Analysis of the finances of Registered Social Landlords for 2020/21

May 2022

Contents

Highlights 1

Executive Summary 2

Financial Review 2020/21 9

- Statement of Comprehensive Income 9
- Statement of Financial Position 13
- Statement of Cash Flow 15
- Costs per Unit & Ratios 17
- Borrowing & Effective Interest Rates 18
- Rent Increases & Inflation 20
- Arrears & Voids 21

Pensions 22

The Impact of the Pandemic – Quarterly Returns 2021/22 24

The Next Five Years 24

- Aggregate Projections to 2025/26 24
  - Statement of Comprehensive Income 24
  - Statement of Financial Position 25
  - Statement of Cash Flow 26
  - Financial Ratios 27
- Future Development 29
- Investment in Existing Stock 30
- Rent Increases & Inflation 32
- Projected Borrowing 33

Glossary 34

HAPPY TO TRANSLATE

Highlights

Like other areas of the economy and society in general, Scottish Registered Social Landlords (RSLs) have been affected by the unprecedented events of recent years; however, most landlords moved at pace to adapt to the new and challenging operating environment in which they found themselves. Our analysis for 2020/21 is that RSLs have achieved this whilst generally delivering a robust financial performance, backed up by strong liquidity. It is worth noting that over the period of analysis some RSLs received furlough payments and aggregate maintenance costs fell as restrictions meant they had to be deferred.

Turnover RSLs increased aggregate turnover by 0.6% to just over £1.80 billion in 2020/21. Affordable lettings income went up by 0.5% to £1.59 billion, contributing 88% of turnover.

Surplus RSLs reported an aggregate surplus of £309.8 million for the year to 31 March 2021, showing a continuation of the upward trend of recent years. The net margin increased from 14.0% in 2019/20 to 17.2% in 2020/21.

Available Cash RSLs increased cash balances significantly in 2020/21, up £155.0 million (18.5%) to £990.6 million. Quarterly COVID-19 returns submitted during 2021/22 show an overall reduction in cash balances across the year, dropping to £928.6 million at 31 March.

Cash Generated RSLs maintained a strong financial position at the end of 2020/21, with cash generation up £102.4 million to £626.6 million, and interest paid on debt down £9.6 million to £181.6 million.

Interest Cover Increases in operating margins caused a 23-percentage point rise in EBITDA MRI interest cover (Earnings before interest, taxation, depreciation & amortisation, major repairs included), which was up to 285% for 2020/21.

Housing Investment RSLs continued to invest in new and existing homes, with net housing assets up £406.0 million (3.0%) to £14,060.5 million during 2020/21. That said, levels were below those forecast as a consequence of pandemic related restrictions.

Borrowing RSLs increased available debt facilities to £6.41 billion at 31 March 2021, of which £5.36 billion has been drawn down, with a balance outstanding of £4.71 billion. Whilst RSLs agreed new facilities of £0.66 billion in 2020/21, a drop in spend in the year meant available undrawn facilities of £1.05 billion at 31 March 2021. This, and increased cash balances, means sector liquidity remains strong. Borrowing is set to further increase with a forecast requirement for an additional £1.3 billion over the next five years to fund investment in new and existing homes.

Rents & Inflation In aggregate, rent increases were above CPI inflation in 2020/21. Aggregate rents are projected to increase by more than inflation for the majority of the next five years; however, many RSLs have moderated their rent increases down for 2022/23 in response to the circumstances brought about by the pandemic and other economic challenges.

Voids, Arrears and Bad Debts Voids, arrears and bad debts at 31 March 2021 either remained around the previous years' levels or showed some improvement, demonstrating

the positive impact of the work done by RSLs to mitigate these. RSLs are also forecasting reductions over the next five years.

Pensions The move to defined contribution (DC) schemes by RSLs who previously offered only defined benefit (DB) schemes has continued, but at a slower rate than in previous years. There are now 77 RSLs who only provide a DC scheme for employees, up from 69 in 2019/20.

Executive Summary

Overall Conclusion

RSLs' financial performance remains robust, but the challenges ahead are significant.

The Annual Financial Statement (AFS) returns cover the year to 31 March 2021. We know this time was dominated by the pandemic and like other sectors of the economy and society, RSLs were massively impacted during this unprecedented period. Our analysis of the AFS returns for this period show that in general RSLs had a robust financial performance, despite the challenges brought by the pandemic.

During the period, lockdowns and other restrictions resulted in delays to capital investment programmes in particular. This disruption contributed to lower levels of investment in existing stock in 2020/21 and led to lower operating costs. Planned and cyclical maintenance was the most impacted, with expenditure 8.9% lower than the previous year.

The aggregate surplus generated by operating activities decreased from £392.5 million to £390.5 million, however this was predominately a result of a fall in the gain on exceptional items due to reported losses on RSL transfers of engagements.

RSLs have, however reported an aggregate net surplus of £309.8 million for the year to 31 March 2021. This is an increase of 23.4% from 2019/20 and a continuation of the upward trend of recent years. Other key indicators such as net assets, cash generation and interest cover remained strong.

The Five Year Financial Projections (FYFP) returns cover the period from 2020/21-2025/26. These projections were made at a time when the economic outlook remained unclear. RSLs continue to operate in an uncertain environment over this five-year period and our analysis is carried out within this context. We anticipate that the next FYFP returns will be more reflective of the current economic environment.

At the end of 2020/21 RSLs forecast that turnover would increase at a faster rate than operating costs over the next five years, driven in part by the tendency to forecast rents increasing at a faster rate than operating costs. However, recovering from the impact of the pandemic, disruptions in global supply chains, and a tight labour market are likely to result in continuing shortages of materials and skills resulting in sustained increased rates of inflation. Landlords are already seeing increases in development costs and maintenance costs.

RSLs will need to closely monitor the financial implications of spending on existing homes to address remedial safety works, energy efficiency improvements and catch up on repairs. In particular, the drive to achieve net zero and the decarbonisation of heating in homes is likely to bring significant future costs for RSLs. All of this makes it essential for Governing Bodies to fully understand their cost base and capital requirements. They should also stress test their underlying financial and economic assumptions and where appropriate develop mitigation plans in response to risks identified. Given the current level of uncertainty and volatility it is vital that this stress testing is carried out on emerging as well as current risks.

Aggregate gross arrears increased over most of 2021/22; from 4.10% at 30 June to 4.31% at 30 September, to 4.42% at 31 December, before dropping back to 4.34% at 31 March 2022.

Within these figures, there are a number of RSLs who have experienced high levels of gross arrears.

From our most recent financial risk assessment we have concluded that the vast majority of RSLs were managing their resources to ensure their financial well-being, while in general maintaining rents at affordable levels. We have published Engagement Plans and Regulatory Statuses for all RSLs and are engaging with 33 RSLs in relation to finance. Where we are engaging with an RSL on finance and considering its business plan, we will also discuss how it has satisfied itself that rents remain affordable for its tenants.

Keeping rents affordable should be a principal objective of all social landlords. In a context of rising inflation, fuel and energy costs it has never been more important for landlords to vigorously pursue cost efficiency and value for money. It is also important that landlords demonstrate to their tenants that their rents will remain affordable and that they are having effective dialogue with their tenants on rent levels and increases.

Turnover

The aggregate turnover for RSLs is up 0.6% to £1.80 billion, with affordable lettings showing similar marginal growth of 0.5% in 2020/21, and other activities up 2.0% over the same period. Affordable lettings comprise an RSL's income generating activities (rents & service charges) but also the receipt of grant income. Most RSLs release grant income over the life of the related assets, and in 2020/21 that income was down £42.7 million on the previous year to £155.8 million. Grants released from deferred income can fluctuate year on year due to several larger RSLs using the performance method.

The core business of RSLs however is the provision of social housing. This generates an annual income of approximately £1.43 billion (over 79% of all turnover), predominantly from rent and service charges.

RSLs forecast that turnover will increase annually by an average of 4.1% over the next five years, with operating costs set to rise by 3.7% per annum over the same period. Overall, turnover is set to increase by 22.2% to £2.1 billion, and operating costs by 19.5% to £1.6 billion.

Cash Generated from Operations

In the coming years RSLs' costs are expected to rise significantly. Governing Bodies are responsible for ensuring that RSLs have access to sufficient liquidity at all times, that funding is available for immediate cash flow requirements, and that plans are in place to mitigate against possible adverse scenarios. RSLs' forecasts indicate that cash from operations is set to increase significantly from £500.0 million in 2021/22 to £794.0 million by 2025/26.

Cash Generated per £1 of Interest Paid

For many years we have used cash generated from operations to interest paid as a measure of the financial health of the sector and individual RSLs.

This ratio had been falling in recent years; however, it increased to 3.45 in 2020/21 (2019/20 2.74). The main driver of this increase was the rise in net cash from operating activities.

While interest paid is also forecast to increase across the five years, it is not expected to rise to the same extent as net cash from operating activities.

This ratio is forecast to fall again in 2021/22 as re-profiling of spend previously delayed by COVID-19 restrictions takes place. It is then forecast to be at least 3.00 from 2022/23. This means that RSLs, in aggregate, are forecast to generate around £3 in cash from operations for each £1 they pay in interest.

Investment in New & Existing Properties

Lockdowns and other restrictions saw many developments suspended and investment in existing stock slow down. This disruption meant RSLs' expenditure on the acquisition and construction of properties and investment in existing properties reduced substantially. In 2020/21 RSLs invested £907.6 million, a decrease of £183.3 million on the previous year. Net capital grant receipts decreased marginally to £453.0 million (2019/20 £466.9 million).

A small number of RSLs use the proceeds of sales to help finance development. Whilst the numbers remain small at this time, the risk attached is greater as it relies on the ability to be able to sell at a high enough price and volume to meet the required investment in new properties. Cash receipts from property sales fell by £3.5 million to £19.1 million and is forecast to remain at current levels.

The development of new homes remains a key Government priority and RSLs continue to play an important role in meeting this demand. The total number of units forecast to be developed by RSLs is just over 29,000 at a cost of almost £4.5 billion. Exposure to development brings its own set of risks. In addition to slippage and general scheme delays, RSLs have reported development works being affected by the continued supply chain issues and pressures in the contractor market across the construction sector. In many instances this has led to price increases.

RSLs should refer to our development thematic when making decisions about whether to undertake a development project. The thematic sets out ten positive practice principles that will assist Governing Bodies as they go through the process.

In addition to the new development programme, many RSLs are forecasting significant capital expenditure on their existing properties. In total they are projecting spend of almost £1.6 billion over five years.

We encourage all landlords to have robust and up to date information on the condition of all their stock. This is to ensure that landlords have as accurate information as possible to monitor their delivery of the Scottish Housing Quality Standard (SHQS), Energy Efficiency Standard for Social Housing (EESSH) and other tenant and resident safety obligations as well as feeding into their planning for investment in their tenants' homes. We provide guidance for landlords on this and will publish an update to our Asset Management Recommended Practice during 2022/23.

Borrowing

RSLs' aggregate debt facilities secured exceeded £6.41 billion at 31 March 2021. Of that total, £5.36 billion had been drawn down, with a balance outstanding of £4.71 billion. Available undrawn facilities were £1.05 billion. RSLs agreed new finance of £0.66 billion in

2020/21 and debt is expected to increase to £6.3 billion by 2025/26, as funding for the investment in new and existing homes, an increase of around £1.3 billion over the five-year period.

We published our latest summary of the RSL Annual Loan Portfolio Returns in December 2021. Our analysis shows the funding markets continued to function throughout the pandemic and that lending to and investment in RSLs remains high. The ongoing commitment of many long standing lenders and investors continues to represent a considerable vote of confidence in the sector and how it is managed, governed and regulated. This is good news for RSLs and their tenants and service users.

It is important that lender and investor confidence is maintained in order to retain the availability of lending and favourable investment rates for the sector. This will be vital in supporting RSLs as they continue to deliver increased investment in existing stock and new affordable homes.

At the time of writing, the Bank of England base rate of interest had increased from an historically low 0.1% to 1.00% as inflationary pressures increased. The Office of Budget Responsibility (OBR) is forecasting that this will increase further to a peak of 1.9% in 2023/24 before falling back to 1.4% by 2025/26. This is likely to impact on the interest rates being paid by RSLs for new borrowing and we would expect this to be incorporated into assumptions for long term projections and any associated sensitivity analysis.

We expect all RSLs to plan their treasury requirements well in advance. At a time when more RSLs are looking for more finance than ever before and several RSLs now hold published credit ratings, this has heightened importance. For any RSL the provider of private finance is an important stakeholder, and it is crucial for RSLs to be clear what the lender is seeking and what type of relationship they will look to have with their client. Clearly price is an important consideration, but it is not the only consideration. It is essential that RSLs manage interest rate risk and plan for any interest rate increases in the future.

With RSLs now also considering Environmental, Social & Governance (ESG) investments, this may attract new lenders and investors to the sector. This type of lending has the potential to introduce lower interest rates; however, it also tends to bring with it new accountabilities. There can also be extra costs associated with reporting against targets and RSLs should be aware of this.

The EBITDA MRI calculation (Earnings before interest, taxation, depreciation & amortisation, major repairs included) is impacted by the level of capitalised maintenance costs being forecast. Due to the level of catch-up work being forecast, the figure for 2021/22 is significantly lower than the next four years. Many RSLs will have this, or something similar, as a covenant and will need to monitor this calculation closely. Where there is a risk that the covenant level will be breached, RSLs should have early dialogue with the lender. A notifiable event for a potential covenant breach should also be raised through the Social Landlord Portal.

Rent Affordability

Last year we reported that during 2020/21 the average weekly RSL rent was £89.74. In 2021 landlords planned to increase rents by 1.2%, and that is a significant reduction from the

2.5% planned rent increase in the previous year, and from the actual rent increase in that year of 2.7%. Clearly, the pandemic, and the wider economic impact on tenants, have influenced landlords' decisions on rent increases. This is an understandable response to the difficulties that a significant number of tenants have faced over the period of the pandemic.

This reduction means that, for many landlords, their actual income will be less than they had previously projected in forecasts and business plans. We understand the drivers of rent increases can be many and complex, and some will be beyond the control of landlords. That only makes it even more important for landlords to vigorously pursue cost efficiency and value for money to ensure that rents are affordable for tenants.

In their business plans most RSLs use a formula based on past inflation when setting their rents for the year ahead. There is therefore a risk that the increased inflation experienced since April 2021 will result in higher projected rents for RSLs in future years.

Our National Panel of Tenants and Service Users reported in July 2021 that 40% of tenants on the Panel have experienced difficulties affording their rent and 64% were concerned about future affordability.

We will continue to focus on rent affordability and the everyday pressures on tenants' ability to pay. This was brought into sharp focus by the pandemic and is now exacerbated by the recent and forecast sharp rises in inflation and energy and fuel prices.

Arrears & Voids

Bad debts, void losses and current tenant arrears are key performance indicators in assessing the efficiency of letting and rent collection. Throughout 2020/21 and 2021/22, we continued to work with the Social Housing Resilience Group (SHRG) in supporting the recovery from the pandemic. A key aspect of the work was monitoring the operational impact of the pandemic on these indicators through the quarterly survey return.

The last quarterly dashboard collated and published on behalf of the SHRG shows that aggregate rent arrears had fallen across the last three months of 2021/22 to be 4.34% of rent due at March 2022.

In analysing voids, arrears, and bad debts against turnover, we see that other than voids these measures have remained around previous years' levels or shown some improvement. This helps demonstrate the positive impact that the work done by RSLs to mitigate these is having.

RSLs' are also forecasting reductions over the five years of the projections; however, there is still potential for further pressure on arrears. Increasing energy and food costs, reduced benefit incomes, the potential for higher tenant unemployment as government support for the economy winds down as the pandemic eases, may all increase financial pressure on tenants over the coming year.

There is also the continued possibility of rent losses from voids increasing because of ongoing labour shortages, supply chain disruption and cost inflation, which are likely to delay works and increase costs.

A key objective for Governing Bodies is ensuring rental income risks are appropriately managed and demonstrating that they understand the implications of increased arrears. Governing Bodies should continue to stress test against reductions in income and establish mitigations where necessary.

Pensions

The proportion of RSLs that still have some exposure to DB schemes has dropped to 47%. This is the first time it's dropped below 50%. Notwithstanding this recent shift, it still means almost half of RSLs still have some DB exposure in carrying the risk of any shortfall on return on investment. The eventual liability borne by the RSL is uncertain and cannot be controlled by the RSL.

The financial obligations of those RSLs with exposure to DB schemes are recalculated on a triennial basis, creating risks of increased costs where schemes are found to be in deficit. Long-term reductions in interest rates and ongoing weak gilt yields have resulted in many schemes being under-funded. This can, and has done in the past, resulted in increases in pension deficits, and therefore increases in the contributions that landlords must fund.

The main scheme providers to the sector remain the Scottish Housing Associations Pension Scheme (SHAPS) and the Local Government Pension Schemes (LGPS). The outcome of the next triennial revaluation of the SHAPS scheme should be available in the summer of 2022 and we will incorporate the results into our annual financial risk assessment.

Many RSLs are faced with large and growing liabilities if they do nothing, or a large immediate liability if they do something. Acting now to change schemes may crystallise future obligations. Deferring a decision to change away from a DB scheme will increase future liabilities. Although most RSLs have taken a proactive approach to managing this risk, where appropriate Governing Bodies should seek independent professional advice to understand their pension risk exposure.

RSLs need to take pension affordability into account in their business planning and financial forecasts. If they continue to choose to offer the option of DB, then Governing Bodies need to consider the potential impact on rent levels, rent affordability, cost efficiencies and value for money for tenants.

Net Zero-Carbon

The Scottish Government's net zero-carbon commitments will result in requirements for substantial investment in RSLs' existing homes, although the exact costs for this are not yet know.

It is important for Governing Bodies to be aware of this and to be considering what this might mean for investment in homes and for their business plan. Having up-to-date stock condition data should be the basis for building a more in-depth understanding and in turn allow the identification of any current investment needs, while also planning to meet new requirements in relation to energy efficiency and decarbonisation.

As part of our FYFP return for 2022/23, we asked whether RSLs' have considered the future cost of decarbonisation, and if so, what estimated costs have been projected.

Financial Review 2020/21

Statement of Comprehensive Income

The aggregate surplus for the year to 31 March 2021 of £309.8m continues the upward trend of recent years. The net margin increased from 14.0% in 2019/20 to 17.2% in 2020/21 and total comprehensive income for the period was £165.0m. This includes an aggregated actuarial loss on pension schemes of £144.8m. Key movements in the year were:

- turnover, up £11.6m (0.6%)
- operating costs, down £7.8m (0.5%)
- operating surplus, down £2.0m (0.5%)
- interest payable, up £19.5m (10.0%)
- net surplus for the year, up £58.7m (23.4%)
- actuarial pension loss, down £300.8m (192.8%)
- total comprehensive income, down £241.2m (59.4%)

	2020/21 £'000s	2019/20 £'000s	2018/19 £'000s
Turnover	1,804,911	1,793,283	1,704,433
Operating costs	(1,421,729)	(1,429,495)	(1,371,728)
Operating surplus / (deficit), before exceptional operating items	383,182	363,788	332,705
Gain / (loss) on disposal of plant, property and equipment	2,159	1,710	(1,174)
Exceptional operating items	5,156	26,970	(33,433)
Operating surplus / (deficit)	390,497	392,468	298,098
Share of operating surplus / (deficit) in joint ventures and associates	310	526	7,618
Interest receivable & other income	9,573	10,090	6,450
Interest payable & similar charges	(213,950)	(194,494)	(175,350)
Other financing (costs) / income	(1,996)	(3,410)	(2,059)
Release of negative goodwill	646	638	646
Movement in fair value of financial instruments	3,433	(1,633)	(4,283)
Decrease in valuation of housing properties	(216)	(15,799)	(8,174)
Reversal of previous decrease in valuation of housing properties	121,568	62,729	95,083
Surplus / (deficit) before tax	309,864	251,116	218,028
Net tax (payable) / receivable	(44)	(36)	(40)
Surplus / (deficit) for year	309,820	251,080	217,987
Unrealised surplus / (deficit) on revaluation of housing	0	0	0
Actuarial (loss) / gain in respect of pension schemes	(144,848)	156,021	(90,215)
Change in fair value of hedged financial instruments	76	(836)	(140)
Total comprehensive Income for the year	**165,049**	**406,265**	**127,633**

Table 1: Aggregate Statement of Comprehensive Income

Analysis of turnover

Aggregate turnover for 2020/21 was £1,804.9m (2019/20 £1,793.3m), an increase of £11.6m (0.6%) on the prior year and a continuation of steady annual increases (see Figure 1). Income from affordable lettings was the main contributor to the increase, while turnover from other activities rose by only £4.1m.

Care and Support remain the main contributors to other activities turnover. In 2020/21 turnover increased £2.8m to £104.9m (2019/20 £102.1m), meaning it contributes to half of all other activities turnover. By necessity, Care continued during the pandemic when other services could not, so these figures were expected.

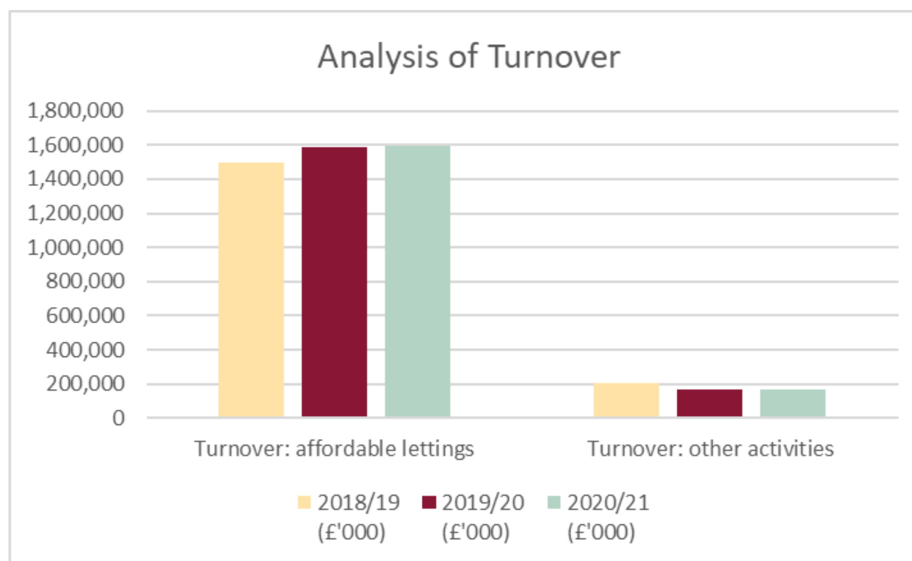

Figure 1: Analysis of turnover, split between affordable lettings and other activities

Analysis of operating costs

Aggregate operating costs for 2020/21 were £1,421.7m (2019/20 £1,429.5m), down £7.8m (0.5%) on 2019/20. Figure 2 below shows the marginal fall in affordable lettings costs, which reverses recent trends. Costs for other activities increased by £18.3m (8.6%) to £231.5m (2019/20 £213.2m).

Operating costs for affordable lettings fell £26.1m (2.1%) to £1,190.3m (2019/20 £1,216.4m). This was the first reduction since 2016/17 and was primarily due to the pandemic, in for example deferring planned maintenance and repairs.

Costs for planned and cyclical maintenance fell £13.5m (8.9%) to £138.3m (2019/20 £151.8m). We will look to see if there are corresponding increases in 2021/22 and beyond with the catch-up repairs and re-profiled expenditure. Reactive maintenance costs also fell, by £9.8m to £183.3m (2019/20 £192.1m). This is not as marked a drop but is understandable as RSLs were restricted to emergency repairs only for long periods.

Management and maintenance administration costs, also fell for the first time in five years (0.4%), in 2020/21 to £395.9m (2019/20 £397.5m). Costs for other activities increased by £18.3m (8.6%) to £231.5m (2019/20 £213.2m). Care and Support costs were again dominant, up £2.5m to £106.3m (2019/20 £103.8m) and contributing 45.9% of all other activities costs.

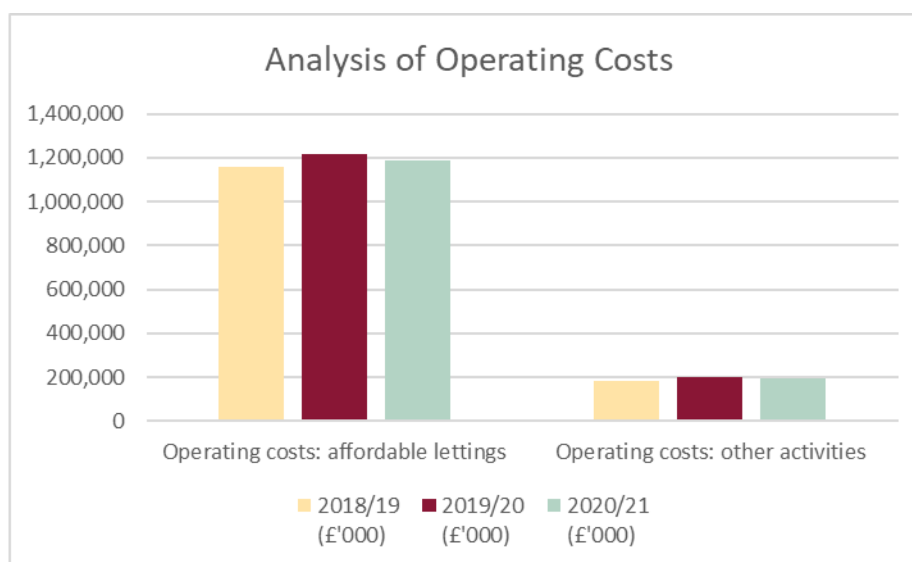

Figure 2: Analysis of operating costs, split between affordable lettings and other activities

Surplus and total comprehensive income

The 2020/21 aggregate operating surplus of £390.5m (2019/20 £392.5m), is down £2.0m (0.5%) on the prior year. Last year we noted turnover growing faster than costs and despite turnover rising by less than 1.0% in 2020/21, that trend continued as operating costs fell for reason mentioned above. Key to the drop in the 2020/21 surplus were:

- affordable lettings surplus up £33.7m (9.1%) to £404.1m (2019/20 £370.4m)
- increased deficit on other activities, up £14.2m to £20.9m (2019/20 £6.7m)
- £21.8m adverse swing on exceptional items.

The number of RSLs reporting operating deficits in 2020/21 increased to seven (2019/20 5), but only two with a 2019/20 deficit repeated that in 2020/21. Deficits peaked at 10 in 2018/19 so although the numbers are still small, 2020/21 sees a move back towards that level. The recent history is summarised in Table 2 below. We will continue to monitor this as RSLs catch up with repairs and re-profiled expenditure. Recent significant increases in cost inflation may also impact on the number of RSLs reporting deficits.

Operating surplus/(deficit)	2018/19	2019/20	2020/21
Below 0	10	5	7
0 - 2,500.0	114	114	101
2,500.0 - 5,000.0	20	16	27
5,000.0 - 7,500.0	5	11	10
7,500.0 - 10,000.0	5	3	2
Above 10,000.0	4	7	7
	158	156	154

Table 2: Operating surplus/(deficit) by no. of RSLs

Figure 3 below shows the upward trend in aggregate affordable lettings surplus but also the recent aggregate deficits on other activities.

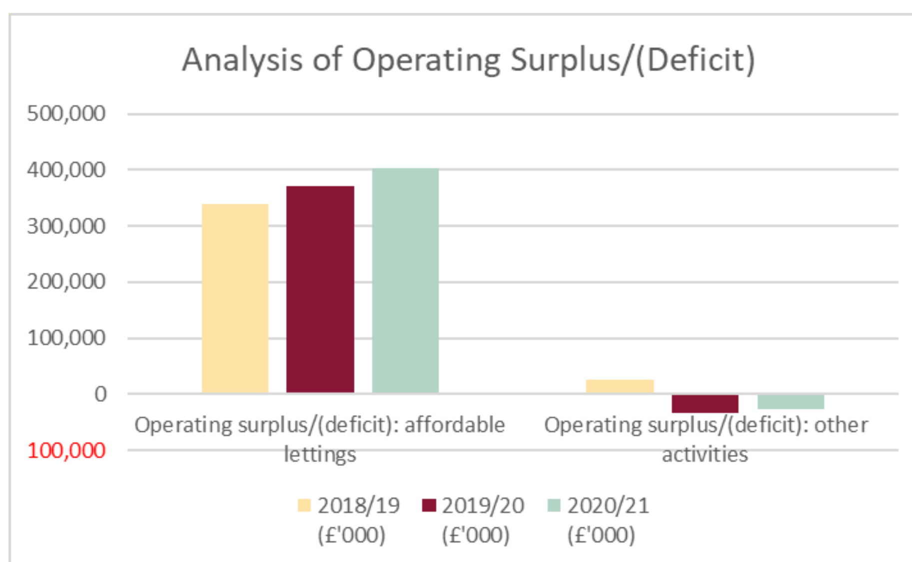

Figure 3: Operating surplus/(deficit), split between affordable lettings and other activities

On other activities, 2020/21 saw more individual activities reporting deficits than surpluses. While this is often just down to how individual RSLs allocate costs, a deficit on an individual activity is nevertheless subsidised by the stability of lettings income. This can be difficult to see within an overall increase in aggregate turnover from other activities but in 2020/21 nearly half of all RSLs reported a cumulative deficit on other activities.

Across the last five reporting years, operating deficits have been reported by only 20 RSLs. Eight have appeared more than once in that period, none have appeared every year and six have since been the subject of transfers of engagements.

The aggregate net surplus for 2020/21 rose again, up £58.8m (23.4%) to £309.8m (2019/20 £251.0m), with the cost of debt servicing remaining the largest deduction from gross surplus:

- interest payable continues to rise, up £19.5m to £214.0m (2019/20 £194.5m)
- interest receivable was down £0.5m to £9.6m (2019/20 £10.1m), symptomatic of long-term low interest rates, despite an increase in year-end cash

The Bank of England has increased its Base rate to 1.00% from a historic low of 0.1% in recent months, with the prospect of further increases to follow to help combat rising inflation. However, with rates still significantly below the longer-term average, borrowing continues to increase, and it is therefore essential that RSLs manage their interest rate risk effectively and plan for the anticipated rises. Governing Bodies should ensure they have robust stress testing in place to help them understand the sensitivity of business plans to increases in interest rates.

As a percentage of turnover, interest payable is 11.3% (2019/20 10.4%). This is a further increase after last year's rise, which went against the levelling out between 2016/17 (10.1%) and 2018/19 (9.9%). With interest rates now rising, and RSLs facing inflationary pressures on costs and potentially on their ability to increase rents, we can expect this measure, at least in the short term, to increase further.

Aside from interest payable, other key contributors in arriving at the net surplus included:

- a £121.6m gain on the reversal of previous decreases in the valuation of housing properties. This was approximately double what it is was in 2019/20 (£62.7m)

- movements in the valuation of housing properties, which can fluctuate significantly from one year to the next, saw 2020/21 continue with a favourable move of £15.6m to report a loss of just £(0.2)m (2019/20 £(15.8)m)

12 RSLs (2019/20 12) each generated a net surplus more than £5m with eight of those more than £10m (2019/20 5). 2020/21's median net surplus of £1.06m was approximately double the prior year's £0.6m, and the highest reported in recent years. We also saw the biggest reduction in RSLs recording net deficits, a drop to only nine RSLs (2019/20 17) being further evidence of reduced costs through the pandemic

Net surplus/(deficit)	2018/19	2019/20	2020/21
Below 0	13	17	9
0 - 2,500.0	125	121	113
2,500.0 - 5,000.0	13	6	20
5,000.0 - 7,500.0	3	5	3
7,500.0 - 10,000.0	2	2	1
Above 10,000.0	2	5	8
	158	156	154

Table 3: Net surplus/(deficit) by no. of RSLs

The aggregate net surplus of £309.8m (2019/20 £251.1m) reduces by £144.8m (2019/20 £155.1m increase) to give total aggregate comprehensive income for the year of £165.0m (2019/20 £406.3m). This drop is almost entirely down to the actuarial pension scheme loss reported in the year.

Actuarial gains and losses on pension schemes can fluctuate materially year on year. 2020/21 saw an aggregate actuarial loss of £(144.8)m, following a gain of £156.0m in 2019/20. The loss is included in the movement in total pension provision for liabilities. This has increased by £122.8m to £174.6m in 2020/21.

In 2020/21, 134 RSLs reported an actuarial loss, with values ranging from £5k to £7.3m. 15 reported no gain/loss and only five recorded a gain for the year, the largest being £497k. Unlike DB schemes, DC providers contribute at defined rates, with no obligation to cover shortfalls in the pension scheme.

The movement in the provision and the associated loss reported as part of other comprehensive income is a result of movements in underlying pension scheme actuarial assumptions. These include forecast changes in the rate of any increase in the level of pensions paid, future increases in salaries, inflation, a discount rate linked to gilts, and assumptions on how long a pension is to be paid. In 2020/21, changes to the assumptions led to an increase in liabilities, resulting in an actuarial loss for the year.

Statement of Financial Position

Aggregate net assets at 31 March 2021 continued the growth trend of recent years, but at a slower rate of 3.6% (2019/20 18.8%). The key movements were:

- net housing assets up £406.0m
- net rent receivables up £5.8m
- cash and cash equivalents up £155.0m
- pension liability up £122.8m

	2020/21 £'000s	2019/20 £'000s	2018/19 £'000s
Intangible assets and goodwill	4,912	5,134	4,619
Housing properties net book value	14,083,014	13,677,638	12,718,174
Negative goodwill	(22,479)	(23,125)	(23,762)
Non-current investments	149,190	146,719	111,805
Other plant, property and equipment	236,282	238,095	229,768
Investments in joint ventures and associates	15,313	6,713	3,299
Total non-current assets	**14,466,232**	**14,051,174**	**13,043,903**
Receivables due after more than 1 year	65,637	66,548	82,250
Investments	168,956	9,847	10,161
Stock and work in progress	36,351	30,594	37,569
Trade and other receivables due within 1 year	208,848	211,426	204,444
Cash and cash equivalents	990,623	835,631	733,450
Total current assets	**1,404,778**	**1,087,498**	**985,625**
Payables due within 1 year	(687,605)	(648,422)	(606,346)
Scottish housing grants due within 1 year	(165,801)	(178,941)	(184,941)
Other grants due within 1 year	(3,812)	(2,728)	(6,229)
Total current liabilities	**(857,217)**	**(830,092)**	**(797,516)**
Net current assets / (liabilities)	**547,561**	**257,407**	**188,109**
Payables due after more than 1 year	(4,850,533)	(4,646,162)	(4,396,368)
Provisions	(23,656)	(23,849)	(48,277)
Pension asset / (liability)	(174,608)	(51,806)	(212,717)
Scottish housing grants due after more than 1 year	(5,904,701)	(5,667,903)	(5,297,294)
Other grants due after more than 1 year	(75,519)	(76,016)	(68,829)
Total long-term liabilities	**(11,029,017)**	**(10,465,736)**	**(10,023,485)**
Net Assets	**4,050,413**	**3,909,393**	**3,290,777**

Table 4: Aggregate Statement of Financial Position

Significant investment by RSLs continues, with net housing assets up £406.0m (3.0%) to £14,060.5m (2019/20 £13,654.5m).

Rent arrears increased by £5.8m (17.4%) to £39.2m (2019/20 £33.4m). While this appears to be a significant increase, it is still at a lower level than the £43.5m reported in 2018/19. While many thought the pandemic would lead to much higher arrears' levels, the numbers would suggest that the effective efforts of RSLs to control their rental income streams in unprecedented circumstances has been relatively successful.

The focus on rent affordability will continue and we will not lose sight of the everyday pressures on tenants' ability to pay. This was brought into sharp focus by the pandemic and is now exacerbated by the recent and forecast sharp rises in inflation, energy & fuel prices etc. It remains unclear what the full impact of the pandemic will be, so we continue to expect arrears and debt management to form a critical function of all RSLs.

Cash balances increased significantly in 2020/21, by £155.0m (18.5%) to £990.6m (2019/20 £835.6m). This may be due to new borrowing and the timing of drawdowns but for 2020/21, we also saw reduced spending during the periods of lockdown restrictions. Our Loan Portfolio analysis showed a decrease in amounts drawn down across 2020/21 and with spending also down, a corresponding increase in available undrawn facilities.

As a short-term liquidity measure, the sector has strengthened its net current assets, up £290.2m to £547.6m (2019/20 £257.4m). Driven by the increase in cash, this is likely to be temporary, caused by the pandemic and delayed spend. We will continue to monitor this measure for changes in the coming years.

Statement of Cash Flow

Cash generated from operations remains crucial to the ongoing financial viability of every RSL. It remains important as RSLs look to fund ongoing investment in improvements to existing housing and the construction of new housing, as well as servicing private finance debt. Key movements in 2020/21 were:

- net cash in from operating activities, up £102.4m to £626.6m (2019/20 £524.2m)
- net cash out from investing activities, down £182.3m to £448.6m (2019/20 £630.9m)
- net cash in from financing, down £192.9m to £18.0m (2019/20 £210.9m)
- net change in cash, up £55.7m to £159.9m (2019/20 £104.2m)

	2020/21 £'000s	2019/20 £'000s	2018/19 £'000s
Net cash inflow / (outflow) from operating activities	**626,610**	**524,227**	**503,150**
Tax (paid) / refunded	**(43)**	**(31)**	**(44)**
Cash flow from investing activities			
Acquisition and construction of properties	(907,649)	(1,090,909)	(1,059,944)
Purchase of other non current assets	(19,774)	(41,890)	(29,889)
Sales of properties	19,046	22,642	67,870
Sales of other non current assets	2,329	5,999	4,145
Capital Grants received	456,085	471,844	476,530
Capital Grants repaid	(3,070)	(4,949)	(6,707)
Interest received	4,424	6,365	4,961
Net cash inflow / (outflow) from investing	**(448,610)**	**(630,897)**	**(543,035)**
Cash flow from financing activities			
Interest paid	(181,626)	(191,159)	(174,205)
Interest element of finance lease rental payment	(43)	(46)	(608)
Share capital received/(repaid)	0	1	1
Funding drawn down	423,283	839,584	557,764
Funding repaid	(256,181)	(428,679)	(281,786)
Early repayment and associated charges	(5,931)	(10,375)	(2,721)
Capital element of finance lease rental payments	(204)	(341)	(24)
Withdrawal from deposits	2,686	1,268	2,849
Net cash inflow / (outflow) from financing	**(18,014)**	**210,252**	**101,271**
Net change in cash and cash equivalents	**159,942**	**103,551**	**61,343**
Cash and cash equivalents at the beginning of the year	**830,321**	**732,080**	**672,108**
Opening balance adjustments	360	0	0
Cash and cash equivalents at the end of the year	**990,623**	**835,631**	**733,450**

Table 5: Aggregate Statement of Cash Flows

Any material adverse movement in cash from operations can have a direct impact on an RSL, for example on their ability to cover capital repayments and associated debt servicing costs.

Interest paid in 2020/2021 fell by £9.6m to £181.6m (2019/20 £191.2m). This is covered in more detail in ‘Borrowing & Effective Interest Rates’ later in this report, but the recent trends in cash from operations and debt servicing are illustrated in the chart below.

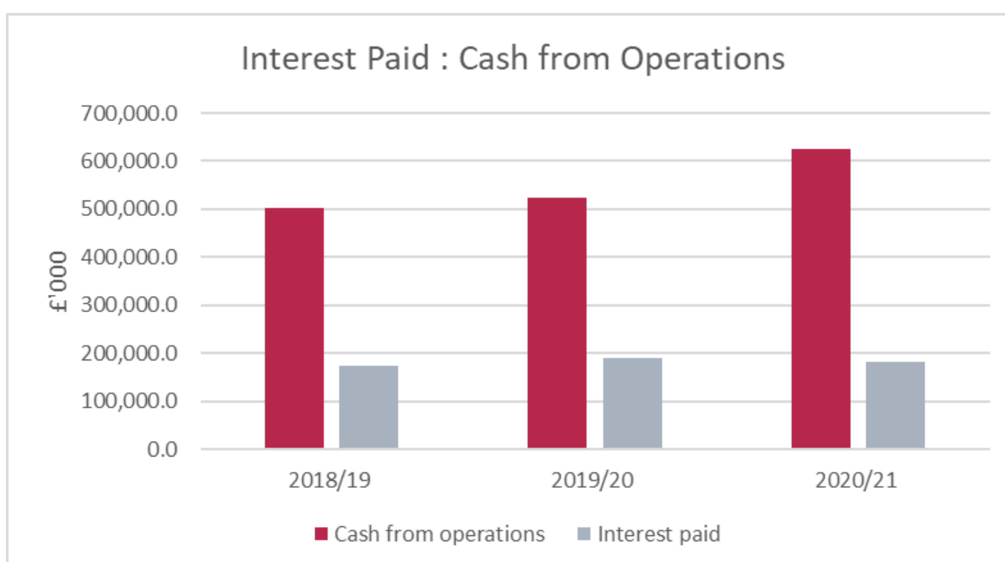

Figure 4: Interest paid compared to cash generated from operations

The 21 systemically important RSLs, which can be subject to additional regulatory information and assurance requirements, accounted for £119.0m, or 65.5% of the £181.6m interest paid.

The ratio of cash generated from operations for each £1 of interest paid had been falling in previous years; however, it increased to 3.45 in 2020/21 (2019/20 2.74) and should continue to be a source of assurance for lenders and other key stakeholders. It also underlines the importance of RSLs continuing their efforts to seek and implement operational efficiencies across their organisations.

	2020/21	2019/20	2018/19
Cash from Operations (£m)	626.6	524.2	503.2
Interest Paid (£m)	181.6	191.2	174.2
Ratio	3.45	2.74	2.89

Figure 6: Cash generated per £1 of interest paid

Cash out on investing activities is primarily the investment in new housing and improvements to existing housing. It was projected to fall in 2020/21 and was down £182.3m to £448.6m (2019/2 £630.9m).

	2020/21 £m	2019/20 £m	2018/19 £m
Acquisition & construction of properties	(907.6)	(1,090.9)	(1,059.9)
Purchase of other assets	(19.8)	(41.9)	(29.9)
Net capital grants received	453.0	466.9	469.8
Sales of properties	19.1	22.6	67.9
Sales of other assets	2.3	6.0	4.1
Interest received	4.4	6.4	5.0
Total	(448.6)	(630.9)	(543.0)
Loan advances received	423.3	839.6	557.8

Figure 7: Aggregate cash flow from investing activities

We saw the expected dip in the development and capital maintenance programmes, with the lockdown restrictions curbing expenditure, down £183.3m (16.8%) to £907.6m (2019/20 £1,090.9m). Net grant receipts decreased again, £13.9m to £453.0m (2019/20 £466.9m) but combined with £423.3m of loan advances (2019/20 £839.6m), broadly offset the reported £907.6m of acquisition & construction costs.

Costs per Unit & Ratios

With the increasing possibility of operational cost inflation rates rising faster than rental income, there is even more pressure on RSLs to be as efficient and effective as possible. Cost per unit is one measure that has consistently been used to provide more cross sector analysis and information.

Analysis of unit management & maintenance costs

Management & maintenance costs dropped 3.9% to £2,360/unit (2019/20 £2,455), marking a change in the recent trend of year-on-year increases. This is consistent with an overall drop in total maintenance spend through the pandemic but also reflective of the types of repairs being carried, for example RSLs delivering an emergency repairs service only during the periods of strict lockdown restrictions.

	2018/19 £	2019/20 £	2020/21 £
Management and maintenance administration	1,299	1,314	1,302
Planned maintenance	457	502	455
Reactive maintenance	634	639	603
Total direct maintenance	1,091	1,141	1,058
Total management and maintenance	2,391	2,455	2,360

Table 8: Aggregate management & maintenance costs per unit

Ratio of Reactive to Planned Maintenance

The 2020/21 distribution curve shows some changes from prior years. Most RSLs (44) now fall into the 50%-75% category, followed by the 25%-50% category (32). This is the reverse of previous years. The key points to note are:

- 38 RSLs now have a ratio of greater than 100% (2019/20 22)
- with 10 of those having a ratio more than 200% (2019/20 5)

- 73 RSLs have a ratio between 50% & 100% (2019/20 59)
- with 29 of those having a ratio between 75% & 100% (2019/20 17)

Only seven RSLs (2019/20 8) have maintained a ratio of greater than 100% across a three-year review period. The key point is that reactive costs consistently exceed planned maintenance costs for these RSLs. We will look to discuss this further with the relevant RSLs to better understand their business reasons for this.

Aggregated Total Staff Costs

Governing Bodies are responsible for ensuring that employee salaries, benefits and pension offerings are at a level to secure the appropriate quality of staff, but which is affordable and not more than is necessary for this purpose.

Total staff costs increased by 1.1% to £477.2m in 2020/21 and have risen by 12.6% in the five years since 2016/17. The 2020/21 increase of 2.1% down on 2019/20 but still above average CPI and RPI figures for the year. We do have to consider any staffing rationalisations implemented by RSLs, and how intervention costs are recorded for example.

Total FTE in 2020/21 rose 0.9% to 13,029. At the same time the average cost per FTE increased by 0.2%, reaching £36,625 for 2020/21. This was the smallest increase since 2016/17.

	2020/21	2019/20	2018/19	% change 19/20 to 20/21
Staff Costs[1]	£477.2m	£471.9m	£457.2m	1.1%
Staff Number (FTE)[1]	13,029	12,913	12,715	0.9%
Average Cost per FTE	£36,625	£36,541	£35,954	0.2%

Table 9: Aggregate staff cost information

Employee FTE numbers in the ARC and AFS returns use different definitions and consequently can generate different values. Care should therefore be taken when interpreting the results. We pay particular attention to the staff costs of those RSLs that may show disproportionate increases to better understand any underlying reasons.

Staff costs per unit have been steadily increasing, up more than 7% in the last five years. However, the 0.6% increase in 2020/21 is the smallest jump in that period and much closer to CPI and RPI than in previous years. It is also below the 1.1% increase in total staff costs noted above.

The aggregated cost for employing CEOs was marginally down at £11.2m (2019/20 £11.4m). Compared with £10.9m in 2016/17, this represents a modest rise of 2.7% across that 5-year period. Overall, there is no sector trend but there are some RSLs where the cost has risen well more than inflation in recent years.

Borrowing & Effective Interest Rates

Total borrowings continued to grow and at 31 March 2021 facilities secured had passed £6.41bn. Of that total, £5.36bn was drawn down, with an outstanding balance of £4.71bn. A £234m increase in new facilities secured, but a drop in spend in the year, means available undrawn facilities are up at a little over £1.05bn.

	Total Facilities £m	Facility Drawn £m	Facility Undrawn £m	Balance Outstanding £m
As at 31 March 2021	6,412.9	5,362.4	1,050.5	4,706.2
As at 31 March 2020	6,179.2	5,177.0	1,002.2	4,522.7
Increase/(Decrease)	233.7	185.4	48.3	183..5
% Change	3.8%	3.6%	4.8%	4.1%

Table 10: Summary of total facilities available (Source – annual Loan Portfolio returns

At the time of writing, the Bank of England had increased its Base rate from the historic low of 0.1% to 1.00% as inflationary pressures increased. The OBR are forecasting further increases, peaking at 1.9% in 2023/24 before falling back to 1.4% by 2025/26. This is likely to impact on the interest rates being paid by RSLs for new borrowing and we would expect this to be incorporated into assumptions for long term projections and any associated sensitivity analysis.

	2018/19	2019/20	2020/21
Annual turnover (£m)	1,704.4	1,793.3	1,804.9
Interest payable (£m)	175.4	194.5	214.0
Capitalised interest (£m)	6.9	6.6	6.4
Loans outstanding at year end	4,149.9	4,522.7	4,706.2
Percentage of turnover required to service debt	10.29%	10.85%	11.86%
Effective interest rate	**4.52%**	**4.63%**	**4.78%**

Table 11: Aggregate effective interest rate from o/s loans (Source – annual Loan Portfolio returns)

The effective interest rate has risen in consecutive years to reach 4.78% in 2020/21. As noted earlier, interest payable continued to rise, up 10.0% to £214.0m, but this is more reflective of increased borrowing rather than a marked increase in interest rates secured. A detailed analysis of the borrowings can be found in our summary of the annual loan portfolio returns at 31 march 2021.

Another measure considered is the percentage of turnover needed to service debt year on year. We have previously commented that the growth in interest payable was outstripping the turnover growth. A marked drop in this growth in 2017/18 might have signified the reversing of this trend, but this has not been the case with interest payable for 2020/21 of £214.0m, its highest level to date. Table 11 above profiles the last three years and more information on interest rates can be found in our published analysis of the loan portfolio returns as at 31 March 2021.

It can also be beneficial to put the results into a wider UK context with reference to those published by the Regulator of Social Housing, the social housing regulator in England. In recent years, the Scottish figures have compared very favourably with those in England. This trend has continued in 2020/21, with around 30% more turnover required by English providers to service their debt, a statistic that stems from the long-standing difference between grant rates available north and south of the border.

	2018/19	2019/20	2020/21
Turnover (£bn)	20.9	21.2	22.1
Interest payable (£bn)	3.2	3.3	3.4
Percentage of turnover required to service debt	15.31%	15.57%	15.38%

Table 12: % turnover to service debt (Source - RSH 2021 Global Accounts of Registered Providers)

We expect strong interest cover to become even more important going forward, combined with robust cost control and value for money initiatives. We are aware through our regulatory engagement that many RSLs are actively looking at ways to improve operational efficiencies and reduce their cost base.

We expect all RSLs to plan their treasury requirements well in advance. At a time when RSLs are looking for more finance than ever before and several now hold published credit ratings, this has heightened importance. For any RSL the provider of private finance is an important stakeholder, and it is crucial that RSLs are clear on what the lender is seeking and what type of relationship they will look to have with their client. Clearly price is an important consideration, but it is not the only consideration. It is essential that RSLs manage interest rate risk and plan for any interest rate increases in the future.

EBITDA MRI interest cover remains a key measure of RSLs ability to cover its ongoing finance costs. This measure has continued to improve over the last three years. The increases in operating margins have caused a 23-percentage point increase in EBITDA MRI interest cover, rising to 284.87% in 2020/21. This is the third consecutive year in which levels of EBITDA MRI interest cover have risen (see Table 13).

	2018/19	2019/20	2020/21
EBITDA MRI (%)	233.26	261.83	284.87

Table 13: EBITDA MRI as percentage of interest payable

When compared to aggregate levels for Registered Providers in England this indicator remains favourable for RSLs. A significant number of providers rely on housing sales to bolster their surpluses, which is not the case in Scotland. Affordable housing investment benchmarks levels in Scotland are also significantly higher than England so RSLs can borrow less to fund development and therefore have lower levels of interest payable.

Rent Increases & Inflation

Last year we reported that during 2020/21 the average weekly RSL rent was £89.74. In 2021 landlords planned to increase rents by 1.2%, and that is a significant reduction from the 2.5% planned rent increase in the previous year, and from the actual rent increase in that year of 2.7%. Clearly, the pandemic, and the resulting economic impact on tenants, have influenced landlords' decisions on rent increases. This is an understandable response to the difficulties that a significant number of tenants have faced over the period of the pandemic.

In October 2021, amid the pandemic in the UK, the Office of Budget Responsibility ("OBR") published an updated Economic & Fiscal Outlook. This showed:

- during 2020/21, CPI fell by 0.8% to 0.7%
- Inflation fluctuated during the 12-month period, peaking in July at 1.0% before declining again

The graph below shows the average rent increase in the RSL sector compared with both CPI and RPI rates since 2017.

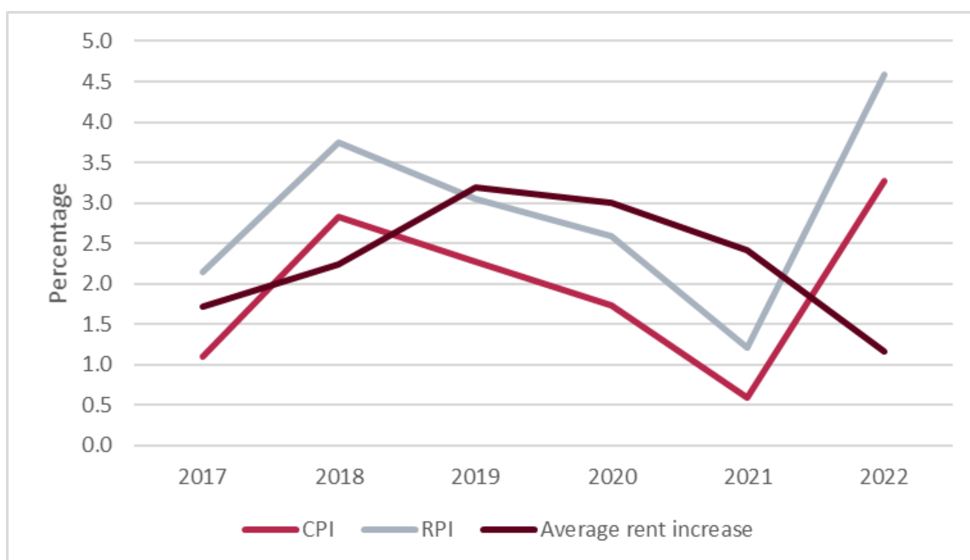

Figure 5: Comparison of RSL average rents (ARC returns) to inflation (Source: OBR Economic and fiscal outlook, March 2022)

In the earlier years, rent increases, while climbing, were lagging inflation. This is particularly clear over the 2018/19 period with inflation rates falling as rents increased. That period took rent increases above both CPI and RPI. The movement since 2019 then initially saw all rates fall with the gap between CPI and RPI narrowing but a widening of the gap between rent increases and inflation. Whilst we see rent increase levels continuing to fall, we also see evidence of the recent rapid rise in inflation. The sector average is based on the ARC data for 2020/21 with rent increases largely set before the inflation rates had started to rise in earnest.

Arrears & Voids

Bad debts, void losses and current tenant arrears are key performance indicators in assessing the efficiency of letting and rent collection. Throughout 2021, we continued to work with the Social Housing Resilience Group in supporting the recovery from the pandemic. A key aspect of the work was monitoring the operational impact of the pandemic on these indicators through the Quarterly survey return.

In analysing voids, arrears, and bad debts against turnover, we see that these measures, except for voids have either remained around previous years' levels or shown some improvement. This helps demonstrate the positive impact that the work done by RSLs to mitigate these is having.

	2018/19 %	2019/20 %	2020/21 %
Voids	1.24	1.22	1.79
Bad Debts	0.97	0.99	0.80
Arrears	3.34	2.45	2.79

Table 14: Voids, bad debts & arrears (Source – annual AFS returns)

There is however the continued possibility of rent losses from voids increasing as a result of ongoing labour shortages, supply chain disruption and cost inflation, which are likely to delay works and increase costs.

Pensions

Although many RSLs have taken a proactive approach to managing pensions risk, it is still a significant risk across the sector and we have previously said that governing bodies may want to seek independent advice, where appropriate, to understand their risk exposure and the impact on cash flow arrangements. This advice could be in conjunction with a consideration of the potential impact on rent levels, cost efficiencies and value for money.

Aggregated Pension Liability

In 2020/21 RSLs reported an aggregate net actuarial loss of £(144.8)m (2019/20 £156.0m gain). 2018/19 was the first year where RSLs offering the SHAPS DB scheme were able to fully disclose their individual pension liability as per Financial Reporting Standard 102 reporting requirements. Prior to that, they mostly treated pensions for accounting purposes as DC schemes as it was deemed not possible to calculate individual employer liabilities from a multi-employer scheme.

The impact in 2018/19 of incorporating full SHAPS liabilities was a material rise in the net pension liability to an aggregate £212.7m, then a significant drop to £50.1m in 2019/20 as the sector recorded a net actuarial gain. In 2020/21 we saw a swing back to a net actuarial loss of £(144.8)m, contributing to an increased pension liability, up £124.5m to £174.6m. An analysis of the £174.6m net liability shows the following:

- one RSL had a pension scheme asset (2019/20 2)
- 14 RSLs had no pension asset or liability (2019/20 42)
- 131 RSLS had a pension liability (2019/20 108)
- The maximum liability for an individual RSL was £11.5m (2019/20 £5.7m)

DB schemes, especially Final Salary (FS), carry significant risks for employers as they have no knowledge of their future liabilities. RSLs run the risk that the liability for servicing the past service element of the provision will increase, both in terms of how much will need to be paid out each year, and for how long. In effect the employer is carrying an unlimited liability.

The triennial SHAPS valuation was due to be carried out in September 2021, however we do not expect to see the results until summer 2022.

Current Position

At 31 March 2021 there were four RSLs where all staff were in FS schemes and seven which only operated an LGPS Career Average Revalued Earnings (CARE) scheme. A total of 30 RSLs still had staff in FS schemes, and 50 RSLs had staff in CARE schemes. Overall, 131 RSLs operate DC schemes, with 77 operating only DC schemes, the others operating it alongside DB schemes. 87 RSLs still have at least some staff in a DB scheme.

Scheme Type (2021)	No of Active Members	% of Active Members
FS schemes	391	3.1%
CARE schemes	2,471	19.5%
Total in DB Schemes	**2,862**	**22.6%**
DC Schemes	9,804	77.4%
Total Members	**12,666**	**100%**
Non-Contributing Staff	2,002	
Total Staff	**14,668**	

Table 15: Active members per scheme type

This pattern has changed in recent years with auto enrolment having significantly increased the number of active members, particularly in DC schemes. Looking at current active membership however underestimates the scale of the risks being faced by RSLs as it does not reflect previous scheme membership and the associated liabilities. In 2013, before smaller employers were obliged to introduce auto-enrolment, the majority of RSL staff in a pension scheme were in a FS scheme, with a very small minority in a DC scheme:

Scheme Type (2013)	No of Active Members	% of Active Members
FS schemes	4,665	70.3%
CARE schemes	1,126	17.0%
Total in DB Schemes	**5,791**	**87.3%**
DC Schemes	841	12.7%
Total Members	**6,632**	**100%**
Non-Contributing Staff	7,191	
Total Staff	**13,823**	

Table 16: Active members per scheme type (2013)

Although the number of individuals in FS schemes has reduced in recent years, many have transferred to a CARE scheme. Those previously in FS schemes will have retained any benefits accrued under that scheme and the RSLs will have retained the liability to meet any associated deficits or cessation costs. The same is true where staff have transferred from a CARE scheme to a DC scheme or do so in the future. Those who have transferred from a FS scheme to a CARE scheme will continue to generate future potential liabilities for the RSL, just at a different, potentially higher, rate. The increase in DC scheme membership in recent years can be largely attributed to the introduction of auto-enrolment, with the total number of staff in DB schemes reducing only slightly.

In 2013 of 153 RSLs, 132 operated FS schemes, 44 operated CARE schemes and just nine operated DC schemes. In total 148 RSLs operated some sort of DB scheme, and so are likely to have ongoing exposure to possible cessation costs. As a result of mergers since 2013 this number has reduced slightly such that 141 of these RSLs are still in existence. Liabilities for staff that have transferred to other RSLs as a result of mergers are likely to have transferred to their new employer.

Due to when individuals joined the different pension schemes, the employees associated with the higher risk pensions are likely to have longer periods of accrued benefits in a DB scheme, and thus longer to generate higher potential liabilities. They are also likely to be closer to pension age, increasing the proximity of possible cessation costs. There are seven RSLs with five or fewer members in an LGPS scheme, including two with only one remaining member. It is considered likely that these RSLs will crystallise their cessation cost risk in the near future. SHR monitors this risk on an ongoing basis.

RSLs that continue to operate an LGPS pension or have a SHAPS pension deficit to repay either currently or in the future face the risk of paying increased pension contributions in the future. Ultimately RSLs must meet these costs from their income which is almost exclusively rent from tenants or associated service charges. Pension obligations are therefore likely to present significant upward pressure on rents in the future which will directly impact on the finances of tenants or on the costs of welfare for those receiving the housing element of Universal Credit. At present pension costs including deficit repayments equate to around 5% of gross rents across the sector, and for eight RSLs it is above 10% of gross rents.

The Impact of the Pandemic

On 11 March 2020, the World Health Organisation declared that the COVID-19 virus was a global pandemic. The UK Government announced on 23 March 2020 that the whole country would be going into lockdown and since then a variety of restrictions have remained in place in Scotland to prevent widespread transmission of the virus.

During 2020/21, we paused our normal regulatory engagement with RSLs to allow them to focus on dealing with the effects of the pandemic. At the request of the Social Housing Resilience Group, we implemented a monthly data collection return collecting key information on the impact of the pandemic. As we moved towards a “new normal” in 2021/22 the collection of additional data changed to quarterly, with the March 2022 return being the last one to be collected.

The aggregate cash balance for the sector has fallen from £1.03bn at 1 April 2021 to £928.6m at 31 March 2022, a decrease of around 10%. Based on the 2021 FYFP returns, the forecast closing cash balance at 31 March 2022 was £761.2m. The higher actual cash balance is likely to be a result of the delays in both planned maintenance and development during the lockdown periods. Given the level of catch-up work required, RSLs will need to be aware of any impact on their interest cover covenant calculations. Where issues are identified it is important that RSLs speak to lenders and SHR at the earliest opportunity.

Whilst cash balances have decreased, this is in line with expectations and at an aggregate level, they remain healthy. Where our analysis has indicated that an individual RSL was potentially experiencing cash flow issues, we have engaged with them on an individual basis to gain further understanding.

Aggregate gross arrears for RSLs increased over the course of 2021/22; from 4.10% at 30 June to 4.31% at 30 September, to 4.42% at 31 December, before dropping back to be 4.34% at 31 March 2022. Over this period furlough payments were gradually phased out, ceasing altogether at the end of September 2021. It is likely that this has resulted in more tenants finding it difficult to pay their rent. Within these figures, there a number of RSLs who have experienced a higher level of gross arrears. We have engaged with these RSLs on an individual basis to gain an understanding of how they are managing this.

Voids showed a similar profile in 2021/22, increasing over the first nine months of the year from 1.35% at 30 June to 1.46% at 31 December, before dropping back to 1.24% at 31 March 2022. We can see how this pattern related to the pandemic restrictions over the course of the year on for example the impact on labour supply, and then the gradual lifting of those restrictions as we moved through the year.

So, RSLs entered the pandemic in a strong financial position and based on the 2021/22 quarterly returns have generally coped well over the last two years with the short-term financial impact of the pandemic, maintaining a strong aggregate financial position.

The Next Five Years – Projections to 2025/26

Statement of Comprehensive Income

The headlines from the aggregate 2021 FYFPs are that turnover is forecast to increase by an average of 4.1% annually over the next five years. This compares to average increases of 3.7% annually for operating costs over the same period. Overall, turnover is set to increase by 22.2% to £2.1bn and operating costs by 19.5% to £1.6bn.

RSLs have been forecasting that turnover will increase at a faster rate than operating costs for a number of years and this is in part driven by the tendency to forecast rents increasing at a faster rate than operating costs. The average margin above inflation for rent increases over the five-year period is 0.4% which compares to 0.2% for operating costs. In line with previous years, turnover is forecast to increase at a faster rate than operating costs in years with the exception being 2021/22 where operating costs are forecast to increase by 11.2% compared to a turnover increase of 5.5%. However, this is in part likely to be related to the impact of the pandemic on the figures for 2020/21 when RSLs were required to adopt new working practices and were unable to carry out their maintenance programmes meaning that a catch-up programme was forecast for 2021/22. Issues in relation to labour and material shortages mean that it is not clear that the level of catch-up being forecast will be feasible.

Affordable lettings remain the main source of income for RSLs, but a number of other regular sources of income continue to make up the total turnover as can be seen in Table 17.

	2021/22	2022/23	2023/24	2024/25	2025/26
Net rents and service charges	78.5%	79.2%	79.4%	79.9%	80.5%
Developments for sale income	0.7%	0.5%	0.1%	0.0%	0.2%
Grants released from deferred income	9.8%	9.6%	10.1%	10.0%	9.3%
Grants from Scottish Ministers	1.1%	0.9%	1.0%	0.6%	0.6%
Other grants	0.6%	0.5%	0.4%	0.4%	0.4%
Other income	9.3%	9.3%	9.1%	9.0%	9.1%

Table 17: Forecast split of turnover

Other income comprises mainly Care and Support activities and continues to be a major source of income for a number of RSLs. More than 60% of the aggregate other income in the projections relates to only nine RSLs who employ more than 50% of their staff in care and support roles. Increasingly, grants released from deferred income is also becoming a key driver of the turnover levels. This does not generate any additional cash for RSLs and is dictated by accounting policy choice. The levels being reported reflect those RSLs with development who have adopted the performance method for accounting for grants. This means that rather than grant being released over the useful economic life of the housing assets, it is released in full when those houses are initially built.

The outcome of all of this is that operating surpluses are forecast to increase from £285m in 2021/22 to £517m in 2025/26.

Interest payable is forecast to increase from £196m in 2021/22 to £249m in 2025/26. This is as a result of an increase in both the level of outstanding debt as well as an increase in the level of interest rates being forecast. Despite this, the net surplus increases from £119m in 2021/22 to £275m in 2025/26.

Statement of Financial Position

The headline from the aggregate statement of financial position is that net assets are forecast to continue to increase at an average of 4.8% over the five years. Growth in net

assets is relatively steady over the five-year period ranging from 3.0% in 2021/22 up to 5.8% in 2025/26. These increases take aggregated net assets to £5.1bn by the end of the five-year projection period with net housing assets up to £17.5bn.

Net rent arrears are forecast to increase sharply in 2021/22 both in monetary terms and as a percentage of net rent and service charges. The monetary value continues to increase over the remaining four years of the projections; however, it falls back to historical levels as a percentage of net rent and service charges. The increase forecast for 2021/22 is likely to reflect the projected impact of the pandemic, including the ending of the Job Retention Scheme payments from the UK Government. It should be noted that these are the figures for net rent arrears and have therefore had a provision for doubtful debt deducted from them. It is for an individual RSL to determine its policy on which debts will fall into the provision, meaning that we will not always be comparing like with like in respect of arrears.

The sector continues to forecast high levels of cash in the short to medium term. The starting position based on the outturn figures for 2020/21 is £983m which is slightly below the position in the last monthly return submitted as at 31 March 2021 of £1.03bn. The figure drops substantially over the first three years before recovering slightly to close at £619m in 2025/26.

Over the same period, funding is forecast to increase by 26.3% to £6.3bn with sharp increases forecast for 2021/22 and 2022/23 before levelling off over the remaining three years. The split of the level of debt is shown below in Table 18.

	2021/22	2022/23	2023/24	2024/25	2025/26
Loans due within one year (£m)	138.8	120.4	204.1	175.3	201.1
Loans due after one year (£m)	5,425.5	5,881.2	5,968.8	6,109.1	6,109.2
Total loans due (£m)	5,564.3	6,001.6	6,172.9	6,284.4	6,310.3
Percentage change	11.4%	7.9%	2.9%	1.8%	0.4%

Table 18: Split of short and long term debt

The impact of this is that net current assets are forecast to decrease from £475.2m in 2021/22 to £253.7m in 2025/26 (see Table 19). The higher figure for 2021/22 is driven by the high cash balance which has resulted from a combination of debt drawdowns in previous years that have yet to be utilised and the impact of the pandemic which meant that RSLs were not able to carry out a significant part of their normal business as a result of the pandemic.

	2021/22	2022/23	2023/24	2024/25	2025/26
Net rental receivables (£m)	49.2	50.6	51.1	51.9	53.0
Other short term receivables (£m)	183.0	188.9	190.6	170.0	169.1
Cash at bank and in hand (£m)	761.2	641.4	599.9	619.9	618.5
Loans and overdrafts due in 1 year (£m)	138.8	120.4	204.1	175.3	201.1
Other short term payables (£m)	379.4	384.7	384.1	383.9	385.8
Net current assets (£m)	475.2	375.8	253.4	282.7	253.7

Table 19: Net current asset position

Statement of Cash Flow

Cash is a crucial element of an RSL business plan and sufficient cash generation remains key to the ongoing financial viability and longer term sustainability of individual RSLs as well as the sector as a whole. We take a keen interest in where and when cash is projected to go, whether maintaining the smooth running of day-to-day operations or sustaining a significant longer term development programme.

The headline figures from the aggregated cash flow are set out in Table 20.

	2021/22	2022/23	2023/24	2024/25	2025/26
Net cash from operating activities (£m)	499.5	637.4	707.6	750.5	794.0
Returns on investment and servicing of finance (£m)	(191.7)	(207.6)	(223.8)	(234.7)	(246.4)
Capital expenditure and financial investment (£m)	(1,074.1)	(988.2)	(690.1)	(604.5)	(571.0)
Net cash from financing (£m)	551.5	438.6	164.7	108.8	22.1
Increase / (decrease) in net cash (£m)	(214.8)	(119.8)	(41.5)	20.0	(1.4)

Table 20: Extract of statement of cash flows

Overall, cash outflows are forecast in four of the five projected years with the largest outflows over the first two years as RSLs forecast a catch-up of the work that has been delayed due to the pandemic. The figures from the quarterly returns show that the aggregate cash balance initially increased to £1.06bn at 30 June, before falling back to £983.4m at 30 September and then to £897.9m at 31 December. This profile suggests that RSLs have not achieved the level of catch-up work that was anticipated in the first half of the year and that substantial expenditure will be required over the second half of the year and especially the final quarter in order for the forecasts to be met.

As can be seen in Table 21 net cash from operating activities is set to increase significantly to £794.0m by 2025/26. This is consistent with our previous comments that turnover is, on average, increasing at a faster rate than operating costs. There is a reduction of 24.1% in 2021/22 as RSLs forecast catch up on work that has been delayed due to the pandemic. This is followed by a steep increase of 27.6% in 2022/23 tapering off to 5.8% in 2025/26 giving an average annual increase of 5.3% over the five years.

Interest paid continues to increase across the five years with the reducing levels of increase reflecting the profile of the increases in outstanding debt discussed earlier. RSLs are not forecasting any significant additional income from interest received with the figure ranging from £2.9m to £4.0m across the five years.

As set out previously, the ratio of cash generated from operations to interest paid had been falling in previous years. However, 2020/21 showed a large increase in the ratio due to the impact of the pandemic. The figure is forecast to fall significantly in 2021/22 as catch-up work is forecast, before recovering to be 3.0 or above from 2022/23 (see Table 21). The main driver of this increase is the rapid increase in net cash from operating activities as previously discussed.

	2021/22	2022/23	2023/24	2024/25	2025/26
Net cash from operating activities (£m)	499.5	637.4	707.6	750.5	794.0
Interest paid (£m)	194.5	210.9	227.1	238.3	250.3
Ratio	2.6	3.0	3.1	3.1	3.2

Table 21: Ratio of cash generated from operations to interest paid

The most volatile figure in the statement of cash flows is capital expenditure and financial investment which shows an increase of 122.7% in 2021/22 before then showing decreases of 8.0%, 30.2%, 12.4% and 5.5% in the subsequent four years. This reflects both the profile of development commented on later in the report and the re-profiling of investment expenditure that has been necessary as a result of the pandemic.

Financial ratios

A summary of the forecast interest cover and gearing ratios is shown in Table 22.

	2021/22	2022/23	2023/24	2024/25	2025/26
Interest cover (%)	258.2	303.7	313.0	316.5	318.7
EBITDA MRI (%)	166.7	226.6	251.7	262.6	272.1
Gearing (%)	115.6	123.5	122.1	117.5	111.7

Table 22: Interest cover and gearing forecasts

As can be seen from this, interest cover is forecast to remain healthy over the five years, despite a drop of 18.9% in 2021/22. The steady increase to 318.7% in 2025/26 gives an average figure of 302.0% across the projections, which compares to an average of 292.4% in the 2020 FYFPs.

Interest cover continues to be of interest to lenders and is a common ratio for loan covenants. Whilst we remain aware that certain aspects of the calculation can vary from RSL to RSL and from lender to lender, meaning that it can be difficult to compare figures, we can say that whatever the nuances of the calculations, the aggregate figure is strengthening in the short to medium term.

The EBITDA MRI calculation is impacted by the level of capitalised maintenance costs being forecast. Due to the level of catch-up work being forecast, the figure for 2021/22 is significantly lower than the other four years. Many RSLs will have this, or something similar, as a covenant and will need to monitor this calculation closely. Where there is a risk that the covenant level will be breached, early dialogue with the lender should be undertaken. A notifiable event for a potential covenant breach should also be raised through the Social Landlord Portal.

The increase in gearing over the first two years of the projections reflects the level of increase in debt funding in those years. Debt continues to increase over the remaining three years, but at a much slower rate, meaning that with the increases in the level of net assets, the gearing levels fall. The levels of gearing being experienced by RSLs reflects the nature of the sector and the reliance on both grant and private finance to fund developments.

Alongside the improving interest cover figures, the key profitability ratios also project an upward trend as can be seen in Table 23

	2021/22	2022/23	2023/24	2024/25	2025/26
Gross surplus / (deficit) (%)	15.4	20.8	22.2	23.4	24.2
EBITDA to revenue (%)	17.6	24.8	28.6	30.3	31.7
Net surplus / (deficit) (%)	6.6	9.6	11.3	12.0	12.9

Table 23: Forecast profitability

Of greater interest for some at this time is the forecast impact of the COVID-19 pandemic, in conjunction with the continued impact of Universal Credit, on voids, arrears and bad debts. Table 24 sets out the aggregate sector position from the FYFPs.

	2021/22	2022/23	2023/24	2024/25	2025/26
Voids (%)	1.7	1.6	1.4	1.4	1.3
Arrears (%)	3.4	3.3	3.2	3.1	3.1
Bad debts (%)	1.6	1.5	1.4	1.4	1.4

Table 24: Forecast voids, arrears and bad debts

The forecast for voids shows a broadly similar profile to the FYFP from last year with the medium to long term figures being almost identical. The figures for arrears and bad debts do not have the significant spike that was incorporated last year suggesting that they feel that the mitigating actions that have been undertaken continue to work and that the longer term risk of tenants not being able to pay their rent is similar to the pre-pandemic levels. There remains the continued possibility of rent losses from voids increasing because of ongoing labour shortages, supply chain disruption and cost inflation, which are likely to delay works and increase costs.

Future development

2021 marked the end of the of the Scottish Government (SG) commitment to deliver 50,000 affordable homes. Following the Parliamentary elections in May 2021, a new commitment to deliver 110,000 affordable homes by 2032 was put in place. At least 70% of those new homes are to be for social rent. At the time of submission of the FYFPs, affordable housing investment benchmarks levels had not been determined and this is likely to have impacted the level of development that is being forecast in the medium term. Grant rates have now been confirmed and we would expect RSLs to incorporate these into future versions of the projections. A summary of the current development plans is shown in Table 25.

	2021/22	2022/23	2023/24	2024/25	2025/26
New social rent properties added	6,667	7,176	4,593	3,119	2,755
New MMR properties added	1,256	1,012	1,167	762	617
New Low Cost Home Ownership properties added	41	28	77	2	0
New properties - other tenures added	3	14	4	0	0
Total number of new affordable housing units added during year	7,967	8,230	5,841	3,883	3,372

Table 25: Forecast development numbers

When considering the development programmes projected by RSLs, it is important to bear in mind that whilst some RSLs include their aspirational plans, many RSLs only include developments in their projections where there is a clear commitment or where a site has been identified. This will lead to a natural tailing off of projections in the later years.

The total number of units forecast to be developed of just over 29,000 is a slight reduction compared to the 2020 FYFP of just under 30,000. The new units will be funded mainly by social housing grant of £2.2bn (49.1% of the total cost) and private finance of £1.8bn (41.0% of the total cost). A full breakdown of the forecast development funding based on the year that the units are due to be completed is provided in Table 26.

	2021/22	2022/23	2023/24	2024/25	2025/26
HAG (£m)	540.6	608.0	466.4	304.4	262.1
Other public subsidy (£m)	3.4	10.1	1.2	0.5	0.3
Private finance (£m)	497.9	534.2	332.3	260.6	196.6
Sales (£m)	17.1	19.1	18.8	2.7	8.0
Cash reserves (£m)	64.9	77.0	82.4	40.7	62.0
Other finance (£m)	27.5	2.9	0.1	0.1	0.1
Total cost of new units (£m)	1,151.3	1,251.4	901.1	609.0	529.1

Table 26: Forecast development costs

In addition to the more traditional methods of financing development, a small number of RSLs are looking to use the proceeds of sales. Whilst the numbers remain small at this time,

the risk attached is greater as it relies on the ability to be able to sell the properties at a high enough price and volume to meet the required investment in new properties.

Whilst the level of development being forecast has fallen slightly, the overall numbers remain high. A small number of RSLs are responsible for the majority of the development, however, there remains a significant number of RSLs who are developing for the first time in a number of years or, in some cases, for the first time ever. RSLs should refer to our development thematic when making decisions about whether to undertake a development project. The thematic sets out 10 positive practice principles that will assist governing bodies as they go through the process.

COVID-19 has led to significant disruption to RSL developments. Delays or increased cost pressures caused by supply chain disruption and changes to working practices have seen development risk increase. The general slowdown in economic activity has increased risk of business failure, including in the construction sector. It is important that RSLs have appropriate plans in place to mitigate these risks. Reflecting this, the development cost per unit is forecast to increase by 8.6% from £144,510 in 2021/22 to £156,913 in 2025/26.

Funding of £3.2bn over the current parliament has been committed to help achieve this. However, it is possible that the competing pressures of making the existing stock net carbon zero will lead to pressure to redirect the funding to help achieve that. In addition, when comparing the outturn development figures for the last nine years against the Year 1 forecast figures from the previous year's projections, the RSL sector has only achieved development more than 5,000 units on three occasions, averaging completions of 4,101. They have consistently over-forecasted by more than 20% since the 2017 FYFPs were submitted (see Table 27).

	2016/17	2017/18	2018/19	2019/20	2020/21
Year 1 forecast (£m)	3,603	5,325	6,358	7,064	6,025
Outturn (£m)	3,494	3,914	5,054	5,314	3,412
Percentage difference	(3.0%)	(26.5%)	(20.5%)	(24.8%)	(43.4%)

Table 27: Outturn development numbers compared to forecast

Whilst the pandemic had a significant impact on the number of developments that could be completed in 2020/21, there has been a pattern of over-forecasting since the last target for affordable homes was announced by the SG. To achieve the target of at least 77,000 homes by 2032, an average of 7,700 homes will need to be delivered on an annual basis. Some of this target will be met by Local Authorities, but the bulk of the delivery will be expected to come from RSLs.

Investment in existing stock

In addition to the new development programme, many RSLs are forecasting significant capital expenditure on their existing properties. In total, they are projecting spend of almost £1.6bn over five years which equates to £4,991 per property.

RSLs have significant additional investment requirements in relation to both EESSH and their pre-1919 stock. In total, they are forecasting capital and revenue spend of £320m on EESSH requirements and £431m on pre-1919 properties, of which around 86% are tenements. Based on information provided to us on numbers of pre-1919 properties owned, this equates to a cost of over £11,600 per unit. This represents an additional £190m spend on pre-1919 properties equivalent to around an extra £5,000 per unit compared to the five-year forecast period last year.

Further investment will also be required as organisations look to de-carbonise their stock as part of the move to a net zero environment. At this stage, limited information is available on the potential additional cost that will be required to achieve this. A recent report published by the NHF based on research by Savills estimated costs of at least £36bn to de-carbonise housing association stock in England by 2050. This is on top of the £70bn investment in stock that is currently forecast and is based on costs of around £24,000 per flat and £37,000 per house. The majority of the spend will be on the fabric of the properties and will be incurred by 2030 to ensure that properties meet a minimum of EPC-C. Costs associated with fitting non-gas central heating are estimated at around £11,500 per property and these are likely to be incurred mainly after 2030.

Just taking the fabric costs attached to a flat by Savills of £12,800 per unit and applying this to the total number of units at 1 April 2021 from the FYFPs would give an additional cost of £3.7bn to be incurred across the Scottish sector by 2030. The fabric costs attached to a three-bedroom house by Savills of £25,600 per unit applied to the total number of units at 1 April 2021 would give an additional cost of £7.5bn. To fund the £3.7bn solely from rent would require increases of over 30% each year, whilst the higher level would require increases of over 60% each year as can be seen from Table 12.

	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m	2028/29 £m	2029/30 £m	Total £m	Difference from current
Current gross rent *	1,403.2	1,470.3	1,542.5	1,604.5	1,664.3	1,702.6	1,741.7	1,781.8	1,822.8	14,733.7	0.0
30% increase	1,403.2	1,863.5	1,938.00	2,024.6	2,103.8	2,163.6	2,213.3	2,264.2	2,316.3	18,290.6	3,556.9
60% increase	1,403.2	2,293.5	2,385.2	2,491.9	2,589.3	2,662.9	2,724.1	2,786.8	2,850.9	22,187.7	7,453.9

Table 28: Rent increases required to fund potential de-carbonisation costs

* Current gross rent inflated by 2.3% per annum from 2026/27, the average rent increase across the FYFP

To put this into perspective, using a base rent level of £1,000 for 2021/22, based on the rent increases that are currently in the FYFPs and using the average increase of 2.3% from 2026/27, rents would increase by 19.9% to £1,199 in 2029/30. If rents were to increase by 30% per annum, that level would be £8,157 which is an increase of 715.7%. If rents were to increase by 60% per annum, the level would be £42,950, an increase of 4,195.0%.

Clearly RSLs would not fund the entire increase solely through an increase in rent levels. However, even the option of taking on additional borrowing could require higher rent increases as they would be required to meet the servicing costs of the additional debt. As a result, there may be pressure to redirect grant funding from new development to investment in the existing stock.

It is important that RSLs fully understand the condition of the stock that they own and what investment is required to maintain it. This would include any additional requirements in relation to Health and Safety as a result of any new reviews by the SG. A good asset management strategy, with clear links to financial projections and business plans, will help to increase confidence in the long term viability of the RSL. RSLs should refer to our Asset Management Recommended Practice when looking to develop and improve their approach to asset management.

Difficult choices may have to be made by RSLs between essential ongoing investment in the existing housing stock and contributing to new supply. The needs of current tenants will have to be balanced with future demands and forecasts from RSLs would indicate unprecedented levels of debt need to be raised and serviced.

Rent increases and inflation

Looking forward, our analysis of the inflationary assumptions in the FYFP returns compared to the forecast figures published by the OBR in March 2022 shows that RSL rents will increase by around 2.5% each year. From Year 3 this compares unfavourably to the forecast for both CPI and RPI in most cases (see Table 13).

	2021/22	2022/23	2023/24	2024/25	2025/26
Average rent increase	1.6	2.4	2.5	2.5	2.5
CPI	3.9	8.0	2.4	1.7	2.0
RPI	5.7	10.3	3.6	2.4	2.6
Eligible rent growth assumptions for RSLs	3.0	2.7	4.5	4.4	5.0

Table 29: Average RSL rent increases from the FYFP compared to OBR inflation forecasts

Following a series of economic shocks, CPI is now forecast to be significantly above the Bank of England target rate of 2.0% until 2024/25, whilst RPI is more than the average rent increase in most years of the projections. In addition, the eligible rent growth assumptions for RSLs used by the OBR to inform the housing benefit forecasts are significantly more than the average rent increase from the FYFPs.

Considering this from an individual RSL level, the spread of rent increases compared to inflation is shown in Table 14.

	2021/22	2022/23	2023/24	2024/25	2025/26
Average rent increase	1.6	2.4	2.5	2.5	2.5
CPI or less	144	146	53	8	51
CPI to RPI	2	0	86	46	31
RPI or more	0	0	7	92	64

Table 30: Spread of RSL rent increases compared to OBR inflation forecasts

As can be seen from this, the overwhelming majority of RSLs would be increasing rents by less than CPI in the first two years. This is partly in recognition of the impact of the pandemic on tenants and in particular their ability to absorb a higher level of rent increase and partly due to the forecasts being produced well in advance of the issues identified recently that have caused inflation to increase. In previous years, almost all RSLs have had above RPI rent increases in the early years of the projections and above CPI in the latter years. This year, there has been a marked movement towards CPI or less rent increases in the latter years giving a more even spread of RSLs across the categories. However, any rent increase above CPI is likely to increase the pressure on how affordable rents are to tenants.

The trend of rents being forecast to increase above CPI has been in evidence over the last few years. Regulatory Standard 3 requires each RSL to manage its resources to ensure its financial well-being, while maintaining rents at a level that tenants can afford to pay.

RSLs face the potentially conflicting and difficult challenges of keeping rents at levels that tenants can afford to pay but at the same time continuing to provide all the tenant services and maintenance whilst building the necessary financial headroom for the risks they face. The drivers of rent increases can be many and complex, with some of them beyond the control of RSLs. However, tenants are finding it more difficult to afford their rent. Our National Panel of Tenants and Service Users reported in July 2021 that:

- Nearly a third (29%) had seen a decrease in their income during the pandemic, and more than half (56%) of all respondents had taken some cost-saving action.

- A fifth (20%) are not managing well financially at present, and a similar proportion (21%) are not managing well with their housing costs.
- Most struggle with unexpected expenses, a fifth often have to delay/miss paying a bill, and more than a third say that money worries effect their relationships.
- 40% have experienced difficulties affording their rent and 64% were concerned about future affordability. These concerns most related to future rent increases.
- More than half (53%) of respondents had experienced difficulty heating their home, and more than a quarter (27%) were having difficulties at the time of the survey.
- Those who had experienced difficulties affording their rent were significantly more likely to have also had difficulty heating their home.
- A range of factors contributed to respondents' difficulties heating their home, with poor energy efficiency the most common.

Rent increases above inflation are likely to become less affordable for tenants who have other pressures on their income such as low wages, food, and fuel poverty to contend with.

We require landlords to:

- demonstrate to their tenants that their rents will remain affordable and that they have effective dialogue with their tenants on rent levels and increases.
- vigorously pursue cost efficiency and value for money.

Cost efficiency and value for money will be crucial in keeping rents affordable in the coming years. RSLs do considerable work in this area, but they need to critically question whether everything possible has been done to be efficient and drive costs from their business, before passing costs onto tenants.

Projected borrowing

Our analysis of the FYFPs shows that RSLs expect to increase debt to £6.3bn by 2025/26, an increase of around £1.3bn over the five-year period. This is well above the £6.1bn being forecast last year for the end of 2024/25 and is despite the forecast for borrowing for 2021/22 being almost £100m lower this year compared to the 2021/22 figure in last year's projections.

The amount of additional loan finance being forecast continues to be significant and is required to fund both new development and investment in existing stock. Despite this, lenders continue to indicate that the sector remains an attractive option and we expect RSLs will be able to access new funding for these.

At the time of writing, the Bank of England base rate of interest had increased from the historically low 0.1% to 1.00% as inflationary pressures increased. The OBR are forecasting that this will increase further to a peak of 1.9% in 2023/24 before falling back to 1.4% by 2025/26. This is likely to impact on the interest rates being paid by RSLs for new borrowing and we would expect this to be incorporated into assumptions for long term projections and any associated sensitivity analysis.

Glossary

Annual Return on the Charter (ARC)	The annual return collating data on the indicators from the Scottish Social Housing Charter
Audited Financial Statements (AFS) return	The annual return collating data from the audited annual financial statements of RSLs
Care organisation	An organisation employing greater than 50% of their FTE staff in a care role
Career average revalued earnings (CARE)	A defined benefit pension scheme based on the average salary across each year of scheme membership.
Consumer Prices Index (CPI)	The benchmark inflation rate calculated by the Office of National Statistics (ONS) and used by the Bank of England to determine monetary policy
Defined benefit (DB)	A pension scheme that pays benefits based on a link to employee salary and where the risk lies with the employer
Defined contribution (DC)	A pension scheme that pays benefits based on the level of contributions paid into a fund and where the risk lies with the employee
EBITDA MRI (Earnings before interest, tax, depreciation, amortisation, major repairs included)	[(Operating surplus + depreciation + impairment – capitalised maintenance costs) / interest payable]. A version of interest cover commonly used as a loan covenant.
Final salary (FS)	A DB pension scheme that pays benefits based on the highest salary in the last 3 years of scheme membership
Five year financial projections (FYFP)	The annual return collating data from the 5 year financial projection submissions from RSLs
Gearing	[(Total outstanding debt – cash & cash equivalents)/net assets]. Commonly used as a loan covenant, the calculation used by SHR cannot generally be compared to covenant calculations as it does not adjust for grants held as deferred income in the statement of financial position
Housing Association Grant (HAG)	Grant funding provide by the Scottish Government to part finance the development or purchase of social housing by an RSL.
Interest cover	[(Net cash from operating activities + interest received) / interest paid]. Commonly used as a loan covenant, the calculation used by

	SHR cannot generally be compared to the covenant calculations as it is based on figures from the cash flow rather than the statement of comprehensive income
Key management personnel	Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) and Governing Body members of that entity
Loan Portfolio (LP) return	The annual return collating data on the private borrowings held by RSLs.
Local Government Pension Scheme (LGPS)	The common name applied to all pension schemes offered by Local Authorities, for example the Strathclyde Pension Fund.
Performance method	Accounting policy choice allowing the release of capital grants as deferred income when the related performance criteria are met. Can only be used where housing assets are valued using a revaluation method.
Registered Social Landlord (RSL)	As registered under the Housing (Scotland) Act 2010 to provide Scottish Secure Tenancies. This does not include Local Authorities.
Retail Prices Index (RPI)	RPI is another ONS inflation rate, this one including housing costs.
Stock / unit numbers	The unit numbers entered into the Annual Financial Statements, or AFS, return that we require each RSL to complete.
Systemically important RSLs	We refer to a small number of RSLs as systemically important because of their stock size, turnover or level of debt, or because of their significance within their area of operation. We need to maintain a comprehensive understanding of how their business models operate, how they manage the risks they face, and the impact these may have. We seek some additional assurance through our engagement plans as a result of this.
Total staff costs	The total staff costs for the organisation including any payments made in respect of pension deficit recovery programmes.

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