Scottish Housing Regulator

Summary of Registered Social Landlord Financial Projections 2023/24 - 2027/28

December 2023

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About this report

This report provides an overview of the aggregate financial forecasts as submitted to the Scottish Housing Regulator (SHR) by all Registered Social Landlords (RSLs) during the return submission period to May 2023. These projections cover the period from April 2023 to March 2028 and reflect the corresponding five-year period from RSLs' business plans.

We collect five-year financial projections (FYFP) annually from all RSLs. The returns set out the financial projections from RSLs' business plans across a five-year, medium term reporting period. They incorporate the main financial assumptions applied by each RSL, along with the key financial statements plus additional details on their development programmes and decarbonisation plans.

Those business plans should set out an RSLs strategic direction and financial plans. In setting out how RSLs will resource those plans for a specific period at a given point in time, there can often be materially significant changes made to forecasts between years.

Since RSLs submitted their projections to us in May 2023, several key factors will have continued to impact RSLs' business plans across the year and are likely to have led to further changes to individual financial projections:

1. the cost-of-living crisis that is still impacting tenants;
2. the increasing requirements to address the safety and quality of homes, including on energy efficiency and decarbonisation;
3. the ongoing economic uncertainty and volatility including – high inflation, higher borrowing costs and skilled labour shortages;
4. the risk of further disruption as the war in Ukraine continues and instability in the Middle East escalates.

The current and ongoing economic context for RSLs means that they are likely to have made significant changes to their financial projections and business plans since they were submitted to us in May, and it is important therefore to read this report with that in mind.

HAPPY TO TRANSLATE

Highlights

RSLs' projections show aggregate financial performance will remain robust. Whilst RSLs have coped well with the financial challenges, there has been a tightening of sector finances. This means RSLs will have reduced financial flexibility to respond to further challenges due to restraint on rent increases and cost increases. Governing Bodies are likely to face difficult trade-offs as they prioritise expenditure.

At an aggregate level over the five years to 2027/28 RSLs forecast:

- continuing to consistently generate operating and net surpluses;
- annual turnover to increase by an average of 1.0% (2022, 0.4%) more than operating costs;
- net assets to grow by an annual average of 3.9% (2022, 5.0%), with modest but steady growth of 3.8% in 2023/24 dropping to 3.0% in 2027/28;
- taking aggregate net housing assets to £19.30 billion (2022, £18.77 billion), and net assets to £5.59 billion (2022, £5.41 billion);
- net cash from operating activities to increase significantly to £855.7 million by 2027/28;
- significant but reducing cash reserves, with an aggregate closing balance of £801.0 million at March 2023 (2022, £892 million), dropping to £565.9 million by March 2028;
- interest cover remaining healthy, but lower than forecast in the 2022 returns;
- rent arrears steadily reducing, from 3.3% in 2023/24 to 2.8% by 2027/28;
- significant capital expenditure of £1.68 billion on existing homes, an average of more than £5,000 per property; and
- a projected 26,000 new homes, to be funded primarily by £2.45 billion of social housing grant (51% of total cost) and £2.00 billion of private finance (42%).

RSLs have faced, and continue to face, uncertainty in the national and global economy which has contributed to the cost-of-living crisis, alongside significant and sustained cost increases, higher energy costs, higher borrowing costs, continuing supply chain disruption and labour scarcity. The effects from some of this is only now starting to crystalise and impact the financial position of RSLs. As this happens and uncertainty remains, it is essential that RSLs maintain sufficient liquidity.

Keeping rents as affordable as possible for their tenants is a principal objective of all social landlords and RSLs have shown restraint when increasing their rents. However, tenants are still facing enormous financial challenges and RSLs should therefore continue to vigorously challenge every element of their cost base to ensure that it is necessary, is focused on the delivery of outcomes for tenants and others who use their services and represents value for money.

In response to an agreement by social landlords to voluntarily restrict rent increases for 2023/24 the Scottish Government's (SG) emergency legislation that brought in a freeze on rent increases during 2022/23 was not extended beyond March 2023 for social lettings. This prevented the estimated removal of up to £60.0 million in rental income from RSL business plans.

With increased costs and below inflation rent increases, RSLs have a reduced financial flexibility to respond to further challenges. This has many implications for RSLs, tenants, and the SG, including a reduction in housebuilding, restrictions on maintenance expenditure and less expenditure on some of the wider role activities that support tenants and communities.

Over this financial year and last, interest rates have risen from a record low of 0.1% to 5.25%, their highest level for more than 15 years, although there may now be signs that the Bank of England Base Rate has peaked as at the time of writing it has been held at the current rate for 3 months. Despite that, we estimate that an additional 1.0% rise in interest rates could put RSLs' aggregate debt servicing costs up by as much as £14.5 million a year. Rising interest rates are also likely to result in a reduction in interest cover for many RSLs.

Against this background, RSLs are facing the challenge of balancing stock quality, the need to invest in decarbonisation measures, delivering on tenant and resident safety and the construction of new homes. This planned activity could result in a reduction in RSLs' forecast interest cover and consequently will reduce some RSLs' capacity to manage any additional financial shocks. And we are seeing Governing Bodies reconsider their priorities as they face difficult trade-offs.

Around 29% of total RSL loan debt outstanding at 31 March 2023 was held on a variable interest rate, highlighting the importance of Governing Bodies ensuring they manage the risks from existing debt and understand the sensitivity of business plans to any further increases in interest rates. Further analysis of RSLs' annual loan portfolio returns at 31 March 2023 can be found in our annual loan portfolio report for 2023.

Voids, arrears, and bad debts remain key performance indicators in assessing the efficiency of RSLs' letting and rent collection. Each of these are forecast to either remain around the previous years' levels or show some improvement, demonstrating the positive impact of the work done by RSLs to manage these. However, the sustained financial pressure on tenants means that RSLs cannot yet rule out further increases in arrears. RSLs should continue to ensure void, arrears, and bad debt risks are managed appropriately as failure to do so can materially impact their financial position. Stress testing against income reduction remains vital.

Analysis of the FYFP inflation assumptions compared to the forecast figures published by the Office for Budget Responsibility in November 2023 shows aggregate rents increasing by less than both CPI and RPI in Year 1 but by more than both inflation measures across the remainder of the current projections period.

The construction of new homes remains a priority for the SG and RSLs continue to play a key role in delivering this. The total number of new homes RSLs forecast to build over the five years of their projections has dropped to 26,000, potentially reducing rental income, but despite that, costs are only marginally down at £4.82 billion. Engaging in development brings its own set of risks, and high inflation, labour shortages, supply chain issues and contractor insolvencies are delaying and impacting RSL developments. This highlights the importance of effective oversight and management of development programmes by Governing Bodies, including stress testing against increased costs or delays. Our development thematic continues to be a relevant reference for RSLs when making decisions about whether to undertake a development project.

RSL expenditure on repairs and maintenance is at a record level and they are forecasting further increases, albeit some of this will be to reflect the ongoing impact of cost inflation. Many RSLs continue to report changes to their repairs and maintenance programmes, with limitations on access to contractors and inflationary cost increases often leading to investment being delayed, and in some cases, postponed.

The Next Five Years – Projections to 2027/28

Statement of Comprehensive Income

The headline from the 2023 FYFPs is that annual aggregate RSL turnover is forecast to continue to increase, on average, by more than operating costs over the next five years, with the RSL sector therefore expecting to continue generating annual surpluses.

An average annual rise in turnover of 5.2% (2022, 4.6%) across the projections period is up on last year, and compares favourably with a projected 4.2% (2022, 4.1%) average increase in operating costs over the same period. Overall, the sector forecasts that turnover will increase by 28.6% (2022, 24.8%) to £2.51 billion by 2027/28, with operating costs up 23.0% (2022, 22.1%) to £1.96 billion across the same period.

The impact, as the extracts in Table 1 below show, is that the aggregate annual operating surplus is forecast to increase each year from Year 1 to Year 4; from £393.4 million in 2023/24 to £580.0 million in 2026/27, before dropping back to £540.7 million in 2027/28, the final year of the current projections period. Increasing loan debt and interest rates mean the cost of servicing that debt is set to rise too, with interest payable increasing from £248.0 million in 2023/24 to £298.5 million in 2027/28. The sector projects a fluctuating annual net surplus; from £157.3 million in 2023/24, to a low of £140.5 million in 2024/25, peaking at £268.5 million in 2026/27, and dropping back to £161.5 million in 2027/28.

	2023/24	2024/25	2025/26	2026/27	2027/28
Turnover	2,074.4	2,238.7	2,335.4	2,423.3	2,510.0
Operating costs	1,723.0	1,779.3	1,832.4	1,898.3	1,959.4
Operating surplus	393.4	468.8	476.7	580.0	540.7
Interest payable	248.0	264.4	275.8	291.9	298.5
Net surplus	157.3	140.5	226.0	268.5	161.5

Table 1: Turnover & costs

The sector has consistently projected turnover increasing by more than operating costs, the assumption being that, particularly for those RSLs with new build development programmes, rental income will increase by more than the associated operating costs. That assumption had been maintained across recent FYFPs however, the current economic climate has tested it with RSLs now finding themselves having to absorb the impact of restrained rent increases and delayed or postponed development projects, while managing the trade-off between recouping lost revenues and being mindful of affordability for their tenants.

This is reflected in the current year's projections, with an average 2023/24 rent increase assumption of 3.0% below inflation, against average increases in operating costs and direct maintenance costs of 0.2% and 0.9% above inflation, respectively. Rent increases are set to match assumed increases in operating costs in 2024/25 and exceed them across the remaining years of the projections period.

The aggregate projections forecast that the total monetary increase in turnover will exceed the increase in operating costs in all five years. The gap between increase assumptions is more pronounced in the earlier years, with rent set to increase by 7.9% in 2023/24, against a 3.3% increase in operating costs, but by 2027/28, as development programme additions tail off, that gap narrows, with rental income up 5.2% against a 4.2% rise in operating costs.

For 2023/24, the Covid-19 pandemic and the war in Ukraine still have an influence, but most impact is now from the cost-of-living crisis, with RSLs trying to balance recouping sufficient lost revenues to fund their business plan priorities with affordability pressures on their tenants. RSLs are still facing issues with labour and material shortages, combined with material cost increases, and increasing labour costs as contractors face higher wage demands. In many cases there is also the need for expenditure on delayed repairs stretching back to 2020/21, still falling into 2024/25 for some RSLs. Whether catch-up repairs or more recently delayed expenditure because of two years of suppressed rent increases, RSLs need to continue to be mindful of the impact on any interest cover covenants.

Rental income will always be the core revenue stream for most RSLs, but other regular sources of income continue to contribute to turnover, as shown in Table 2 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
Net rents and service charges	79.1%	77.9%	78.4%	78.9%	79.3%
Developments for sale income	0.4%	0.6%	0.1%	0.0%	0.0%
Grants released from deferred income	8.0%	10.5%	10.8%	10.4%	9.9%
Grants from Scottish Ministers	1.5%	0.7%	0.5%	0.5%	0.5%
Other grants	0.9%	0.6%	0.5%	0.5%	0.5%
Other income	10.1%	9.7%	9.6%	9.7%	9.8%

Table 2: Forecast split as % of turnover

The release of grants remains a steady driver of turnover. This does not generate additional positive cashflow benefits but is instead dictated by an accounting policy choice and reflects developing RSLs adopting the performance method of grant accounting, whereby rather than releasing grant over the useful economic life of the properties it funds, it is released in full as those properties are built.

With more than 60% of aggregated other income coming from care and support organisations, care is clearly still a key revenue stream for the sector. However, that income will continue to be largely generated by fewer than 10 RSLs who employ more than half of their staff in a predominately care and support role. RSLs involved in care and support continue to experience cost pressures. They should also be aware of downward pressure on support contracts as local authorities also experience financial pressures.

Statement of Financial Position

Aggregate net assets are projected to grow by an annual average of 3.9% (2022, 5.0%) over the five years. Growth forecasts are down on last year but are still expected to be steady, increasing in each of the first four years from 3.8% in 2023/24 to 5.2% in 2026/27, before dropping back to a 3.0% increase in 2027/28. This growth profile would take aggregate net housing assets to £19.30 billion and net assets to £5.59 billion by the end of 2027/28.

As forecast last year, rent arrears rose in 2022/23 both in monetary terms and as a percentage of net rent and service charges. Current projections are for a further significant increase to £54.8 million in 2023/24 and then stability across the rest of the projections period, only rising to £56.2 million by 2027/28. As reported previously, 2022/23 likely reflects the lasting impact of the pandemic, more specifically the end of the UK Governments Job Retention Scheme part way through the previous financial year (Oct 2021); however for 2023/24 we would be looking at the cost-of-living crisis more generally as having the greatest impact on tenants ability and willingness to keep up with their rent payments. It

should be noted that these arrears figures are net of any provision for bad debts and as it is for individual RSLs to determine their own provisions policy, it is therefore difficult to consider a like for like comparison on arrears without knowing the detail of those policies.

At an aggregate level RSLs continue to project the availability of significant cash reserves. However, from the 2022/23 Audited Financial Statements (AFS) returns closing balance of £776.7 million, cash is projected to drop sharply to £540.8 million across Years 1–4, recovering marginally to close 2027/28 at £565.9 million (see Table 3 below).

2022 projections	2023/24	2024/25	2025/26	2026/27	2027/28
Net rental receivables	54.8	54.6	54.8	55.7	56.2
Other short-term receivables	247.8	253.2	271.5	253.5	271.9
Cash at bank and in hand	632.0	609.0	577.8	540.8	565.9
Loans due within one year	(101.8)	(169.3)	(162.7)	(152.4)	(134.1)
Other short-term payables	(641.7)	(638.8)	(657.1)	(654.8)	(677.4)
Net current assets	191.1	108.8	84.3	42.7	82.4

Table 3: Net current assets

The profiled movement in net current assets would see it drop by more than half, from £191.1 million in 2023/24 to £82.4 million by 2027/28. The higher 2023/24 figure is largely driven by cash, a combination of prior year unutilised drawn down debt and the ongoing impact of the pandemic, where RSLs found themselves restricted in carrying out significant parts of their day-to-day business, despite having access to the funds to let them do so.

Outstanding loan debt is forecast to rise by 26.5% to £7.02 billion. An average increase of just over 6.0% across Years 1 & 2 drops to a little less than 4.0% for the remaining three years as committed development activity tails off. The split of the outstanding loan debt balances by maturity date is shown in Table 4 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
Loans due < 1 year	101.8	169.3	162.7	152.4	134.1
Loans due > 1 year	5,760.3	6,076.0	6,364.3	6,638.9	6,889.8
Totals loans balance outstanding at y/e	5,862.1	6,245.3	6,527.0	6,791.3	7,023.9
% annual change	5.6%	6.5%	4.5%	4.0%	3.4%

Table 4: Split of short and long-term debt

Statement of Cash Flows

Cash remains crucial to any RSL business and generating sufficient cash remains key to financial viability and longer-term sustainability, for individual RSLs and for the sector. We take a keen interest in where and when that cash is to be spent, whether maintaining day-to-day operations or sustaining a significant development and investment programme.

The headline figures from the aggregated cashflow projections are set out in Table 5 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
Net cash from operating activities	609.0	717.1	760.1	814.1	855.7
Returns on investment and servicing of finance	(237.1)	(253.4)	(268.2)	(285.0)	(290.9)

Capital expenditure and financial investment	(859.1)	(866.9)	(832.7)	(794.5)	(758.3)
Net cash from financing	321.3	380.2	309.7	228.5	218.8
Increase/(decrease) in net cash	(165.9)	(23.0)	(31.2)	(37.0)	25.1

Table 5: Extract of statement of cash flows

Net cash from operating activities is forecast to increase significantly to £855.7 million by 2027/28, consistent with earlier comments on turnover projections increasing at a faster rate than operating costs, and the projections clearly show steady annual increases in net cash from operating activities.

However, interest payments are also expected to steadily increase, reflecting higher levels of loan debt but also recent increases in interest rates. The lower rate of increase in Year 5, up only 2.1% against an average increase of 6.3% across the other years, reflects a drop off in development in the later years, and consequently in new loan activity.

Seven months on from the projections being submitted, further interest rate rises have taken the Base Rate to 5.25%; however, despite initial forecasts of at least one further increase the Bank of England have since held it at this rate. Although inflation is predicted to ease further over the coming months, interest rates are likely to remain higher than the recent norm. RSL should be prepared to handle further increases in interest payments and operating costs.

With interest rates rising across 2022/23 and into 2023/24 and around 30% of outstanding loan debt on variable interest rates, the sector is more exposed to increasing debt servicing costs than it has been for many years. It is estimated that a 1.0% increase in interest rates could increase annual interest charges by up to £14.5 million.

Also evident from the cash flow projections is a tailing off in annual capital expenditure, dropping around £100.0 million from Year 1 to Year 5. This may just be RSLs being more prudent and only including committed development projects which tend to be profiled in the earlier years, but it could also signal a more general drop brought about by the cost-of-living crisis and the suppressed rent increases of 2022/23 and 2023/24.

In summary, net cash outflows are forecast across Years 1-4, with the largest decrease in net cash set to occur in Year 1 (23/24). This is not entirely unexpected as RSLs still continue to catch up on work initially delayed by the restrictions of the pandemic, but more recently by the economic impact of the Ukraine war and the cost-of-living crisis, and with it suppressed rent increases as RSLs try to balance increasing costs with the affordability concerns of their tenants.
The ratio of cash generated from operations to interest paid had been falling in previous years. The pandemic reversed that trend in 2020/21, and although current forecasts have it steadily rising across the projections (see Table 6 below), it is not expected to peak as high as projected in the 2022 projections, with a previous high of 3.2 now expected to peak at 2.9.

	2023/24	2024/25	2025/26	2026/27	2027/28
Net cash from operating activities	609.0	717.1	760.1	814.1	855.7
Interest paid	245.9	262.0	275.9	292.4	298.1
Ratio (%)	2.5	2.7	2.8	2.8	2.9

Table 6: Ratio of cash generated from operations to interest paid

The most volatile cash flow figure is for the construction and acquisition of housing properties, which shows an increase of 23.2% in 2023/24, before dropping to only a 0.5% increase in 2024/25, and then year-on-year decreases of 19.1%, 7.8% and 12.7%. The earlier years reflect some of the necessary re-profiling of expenditure because of restrictions during the pandemic, and the later years the reduction in development activity as committed projects typically tail off.

Financial Assumptions

As part of the FYFP return RSLs provide the key financial assumptions which form the basis of their short, medium, and long-term financial projections. Data collected in the 2023 FYFPs gives an insight into how RSLs saw the operating economic climate at that time, with Tables 7 & 8 below sharing some of the information on key planning assumptions on inflation and rents.

General inflation	2023/24	2024/25	2025/26	2026/27	2027/28
Sector	8.4	4.7	2.9	2.5	2.4
Minimum	0.0	0.0	0.0	(0.8)	0.0
Median	10.0	5.0	2.5	2.0	2.0
Maximum	15.0	10.0	7.5	7.5	7.5

Table 7: General inflation

	2023/24	2024/25	2025/26	2026/27	2027/28
Sector	5.4	4.9	3.6	3.1	3.0
Minimum	0.0	0.0	0.0	0.0	0.0
Median	5.0	5.0	3.2	3.0	3.0
Maximum	15.0	10.0	10.0	10.0	10.0

Table 8: Gross rent increase

As RSLs approach their annual rent setting for 2024/25, inflation has been slow to drop towards the levels that were being forecast around the time the FYFPs were submitted so we may not yet see an average rent increase above inflation if CPI remains closer to 5.0% at the end of the year.

What is clear is that RSLs continue to face an uncertain and challenging operating environment and Governing Bodies must ensure appropriate stress testing of any changes in underlying assumptions to fully understand the impact on their business and to help mitigate against unforeseen movements.

Rent Increases and Inflation

Analysis of the inflation assumptions compared to the most recent figures published by the OBR in November 2023 shows aggregate rents increased by less than CPI and RPI forecasts in Year 1 of the projections. However, although the average rent increase is forecast to fall each year it is still set to stay above both CPI and RPI forecasts for the remainder of the projections period. Seven months on from the projections being submitted and with the benefit of an up-to-date OBR publication, the likelihood is that the gap between the sectors average rent increase assumption and CPI/RPI going forward will narrow. The full five-year forecast figures are shown in Table 9.

	2023/24	2024/25	2025/26	2026/27	2027/28
Average rent increase	5.4	4.9	3.6	3.1	3.0
CPI	6.1	3.0	1.6	1.5	1.8

RPI	8.3	4.3	2.4	2.6	2.8
Eligible rent growth assumptions for RSLs	8.9	7.6	4.5	2.7	2.6

Table 9: Average RSL rent increases from the FYFP compared to OBR inflation forecasts

CPI peaked at 11.1% in October 2022 and at March 2023 it was forecast to fall sharply to 2.9% by the end of the year, falling further beyond that but not returning to the long-term target of 2.0% until 2027/28. In addition, the eligible rent growth assumptions for RSLs used by the OBR to inform housing benefit forecasts exceed average rent increases in 2023/24 and are expected to remain above in 2024/25 and 2025/26 before dropping quite sharply in 2026/27. At an individual RSL level, Table 10 shows the spread of rent increases compared to inflation. In analysing this data, it is noted that traditionally the sector has tended to base its annual rent increase assumptions on the inflation rates in the previous September or October. So, while the table shows more than 100 RSLs raised rents by no more than CPI for 2023/24, that average increase assumption of 5.4% was set at a time when inflation was still significantly higher than that but with the prospect of rent controls having been lifted.

Rent increases	2023/24	2024/25	2025/26	2026/27	2027/28
Average rent increase (%)	5.4	4.9	3.6	3.2	3.0
No. of RSLs at CPI or less	113	27	4	5	2
No. of RSLs between CPI & RPI	27	18	15	42	44
No. of RSLs at RPI or more	3	98	124	96	97

Table 10: Spread of RSL rent increases compared to OBR inflation forecasts

RSLs in Scotland applied an average rent increase in April 2023 that was significantly below the CPI inflation rate of 8.7% at that time. Landlords told us that last year's annual rent setting exercise was one of the most difficult they have faced. This year will also be hugely challenging as they consider further rising costs and high inflation while recognising the financial hardship that is a reality for many of their tenants. Any increase above CPI, particularly in the current economic climate, is likely to increase the pressure on affordability for tenants.

The drivers of rent increases can be many and varied, with some beyond the control of RSLs. They consistently face the conflicting challenge of keeping rents at levels their tenants can afford while continuing to provide tenant priorities in relation to services, maintenance, and planned investment in tandem with building the necessary financial resilience to manage the risks they face.

Tenants and their families are facing an incredibly difficult and worrying period ahead. Our most recent findings from the survey of the [National Panel of Tenants and Service Users] concluded that 41% of tenants that responded have experienced difficulties affording their rent and other housing costs in the last year, up from 28% the previous year and now at the highest level over the last five annual surveys. The cost of heating was the most common factor contributing to rent affordability difficulties, and 83% (2022, 71%) were concerned about the future affordability of their rent.

RSLs have shown restraint when increasing their rents; however, tenants are still facing enormous financial challenges therefore RSLs should continue to vigorously challenge every element of their expenditure to ensure that it is necessary, focused on delivery of outcomes for tenants and others who use their services, and that it represents value for money. The rent setting exercise for several years to come is likely to remain difficult.

Financial Ratios

A summary of the forecast interest cover and gearing ratios is shown in Table 11.

	2023/24	2024/25	2025/26	2026/27	2027/28
Interest cover (%)	251.3	277.0	278.3	280.9	289.5
EBITDA MRI (%)	193.3	226.7	230.0	249.8	234.8
Gearing (%)	109.3	114.4	115.3	115.2	115.5

Table 11: Interest cover and gearing forecasts

Interest cover forecasts are down on the 2022 FYFP returns but remain healthy and anticipate year-on-year increases. Since the 2023 returns were submitted interest rates have risen to their highest level in nearly 16 years. Those rates may yet rise further as the Bank of England seeks to control stubbornly high inflation and we estimate that every additional 1.0% increase could potentially raise annual interest charges across the sector by as much as £14.5 million, with higher rates also likely to mean a reduction in interest cover for many RSLs.

Steady increases take interest cover to 289.5% for 2027/28, with an annual average of 275.4% which, although down on the 308.7% average from the 2022 FYFPs, is still a healthy position for the sector. Interest cover continues to be of interest to lenders and remains a common ratio for covenants. We know that calculations can vary from RSL to RSL and from lender to lender, and it can therefore be difficult to draw meaningful comparisons, but whatever the nuances of the calculation, the aggregate position is forecast to strengthen over the short to medium term.

Earnings Before Interest, Taxation, Depreciation & Amortisation, Major Repairs Included (EBITDA MRI) is impacted by capitalised maintenance costs and due to an increase in those costs, the figure for 2023/24 is lower. Many RSLs will have this as a loan covenant and we have previously highlighted that ongoing issues, particularly in relation to labour and material shortages, meant that the need for expenditure on catch-up repairs in 2022/23 could yet stretch into 2023/24 and beyond. Given the level of catch-up required, RSLs should continue to be aware of any impact on their interest cover covenants. We also know we know many RSLs are negotiating with lenders reference potential waivers/changes to covenant requirements. Any RSL at risk of a covenant breach should have an early dialogue with their lender and should also submit a notifiable event for a potential breach to SHR through the Social Landlord Portal.

Increasing gearing over the first half of the projections reflects increasing borrowing. Loan debt is expected to rise over the remaining years, albeit at a slower rate, so with increased net assets gearing levels fall. Gearing reflects the sector's reliance on private finance but also on Government grant funding, with the sector traditionally in receipt of a higher state contribution than its English and Welsh counterparts.

At 31 March 2023, 29% of outstanding loan debt was on a variable interest rate, and Governing Bodies should ensure they are managing risks from existing debt. RSLs should ensure robust stress testing to help them understand how sensitive their business plans are to increases in interest rates. Further analysis of RSLs' annual loan portfolio returns for the year to March 2023 can be found in our annual loan portfolio report for 2023.

Alongside improving interest cover and earnings, other key profitability ratios also project a slow and fluctuating but broadly upward trend throughout, as shown in Table 12 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
Gross surplus (%)	19.0	20.9	20.4	23.9	21.5
EBITDA to revenue (%)	23.1	26.8	27.2	30.1	27.9
Net surplus (%)	7.6	6.3	9.7	11.1	6.4

Table 12: Profitability forecasts

As the sector continues to recover from the impact of the pandemic and negotiate its way through the cost-of-living crisis, we will continue to monitor the impact, particularly on voids, arrears, and bad debts. Table 13 below sets out the projected aggregate sector position across these three key measures.

	2023/24	2024/25	2025/26	2026/27	2027/28
Voids (%)	1.7	1.5	1.5	1.5	1.4
Arrears (%)	3.3	3.1	3.0	2.9	2.8
Bad debts (%)	1.3	1.4	1.3	1.3	1.2

Table 13: Voids, arrears, and bad debt forecasts

Voids, arrears, and bad debts remain key performance indicators, particularly in assessing the efficiency of letting and rent collection. Voids show a broadly similar profile to last year, with mid-term figures almost identical. However, there remains the continued possibility of rent losses from voids increasing, particularly if ongoing labour shortages and supply chain disruption leads to delayed works, and in turn, increased re-let times.

Arrears as a percentage of rental income are forecast to peak in 2023/24, reflecting tenants experience of cost-of-living pressures while incomes fall in real terms. Beyond that they are expected to steadily return to more recognised pre-pandemic levels. There is no similar spike expected for bad debts, suggesting that RSLs feel their mitigating actions are continuing to work and that the longer-term risk of tenants not being able to pay their rent is in fact not dissimilar to pre-pandemic levels.

Investment in Existing Stock and Net Zero Carbon

RSLs continue to forecast significant capital expenditure on improving existing stock, a total of £1.68 billion over five years, or an average of more than £5,000/unit.

As well as routine cyclical maintenance and a component replacement programme, RSLs can expect additional significant and costly future investment in meeting the Social Housing Net Zero Standard (SHNZS). The SG recently published a consultation that seeks views on this new standard which will replace the second Energy Efficiency Standard for Social Housing (EESSH2). The outcome of this consultation should help RSLs plan what investment will be needed and will be a key driver of RSLs medium to long term investment requirements.

This is likely to be particularly true for pre-1919 tenemental stock held. The sector currently forecasts combined capital and revenue expenditure of £351.0 million (2022, £330.8m) on EESSH compliance and a further £370.0 million (2022, £341.3m) on any pre-1919 stock. From information provided on the number of pre-1919 units, this equates to around £13,300/unit, and represents an increase of £29.7 million from the 2022 FYFPs.

It is important that RSLs fully understand the condition of their stock and what ongoing investment is needed for its upkeep. This includes any additional requirements to ensure they meet tenant and resident safety obligations. A good asset management strategy, with

clear links to business plans and financial projections, should help to increase confidence in long-term viability. RSLs should refer to our updated Integrated Asset Management Recommended Practice which was published in February 2023 when looking to develop and improve their approach to asset management.

Difficult choices may have to be made between investing in existing properties and funding a new build development programme. The needs of current tenants must be balanced with future demands, and forecasts from RSLs would indicate that unprecedented levels of debt may need to be raised and serviced.

It is also recognised that significant future investment will be required to de-carbonise stock towards the SG's 2045 net zero carbon target. To achieve this, targeted investment in existing stock will be essential; to improve energy efficiency but also to aid the move away from fossil fuel-based heating.

Recognising the importance of this area and its potential impact on financial health, we again posed some additional questions in the FYFP return, asking if RSLs had considered de-carbonisation and if so, to indicate the extent to which estimated future costs are incorporated into their projections. The responses are considered below:

- 26 RSLs indicated they had considered de-carbonisation as part of their business planning, 19% of all RSLs. This is down on the 35 that indicated their consideration in 2022. Of those 26, only three have not yet considered the cost impact on their forecasts, an improvement on the 10 who last year said they had yet to consider the cost implications.

- all three who answered 'yes,' but without costs, did provide a comment. Of the 23 RSLs who included costs, the estimates ranged from £0.2 million to £38.8 million. All acknowledge that these costs are likely to fall well short of what is required to decarbonise their homes.

- 18 of the RSLs who answered 'yes' also did so in 2022. One reduced their estimate to zero, but the others have continued to include an estimate in their projections. The aggregate across these 18 has fallen from £107.5 million to £104.2 million, but the total for all RSLs indicating 'yes' has increased from £111.4 million to £129.5 million, despite the number of costed RSLs falling from 26 to 23.

- a further 22 RSLs said 'no', with a comment explaining that de-carbonisation had started to be a consideration. Had they therefore said 'yes' but input zero costs this would take 'yes' to 48 RSLs, or 35% and similar to the 2022 figures of 49, or 35% of all RSLs.

- where comments have been input, but no costs attributed, the underlying theme is on of waiting for clear guidance, and confirmation of what grant funding might be available, suggesting that RSLs are waiting to see what public funding is available before they commit to undertaking any de-carbonisation works.

- whilst this position is understandable, it means that one of the key risks to the sector is not currently being adequately covered within the financial projections and it is disappointing that the number of RSLs intimating their consideration of the potential

financial impact of decarbonisation has fallen, without a fuller explanation as to why so many appear reluctant to include any estimated costings in their projections.

There remains limited data on how much additional investment might be required. If we were to update the details in the 2021 joint report by Savills and the National Housing Federation for recent CPI inflation then estimated costs in England would range from £27,943 for a flat (was £24,250) to £42,635 for a 3-bed semi-detached house (was £37,000), with figures inclusive of non-fabric costs of £13,194 (was £11,450). However, in discussions with RSLs we are told that the cost inflation rates experienced have been significantly higher than CPI so these estimates would reflect an optimistic position.

In Scotland, it is expected that pre-1919 tenements will prove the most difficult and therefore the costliest to get to net zero carbon. Similarly, therefore, if we take the 2021 Southside HA retrofit pilot that raised eight sandstone tenement flats up to Passivhaus standard and inflate the original figures then Southside would have spent an equivalent £42,635 per flat (was £37,000) on energy efficiency measures.

The sector has around 25,000 pre-1919 tenements. If we take the inflated cost of Southside's energy efficiency measures as a proxy, then the cost to the sector would be over £1.00 billion. The latest aggregate figure included in the FYFPs for capital and revenue expenditure on pre-1919 properties is only £370.0 million.

Similarly, if were to extrapolate the inflated cost of the Savills/NHF figures using the outturn units from the 2023 FYFPs of approx. 315,000 then the additional fabric costs in the period to 2030 could range from £4.60 billion (from the flat estimate) to £9.30 billion (from the house estimate).

These figures bear no resemblance to the current aggregate level of costs included of £129.0 million and to fund these higher estimates entirely from rents would require annual increases of between 42% and 80%. Alternatively, to fund solely through additional borrowing could see interest charges upwards of £1.30 billion being added in the period to 2030, on the assumption that RSLs were able to access fully amortising borrowing at the current Bank of England Base Rate of 5.25%.

Future Development

The development of new affordable homes is a government priority and the Programme for Government sets out a commitment to deliver 110,000 affordable homes by 2032 of which at least 70% will be for social rent and 10% will be in remote, rural and island communities. In addition to providing quality, affordable and secure homes to those in housing need, the affordable housing programme also aims to bring benefits across the National Performance Framework, as well as being a fundamental part of the strategy to tackle homelessness.

A summary of the new units projected to come out of the current development plans over the next five years is shown in Table 14 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
Social rent properties added	4,726	4,388	4,387	3,852	3,523
MMR properties added	1,271	752	1,120	860	759
LCHO properties added	78	54	2	0	12
Other tenure properties added	34	60	99	65	40

Total affordable units added	6,109	5,254	5,608	4,777	4,334

Table 14: Forecast development numbers

In looking at these plans, it is important to bear in mind that whilst some RSLs will include aspirational plans, many more are likely to be more prudent, only including those projects where there is a clear development commitment. Rising build costs and finance costs are making it harder for RSLs to put those firm commitments in place and the aggregate projections reflect this, with forecast completions tailing off towards the end of the projections period.

The total number of new units forecast for development, at a little over 26,000, is 17% down on the 30,600 projected in the 2022 FYFPs. The new units, at a cost of £4.82 billion, are expected to be funded primarily by social housing grant (£2.45 billion, or 51% of cost) and private finance (£2.00 billion, or 42% of cost). A full breakdown of the forecast development funding is shown in Table 15 below.

	2023/24	2024/25	2025/26	2026/27	2027/28
HAG	535,101.2	495,180.8	527,714.7	478,673.6	409,187.7
Other public subsidy	3,798.9	3,630.2	2,781.0	634.0	310.0
Private finance	459,351.8	370,872.8	456,258.8	393,349.6	324,449.3
Sales	15,133.9	11,792.7	16,121.2	7,568.7	2,320.2
Cash reserves	48,470.5	57,508.3	54,720.0	45,781.0	91,020.4
Other finance	0.0	0.1	0.0	0.0	7,369.7
Total cost of new units	1,061,856.3	938,984.9	1,057,595.7	926,006.9	834,657.3

Table 15: Forecast development cost & funding

In addition to the traditional methods of funding, some RSLs will look to sale proceeds and whilst the number of sales has always been lower in Scotland than in England, the risk attached to relying on sales is greater if RSLs need to be able to sell at a high enough price and/or volume to at least partly cover the required investment in new properties. However, from the forecast figures sales are more a top up funding source, reducing the reliance on grant funding and private finance, and not something that the sector is likely to overly rely on.

Although forecast development levels have dropped, this is having no measurable impact on the already relatively small number of RSLs that continue to be responsible for the bulk of the proposed new build development. For all RSLs the development process carries a significant range of additional risks which, inadequately managed, have the potential to seriously impact on individual RSLs, their tenants and on the sector. Given the turbulent economic climate in recent times, these risks have significantly magnified, particularly over the past year or so. All RSLs including those looking to develop for the first time, or for the first time in a long time, can refer to our development thematic to assess the potential risks when they are making decisions on whether to take forward a project.

There can be no doubt that the economic turmoil of the last few years has brought significant disruption to RSLs new build development programmes. That disruption continues to be felt through delays, supply chain disruption, changes to working practices, and most significantly inflationary cost increases. The economic slowdown has also increased the risk of business failure, nowhere more so than in the construction industry, and to reflect this and the other financial challenges brought about more recently by the cost-of-living crisis, RSLs forecast that the development cost per unit will rise by around 11%, from around £174,000 in 2023/24

to £193,000 by 2027/28. It is therefore important that RSLs have appropriate plans in place to try to mitigate as best they can against these risks.

Since the 2023 FYFP returns were submitted the economic picture has shown some signs of improvement, with inflation reducing and interest rate rises possibly having peaked. Despite that we are still seeing evidence of continuing supply-chain and labour market pressures, with cost inflation still expected to lead to a further squeeze on development plans in the next round of projections.

Against this backdrop is the SG 2032 new homes target. Funding of £3.20 billion across the current parliamentary term has already been committed to this; however, RSLs are becoming increasingly more mindful of the competing pressure of net zero carbon and the prospect of Government funding potentially having to be redirected towards that in the years ahead.

In addition, when looking at the recent outturn development figures the sector has only achieved annual completions of more than 5,000 units five times in the last ten years, averaging only around 4,700 new units across that period (see Table 16 below).

	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23
Year 1 forecast	4,743	4,230	3,723	3,603	5,325	6,358	7,064	6,025	7,947	8,122
Outturn	5,021	3,753	3,755	3,494	3,914	5,054	5,314	3,412	7,158	5,913
% difference	5.9%	-11.3%	0.9%	-3.0%	-26.5%	-20.5%	-24.8%	-43.4%	-9.9%	-27.2%

Table 16: Outturn development numbers compared to forecast

The pandemic clearly had a significant impact on completions in 2020/21, but from 2017/18 onwards in particular we can also see a consistent pattern of over-forecasting, with actual completions consistently more than 20% down on forecast.

To achieve the 2032 target of at least 77,000 affordable new homes across a ten-year period, albeit with some of that number to be delivered by the local authorities, an annual average of 7,700 new homes would need to be delivered, a figure that the sector has not come close to achieving in the last ten years.

Projected borrowings

Our analysis shows that RSLs expect to increase loan debt to £7.02 billion by the end of 2027/28, a net increase of £1.47 billion across the five-year period and some way above the £6.67 billion that was forecast in the 2022 returns to the end of 2026/27. This is despite the forecast for new private finance for 2023/24 being more than £50 million lower this year than the equivalent figure from the 2022 projections.

The additional loan finance forecast remains a substantial number and is required to fund not just new build development but also ongoing investment in existing stock. The regular communication we have with lenders continues to indicate that lenders and investors still consider the social housing sector an attractive sector for lending.

At the time of writing the Bank of England had raised Base Rate from an historic low of 0.1% to 5.25% by August 2023 amidst sustained pressure from inflation. The OBR had forecast that further increases were still possible, but that rate has so far been held at 5.25%. Current forecasts suggest it has peaked for now, but that borrowers should not expect an immediate drop in rates in response. This will impact on the interest rates applied to new borrowing and

we would expect RSLs to incorporate this into their long-term business planning assumptions and any associated sensitivity analysis.

Glossary

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.
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.
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.
Energy Efficiency Standard for Social Housing (EESSH)	EESSH aims to improve the energy efficiency of social housing in Scotland. It will help to reduce energy consumption, fuel poverty and the emission of greenhouse gases.
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 SG 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.
Loan Portfolio (LP) return	The annual return collating data RSLs private borrowings.
Office for Budget Responsibility (OBR)	Non-departmental public body funded by the UK Treasury and established by the UK Government to provide independent economic forecasts and analysis of the public finances.
Performance method	Accounting policy choice allowing release of capital grant as deferred income when related performance criteria are met. Can

	only be used where housing assets are valued using 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.
Social Housing Net Zero Standard in Scotland (SHNZS)	This new standard will replace the planned EESSH2 standard.
Stock/unit numbers	The unit numbers from the Annual Financial Statements, or AFS return that we require each RSL to complete.

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