Defined Benefit Code of Practice Consultation

Consultation response from the National Housing Federation on behalf of the social housing sector

Summary of our proposals

We propose that the Pensions Regulator:

- Recognises the minimal risk of default from housing associations.
- Formally recognises the significantly longer covenant visibility and resilience to risk of housing associations and converts this into funding parameters appropriate to be adopted for any scheme sponsored by our members.
- Understands the significant impact on national housing (a key government priority) from requiring more money to be directed into pension schemes sooner, rather than into the housing development and building.
- Creates a "fast lane within bespoke" route for housing, which recognises the unique position of the sector as well as avoids replication of effort by both the Pensions Regulator and individual organisation.
- Has a clear approach internally to dealing with schemes sponsored by housing associations to ensure that a consistent approach is taken.
- Enables trustees to have clear guidance that schemes sponsored by our members can work within the principles agreed for housing employers, to enable consistency and efficiency for both the Pensions Regulator and individual housing associations.

Our full response to the Regulator begins on the next page.

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NATIONAL HOUSING FEDERATION

Introduction

Who we represent

This consultation response is submitted by the National Housing Federation on behalf of the social housing sector in England. Our members are 800 housing associations and make up 98% of all social housing associations in England. We refer to “us” and “we” in this response in respect of both the NHF and our member organisations.

Paragraph 219 of consultation

There is reference (paragraph 219) in the consultation to schemes with ‘atypical’ employer covenants. This includes multi-employer schemes (including with non-associated employers) and schemes supported by not-for-profit organisations, including charities and public sector. Although housing associations can be set up as charities and not-for-profit organisations, we are very different in structure and prospect. It is important that the Regulator understands that. Given the housing sector’s unique position and difference from typical not-for-profit organisations, we are keen to engage with the Pensions Regulator as part of this consultation rather than wait for the second consultation.

“Fast lane through bespoke”

We fully support the Pension Regulator’s desire to focus on the security of pension scheme members’ benefits and we acknowledge the general principle of seeking early funding where a pension scheme sponsor has the resources to do so and where there is a material impact of doing so on the security of members’ benefits.

We also acknowledge that the proposed “bespoke” route is designed to offer an organisation the ability to agree an alternative to the fast track default parameters.

To recognise the social housing sector’s very strong covenant, covenant visibility and resilience to risk, and to avoid the inefficiency of applying the same principles across a large number of individual housing associations, we believe there should be an agreed route through the code for housing associations. For example:

- A “fast lane through bespoke” with an underlying understanding with specific case officer would be welcome.

- Clarity on how much credit can be given for strong informal support offered by the sector given its unique business model.

This could be supported by the 30-year financial stress testing already required from housing associations by the Regulator of Social Housing (RSH).

Any approach will need to recognise the interests of both the Regulator of Social Housing (RSH) and the Pensions Regulator. The RSH regulates registered providers of social housing to promote a viable, efficient and well-governed social housing sector able to deliver homes that meet a range of needs. The housing sector must continue to develop and build homes for the nation whilst also providing pension scheme funding at an appropriate level.

What makes the housing sector unique?

We believe there are some key reasons why a housing association has a uniquely high covenant visibility and resilience to risk when viewed from the perspective of the pension scheme. In particular:

- Strong, independent organisations required by society and backed by government.
- Long term, inflation linked, secure income with demand stretching at least 50 years.
- Regulated by the Regulator of Social Housing, with many tools including stress testing of 30 year business plans.

Together these mean that a pension scheme sponsor can afford to take more risk within its investment and funding strategy, without materially increasing the risk of pension benefits not being paid in full.

Action to date and next steps

The NHF and some representatives from member organisations held a meeting with David Fairs on behalf of the Pensions Regulator on 10 July 2020 at which we presented the reasons why the social housing sector has particular favourable characteristics and why a pension scheme with a sponsor in the sector should be able to implement a more optimistic investment strategy and a longer recovery plan with no material increase in risk.

David Fairs proposed that we put these in writing in this response to the consultation.

We understand that the Pensions Regulator is to hold bi-lateral talks with the Regulator of Social Housing. We are keen to continue to feed into these as required.

We have set out our proposed way forward below. We would be open to discussion of these at a further meeting.

Our proposals

We propose that the Pensions Regulator:

- Recognises the minimal risk of default from housing associations.

- Formally recognises the significantly longer covenant visibility and resilience to risk of housing associations (for example, this could be supported by exiting stress testing required by the RSH) and converts this into funding parameters appropriate to be adopted for any scheme sponsored by our members.

- Understands the significant impact on national housing (a key Government priority) from requiring more money to be directed into pension schemes sooner, rather than into the housing development and building.

  Some of our largest members have offered to put resource aside for some of their senior people to take Pensions Regulator case officers through the fundamentals of a housing association's finances and how this supports the evidence set out here.

- Creates a "fast lane within bespoke" route for housing, which recognises the unique position of the sector as well as avoids replication of effort by both the Pensions Regulator and individual organisation.

  This would use existing measures of financial and governance strength required by the Regulator of Social Housing, together with an agreed approach to using the current 30 year business plan projections, to enable housing associations to adopt an approach and assumptions with a revised set of fast track principles designed for this sector.

  If this is not put in place, this would result in each individual housing association, as well as the Pensions Regulator, having to invest a significant amount of resources and money in each individual case, which would otherwise have gone into housing & development.

- Has a clear approach internally to dealing with schemes sponsored by housing associations to ensure that a consistent approach is taken.

- Enables trustees to have clear guidance that schemes sponsored by our members can work within the principles agreed for housing employers, to enable consistency and efficiency for both the Pensions Regulator and individual housing associations.

- We would be open to alternative approaches which would achieve the same aim.

Pension schemes in the housing sector and scope of this response

Within the sector there are two main types of housing association:

- Registered Social Landlords (RSLs), who will participate in any of the following:

  - The Social Housing Pension Scheme (SHPS), or
  - The housing associations' own section within The Pensions Trust (TPT), or
  - The housing association's own Trust.
  - SHPS DC.
  - Another DC scheme.

- Large Scale Voluntary Transfers (LSVTs), who will participate in any of the following:

  - The Local Government Pension Scheme (LGPS).
  - Another DC scheme.

- There are also a number of mixed groups or mergers.

We are commenting in this response only on Trust based schemes (the LGPS does not fall under this code).

The sector is served by a last-employer standing scheme, the Social Housing Pensions Scheme (SHPS), which sits within the pensions trust run by TPT Retirement Solutions. We believe that the principles we are setting out here apply to SHPS, but there are some further considerations in relation to the SHPS and its multi-employer status which we do not address in this consultation.

The National Housing Federation (employers we represent)

We are the National Housing Federation, the voice of housing associations in England. With almost 800 housing association members providing homes for around six million people, we are at the forefront of tackling the nation's housing crisis.

From our largest member, Clarion Housing, with over 120,000 properties, to our smallest, with a handful of supported housing properties, we represent 98% of all housing associations' (based on number of properties).

We speak for the whole sector, although of course some individual housing associations may also submit a separate response.

Housing associations own in excess of 2.7 million homes and in the last recorded year (2019) delivered 26% of all new homes (45,749 properties) and approximately 95% of all new affordable homes, including social rent, affordable rent and low cost home ownership properties.

Shared ownership properties constitute the vast majority of low cost home ownership properties. This product, first developed by our sector, enables a first time buyer to buy a share of a home for as little as 1.25% of the value of the property and access a mortgage for as low as a 25% share of the property.

As part of the 2.7m properties the sector owns, around 450,000 properties are supported housing properties. The housing associations that provide these homes also provide some element of support, often to vulnerable groups including those seeking refuge in domestic abuse shelters and homelessness hostels.

100% of our members are not for profit and do not pay dividends to shareholders. The majority of the entities operating in our sector are charitable.

What are the special characteristics of social housing organisations in this context?

Housing associations – a very strong covenant

We are strong, independent, long-term organisations needed by society, backed by regulation and partnered by government.

A strong, independent regulator

The Regulator for Social Housing (RSH) is a quasi-governmental, independent regulator that sits under the Ministry of Housing, Communities and Local Government and aims to ensure the financial stability of the sector.

To do this the RSH uses a variety of tools including annual regulatory returns, In Depth Assessments (similar to rating agencies assessments, occurring every 4 years for a non-developing and every 2 years for a developing housing association) and organisational public ratings (under V for Viability and G for Governance).

The RSH also requires housing associations to carry out stress testing of their business plans. These stress tests are similar to the Bank of England's requirements for the banks but the RSH requires each individual housing association to develop their own scenarios. Housing associations are also obliged to stress test their business plans until organisational failure occurs.

Long-term investors in housing associations' public and private bonds consider the sector's regulatory regime a key element in their decision to invest.

Zero default record

Housing associations have been accessing funds from financial institutions since the 1988 Housing Act. In that time no housing association has ever defaulted on its debt. This is also considered important in banks and investors continuing to fund are operations.

Government backed income

Over 90% of our income is insured by central government. For example, as a result of the current pandemic and the end of the furlough scheme it is likely that the number of tenants paying their rent using full, or partial, benefit payments will increase.

30 year investments by (pension) fund managers

The majority of our member's debt has terms of 30 years or more. It is a sought after investment given it is index linked, secure and long term.

Demand forever (or at least 50 years)

The demand for housing associations properties is significant. With the country in the midst of a housing crisis and the existing social housing waiting list at 1.16 million households there is no end in sight to the demand for our members' product.

Beyond this an All Party Parliamentary Group report released last year stated that 630,000 young people could be homeless by retirement age because their pension income will not be sufficient to pay for private rented properties. This was published before the current pandemic.

Investment grade credit ratings

Approximately 50 of our members have credit ratings from one, or more, of the three credit rating agencies (CRAs). Our member's debt is all considered investment grade by all three of the CRAs.

Long-term covenant visibility

A significant proportion of our assets and liabilities are for the long term. For example, as stated above, our loans run for 30 plus years, our housing properties are depreciated over 50 years in housing associations' financial statements and the most common valuation methodology for our properties (Existing Use Value for Social Housing, EUV-SH) utilises a 30 year discounted cash flow model.

Housing associations have been in existence since 19th century philanthropists were concerned with the state of housing for their workers. For example, George Peabody built Peabody housing association's oldest block in 1865 in Whitechapel. Since this time the sector has seen over 150 years of wars, economic turmoil and more sanguine times.

The current pandemic is an example of housing associations' longevity, fortitude and financial resilience. They paused developments and non-essential repairs, they increased the amount of money advice for tenants suffering economically from the crisis and they signed up to no evictions before the government required them to and continue to offer it after the government's mandate has ended.

As has been stated above, the sector's strength is reinforced by the RSH and as part of this the RSH requires all housing associations above 1,000 properties in size to submit 30-year business plans every year. These are then analysed and reviewed by the RSH to ensure the financial viability of the sector in the long term.

Surplus is leveraged for development. A £1 reduction in surplus has an asymmetric (x20) impact on capital development. It is vital for the health of the sector (and wider

social purpose) that surpluses are protected.

Why does this matter in the context of pension scheme funding?

The proposed regime is a significant step change from the current regime for the housing sector and will lead to significantly higher deficit contributions if the fast track approach is followed. This has wider implications for the sector, including an impact on house building and an impact on longer term covenant.

On the other hand, if all of our members have to take a bespoke route it will take up a significant amount of time and cost as is likely to lead to inefficient and inconsistent outcomes.

We fully support the Pension Regulator's desire to focus on the security of pension scheme members' benefits and we acknowledge the general principle of seeking early funding where a pension scheme sponsor has the resources to do so.

We also understand why the Regulator is looking to de-risk pension schemes by limiting the level of investment risk and increasing the pace of cash contributions, where there is a material risk that these may not be paid in the future.

We understand that the key measures supporting the amount of risk that it is appropriate for a pension scheme to take are covenant visibility and resilience to risk.

However, where the covenant is so strong that it is difficult to evidence a material risk that the pensions creditor will not be paid in full, we believe that employers should have flexibility, within reason, to agree a long-term funding planning which anticipates future investment returns on return-seeking assets.

We believe the unique features of the social housing sector lead to a clear argument for why it is likely that there is no material risk that contributions will not be paid in future, given the high covenant visibility of the sector and the high resilience to risk.

This can be evidenced by the sector wide information set out above and, in relation to individual housing associations, by the financial stress testing already carried out by the Regulator of Social Housing, which can be developed to take into account future outturns for these housing associations' pension scheme trustees.

We therefore do not believe that an increase in the pace of funding or decrease in a scheme's investment risk will materially affect the funding outcome of the pension scheme for members.