Market Commentary – August 2018

When the Homes and Communities Agency (HCA) split in January 2018 following the government review in November 2016, the decision was deemed necessary so as to maintain a separation between the commercial and the regulatory. Subsequently, the HCA devolved into two separate parties: Homes England (HE) and the Regulator of Social Housing (RSH).

The RSH immediately got to work in its regulatory capacity and in April 2018 it contacted 30 registered providers with the view to better understanding the financial viability and governance of these smaller providers. One of the main concerns of the newly minted regulator was the perceived exponential growth of these providers over the past three years. Some had grown from administering 40 units to in excess 1,000 within this short time period.

During this time, and even more well publicised, was the RSH's investigation into matters regarding First Priority Housing (a registered provider), both from a governance and financial standpoint. Specifically, amongst their concerns was the stratospheric growth over a short period of time in terms of providing supported housing units.

Why the growth in Housing Associations?

The rapid expansion of these small providers can be attributed to several market conditions. Property investment linked to supported housing as recently as 2014, can be described as a niche sector within a sector. Healthcare investment was dominated by nursing homes and elderly care. The allure of the sector, namely the acquisition of ordinary residential properties coupled with secure long-term income streams, was yet to break cover. This situation dramatically changed late 2016 when Civitas Social Housing raised £350m with a REIT launch. This was subsequently increased further when Triple Point Social Housing raised an additional £200m. Both management teams had identified the investment opportunity in supported housing (since launch both entities have successfully raised additional capital).

The necessity to deploy this capital into the supported housing arena over a short period of time can be seen as the main driver behind the expansion of the smaller providers. The concern, correctly identified by the RSH, was simply that this new influx of private capital was having an adverse and altering effect on market place.

The past four years have therefore seen changes in terms of supported housing investment. Specific changes since 2016 include variations in lease length, annual rent reviews, and from an investment standpoint there have been yield compressions on good quality investments. In addition to this, there are concerning signs that in view of the First Priority case, the private sector is now aiming to dictate terms, and thus there is the potential for over-dominance.

Supported housing at its core is a public-private partnership, in which both parties should be equal partners. The public sector has a considerable shortfall of suitable housing stock and there is a quantifiable saving to the Exchequer by allowing the private sector to build the infrastructure to satisfy this need rather than administering it directly. The basis upon which the sector will survive and thrive depends specifically on arm's length dealings with the registered providers who are the counter party between the private and public sector.

Regulatory Action

As at 12th July 2018, there are 1,708 registered providers of social housing in England of which 1, 468 are non-profit entities, 198 are local authorities and 42 are for-profit entities. 66 of these have been registered since 2016 (+3.8%). Since the beginning of 2018, the RSH has removed 39 providers from the register.

It is clear that the RSH, in addition to regulating historical entities as described above, are keen to consolidate the registered providers operating in England. Long term, it is envisaged that the increased oversight, and reduction in the numbers of registered providers will create a smaller group of better regulated parties administering social housing in England. Ultimately, this will reduce the risk of future financial catastrophes for registered providers as well as provide greater investor confidence in the sector.

Registered Provider Due Diligence

Out of the 1,708 Registered providers, due diligence remains a key facet to appraising a supported housing investment. Whilst the RSH in their role as regulator can give guidance as well as grade registered providers (a recent development), they cannot advise on investment risk.

RSH Requirements:

Registered providers of social housing in England must meet regulatory standards. The standards are classified as either economic or consumer. The RSH in its capacity as regulator is looking at addressing the points specifically through its Regulatory Framework Requirements:

- **Rent Standards**

  The Rent standard requires compliance with “key requirements” as set out in their Rent Standard Guidance.

- **Register and deregister as provider of social housing**

  In order to be registered or deregistered, applicant must meet specific requirements.

- **The accounting direction**

  The accounting direction sets out specific requirements that registered providers must meet when producing their annual accounts.

- **Information required from registered providers**

  Registered providers are required to submit various types of information to the regulator: including statistical data and annual accounts.

- **Consent to disposals**

  All registered providers are required by law to notify the regulator of relevant disposals of social housing dwellings, including relevant sales, charging and leasing.

Non-profit registered providers are required to provide information to the regulator early on, regarding any restructures and are required by law to notify the regulator when making certain changes to their constitutions.

Fundamentum Property Due Diligence Standards

In terms of partnering Registered Providers, from an investment risk point of view, below is a break down of what we believe are the pertinent questions:

- **Registration with RSH** - Copy of Registered provider certificate / number and ongoing notification regarding RSH involvement.

- **Review of the board trustees & performance of the board of trustees** - What is the composition of the board of trustees, are any of the trustees conflicted? In addition to this; what is their background; do any of them have any business failures, disqualifications etc?

- **Ongoing review of Registered Providers financial statements** - Sight of and review of the produced monthly, quarterly managements accounts and financial statements. Annual credit checks on the business to include viability in line with the business strategy.

- **Sight and review of polices and memorandum of articles** - How many local authority frames works are the registered provider on?

- **Local authority referral rates** - i.e. how many and how often are local authorities referring placements to the registered providers

- **Voids review** - What monthly, quarterly void rate do the registered provider run at? If they run above 10% why ?

- **Rent model review** - Sight of and review of the registered provider's rent model on all investments. Is every facet of the rent model in line with the RSH, Local Authority and comparable with other registered providers operating in the same vicinity?

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Conclusion

Private investment into both supported and general social housing will continue grow exponentially over the foreseeable future. The economic efficiencies that can be derived by the third sector building the infrastructure also mean that this a policy that both the current and future governments should welcome. However, as the regulator has been quick to engage with registered providers over the recent months, this partnership only works if the private sector is not dictating terms to the public sector. Due to the consolidation implemented by the RSH, it is also more likely than not that the number of registered providers will reduce over the short to medium term. From a financing point of view, this should be considered a strong positive for the supported housing arena subject to the correct due diligence being conducted by the private sector in terms of overseeing investment and by the RSH in terms of Regulation.

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