties. The focus here is on transactions which, for example, over-price a service received so that the contractor is paid more than market value or where services are given without an appropriate charge being levied. It is not the Regulator's intention to restrict a registered provider's ability to benefit partners where doing so is in line with their objects (such as supporting a charity or community venture). Rather the focus is on restricting inappropriate transactions which are designed for the personal or professional benefit of a third party.
- 3.35 Profit making registered providers have a legitimate claim to extract profit, so long as in doing so they do not put the social housing assets at undue risk. Unreasonably restricting a profit making registered provider's ability to, for example, pay dividends would not be proportionate and would interfere with their ability to be a profit making registered provider. For the avoidance of doubt, the Code therefore makes clear that appropriate dividend payments made in the course of distributing profit are not caught by this requirement.
- 3.36 The Code also makes clear that where there are conflicts or perceived conflicts of interest registered providers must clearly set out how these are managed.
- 3.37 Introducing this requirement helps to ensure social housing assets are protected and that value is not lost to the sector. It meets the fundamental objective of "guard[ing] against the misuse of public funds" and protecting the social housing assets also helps to ensure the Regulator "support[s] the provision of social housing sufficient to meet reasonable demands".

Reporting requirements

- 1.7 Registered providers shall communicate with the Regulator in an accurate and timely manner. This includes returns to the Regulator, including an annual report on any losses from fraudulent activity, in a form determined by the Regulator.
- 1.8 Registered providers shall assess their compliance with the Governance and Financial Viability Standard at least once a year. Registered providers' boards shall certify in their annual accounts their compliance with this Governance and Financial Viability Standard.

- 3.38 This section of the consultation relates to paragraphs 1.7 and 1.8 of the Standard and C1.7 and C1.8 of the Code.
- 3.39 The current Standard includes a requirement for returns to the Regulator. The proposed standard widens this to ensure that registered providers communicate with the Regulator in a timely and accurate manner. This may be, for example, providing good quality information requested as part of routine engagement with a registered provider, and providing that information without the need for the Regulator to chase it. Requiring registered providers to communicate with the Regulator in an accurate and timely manner contributes to the Regulator being able to effectively regulate a registered provider and meet its statutory objectives.
- 3.40 The current Standard has specific reporting requirements, for example around compliance with the registered provider's chosen code of governance and with funders' covenants. These requirements are maintained in the proposed Standard. The Regulator is proposing that registered providers assess their compliance with the Governance and Financial Viability Standard at least once a year, and that in order to be transparent they must certify compliance, or otherwise, in their annual accounts. The Accounts Direction will be amended in due course to reflect this requirement.
- 3.41 All registered providers must comply with regulatory requirements, and registered providers should be assuring themselves of this on a regular basis. By requiring certification in the accounts registered providers are providing a transparent statement to their stakeholders, which is also available to the Regulator, without the need for specific regulatory reports.
- 3.42 The Code makes clear that when certifying compliance with the Governance and Financial Viability Standard, registered providers should ensure that they consider compliance with regulatory standards in the round. This is set out in the required outcome on governance in the Standard. For clarity, since the Code is not guidance, certification of compliance with the Code is not required.

Section 2 requirements

- 3.43 Section 2 requirements apply to specific classes of registered provider where the Regulator considers that additional controls are needed in order to protect social housing assets.

Legal entity – profit making registered providers

2.1 Profit making registered providers shall ensure that they undertake their social housing activities in an entity which is legally and operationally separated from any other activities they may undertake, except as set out below:

Profit making registered providers should ensure that activities they undertake which do not relate to the provision of social housing:

- (i) form only a very small part of the activities they undertake
- (ii) are not such as to mean that registered providers place social housing assets, activities relating to the provision of social housing or their own financial viability at undue risk

3.44 This section of the consultation relates to paragraph 2.1 of the Standard and C2.1 of the Code.

3.45 Section 194 (2) of the Act states “In respect of profit-making registered providers, standards may be made in relation to the management of their affairs only so far as relating to the provision of social housing.” It is therefore clear that the Regulator’s Standard setting powers only extends to the provision of social housing. The Regulator needs to ensure that appropriate mechanisms are in place to ensure that the Regulator only regulates the social housing part of the business and that the social housing can be adequately protected from the effects of failure in non-social housing parts of the business where there is no regulatory remit.

3.46 The proposed Standard addresses this issue by requiring profit making registered providers to place their social housing in a separate legal entity which conforms with s.79 of the Act. This requirement allows better protection of the social housing from potential or actual failures in the non-social housing part of business, by:

- lowering the risk of the non-social housing assets having direct recourse to the social housing assets as they are operationally and legally separate
- allowing the boards of the registered provider to actively manage the risks to social housing assets in the new legal entity
- enabling the Regulator to have oversight over the whole of the registered entity and to take immediate and effective steps in the event of failure

3.47 Requiring a separate legal entity contributes to achieving the Regulator’s objective of “ensuring that registered providers are financially viable and properly managed”. By clearly separating out the social housing it gives transparency to the registered provider, the Regulator and other stakeholders, such as lenders, about what is subject to regulation.

3.48 In considering whether the proposed approach is reasonable, the Regulator has also considered the burden it places on the profit making sector and the extent to which it interferes with registered providers’ ability to run their business in an effective manner. Requiring social housing to be in a separate legal entity does not stop a profit making provider from being able to implement cost saving measures, such as using shared functions. It just means that formal arrangements must be in place and specific thought has to be given to the terms on which transactions are entered into

and the possibility of risk from other activities. It allows the registered provider to better understand its cost base and ensure it is achieving value for money from the services received.

- 3.49 Boards should have oversight of the process of determining what is and is not social housing, and should expect the Regulator to seek assurance on the robustness of their processes and to challenge where the conclusions reached are not consistent with the required outcomes of the Standard.
- 3.50 The Regulator has a duty to minimise interference and regulate in a way that is proportionate. There are some circumstances where it may be appropriate and reasonable to have a small amount of non-social housing within the legal entity, for example, where a registered provider is undertaking mixed tenure developments. In other regulatory sectors this ranges from 2.5 to 5% of turnover. Given this, the Code sets this figure at 5% of capital or turnover. Included in this figure should be any arrangements which relate to non-social housing that may have recourse onto the social housing assets.

Assistance – registered group parents

2.2 Registered providers which are parent companies shall, as appropriate, support or assist those of their subsidiaries that are registered providers with a view to ensuring compliance with regulatory requirements.

- 3.51 This section of the consultation relates to paragraph 2.2 of the Standard and C2.2 of the Code.
- 3.52 The Regulator expects that where the parent company of a group is a registered provider it should look to maintain not only its own but also the on-going viability and compliance with Regulatory standards of all the registered providers within the group. This requirement does not change that, instead it enhances it, giving additional protection to the social housing, making clear that if appropriate the parent must step in to help ensure compliance of all registered providers in the group. This is not a change to existing practice: the Regulator has always expected this to happen. The proposed Standard aims to make this transparent by inserting it as a formal requirement.
- 3.53 The Regulator considers that this is a reasonable expectation of a registered provider participating in this regulated sector. It is important to ensure the Regulator meets its objective of “support[ing] the provision of social housing that is well-managed and of appropriate quality” and “to ensure that actual or potential tenants of social housing have an appropriate degree of choice and protection”. It is also consistent with the responsibility of the registered provider group parent in ensuring its compliance with regulatory standards. The Regulator is aware that there may be circumstances where it is not appropriate to provide financial assistance, for example, where in doing so it would put the financial viability of the registered parent or other registered parts of the group at risk, or where there is a charitable parent and a non charitable subsidiary. However, the Regulator does expect that the parent look at all forms of assistance that might be appropriate and how it might best achieve compliance with regulatory requirements for the group as a whole.

Arrangements entered into - registered providers with unregistered parents

3.54 Where the parent is not a registered provider the Regulator does not have oversight over the whole of the business. Decisions and actions taken by the parent or other parts of the group may negatively impact on the social housing assets. The Regulator is therefore proposing additional requirements for this group to ensure that social housing assets are protected.

2.3 Registered providers with parent companies who are not registered providers shall ensure that they do not enter into agreements to support the activity of the parent or another group member that may have a material negative impact on the social housing assets of the registered provider.

3.55 This section of the consultation relates to paragraph 2.3 of the Standard and C2.3 of the Code.

3.56 The Regulator requires that where a registered provider has a parent which is not registered, the registered provider does not enter into agreements that would support the parent or another part of the group that may have a material negative impact on the social housing assets. The Code provides examples of arrangements that a registered provider might enter into which includes both formal agreements, such as guarantees and less formal or indirect arrangements which give creditors of the non-social housing activity recourse to the regulated assets. For example, in the event of insolvency the existence of common directorships.

3.57 This requirement is designed to ensure that social housing assets are not used to benefit the wider non-social housing activities of a group, where the Regulator has no oversight, to the detriment of the social housing assets. This requirement contributes to the Regulator meeting its fundamental objective of “ensur[ing] that registered providers of social housing are financially viable, properly managed, and perform their functions efficiently and economically”, “support[ing] the provision of social housing that is well managed and of appropriate quality” and “to ensure that actual or potential tenants of social housing have an appropriate degree of choice and protection” and “to guard against the misuse of public funds”.

Effective mechanisms – registered providers with unregistered parents

<p>2.4 To enable compliance with the Regulator’s standards or other regulatory requirements, registered providers with parent companies that are not registered providers shall have in place effective mechanisms to ensure that:</p> <ul style="list-style-type: none">(a) such parent companies will give any appropriate support or assistance as necessary to the registered provider(b) such registered providers have the ability to require the support or assistance of the parent company concerned(c) the registered provider’s ability to meet the Regulator’s standards and other regulatory requirements is not and cannot be prejudiced by the activities or influence of the parent company or another part of the group
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3.58 This section of the consultation relates to paragraph 2.4 of the Standard and C2.4 of the Code.

3.59 It builds on previous expectations in paragraph 1.4 of the current Governance and Financial Viability Standard. Feedback regarding the existing Standard has been that there is some confusion as to when paragraph 1.4 applies and what the expectation is to ensure compliance. In revising this section of the Standard, the Regulator has aimed to resolve any confusion making clear what the expectations are and who must comply with them. The Code exemplifies how compliance might be achieved. The requirement is designed to ensure that where the parent is not a registered provider, and therefore does not have to comply with regulatory requirements, that protections are put in place to ensure that registered provider subsidiaries are able to ensure ongoing compliance with standards.

3.60 The requirements themselves are not new and they do not represent an additional burden. The application of this requirement has been simplified to help ensure that the Regulator is transparent about its expectations. It remains for registered providers to determine which mechanisms are appropriate for their business and to ensure that they are put in place. It is likely that this will vary according to the specific risks posed to social housing from the structure of the group. The Regulator is aware that the success of this requirement is impacted by the quality and independence of the registered provider. It is therefore important that registered providers consider paragraph 1.2 of the proposed Standard alongside this requirement.

3.61 The Code provides examples on what mechanisms might cover. It includes things such as corporate structural arrangements (governance, internal control etc), contractual and financing arrangements. It is not intended to be an exhaustive list, but rather to help registered providers to understand what sorts of things they will need to consider depending on the specific risks that are present.

Code of practice (Annex 2)

3.62 Section 195 of the Act gives the Regulator the power to issue a code of practice. The Act requires that a code of practice must amplify the Standard and relate to a matter addressed by a Standard. In considering whether standards have been met, the

Regulator may have regard to a code of practice. However, it is the Standard rather than the code of practice that the Regulator would enforce against.

- 3.63 The Regulator has not previously issued a code of practice. In designing the changes to the Governance and Financial Viability Standard the Regulator has given consideration to whether a code of practice would be beneficial.
- 3.64 To help registered providers meet its standards, the Regulator publishes a range of documents that explain its approach and clarify the issues that are of concern. These are designed to help registered providers ensure ongoing compliance with the Standards and include Regulating the Standards, Sector Risk Profile, Quarterly Surveys and the Global Accounts.
- 3.65 Regulatory standards are written in such a way that they are clear concise requirements, but they are concerned with often complex issues. The Regulator proposes to introduce a code for the Governance and Financial Viability Standard to explain and elaborate on the content of the Standard, sometimes with illustrative examples.
- 3.66 The Regulator is committed to its co-regulatory approach. The Code is not guidance and is not a tick list to ensure compliance. When assessing compliance with the Standard the Regulator will have regard to the Code, but it is the Standard rather than the Code that the Regulator will seek assurance on and if necessary enforce against.
- 3.67 The power given to the Regulator in the Act to issue a code means that a code has a status in law. It therefore has a role to play both in helping registered providers to achieve compliance with the Standard and in the Regulator assessing whether compliance has been achieved.
- 3.68 With this in mind, the Regulator is proposing a Code which sets out clearly what compliance with the Standard looks like whilst giving registered providers the flexibility to innovate and develop their own approaches to achieve the outcome set out in the Standard.
- 3.69 The Regulator is consulting on the Code alongside the Standard. Once adopted, any subsequent proposed changes to the Code will be subject to appropriate consultation and the Regulator will make clear any changes to registered providers and key stakeholders.

Other changes

- 3.70 In order to achieve the objective of protecting social housing assets the Regulator is proposing to make amendments to Category 6 of the General Consent. The General Consent is designed to allow registered providers to carry out particular types of disposals of land and property without reference to the Regulator. It reserves the right to require specific consent for those disposals that the Regulator is most concerned to scrutinise. The Regulator recognises that there is a balance to be struck between ensuring social housing is protected and registered providers having the flexibility to manage their asset base effectively.
- 3.71 The Regulator has reviewed the existing General Consent to ensure it continues to reflect the right balance between protection of social housing and flexibility for registered providers. A draft of the revised General Consent is set out in Annex 4.

This also proposes changes to improve consistency and harmonise consent requirements between different legislative regimes in order to simplify the system. Other aspects of the disposals regime are discussed in Chapter 4 of this consultation.

Category 6

- 3.72 This category of the General Consent allows non-profit registered providers to grant a security interest over a social housing dwelling to a private finance provider, as long as certain specific conditions are met. The main condition is that the registered provider has a letter of authorisation from the Regulator allowing them to access category 6. Such letters remain valid until the Regulator withdraws or amends them. Registered providers that do not have access to category 6 must apply for specific consent when they wish to put assets into security.
- 3.73 The category of General Consent was introduced, following consultation, in 2010 and is intended to reduce the administrative burden on registered providers. (Previously, specific consent was required for each occasion on which private finance was secured.)
- 3.74 The Regulator has reviewed the conditions of category 6 consent in light of the proposed changes to the framework and the Regulator's experience to date, to ensure they remain fit for purpose. The proposed changes are set out below:
- a. To amend the definition of 'private finance provider' to clarify that category 6 cannot be used for lending between otherwise unrelated registered providers. This does not close the door to lending between registered providers, but they will require specific consent to do so.
 - b. To further restrict access to category 6, so that it is not open to a registered provider whose parent is not registered. As explored earlier in this chapter, such arrangements potentially pose a greater level of risk to the protection of social housing and therefore require individual scrutiny by the Regulator prior to a security interest being granted.
 - c. To extend the condition on category 6 that restricts on-lending of the facilities secured on social housing assets within groups. The new condition will require that that on-lending to either profit making registered providers or to non-registered bodies within the group must be for social housing purposes only and that it must be only to group members that operate in England. This restriction is to maintain consistency with the Regulator's proposals on the prominence of social housing activity within profit making registered providers. It is also to prevent social housing assets being placed at undue risk due to the diversion of funds into markets of which the Regulator will have no sight. As above, this does not prevent such transactions taking place, but it ensures that there is regulatory oversight of them as specific consent will be required.
 - d. To change the conditions on category 6 so that it is clear that the General Consent cannot be used to secure finance which is on an index linked basis. This is to reflect the Regulator's concern with the different risks associated with index linked finance and its interest in scrutinising such arrangements prior to them being entered into.
 - e. To amend the definition of Private Finance Facilities so that it is clear that granting security interest to support a guarantee will not be covered by the General Consent. Therefore specific consent will be required for such

arrangements. The intention here is to ensure the Regulator has the ability to scrutinise such arrangements.

The Regulator will also use the withdrawal of access to category 6 as a regulatory tool where, for example, it has concerns about the governance⁸ of a provider.

Consultation questions

1. Governance and Financial Viability Standard:
 - a) Overall does the proposed Standard meet the Regulator's economic objectives which require the protection of social housing assets?
 - b) Does the proposed Standard express the requirements of registered providers in a way that is clear, succinct and as outcome focused as possible?
 - c) Do the requirements in paragraph 1.3 on skills, capability and independence i) meet the Regulator's aim of protecting social housing assets and ii) balance the aim of protecting social housing assets with registered providers being free to run their own businesses?
 - d) Do the requirements in paragraph 1.5 and 1.6 on risk i) meet the Regulator's aim of protecting social housing assets ii) balance the aim of protecting social housing assets with registered providers being free to run their own businesses?
 - e) Are the requirements for specific types of registered provider in Section 2 reasonable given the Regulator's aim of protecting social housing assets?
2. Code of practice:
 - a) Does the proposed Code assist registered providers to understand how compliance with the Standard can be achieved?
 - b) Is the role of a code clear and reasonable?

⁸ For further detail see Disposing of Land <http://www.homesandcommunities.co.uk/ourwork/consent-disposals>

4. Changes to disposals regime

Summary: An important element of protecting the value in social housing assets is ensuring that when these assets are bought and sold, any capital gains arising are used within the social housing sector. The Regulator intends to achieve this by introducing an extension to existing requirements in relation to the Disposal Proceeds Fund to require all profit making registered providers' sale proceeds that are derived from existing stock in the non-profit sector to be used to build replacement units.

Overview

- 4.1 To meet the fundamental objectives of protecting public investment and encouraging supply, the Regulator needs to be able to regulate effectively what happens to the proceeds of disposals of social housing stock. The Regulator's aim is to protect social housing and for the purposes of this chapter the Regulator is particularly concerned about the value within that social housing.
- 4.2 Social housing stock, which has been historically owned in the non-profit sector, usually has a value in its existing use which is lower than its value if it were to be sold as vacant on the open market. This latent value leaves considerable potential for capital gains to be made when properties are bought and sold, whether within or outside the sector.
- 4.3 The Regulator considers that the social housing assets it is seeking to protect include any latent value contained within the stock. Whilst the money embedded in social housing has come from a variety of sources, some private and some public, the stock would not exist in such quantity, quality or location were it not for decades of public investment and public policy towards the non-profit sector. The release of latent value is part of the return reasonably expected from that investment. The tax payer therefore has a legitimate claim to a stake in any such capital gains.
- 4.4 The diversification of the sector has brought with it the possibility that any gains from social housing stock can be used for a wider range of purposes than ever before. For example, to subsidise entry into the provision of private rented sector accommodation. In meeting the aim of protecting social housing and the value within it, the Regulator has considered whether it is necessary and reasonable to put further restrictions on the use of disposal proceeds by non-profit and profit making registered providers.
- 4.5 For non-profit registered providers the Regulator is aware that cross-subsidy is commonplace. The status of this group means that surpluses must be re-invested in activities which are compatible with their constitutions (including their objectives). Where they are charitable the activities must also be compatible with charity law. For this reason, such cross subsidy often serves a social purpose which is consistent with the achievement of the consumer objective, particularly the requirement "to encourage registered providers of social housing to contribute to the environmental, social and economic well-being of the areas in which the housing is situated". Mindful of its statutory duty to minimise interference and given these additional protections offered by non-profit status, the Regulator is not proposing to place any further restrictions on use of disposal proceeds by non-profit registered providers.

- 4.6 The protection offered by non-profit status is lost on transfer from a registered provider in the non-profit sector to a profit making registered provider, and a risk arises of gains being distributed on the subsequent disposal of the stock.
- 4.7 There is a balance to be struck with all sides of the Regulator's economic objective. The requirement to encourage private investment sits alongside the remainder of the economic objective which the Regulator must meet: "to ensure that value for money is obtained from public investment in social housing"; "to ensure that an unreasonable burden is not imposed (directly or indirectly) on public funds"; and "to guard against the misuse of public funds". Taking all this into account, the Regulator views it as reasonable and proportionate to control the potential loss of assets where the assets transfer from a non-profit registered provider or local authority registered provider to a profit making registered provider. In order to achieve this, the Regulator is proposing to introduce restrictions on the use of disposal proceeds by profit making registered providers. It is proposed that restrictions are placed only where the proceeds arise from existing social housing stock originally acquired from a non-profit registered provider or local authority registered provider.
- 4.8 Profit making registered providers should legitimately be seeking to make a profit out of running their social housing businesses. This proposal to restrict the use of disposal proceeds will not intervene in their ability to generate profits through management efficiencies. It will not apply to stock built by a profit making registered provider or acquired from outside of the social sector. The proposal only applies to sales of stock where the capital base originated from social housing assets held by non-profit registered providers or local authority registered providers. This will enable the Regulator to meet its aim of protecting social housing assets and creates an equivalent position as if the assets had remained within the non-profit sector. The following section sets out in detail the action proposed and how it will affect registered providers⁹.

Proposed changes

Requirement to place sale proceeds in a disposal proceeds fund

- 4.9 Section 177 of the Act gives the Regulator the power to require private registered providers to account separately for net proceeds of specific types of disposal and to place these proceeds in a Disposal Proceeds Fund (DPF).
- 4.10 The Act sets out the types of proceeds this requirement applies to, which include "other proceeds of sale specified by the Regulator". The Regulator proposes to use this power to specify that when profit making registered providers acquire stock which was previously held by a non-profit registered provider or local authority

⁹ Note that these proposals are independent of provisions by the investment agencies regarding recovery of grant. Currently under the Recovery of Capital Grants and Recycled Capital Grant Fund General Determination 2012 and the Agency's Affordable Housing Capital Funding Guide operated by the HCA and also currently relied upon by the GLA in London, grant must be recycled through the recycled capital grant fund by non-profit registered providers at the point at which units are sold to profit making registered providers. Any change to this position will be a matter for the investment agencies. The Capital Funding Guide can be found on HCA's website, link here http://www.homesandcommunities.co.uk/cfg?page_id=&page=1

registered provider, and then dispose of it, they must place the net proceeds in a DPF. This must be done for all subsequent disposals of that property.

- 4.11 It is not proposed to introduce a requirement on profit making registered providers to place proceeds in a DPF where the proceeds of sale do not arise from social housing stock originally owned by the non-profit sector.
- 4.12 Where profit making registered providers' sale proceeds arise from social housing stock which has been acquired from non-profit registered providers or local authority registered providers, then all disposals are to be included in the requirement. This means:
- i. Disposal of any interest in the property is included, freehold or leasehold, with the sole exception of the granting of assured tenancies. This includes tranche arrangements under shared ownership terms.
 - ii. Disposal to any purchaser is included, whether a registered provider of social housing, inside the sector or out of it. This includes any sale to sitting tenants.
 - iii. All net disposal proceeds will be required to be placed in the DPF, rather than part using a formula. Use of a formula to apportion proceeds is open to manipulation to minimise sums going into DPF. For this reason, the Regulator has prioritised the simplicity and transparency of a requirement to place all net proceeds in a DPF.
 - iv. Where profit making registered providers place funds in a DPF, then use them to build or acquire new stock, all net proceeds from the subsequent disposal of that new stock will also have to go into the DPF, and so on through any subsequent series of transactions. This is to prevent profit making registered providers being able to distribute gains made from assets obtained from a non-profit registered provider on a delayed basis. The other requirements proposed in i) to iii) above will also apply.
 - v. Where one profit making registered provider acquires social housing stock from a non-profit registered provider or local authority registered provider and then transfers ownership to another profit making registered provider, the second profit making registered provider will also be required to place all net proceeds from subsequent sales of this stock in a DPF. The other requirements proposed in sections i) to iii) above will also apply.

The purpose of the final two proposals is to reduce the risk of value generated from current assets leaking out of the sector through a complex series of transactions.

- 4.13 Section 177 of the Act gives the Regulator power to specify what deductions may be made from gross sale proceeds to arrive at the net sale proceeds which must be placed in the DPF. The proposal is that the deductions allowed from gross proceeds will be reasonable costs of transaction only, comprising items such as legal and valuation fees. Allowable deductions will exclude any actual or notional costs of private finance in order to avoid perverse incentives to high gearing.

Use of Disposals Proceeds Fund

- 4.14 Once the net disposal proceeds are established and placed in a DPF, the Regulator has a power under section 178 of the Act to direct, subject to the consent of the Secretary of State, what they may be spent on. The General Determination on DPF contains the existing direction from the Regulator. It covers what non-profit registered providers may do with sums in the DPF. The Regulator will issue a new General Determination to replace the existing one following this consultation and will support this with non-statutory guidance. The Regulator will take the opportunity to amend

requirements in a number of minor ways. In particular, the Regulator will look at tightening up procedures to ensure that private registered providers plan and account effectively (in agreement with the Regulator and investment agencies) how they will spend DPF balances within the three year time limit. The core principles, however, will be retained.

- 4.15 The essence of the determination will be that both non-profit and profit making registered providers will be able to use sums in the DPF for building, acquiring, or refurbishing properties to be let as either social “formula” rented housing, or Affordable Rent housing under terms appropriate to the Affordable Housing Programme administered by the HCA, or GLA in London. This will place the same requirements on both types of private registered providers with the sole exception of the use of shared ownership receipts as set out below.
- 4.16 Where registered providers have put proceeds in the DPF from sales of shared ownership units, whether those proceeds come from the tenant staircasing upwards or from sale to another party of the provider’s equity in the unit, then these proceeds (and only these proceeds) may be used to build or acquire new shared ownership units. In practice this additional permitted use will only be relevant to profit making registered providers because non-profit registered providers are not required to place proceeds from shared ownership disposals into a DPF.
- 4.17 The effect of these proposals is to produce a broadly consistent approach for profit making registered providers as for non-profit registered providers regarding restrictions on use of sale proceeds. The extension of non-profit registered providers’ broad range of potential uses in the existing DPF determination to profit making registered providers and not restricting them to Affordable Rent only means that there is so far as possible consistency between the different types of registered providers.

Other changes

Requirements on proceeds from sales under preserved Right to Buy

- 4.18 In late 2013, DCLG published a revised manual for stock transfer¹⁰ which contained the proposal that proceeds which stock transfer landlords receive from any preserved Right to Buy sales should be used for new social housing. The Regulator considers this compatible with its objectives and will therefore be using the same power of determination under s177/8 of the Act, to introduce a further requirement on private registered providers who have received stock by transfer from a local authority after 30 September 2014, whether non-profit or profit making. These registered providers will be required, where any units forming part of the stock transfer are sold to tenants under the preserved Right to Buy, to place proceeds of such sales within a DPF. The transfer manual suggests that these proceeds should be used “to fund new affordable housing at no greater subsidy cost than under the main affordable homes programme and that net proceeds which remain unspent after three years are surrendered to the HCA (or in London, GLA) so that they can be re-allocated for investment in new affordable housing”.¹¹

¹⁰ *Housing Transfer Manual period to March 2015*, DCLG/HCA/GLA November 2013, link here https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/256529/131111_Housing_Transfer_Manual_-_Period_to_31_March_2015_as_published.pdf

¹¹ *Ibid*, p24

- 4.19 In order to facilitate this, the Regulator will require that such sale proceeds are placed in the DPF and used for the same range of priorities as available to registered providers in other circumstances through the DPF. The sums permitted to be deducted from gross proceeds of these preserved right to buy sales in order to arrive at the net proceeds to be placed in the DPF will be unique to this type of sale. The permitted deductions will consist of transaction costs of sale, plus the net present value of rent foregone. The precise method of calculating the net present value of rent foregone will be set out in the new DPF general determination and guidance when published later this year.

Disposing of land

- 4.20 Following consultation on these proposals the Regulator's guidance on disposal consents, "Disposing of Land", will be revised to reflect the changes resulting from the outcome of this consultation.

Forthcoming revision to the Accounting Direction

- 4.21 The Regulator intends to consult on and finalise a revised version of its Accounting Direction in due course, to encompass a number of changes needed for reasons including the publication of a new Statement of Recommended Practice (SORP) which will take effect in 2014. The revised scope and uses of the DPF set out above will necessitate some relatively minor changes to accounting for providers, to do with how the DPF is presented in accounts, identifying more clearly different sources of funds and directions of outgoing funds. These changes, on which the Regulator has a statutory duty to consult, will be incorporated into the overall revision of the Accounting Direction and included in that consultation.

Consultation questions

3. Do the proposed revisions to the disposals regime:
- a) Meet the aim of protecting social housing assets and the value in it?
 - b) Balance this aim with registered providers being free to run their own businesses?
 - c) Are they reasonable?

5. Changes to the registration criteria

Summary: This chapter summarises the eligibility requirements for registration and the current registration criteria that applicants have to meet. It sets out proposals to revise the registration criteria and explains why the Regulator thinks this is necessary. This chapter covers changes to reflect expectations at the point of registration on the new Governance and Financial Viability Standard. Annex 5 covers technical changes relating to the constitutions of non-profit providers; and changes relating to charitable incorporated organisations only.

Background

- 5.1 Anybody wishing to be a registered provider of social housing must seek registration with the Regulator. Social housing can be provided by organisations that are not registered and the only organisations required to apply for registration are those wishing to be the landlords of social housing that is funded by the HCA or by the GLA (if the social housing is within the Greater London area). Local authorities who are landlords of social housing are subject to compulsory registration.
- 5.2 The Act sets out eligibility conditions for registration that include the Regulator's criteria that applicants for registration must meet. Applicants for registration must first meet the statutory eligibility requirements and are then invited to submit a detailed application to enable assessment against the criteria that the Regulator has set. These criteria can be about an applicant's financial situation, its constitution and other arrangements for its management.
- 5.3 Since the current registration criteria were introduced in April 2010 there have been around 170 new registrations, about 20% of which have been profit making registered providers. Consistent with the Regulator's objectives, it is the Regulator's intention to set entry requirements that support an increased supply of social housing by registered providers who are financially viable and properly managed.

Eligibility criteria

- 5.4 Section 112 of the Act sets out the eligibility criteria. To be eligible, applicants for registration must:
 - be English bodies
 - be, or intend to be, providers of social housing in England
 - satisfy the criteria established by the Regulator
- 5.5 Once the Regulator is satisfied that an applicant is eligible for registration, the applicant will be assessed against any registration criteria set by the Regulator. The Regulator **must** register any applicant that is eligible and meets the registration criteria.

Registration criteria

- 5.6 The Regulator's registration criteria can be based on:
 - an applicant's financial situation
 - its constitution
 - other arrangements for its management

- 5.7 These criteria can only be altered following consultation.
- 5.8 The registration criteria are linked to an applicant's ability to meet the Standards that they will need to comply with once registered. At present the criteria are:
- an applicant must meet the financial viability requirements within the Governance and Financial Viability Standard at the point of registration and demonstrate it can sustain this on an ongoing basis
 - an applicant must meet, or demonstrate a reasonable path to meeting, the governance requirements of the Governance and Financial Viability Standard
 - an applicant must have in place management arrangements that enable it to demonstrate the capacity to meet the other regulatory standards
 - a non-profit applicant must have within its objects the provision of social housing, non-profit status and non-distribution of assets to members

Changes to the registration criteria: compliance with standards

- 5.9 The registration criteria have been reviewed in light of the proposed changes to the Governance and Financial Viability Standard (see Chapter 3). The Regulator is of the view that, in the main, the criteria remain appropriate: they do not establish a barrier to entry to new providers of social housing and they recognise the need for new entrants to be financially viable and well-governed. Effective arrangements for governance and financial viability are essential to support registered providers' ability to deliver their objectives effectively and efficiently.
- 5.10 The current registration criteria differentiate between the governance and financial viability parts of the Governance and Viability Standard, in that whilst an applicant must meet the financial viability requirements at registration, it may meet the governance requirements of registration if it demonstrates a "reasonable path" to meeting them.
- 5.11 As the regulatory requirements on governance and financial viability are now entwined, the Regulator is proposing that the registration criterion should reflect these requirements. It is proposed that applicants must be able to meet the Governance and Financial Viability Standard at the point of registration and demonstrate that they can meet this on an ongoing basis. This would mean that applicants for registration would no longer meet the governance requirements of registration if they are able to demonstrate only a "reasonable path" to meeting the governance standard, rather than meeting the standard at the point of registration.
- 5.12 The Regulator will therefore expect applicants to demonstrate compliance with all aspects of the revised Governance and Financial Viability Standard at the time of registration. Applicants will be assessed according to the stage their business is at when it registers and the Regulator's judgement of compliance with the Standard will reflect this. So an applicant can demonstrate that it meets the Standard by having in place systems and processes that are commensurate with its stage of development and that it has appropriate plans for enhancement as its business develops.
- 5.13 The current registration criteria also require that an applicant has in place management arrangements that enable it to demonstrate the capacity to meet the other regulatory standards. There is no proposal to amend this criterion. The registration process does not directly assess compliance with the Rent Standard, the

Value for Money Standard or the consumer standards. Instead it focuses on the management arrangements that an applicant has in place which support its compliance with these standards, although clearly standards are relevant. For example, the Rent Standard has to be taken into account in the business plans which support the Regulator's assessment of financial viability. The Regulator's assessment will also include things such as contractual arrangements where key services are contracted out.

- 5.14 In addition to the changes to the registration criteria required as a result of changes to the Standards, the Regulator has undertaken a review of the criteria as a whole. Annex 5 includes further changes that are proposed as a result of this review on technical changes relating to the constitutions of non-profit registered providers and changes relating to charitable incorporated organisations.

Consultation question

4. Do the changes to the registration criteria:
- a) Reflect the proposed changes to the Governance and Viability Standard?
 - b) Are they reasonable?

6. Changes to the Rent Standard

Summary: The Rent Standard is an important element of the economic regulation role of the HCA which affects virtually all tenants. Section 197 of the Housing and Regeneration Act permits the Secretary of State to direct the Regulator on rent and the changes described below are a result of a new Direction received in May 2014, as a result of changes in Government policy on rents. The Rent Standard explains the way in which rents are set and applies limits on annual increases. The Rent Standard guidance, which forms a part of this Standard, is attached at Annex 3. It provides more detail on different elements of the Rent Standard, how it is implemented and the application of various exemptions.

Overview

Why revise the standard?

- 6.1 In the 2013 Spending Review Government announced changes to rent policy. In addition, in the 2013 Budget, changes were announced which would permit registered providers to charge up to market rent levels to tenants earning high incomes. Accordingly, under s.197 of the Act, Government has issued a revised direction in relation to rent which requires the Regulator to introduce these changes for private registered providers.

Proposed changes

- 6.2 The proposed Standard incorporates the changes required by Government, which cover:
- the guideline limit for annual rent increases to be CPI +1% rather than RPI +0.5%
 - ending upward convergence of rents by means of adding up to £2 a week
 - permitting flexibility in rents to be charged to high income social tenants
- 6.3 The proposed Rent Standard, based upon the direction to the Regulator, is shown below. The Rent Standard guidance, which takes account of guidance on rents for Social Housing issued by the Government, can be found in Annex 3 of this consultation document. The 'key requirements' identified within the Rent Standard Guidance constitute part of the Rent Standard and the rest of the guidance provides further explanation of how the Standard will work.

Figure 1 Draft Rent Standard 2014

Required outcome of the Rent Standard

Private registered providers shall charge rents in accordance with the Government's direction to the Regulator of May 2014 and the Rent Standard Guidance.

Specific expectations

1. Private registered providers shall ensure they meet the following requirements, which derive from the Government's direction to the Regulator of May 2014, and the 'key requirements' set out in the Rent Standard Guidance that accompanies this Standard.

1.2 Subject to paragraphs 1.3, 1.5 and 1.6 private registered providers shall set rents for low cost rental accommodation with a view to achieving the following so far as possible.

1.2.1 Rents conform with the pattern produced by the rents formula set out in the Rent Guidance¹² ('formula rents') with a 5% upward tolerance on individual rents (10% for supported housing and sheltered housing) ('the limit of the rent flexibility level'), but subject to the maximum rent levels specified in that Guidance ('rent caps').

1.2.2 Weekly rent for accommodation increases each year by an amount which is no more than CPI + 1%.

1.2.3 Weekly rent for accommodation which is above the limit of the rent flexibility level increases each year by an amount which is less than CPI +1%, until it reaches the limit of the rent flexibility level.

1.2.4 Rent caps increase annually by CPI +1.5%.

1.2.5 Formula rents increase annually by CPI + 1%.

1.3 The requirements of paragraph 1.2 do not apply to accommodation let on Affordable Rent terms. Subject to paragraph 1.6, where accommodation is let on Affordable Rent terms, registered providers shall set rents with a view to achieving the following, so far as possible.

1.3.1 Rent for accommodation (inclusive of service charges) is set at a level which is no more than 80% of the estimated market rent for the accommodation (inclusive of service charges), based on a valuation in accordance with a method recognised by the Royal Institution of Chartered Surveyors.

1.3.2 Rent for accommodation increases each year by an amount which is no more than CPI + 1%.

1.3.3 Rent for accommodation is re-set, based on a new valuation, each time the accommodation is:

(i) let to a new tenant

(ii) re-let to the same tenant (but where a probationary tenancy comes to an end and the registered provider re-lets the accommodation to the same tenant the provider is not required to re-set the rent).

1.4 Affordable Rent terms can only be used in relation to accommodation provided pursuant to a housing supply delivery agreement entered into between a private registered provider and the Homes and Communities Agency (HCA) or the Greater London Authority (GLA).

1.5 The requirements of paragraph 1.2 shall not apply to rental accommodation let by private registered providers to a social housing tenant household during a financial year where the household income was £60,000 or more in the tax year which ended in the

¹² The Rent Guidance means the Guidance on Rents for Social Housing issued by the Government on xxxx and any other guidance issued by the Government in relation to that document.

financial year preceding the financial year in which the Rent Standard will not apply.

1.6 Where the application of the Rent Standard would cause providers to be unable to meet other standards, particularly in respect of financial viability, including the risk that a reduction in overall rental income causes them to risk failing to meet existing commitments such as banking or lending covenants, the Regulator may agree to waive specific requirements of the Rent standard for a period of time.

1.7 Private registered providers shall provide clear information to tenants that explains how their rent and any service charge are set, and how they are changed, including reference to the CPI benchmark to which annual changes to rents should be linked (except where rents are controlled under different legislation).

Consultation question

5. Do the proposed changes to the Rent Standard:
 - a) Reflect the direction from DCLG?
 - b) Express the requirements of private registered providers in a way that is clear, succinct and as outcome focused as possible?

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