Ministry of Housing,
Communities &
Local Government

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Assessment of Impact of The Insolvency of Registered Providers of Social Housing Regulations 2018

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ASSESSMENT OF IMPACT - THE INSOLVENCY OF REGISTERED PROVIDERS OF SOCIAL HOUSING REGULATIONS 2018

Problem

1. There are almost 1,500 Private Registered Providers of social housing in England. The housing association sector has changed significantly in recent years and the level of private finance has grown from £48 billion in 2012 to £70 billion in 2017. Housing Associations are also significantly more exposed to uncertainties in the housing market because they build more homes for private sale than they previously did. While financial failure remains extremely rare, the existing insolvency regime for housing associations is no longer best-suited to dealing with the size and complexity of some of these bodies if they were to encounter financial difficulty.

2. In addition, under the existing arrangements, there is the risk that if the Regulator for Social Housing ("the Regulator") cannot reach a solution with creditors within a 28 working day moratorium period, creditors are able to call in loans and seek to recover funds through sale of assets (including social housing stock). A failure to protect social housing assets in an insolvent provider would mean that the tenants were at risk of losing their homes or having their rents increased to market levels. Much-needed affordable housing would be lost and the taxpayer's investment through affordable housing grant could be lost.

Rationale for intervention

3. In 2012, a medium-sized housing provider with around 13,000 properties experienced serious financial difficulties. While the Regulator managed to broker a takeover without triggering a moratorium, a subsequent, independent "lessons learned" report[1] highlighted that existing insolvency arrangements may have been insufficient to resolve the problems in this case had they been triggered and would be very unlikely to be effective with an insolvency of a larger, more complex association.

4. An effective response to a large-scale insolvency is important to protect tenants and to protect Government's investment in social housing. It is also critical to protect wider investment in the sector. Housing associations have a very good track record of meeting their obligations to lenders underpinned by a steady income stream and robust regulation. Informal consultation with representatives

[1] *Cosmopolitan Housing Group, Lessons Learned, June 2014*
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/372166/cosmopolitan_lessons_learned_report.pdf

of lenders demonstrated clear support for the proposed changes.

5. Current insolvency arrangements for other parts of the economy are largely governed by legislation. There is also already Government intervention to the extent that existing legislation provides the Regulator with a 28 day moratorium period to deal with an insolvency. This policy aims to improve the regulatory regime for housing association insolvencies. There is also an equity rationale in strengthening the protection of the social housing assets, given the circumstances of those who rely on the sector to meet their housing needs.

Proposed approach

6. The Housing and Planning Act 2016 created a new housing administration regime. Under this regime, if a housing association became insolvent, the Secretary of State, or the Regulator with the Secretary of State's consent, could apply to the courts for a housing administrator to be appointed. The main objective would remain to rescue the organisation or return money to creditors. However, the administrator would also have a secondary objective - to retain as much of the social housing as possible within the regulated sector. In doing this, the administrator would not be subject to the current 28 working day time limit.

7. The Housing and Planning Act 2016 applies the housing administration provisions to companies directly. However, the vast majority of housing associations are not companies. The Act took a power to make regulations to extend the primary legislation to these other types of housing association ie registered societies and charitable incorporated organisations. It is the impact of these regulations that this note covers.

8. The Act also took power for regulations to set out how housing administration would operate. These "housing administration rules" are being taken forward separately (by the Lord Chancellor under the terms of the Insolvency Act 1986).

9. Informal consultation with those most likely to be affected by the changes, including insolvency practitioners and lenders, demonstrated broad support for the approach.

Impact

10. The regulations will not have any impact on solvent providers. As set out above, incidences of insolvency in the sector have been extremely rare and putting in place more robust insolvency arrangements will not increase the likelihood of insolvency occurring.

11. A number of different types of entity are registered with the Regulator as providers of social housing. Disregarding local authority providers, there are currently almost 1,500 private registered providers – the type of organisation most commonly thought of as a "housing association". Between them they provide over 2.6 million homes. The vast majority of housing associations are not companies, however, and these regulations therefore apply to the other 1,100 private registered providers that own almost 2.3 million homes.

12. Despite the number of providers potentially affected, it is likely that the need to make use of the regulations to appoint a housing administrator will occur rarely. This is because of two main factors:

- Financial failure in the sector is rare – in recent history there has been only one case of a serious threat of insolvency and one technical insolvency where the insolvency was necessary to deliver the rescue package in those particular circumstances.

- Existing arrangements may be sufficient and will remain in place – in the majority of cases of financial difficulty the Regulator is able to resolve matters without recourse to insolvency legislation. This would remain the preferred approach to dealing with cases of financial failure wherever possible. The Regulator may also (although perhaps not always) be able to resolve the financial situation for small and medium registered providers, within the existing 28 working day moratorium period without the necessity of resorting to the appointment of a housing administrator. The most recent statistics[2] show that less than 5% of private registered providers own more than 10,000 units.

13. As stated previously, the regulations will not have any impact on solvent providers and incidences of insolvency in the sector have been extremely rare.

14. The main potential cost of these regulations would be the cost of appointing a housing administrator in any instances where these insolvency procedures apply. The organisation facing insolvency will bear these costs; costs will be payable out of the assets of the company. As such, this potentially reduces the amount available for creditors. These costs would vary substantially depending on the size and complexity of each housing association. However, based on examples of the costs of insolvencies of property companies, we believe an average additional cost of housing administration (over and above that associated with managing an insolvency through a moratorium) would be in the

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[2] *Private registered provider social housing stock in England, 2016-2017*
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/654616/SDR_Statistical_Release_2017_Full_v1.0.pdf

region of £500,000.

15. Any additional cost, however, has to be set against the likely benefits associated with dealing with an insolvency under a regime better suited to dealing with a housing association that is facing more complex financial difficulties. The provider and creditors may benefit from the greater potential for the administration to result in the provider being rescued as a going concern (although this is difficult to assess against the counterfactual). Where that is not possible, creditors should still at least achieve a better result than under a liquidation by enabling assets to be realised through a more orderly process than a fire sale that sees significantly reduced asset values.

16. Tenants would also benefit from their homes being more likely to remain in the regulated sector (as a result of: 1) a greater likelihood of avoiding assets being sold off; and 2) the introduction of a secondary insolvency objective of retaining as much of the social housing as possible within the regulated sector).

17. The variety of scenarios (the nature of the problems, the size of the provider, the outcome under the counterfactual etc) makes it extremely difficult to estimate the size of that benefit where a future insolvency is subject to the new housing administration regime.

18. As well as the difficulty in assessing the impact in relation to a particular instance of insolvency, there is also a further substantial obstacle to monetising the likely impact. The historic rarity of insolvencies means that there is little evidence on which to base any estimate of the probability of future incidences - there has been only one in the past 22 years and this was a “technical” insolvency and dealt with under the existing arrangements. The Regulator will continue to oversee the financial viability and management of housing associations. This should ensure that financial failure will continue to be unlikely in the future. Confidence in the approach to regulation is reflected by the very low interest rates at which the market lends to the sector.

19. Indeed a less direct benefit of the proposed change is that with the administration regime in place, there is a reduced risk that a future unmanaged workout of an insolvent provider would impact on lender confidence and in turn lead to an increased cost of private finance for the sector as a whole.

20. Therefore, monetising the gross benefit is extremely challenging. However, given the relatively low additional costs, it seems highly probable that these would be in excess of gross costs meaning there would be a net benefit where the new regime was used. However, it is probable that the use of the regime will be infrequent meaning that an average annual net benefit would be small.

Summary

21. The changes made by these regulations would make available an insolvency regime that is better able to deal with the current and future nature of the housing association sector. Insolvencies have been rare and the changes will not increase the likelihood of this occurring in the future. It is not possible to provide an estimate of the annual net cost/benefit given:

    - the infrequency of insolvency occurring;
    - the range of size of providers that might be affected;
    - the nature of the financial difficulties that might occur and the actions and outcomes that would result;
    - the difficulty of establishing the likely costs and benefits that might apply in the counterfactual given the above limitations.

    However, based in particular upon the frequency with which the regime is likely to be called upon, we believe that a monetised net benefit figure would be small.