



PlaceShapers response to HCA discussion paper:

“Protecting social housing assets in a more diverse sector”

Background

PlaceShapers is a network of almost 100 community-based housing associations formed in 2008. Between us we own more than 700,000 homes and provide housing and support services to more than two million people. These include health services, social care and a range of other community services. Together we completed over 40,000 new affordable homes between 2008 and 2012 and we collectively plan to invest around £5bn to deliver a further 32,000 new homes by 2015. ***As an alliance, our views on the discussion paper as set out below therefore represent those responsible for over a quarter of the sector's housing stock.***

We came together because we see the importance of working in depth with partners at a local level to achieve real improvements for an area. Indeed, localism and the big society are at the heart of what we do. We distinguish ourselves as a group because we are committed to local focus. Unemployment, crime, poor health and low educational achievement are all linked so what we do as housing organisations to help residents, local government and other agencies work together can make a huge difference to lives.

Some associations have become very large through mergers and have lost the ability to engage properly in their communities because of excessive scale or spread. We believe that it is crucial to remain truly accountable at the local and regional level. As such many of us invest heavily in local activities and partnerships designed to provide additional support for our own residents and also the wider communities within which we work. Details of our members and more about what we do can be found on our website: www.placeshapers.org

In preparing our response we were delighted to welcome Julian Ashby, Chair of the HCA's Regulatory Committee, to two round-table discussions on the proposals with our members. At these we engaged in very useful discussions and the two-way dialogue with Julian was extremely useful in assisting us to frame this response.

This letter represents the collective response from PlaceShapers on the key issues arising from your discussion document that we believe will impact on all or most of us. Individually, many of us have submitted responses on behalf of our own associations and in those we have provided more detail on the activities that we expect to participate in that may be considered wider than social housing, the level of turnover involved in such activities and therefore the level of risk.

We hope our response demonstrates our understanding of the Regulator's key concerns and that ***our request for a more permissive and proportionate approach than that outlined in the discussion paper*** will be embraced. Each year PlaceShapers make a significant contribution to the expansion of social housing stock and other housing tenures, the provision of care and support in the widest possible sense and community investment activities. We do not see this work as the sector's equivalent of casino banking – even if much of it might be considered to fall outside the narrowest definition of “social housing”. Our governance structures and Boards have evolved to respond to the dual challenges of co-regulation and developing new community enterprises. We believe we can develop the right approaches to risk management which will enable us to continue to manage social and



non-social housing activities in the same organisation. Our Boards are geared up to do this now. ***The proposals as currently framed would, we believe, constitute a significant set-back to the contribution we make to our local communities*** through the work summarised above. ***We set out below our thoughts on an alternative approach that focuses on risk management*** and is not focused on turnover (which we believe is a poor substitute for risk).

Our detailed response to the questions in your document follows:

Q1 a)	<p>Do you agree with our rationale for reviewing how the Regulatory Framework protects social housing assets in a more diverse sector?</p>
<p>PlaceShapers understands and agrees with the rationale for reviewing how the Regulatory Framework protects social housing assets in a more diverse sector.</p> <p>RPs are increasingly looking at new business opportunities to cross-subsidise their social housing businesses due to reduced levels of Government grant and long term debt on low margins.</p> <p>The reduced funding climate along with Welfare Reform means that the sector is facing risks to its balance sheet that it has not faced for many years. This is driving RPs to look to diversify and to participate in non-regulated income generating activities. PlaceShapers appreciates and understands that this carries with it different and increased risks with an increasing number of RPs who are diversifying.</p> <p><i>We agree with the range of risks identified in the Sector Risk Profile – reductions in grant, sales exposure, treasury risks and risks to income as a result of the changes brought by Welfare Reform. However, we know that RPs have been preparing and planning for these risks and, in many instances, it is the mitigation of these that has encouraged diversification into wider service delivery and non-regulated activities.</i></p> <p>Alongside this is the fact that the approach of Government to the sector has been to:</p> <ol style="list-style-type: none"> 1. Use RPs for the efficient delivery of low cost accommodation to those in need of housing using grant to achieve this; and 2. Involve those RPs in a range of other socially beneficial activities associated with the development and provision of housing – regeneration, the development of mixed communities, key worker and student accommodation and temporary accommodation to name a few. <p>The combination of the above factors has meant that <i>RPs have used the income from operations outside social housing to subsidise the development of their social housing businesses whilst also using the strength and predictability of the social housing activities to compensate for the risks inherent in the other activities.</i></p> <p>In this light, we can understand the HCA’s concern to ensure that the regulatory regime gives complete assurance that social housing assets are protected from the risks of non-regulated activities. This is combined with the fact that third party stakeholders such as rating agencies and lenders expect an ‘extraordinary level of support’ to the sector, the absence of which could materially impact on funding costs.</p>	

Despite our understanding of this context, ***we consider that the HCA’s initial proposals are in conflict with the approach of Government on both a national and local basis.*** An approach that seeks to protect social housing assets from any risk associated from non-regulated activities is not proportionate and we believe this to be in conflict with one of the HCA’s fundamental objectives: to support the provision of social housing sufficient to meet ‘reasonable demands’.

In order for PlaceShapers’ members to pursue a (Government supported) agenda of a wider range of housing and community based solutions, there needs to be a proportionate regulatory response to the perceived increased risk of diversified businesses. In the absence of a clear definition of what the above “reasonable demands” for social housing are, this should be left by the HCA to local decisions by individual RPs in conjunction with their own objectives within a risk based framework.

The case studies we highlight in our individual responses evidence the successful cross-subsidisation of new social housing development and the efficient management of social housing stock alongside wider non-regulated activities. These should not be dispensed with simply to further the objective of “de-risking” social housing assets.

We do not disagree with the HCA’s desire to protect social housing assets. However, we do question whether the ‘no risk’ approach to social housing assets is the correct approach. RPs need to be able to manage their assets and many now regularly dispose of social housing assets to further their investment strategies. ***The HCA’s approach needs to recognise these asset management freedoms.***

We remain supportive of the co-regulatory approach favoured by the HCA. As a result, we believe that it is for RPs themselves to understand the risks they face and to manage them effectively via the governance controls they have in place. The HCA’s role is to set the framework and obtain assurances that the standards are being met.

The discussion paper appears to suggest an HCA view that RP Boards may not be sufficiently able to direct and manage diverse business interests. We do not think there is the evidence to support this and believe that the Regulator has sufficient powers to intervene in individual cases should such weaknesses be identified. This is far preferable to a general shift back towards a more prescriptive, less collaborative “rules” based approach. If the RP sector is to continue to benefit from income generated by mixed business models, RP boards need to be in a position where they are able to take measured risks and expand their businesses as they see fit. PlaceShapers members demonstrate a clear success story in this strategy and the increased emphasis on improved governance arrangements and the quality of Board Members post April 2010 should give the HCA comfort in this regard.

Finally, we agree that the entrance of ‘for-profit’ providers does create an issue for the HCA and that this needs to be managed appropriately.

Q1 b)	Are there any other reasons you can suggest for reviewing how the current Regulatory Framework deals with greater diversity in the sector?
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No.

Q1 c)	Do you agree that we have selected the appropriate elements of the Framework to review?
Yes, we do agree.	
Q2 a)	Do you agree that the proposed ring-fencing mechanisms, as it is currently envisaged they will apply to different classes of provider, will effectively protect social housing assets from activities in the non-social housing sector?
<p>Whilst we agree with the ring-fencing approach in general (i.e. the concept of protecting the regulated business from failure in another part of a business), we do not believe that this question should be prioritised above others, or that it is necessary to artificially segregate the two types of activity into separate organisations. Arguably, the biggest risks to social housing assets are ones that come with the social housing activities themselves, e.g. the impact of Welfare Reform, the development of new social housing stock at much reduced grant levels, shared ownership development and sales etc. All of these regularly lead to risks within RPs that can lead to the requirement to dispose of social housing assets. The discussion paper does not propose to address any of these risks and therefore attempting to de-risk social housing assets from non-regulated activities ignores the fact that social housing assets may well still be lost to the sector due to these core social housing risks.</p> <p>The key issue with the proposed ring-fencing (especially in relation to the non-recourse to social housing assets) is that all RPs would be treated in the same way, without recognising the major differences in size, complexity and types of business now evident. The HCA refers to a ‘sector’ without recognising that existing levels of diversification within the sector mean a sector-wide, “one size fits all” approach will not be fit for purpose in any regulatory framework and cannot be a proportionate response to risk.</p> <p>Furthermore, the non-recourse to social housing assets proposals do not reflect the excellent track record that most non-social housing activities have had for years and the generated surpluses that have been reinvested in social housing activities and new assets. In the case of PlaceShapers members it does not recognise our excellent record in relation to wider investment in local communities. Stopping such cross-subsidisation would have a major and negative effect on the sector and a material impact on the plans of most PlaceShapers members. We urge a more proportionate approach that takes account of the materiality and scale of such activities and does not put everyone ‘in the same box’.</p> <p>One of the key issues arising from this debate is the definition of Social Housing. Clearly this cannot be tightly defined as just ‘low cost rented housing (including Affordable Rent properties), low cost home ownership housing and legacy stock owned by social landlords registered prior to 1 April 2010’. A tight definition such as that could exclude RPs from participating in mixed tenure developments, community cohesion activities, care services and regeneration. In our view these are all items that ought properly to be included or recognised within the definition.</p>	

We propose that any revised definition is approached on a tier basis with items that (a) are clearly social housing, (b) items that are not social housing (e.g market renting) and (c) items where there are grey areas (e.g. regeneration, Supporting People etc.). We address this further in our answer to Q2 b).

Additionally, as the HCA will be aware, the care sector already has its own regulatory regime so there is already a position of material overlap between regulators for RPs with care businesses. Any new approach needs to recognise this overlap as a live issue with increased costs for both RPs and the regulators. As such, there needs to be an accommodation between the regulators in order to deliver the statutory duty on the HCA to minimise regulatory interference for RPs.

In summary, if the HCA is not to undermine its commitment to co-regulation, any revised regulatory approach needs to recognise that **the key responsibility for managing risks and approving sound business models lies with RP Boards. It may well be that the risks within an RP's business are best mitigated by developing other streams of business.** For example, an RP may well want to reduce the potential adverse impact of Welfare Reform and reduced grant for social housing by acquiring a market rented portfolio to be occupied by economically active people. The “no recourse to social housing assets” approach to funding arrangements effectively removes the option of this strategy.

Finally, additional comfort is needed over when any ring fencing requirements would bite under the ‘comply or explain’ process. The discussion document recognises that with such diverse arrangements within RPs no timetable for compliance could easily be set. **We go further and would argue that, for many of our members, compliance, even in the long-term is neither desirable nor practical.** It could prove prohibitively expensive and may prevent an organisation from achieving its wider objectives. We believe that the HCA should accept that the time and costs required to establish new and potentially cumbersome governance models may not be justified where risks are low and that it will be reasonable for some RP Boards to decide against a move away from a business model that continues to work effectively. We return to these issues below.

Q2 b)	Are there alternative ring-fencing mechanisms which could be used to better protect assets?
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We consider the ring-fencing mechanisms can be improved to address the weaknesses we have highlighted above and to continue to allow RPs to run well-managed, diverse businesses that serve their communities.

We consider the ring-fencing proposal in the discussion paper focuses too heavily on a turnover measurement as opposed to capital. Turnover measurement is a poor surrogate to proper risk assessment and management. Our strong view is that it is the risk to capital caused by an unregulated activity that could potentially risk the future of an RP rather than its turnover because an inherently unprofitable revenue business can simply be stopped.

Therefore, rather than having a measurement based on the de minimis turnover figure, a more measured ring-fencing approach would be to limit the amount of capital that an RP could employ (or put into security or at risk) with non-regulated activities. This could cover the aggregate of, for example, the funding provided towards

the build for sale element of a mixed tenure scheme, any current pension deficit relating to staff employed on non-social housing activities (in case of crystallisation) etc.

In relation to any definition of capital deployed, there would be a need to decide whether this was based on one of the following: -

1. The valuation of the real assets on an RP's balance sheet based on an EUV-SH or TMV basis, recognising that the asset management freedoms available to RPs allow for a significant uplift to these if disposing of stock even between RPs; or
2. The overall facility that an RP has secured against its social housing assets.

Definition of Social Housing

We also consider that any ring-fencing proposals need to recognise the uncertainty the HCA has identified with the definition of social housing. We consider there to be four categories of activities that need to be classified in relation to social housing: -

1. Core Social Housing activities – general needs, social housing, affordable rent, housing management, housing maintenance & planned improvements, neighbourhood management, wider regeneration & economic regeneration activities (especially as risk mitigation to Welfare Reform changes);
2. Social value activities – Supporting People contracts, provision of health and social care, mixed tenure development projects, ownership and management of community assets, wider social value service provision commissioned by the public sector (e.g. public sector spin outs), support for social enterprises, local charities and services that serve a range of disadvantaged residents;
3. Investments of RP funding – as governed by RP investment policies and recognised by HMRC as investments rather than any trading activities for tax purposes. For RPs that are also charities, the Charity Commission has established robust guidance (guidance note CC14) which many charitable RPs already comply with. With RPs increasingly accessing capital markets funding, there is a need for RPs to ensure they are receiving the most appropriate investment return from capital markets funding, especially when placing these sums on deposit with banking institutions carries such material counterparty risks and investment returns that may well not even keep pace with inflation. Any regulatory approach that discourages (or even restricts) RPs from making prudent investment decisions that generate positive value real returns should be treated with caution; and
4. Commercial and non-regulated activities – build for sale, market rented and student accommodation ownership and management (where they are undertaken on a commercial trading basis and not on an investment approach).

We recommend the *de minimis* measures for deploying capital (or putting it at risk) should recognise these categories by placing the most restrictive *de minimis* measures over the fourth category above. In relation to the third category and investment decisions, we consider RPs should be allowed to invest in their own, wider activities, most likely undertaken by unregistered subsidiaries with an increased *de minimis* threshold to the fourth category on capital at risk. In relation to the second, social value, category of activities, it is extremely important to recognise the positive and material impact these

activities have across the country. We therefore recommend a higher threshold for these activities so that RPs' work can be maintained on the basis of a limit to the risk placed on social housing assets (on a capital basis). However, whilst we believe a framework that sets boundaries on the activities and risk levels is preferable, we do not think these should be rigid tests. This would enable a collaborative approach in keeping with co-regulation.

Comply or Explain Proposals

If the HCA implements the proposed interim "comply or explain" arrangements there will need to be recognition of the way in which many current arrangements work in practice and the constraints these may present on compliance. For example, many RPs undertaking mixed tenure developments would currently acquire land into the main RP vehicle and build it out with the flexibilities this gives. There may be little option for such RPs but to continue this approach due to current restrictive lending covenants in relation to, say, on-lending. It would be important therefore that the "comply or explain" proposals continue to allow such RPs to operate in this way and do not require new parcels of land to be placed in unregistered subsidiaries as this may be practically unachievable with individual funding arrangements in place.

Living Wills and a Support Fund

We favour an approach that abandons the ring-fencing proposals in their entirety. Our preferred approach is to toughen the Living Will proposals to ensure the appropriate focus on risk is maintained by the Board and that effective recovery plans are drawn up. This should ensure that co-regulation is strengthened, Boards move centre stage in risk management and social housing assets are protected.

As an alternative, we recommend that the HCA considers a model of protection similar to that used by the CAA/ATOL. This would involve a sector wide levy under the HCA's current powers of, say, £1 per social housing property per annum for the foreseeable future that would act as an 'RP Support Fund' for RPs in financial difficulty. The aim of the Support Fund would not be to rescue RPs (due to the obvious moral hazard arguments) but to enable an orderly break up of an RPs business where it was in (terminal) financial distress. In testing this idea amongst our members we are aware of varying degrees of support but we nevertheless consider the idea as worthy of further exploration.

The points in favour of this approach are: -

1. Social housing assets are disposed of by the sector every day. The HCA should not adopt a 'no risk' approach but should simply protect the 'no default' status of the sector with lenders, rating agencies and other third party stakeholders. The Support Fund would do this by allowing for the orderly disposal of social housing assets either between RPs (at increased stock rationalisation values – i.e. not at distressed values) or based on the disposal of voids outside the sector, thus capitalising on vacant possession valuations;
2. Such an approach would allow the RP sector to continue with its mixed business model with RPs able to manage and lead their businesses without being unduly constrained. This reflects a co-regulatory approach much more so than the approach suggested and also reflects sector improvements in governance;

- 3. This type of break-up of any RP is discussed in detail in the Savills report “Viability and Vitality” and, as such, has been intellectually tested; and
- 4. With the orderly disposal of assets at values higher than they appear on RPs’ balance sheets, there would be the flexibility for the Support Fund to be self-financing in the future with it not necessarily therefore being an annual levy.

Q2 c)	Do you think that the proposals as a whole strike an appropriate balance between protecting social housing assets and providers being free to run their businesses?
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As a whole, we do not consider the proposals strike a balance between protecting social housing assets and RPs being free to run their businesses.

The “comply or explain” proposals for RPs do provide a degree of comfort for mixed business RPs going forward where they will not technically comply but the single biggest issue for the RP sector is the proposed ring-fencing of social housing assets so that there can be no recourse to these from non-regulated activities. This approach risks discounting the major financial and other benefits that have been achieved and are being achieved by RPs at the moment as evidenced by our members in their individual responses. The result is that, ***if implemented, the proposals would not allow RPs to run their own businesses in the way they see fit and could unnecessarily constrain them going forward to the disadvantage of their local communities.***

The proposals, as outlined in the discussion paper, appear to put a ‘stop’ on RPs diversifying their businesses even for valid cross-subsidisation purposes. We are pleased therefore that the HCA appears to be indicating in discussion a willingness to rethink this approach and hope that this will be reflected in the eventual outcome.

The other key element to these proposals will be ensuring that the definition of Social Housing is widened to reflect, for example, the categorisation of activities within our answer to Q2 b).

Q2 d)	Are there any impacts on the sector that the Regulator should take into account in developing its final approach?
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We consider there would be a major impact on the RP sector and what it could achieve if these proposals are implemented as currently proposed. Depending on how the ring-fencing rules and “comply or explain” proposals are implemented, a great many valued mixed tenure schemes and community projects currently delivered or planned by our members may have to be curtailed. This would reduce our members’ contribution both to the social housing sector and the local economies in which they operate. We are sure that our members will provide you with example case studies of such schemes in their individual responses to the discussion document.

As already mentioned, there are also some predictable implementation issues concerning the proposed ring-fencing proposals that may mean many RPs would need to operate within the “comply or explain” proposals for some time or even, we would argue, indefinitely. These include: -

1. Legacy lending arrangements with very beneficial lending margins that are not now achievable in the lending market. Separating out non-social housing activities into other corporate vehicles would trigger renegotiation of such arrangements and the loss of these benefits;
2. Cross-default provisions within facility agreements for different parts of an RP business may mean breaches of covenants within unregulated parts of the business could trigger default in regulated parts of the RP business; and
3. Cohorts of employees remain on defined benefit pension schemes, particularly SHPS and LGPS. It may well be that it would be necessary to move these employees around corporate group structures to implement the non-recourse to social housing assets proposals. This could cause the crystallisation of pension deficits within RPs. There are ways of addressing this risk but they generally require the RP itself to maintain their admitted body status and, in the final analysis to be liable for pension deficits if the unregulated entities become insolvent.

The above emphasises our view that the “non-recourse to social housing assets” basis of the ring-fencing proposals as currently proposed would be extremely challenging to implement within the existing RP sector.

Q3 a)	Do you agree with the objectives for recovery planning which we have set out?
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Yes, we support the idea of recovery planning, including the suggestion for living wills. This is where we believe the discussion should now focus. ***Living wills should have teeth, but they should be proportionate (see our response to Q 3 b) below.) For many associations they will need to be comprehensive exercises with full risk analyses, recovery plans and, where necessary, independent validation.*** This single measure should ensure Boards focus on the critical risk management issues facing their associations; ***it is this and not ring-fencing – that will be the most effective safeguard for social housing assets.*** To be effective strict standards of confidentiality will need to be maintained. Without this Associations will inevitably be tempted to pull their punches.

Q3 b)	<p>What are your views on our proposals to introduce recovery planning requirements through:</p> <ol style="list-style-type: none"> i. Changes to the existing Governance and Financial Viability Standard; ii. A code of practice on recovery planning applying to designated providers on the basis of specified criteria; iii. A change in practice to require more detailed plans to be produced as a normal part of the Regulator’s engagement where there are concerns with a particular provider?
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There are advantages to all these but amendments to the current standards to incorporate the requirement for recovery planning in defined circumstances would be the preferred option. We support the idea of a tiered approach to recovery planning as this recognises

the need to minimise the burden on low-risk providers with less complex structures.	
Q3 c)	Do you have any views on the criteria that should be applied to identify providers which should comply with the proposed code of practice?
Key to the recovery plans would be the designation of the category of RPs to fall within Tier 2 – we understand that the likely approach is to focus on the top 60 RPs nationally which we would agree with.	
Q3 d)	Are there any alternative ways to achieve the objectives for recovery planning?
No, we agree that the approach suggested is proportionate.	
Q3 e)	Are there any other impacts on the sector of introducing recovery planning that we should take into account when developing out final proposals?
There are no specific impacts that we wish to highlight. However, it would be helpful as part of the final proposals to know the methods that the HCA will have in place for identifying potential rescuers for a failing provider.	
Q4 a)	Do you agree with the rationale for greater protection of public investment in social housing when stock is disposed?
Yes, we support the approach being taken to ensure that the “public value” held in social housing assets is not lost to the social housing sector when assets are sold. We support the need to remove the potential for ‘asset stripping’ in order to generate profits. However the definitions in Section 4.2 are not, in our view, workable as they stand.	
Q4 b)	What are your views on the two options outlined for ensuring that public investment in social housing is retained within the sector on disposal?
Both of the options outlined in the document have merit although in the current climate we prefer option 1. With social housing in such short supply we feel that the entire proceeds from the sale of social homes (after repaying secure lenders) should be recycled into providing further social housing.	
Q4 c)	Are there any potential impacts on the sector that we should take into account in developing our proposals which have not been highlighted above?
Both options might deter ‘for-profit’ providers from investing in planned maintenance and improvements to social housing assets if they will not be able to distribute any resulting increase in value as profits.	