Housing sector developments

March 2022

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Foreword

With the coming of 2022, we are seeing the relaxing and potential full uplifting of most Covid-19 restriction rules, paving the way forward for the social housing sector to deliver in a post pandemic brave new world. In this publication, we consider the sector risks, the key challenges as well as the opportunities on the horizon for housing associations. We also provide an overview of the wider sector developments, including in the areas of pensions, tax and VAT.

As the housing sector gradually resumes normal operations, catching up on any delayed planned and routine maintenance, as well as getting back on track with development plans where these were significantly impacted, now may be the time to revitalise by seizing new opportunities but the question remains on whether it is too early to loosen the purse strings.

With increasing inflation, significantly higher cost bases, the sector's reliance on overseas labour for new developments, shortage of materials and the still unknown result of how the UK's relationship with the EU will ultimately untangle for the housing sector, a significantly decisive balance must be struck by boards and management in making the right trade-offs.

Not only is there a greater market demand for new social housing supply, but also a calling on the sector to step up and work towards the longer-term commitment of achieving net zero carbon emission by 2050.

Following COP26, the impetus around climate change has heightened even further. The sector faces pressures on becoming enablers of sustainable development, leading on energy-efficient housing and carbon-reducing technologies as well as greener operating models, thus the focus will remain on these matters for many years to come as we now face the biggest challenge of our lifetime.

It cannot be stressed enough that Boards and management should be focusing on stress testing and scenario planning their financial models for the potential impact of climate-change, meeting upcoming health and safety measures as well as increasing consumer regulations; focusing on everything from the cost base of business operations to future development programmes.

In our publication we provide a special focus on the matters that are at the heart of forthcoming changes impacting the sector, including developments in climate change as well as wider technical developments out for consultation impacting audit and corporate governance. The publication contains a number of links in the articles where further details may be accessed.

We hope you find this publication informative and if there are any matters that you would like to discuss further, please do not hesitate to get in touch with your Grant Thornton contacts.

Sector risks

Sector risk profile

In October 2021, the Regulator of Social Housing (the 'RSH') published the Sector Risk Profile 2021[1]. The report sets out the main risks facing the housing sector and suggests some key actions housing associations can take to mitigate those risks.

The RSH notes that the associations have dedicated a large amount of effort to cope with the Covid-19 pandemic and overall, they have responded well. With the uncertain landscape of public health and economic outlook, the housing sector continues to operate in a challenging environment – slow economic recovery, ongoing disruption to supply chains, ongoing shortages of both materials and labour.

The cost base of the sector is increasing due to remedial safety works, catch-up repairs, and energy efficiency improvements. In addition, the associations may face competing demands from various stakeholders, which will need to be managed sensitively and communicated transparently by the Board.

Specifically, the RSH highlights seven key areas of risk for the Boards of associations to consider, which are also areas of focus by the RSH:

- **Strategic choices:** The Boards may take investments in various strategic directions as dictated by competing demands from different stakeholders. For example, investments may be undertaken to:
  - comply with changing building safety and energy efficiency standards;
  - maintain the quality of existing housing stock;
  - develop homes to serve future tenants on the waiting list; and so on.

  The Board is expected to manage competing strategic choices in the context of the association's objectives, as well as being transparent in communicating issues including how it makes choices, how it makes decisions regarding trade-offs, and the performance against organisational objectives. Failure to manage its strategic choices prudently may lead to reputational damage, which could be difficult to repair.
- **Macroeconomic risk:** Currently in the UK we are in an economic environment with high inflation rate[2] and low but increasing interest rate. There is still substantial ongoing economic uncertainty, as the UK and global economies emerge from the pandemic. In the housing sector, supply chain disruption and staff shortage continue to impact the price and availability of goods and services
- **Financing:** Associations are taking on more debt to fund strategic objectives, such as investing in both new and existing housing stock. This has resulted in weaker projected operating margins and lower interest cover, only partially alleviated by low interest rates
- **Stock quality:** With the enactment of Building Safety Bill and the requirement to achieve C rating in energy efficiency by 2035, it is likely that associations will need to undertake substantial investment in existing housing stock over the coming years
- **Health and safety:** Following publication of the Social Housing White Paper, ensuring the safety of tenants in their homes is at the heart of future reforms and has strengthened this fundamental responsibility of all social landlords
- **Service delivery and accountability to tenants:** The RSH continues to emphasise the importance of effective and transparent communication with tenants. Demands for transparency continue to increase following publication of the White Paper. Associations are urged to strengthen engagement with tenants and improve the services tenants receive by taking actions now
- **New supply and the housing market:** It is forecasted that the market demand for housing supply has returned to pre-pandemic level. The development and sale of housing units may impact financial viability, the achievement of strategic objectives, and reputational risk

Overall, both the housing market and government are calling on the sector to deliver more in terms of taking better care of their tenants, satisfying the market demand for new housing supply and stepping up to the environmental commitments.

1 https://www.gov.uk/government/publications/sector-risk-profile-2021
2 In December 2021, inflation rate hit 5.4%, which is the highest level ever recorded over the past 30 years.

Global accounts 2021

The report[3] covers the financial year up to the end of March 2021. Overall, the sector has responded well to the pandemic, maintaining essential services whilst delivering a robust financial performance. Below are some key observations:

- The investment in both new supply and existing stock is lower in 2021 FY compared to 2020 FY:
  - the investment in new supply decreased by 20% (£10.9 billion in 2021 FY);
  - the number of social homes completed in 2021 FY decreased by 9,000 to 40,000;
  - the investment in existing stock decreased by 19% (from £1.9 billion to £1.6 billion).

The decrease is mainly due to the closure of most construction sites and other restrictions which delay capital investment programmes. However, increased investment is expected to be sustained in the longer term in latest plans, particularly in relation to existing housing stock. Capital investment is expected to increase for building safety, decarbonisation costs and enhanced energy efficiency standards:

- Total maintenance and repairs expenditure decreased by 5% compared to 2020 FY to £5.4 billion:
  - the level of maintenance expenditure remains the same
  - some major repair programmes were paused/delayed due to access restrictions.
- Financial performance was generally robust with a slight decrease in 'underlying surplus[4]' (from £2.7 billion to £2.6 billion), attributable to:
  - non-operating income and expenditure (ie. £0.2 billion decrease in the surplus from the sale of properties held for rent and an increase in net finance costs); and
  - improved performance from core social housing lettings activity. Operating surplus increased from £4.7 billion to £4.9 billion, as the permitted rent increases returned to CPI+1% from 1 April 2020.
- The financial impact of deteriorating rent collection indicators at the sector level has not been material. Void losses are highest in providers specialising in care homes, housing for older people and supported accommodation. The rent loss from voids increased from £210 million to £270 million from 2020 FY to 2021 FY.
- The housing market remained strong with average prices increasing. The development for sales (market sales in particular) remains concentrated in a small number of providers. The combined contribution from first tranche shared ownership sales and outright market sales stayed at £0.5 billion.
- The housing sector is still backed up by strong liquidity, with the highest level of new debt facilities ever recorded:
  - debt reported on balance sheet increases by £3.2 billion (4%) to £86.3 billion
  - the sector agreed new facilities of £15.1 billion (including refinancing) in 2021 FY.

Although there is some temporary decrease in overall capital investment, there is a clear trend of forecasted increase both in terms of investment in new and existing housing supply, as well as major repairs programme.

Although void losses remain high, the financial impact on the sector level is not material and overall financial performance remains robust, with permitted rent increases returning to CPI+1% and average housing prices increasing. With strong liquidity and market confidence, the sector is continually being supported both in terms of recovery and future growth.

3 https://www.gov.uk/government/publications/2021-global-accounts-of-private-registered-providers
4 The 'underlying surplus' excludes movements in fair value.

Brexit

Although Brexit has long been finalised, its impact is still being felt in the housing sector. The major concerns are around the economic uncertainty and frictionless trade needed to secure finance and materials for new housing development, for example:

- increase in the cost of materials;
- delay in importing materials;
- the loss of EU funding; and
- the shortage in both skilled and unskilled.

Shortages of suitably qualified safety professionals may become more acute, as implementation of the Fire Safety Act and Building Safety Bill will require a significant increase in demand for qualified fire safety professionals.

Furthermore, housing associations offering care services are also facing substantial shortages in key staff. For instance, the post-EU exit points-based immigration system does not allow for direct recruitment from abroad in most adult social care roles.

Grant Thornton are continually updating their guidance and insight into Brexit[5], covering off the potential impact and opportunities as well as practical steps organisations can undertake in a post Brexit world.

The National Housing Federation (NHF) have also requested that housing associations contact them to let them know how Brexit is affecting them, especially where significant issues are identified[6]. This is so they can feed them into the Government and work with ministers to address and hopefully resolve any significant issues.

Consumer Regulation Review 2020-21

The RSH sets and regulates four consumer standards – Home, Neighbourhood and Community, Tenancy, Tenant Involvement and Empowerment.

In September 2021, the RSH published its Consumer Regulation Review 2020-21, which describes the RSH's approach to consumer regulation and identifies key issues from their casework 2020-21. There is only one case of breach and serious detriment. In addition, the RSH has identified four key lessons for the housing associations:

1. **Health and safety compliance and managing risk** – Housing associations need to ensure that they manage the health and safety risk by ensuring checks and inspections are up to date and that remedial actions are completed in time. In addition, having good quality data about housing stock and tenants is key to identifying risks and implementing mitigating actions when necessary.
2. **Communicating with tenants and understanding their needs** – The Consumer standards require housing associations to engage with tenants and understand their diverse needs. As people spend more time at home during Covid, it is crucial that associations have mechanisms in place to keep open the communication channel between tenants (especially the vulnerable ones) and landlords. Although the RSH does not stipulate what those mechanisms should be, the association should consider how best they can ensure tenant voices are heard.
3. **Continuous learning from tenant complaints** – Learning from tenant complaints provides rich insight about the performance of services and early indicators about when things are going wrong. It is good governance practice for housing associations to be receptive to messages from tenants, so that they can identify trends, themes or wider issues. When the RSH considers cases involving consumer standards, they will look to see if there are indications of systematic failings. Hence, when services fail, housing associations are expected to address the specific matters as well as any issues in wider operations.
4. **Complying with the standards and planning for the future** – With the introduction of Social Housing White Paper proposals[7], the Fire Safety Bill and Building Safety Bill[8], a clear direction of travel has been set and housing associations are encouraged to consider the steps they can take to implement the White Paper proposals, even before the proposals are implemented.

5 https://www.grantthornton.co.uk/en/insights/navigating-brexit/
6 For contact details, please refer to NHF's Brexit page: https://www.housing.org.uk/our-work/brexit/
7 For more details on the social housing white paper, please refer to https://www.housing.org.uk/news-and-blogs/news/government-publishes-social-housing-white-paper/
8 For more details on the Fire Safety Bill and Building Safety Bill, please refer to https://www.gov.uk/government/publications/social-housing-decarbonisation-fund/social-housing-decarbonisation-fund-questions-and-answers

Autumn Budget Review 2021

The government delivered its Autumn Budget in October 2021 and set out spending plans for the next three financial years. We note some key announcements relevant to social housing sector.

The information may be useful for management and boards when putting together strategic plans, going concern reviews, cash flow forecasts and overall business planning.

£800 million to Social Housing Decarbonisation Fund

The funding will help housing associations achieve the goal of improving the energy efficiency of homes below EPC C by 2035. Housing associations would be able to apply for this funding directly. We understand this funding will launch in spring 2022 and run for three years.

Associations may need to consider whether they would be eligible[9] to apply for the Fund. This would also be the basis for determining whether it is appropriate to incorporate the assumption about funding revenue into going concern assessments and cash flow forecasts.

£5.1 billion to Building Safety Fund

The government confirmed £5.1 billion of funding previously announced for cladding remedial works to buildings with a height of 18 million and over with unsafe cladding.

Again, associations with unsafe cladding in their buildings may need to consider whether they are eligible[10] to apply for this Fund, and whether it is appropriate to incorporate the assumption about funding revenue into going concern assessment and cash flow forecasts.

Other funding

Below is a summary of other government spend which may drive up the supply and demand in the housing market, or have implications for collecting rent arrears:

- the government confirmed investing £1.8 billion to convert brownfield land into use and £65 million to improve the planning regime via a new digital system
- the government has committed £639 million per year for rough sleeping and homelessness by 2024
- the government will take £4.8 billion from its Levelling Up Fund and deploy the UK Shared Prosperity Fund worth over £2.6 billion to revive town centres, stimulate regeneration and invest in areas with the greatest need
- the Universal credit taper rate has been reduced from 63% to 55% by 1 December 2021 (ie. 55p in benefits would be lost for each extra pound earned above threshold). However, the effect of this may be partially cancelled out by removing the previous £20-a-week uplift in Universal Credit.

9 More information about eligibility can be found here https://www.gov.uk/guidance/remediation-of-non-acm-buildings
10 More information about eligibility can be found here: https://www.gov.uk/guidance/remediation-of-non-acm-buildings

Building Safety Bill and accounting considerations

The Building Safety Bill was published on 5 July 2021 and is currently being discussed in the Parliament. It is expected to gain Royal Assent after a year. The new regulatory system will then begin in stages in the 18-month period after Royal Assent.

Key changes introduced by the Building Safety Bill include:

- a new Building Safety Regulator (the "BSR") to be created within the Health and Safety Executive – The BSR would oversee the safety of all buildings, register and oversee "building control approvers" and "registered building inspectors"[11], have special responsibilities for "higher-risk buildings" and may propose to expand its current definition
- each higher-risk building must be registered with the new regulator and have a designated Principal Accountable Person (the "PAP") who then appoints a Building Safety Manager (the "BSM"). The PAP is ultimately held responsible for the safety of the building, the maintenance of full records and engagement with residents
- a New Homes Ombudsman (NHO) will receive complaints and may require remedies for purchasers of new homes. All residential developers will be required to join the NHO scheme.

Below we bring some key matters, whilst not an exhaustive list, to the attention of housing associations:

- to consider whether any housing stock would fall within the current "higher-risk buildings" definition[12], as well as monitoring any new proposal from the new Regulator to expand the definition
- to be aware of the potential new legal responsibilities for "higher-risk buildings" and build this into the risk management framework
- to be aware of the various responsibilities of the Client, Principal Designer and Principal Contractor in the context of new legal responsibilities for all buildings (not limited to higher-risk buildings).

Potential accounting considerations

In addition to this, we have identified some accounting matters which may arise once the Building Safety Bill is finalised and for which management and boards will require early planning for:

- the incorporation of estimated costs of remedial work into going concern assessments and cash flow forecasts
- the recognition of provisions under Section 21 Provisions and Contingencies of FRS 102 – provisions would be recognised for legal obligations arising out of past events or constructive obligations, but not for future operational changes
  For example, it would not be appropriate to recognise a provision for obligations arising from future actions whereby the housing association is able to change its method of future operations to avoid meeting the relevant legal requirements
- to identify possible indicators of impairment arising from the housing stock not meeting required building safety regulations
- to consider whether it is appropriate to capitalise costs associated with new works or replacement of components, and assessing whether those costs would lead to incremental future benefits (eg. increase in rental income/ reduction in future maintenance costs/significant extension of economic life).

  This is one area to keep an eye out for as the accounting implications may require further consideration and early planning as well as engagement with your key advisers once the developments are finalised in this area.

11 "Building control approvers" and "registered building inspectors" are two newly created professional roles

12 Part 3 definition (i.e. buildings under planning, design, construction stages): A 'higher-risk building' is defined for the purpose of Part 3 of the Act as being at least 18 metres high or having at least seven storeys, and that contains at least two residential units or is a care home or hospital. Part 4 definition (ie. occupied buildings): A 'higher-risk building' is defined as an occupied building (including student accommodation) that contains at least two residential units and is at least 18 metres high or of seven storeys or more. For the purposes of Part 4 (in contrast to the Part 3 definition above), care homes and hospitals are excluded, meaning that the requirements for occupied buildings do not apply.

Social Housing White Paper – What's on the horizon?

The government published the Social Housing White Paper in November 2020, which presents a charter setting out seven commitments that can be expected from the social housing landlords to tenants. The overarching themes are building safety, resident safety and resident voice, with an objective to deliver improvements in transparency and accountability.

The White Paper outlines plans for new regulation and a strengthened Housing Ombudsman. These plans will include regular inspections for landlords with more than 1,000 homes, regulation on consumer standards, removing the serious detriment test and new powers for the Ombudsman to issue complaint handling failure orders.

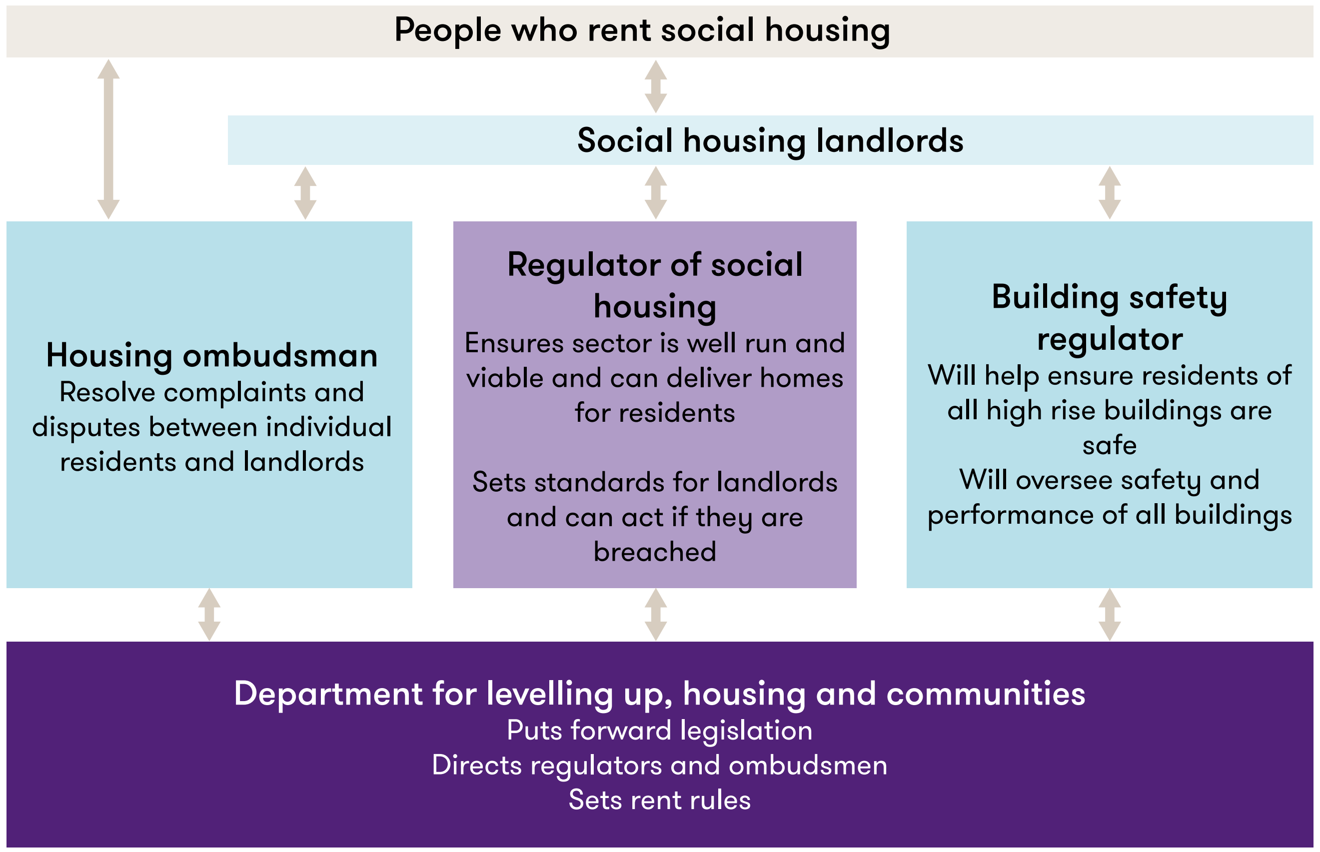
The White Paper also proposes to expand the RSH's role in consumer regulation. Although the proposals have not taken effect yet, the RSH has taken actions to prepare for its new responsibilities, including publishing a paper outlining its preliminary thinking as well as starting the formal consultation on tenant satisfaction measures.

Reshaping consumer regulation

The RSH published a policy paper entitled "Reshaping consumer regulation: our principles and approach"[13] on 17th November 2021. The paper outlines the RSH's preliminary thinking in relation to its expanded role in four key areas – principles and outcomes, new consumer standards, consumer regulation approach and tenant satisfaction measures. It also shows how the RSH expects to work with other key regulatory bodies to implement the white paper proposals. At the time of writing, housing associations are still welcomed to provide feedback to the RSH on any aspect of its preliminary thinking.

Interaction with other key regulatory bodies

The RSH expects to work together with the Housing Ombudsman and Building Safety Regulator to implement the white paper proposals, as shown in the diagram below.



Source: RSH policy paper "Reshaping consumer regulation: our principles and approach"

13 For more details on the policy paper, please refer to https://www.gov.uk/government/publications/reshaping-consumer-regulation-our-principles-and-approach

Although the RSH's consumer regulation role will be expanded, the RSH thinks that its remit should remain focused on organisational issues, with individual complaints being resolved by the Housing Ombudsman. The diagram shows how the RSH expects to work with the Housing Ombudsman in contributing to the new consumer regulation.

Principles and outcomes

The RSH seeks to develop consumer regulation to promote safe homes and quality landlord services. Its vision is that landlords maintain tenants' homes so that they are safe and of a decent standard and that landlords provide quality services. Where things go wrong, complaints are handled effectively, and things are put right. The relationship between tenants and landlords is underpinned by shared expectations of fairness and respect and a shared understanding of their respective rights and responsibilities.

In reshaping consumer regulation, the RSH is working on the basis that its consumer regulation should aim to deliver seven outcomes. However, the RSH does not stipulate how those outcomes should be achieved by landlords – instead, this would form part of the landlords' operational decisions.

New consumer standards

To implement the new consumer regulation, the RSH will be reviewing and updating the consumer standards. They will formally consult on the new consumer standards once the Government has legislated and issued a direction to them.

Consumer regulation approach[14]

The RSH has started considering how they will gather assurance about whether landlords are meeting the new consumer standards (see proposed approach below). The work is still at an early stage and the RSH needs to confirm the new consumer standards before they can finalise the approach.

- Consumer inspections: either as part of a planned programme of gathering assurance, or responding to information that standards are not being met
- Reactive engagement: responsive follow up on information that indicates a potential breach of standards
- Desk-top engagement: reviewing information about landlords' performance from the tenant satisfaction measures and a range of other sources
- Data returns: RSH already collect a wide range of information from landlords a as part of our economic regulation, and are considering the data that they might need for consumer regulation in future

Formal Consultation on Tenant Satisfaction Measures (TSMs)

The RSH was asked to bring in a set of Tenant Satisfaction Measures (the "TSMs") for all landlords "on things that matter to tenants". The RSH has since finished developing the TSMs under four principles – Relevant, Accurate, Responsive and Deliverable, and has launched a formal consultation in early December 2021. The formal consultation on the detailed set of TSMs closed on 3 March 2022.

At the time of our publication the outcomes are still pending, however, the consultation set out 22 proposed TSMs[15] across the five themes as previously set out in the White Paper – keeping properties in good repair, maintaining building safety, effective handling of complaints, respectful and helpful engagement, and responsible neighbourhood management. The measures are aimed at housing providers with more than 1,000 homes, who are expected to publish TSMs annually.

It is worth housing associations reviewing the proposed TSMs as they currently stand, ensuring that the remain on the front foot of forthcoming changes. It is worth considering how changes will be incorporated into building future corporate plans, as well as re-setting, re-aligning, reporting and monitoring any future KPIs in these areas.

14 https://www.gov.uk/government/publications/reshaping-consumer-regulation-our-principles-and-approach/reshaping-consumer-regulation-our-principles-and-approach-accessible-version
15 For more details on those TSMs, please refer to https://www.gov.uk/government/consultations/consultation-on-the-introduction-of-tenant-satisfaction-measures

Other key sector developments

Review of the Decent Homes Standard

Currently Part 1 of the review, which seeks to understand the case for change to criteria within the Decent Homes Standard, has now finished in Autumn 2021. Part 2 will now run from Autumn 2021 to Summer 2022 to consider how "decency" should be defined. The expected outcome will be a refreshed Decent Homes Standard. Currently a summary of the responses received has not been provided. Meanwhile, housing associations are welcomed to submit their comments in writing.

Future Homes and Future Buildings Standard Consultation

The Future Homes Standard Consultation ran from October 2019 to February 2020. It aims to ensure that new homes built from 2025 will produce 75%-80% less carbon emissions than homes delivered under current regulations. Once the legislation is passed in 2025, all new homes will have to be built according to the uplifted standards, including new energy efficiency measures. In January 2021, the government has confirmed that:

- all new homes will be required to be equipped with low-carbon heating and be zero-carbon ready by 2025; and
- the Building Regulations will be updated in 2022, whereby all new homes must produce 31% lower carbon emissions compared to current levels.

The second of the two-part consultation, the Future Buildings Standard Consultation, closed on 13 April 2021. It built on the first consultation by:

- proposing new energy efficiency and ventilation standards for existing homes and non-domestic buildings (eg. offices and gyms)
- reducing the risk of any potential infections being spread indoors
- proposing to mitigate against overheating in new homes.

The Government is yet to provide a summary of responses to the second stage of the consultation.

Next step

An interim step announcing changes to Part L (conservation of fuel and power) of the Building Regulations is expected to be introduced in June 2022. There will be a consultation on the full technical specification for the Future Homes Standard in 2023. It is expected that the necessary legislation will be introduced in 2024 and implemented in 2025.

Clean Growth Strategy

The government has published its Clean Growth Strategy which sets out proposals for decarbonizing all sectors of the UK economy through the 2020s. Specifically, social housing providers have been set a milestone target to attain a C rating on Energy Performance Certificates by 2035, towards the longer-term commitment to make all homes 'net-zero-carbon' by 2050. Housing associations will need to fully assess and understand the scale of the challenge and implement plans for hitting the intermediate EPC C target. For more suggestions about how to tackle the EPC C challenge, please refer to this blog post published on the NHF's website: National Housing Federation - Rising to the EPC C challenge

Annual Rent Increase Cap 2022-23

In September each year, the annual CPI is set, which is used by the RSH to establish the limit on annual rent increases for the social housing sector. Due to the increase in inflation rate from 0.5% to 3.1%, the formula rent inflation to be used from 1 April 2022 is 4.1%. The only exception applies to certain types of housing properties[16], whereby the formula rent inflation has been frozen since 2019. Housing associations will need to reflect the increased rent in their stress testing for going concern assessment and 30-year forecast.

In addition, housing associations are subject to the weekly rent caps[17] which apply to the financial year beginning from 1 April 2022. The amount of rent cap varies with the number of rooms in the property.

16 Those types include supported housing, domestic violence refuge accommodation; almshouse accommodation; accommodation provided by a co-operative housing association or a fully mutual housing association; and accommodation provided by a community land trust. For more details please refer to the RSH's "limit on annual rent increases 2022-23" document.
17 Please refer to the rent caps table at https://www.gov.uk/government/publications/rent-standard/limit-on-annual-rent-increases-2022-23-from-april-2022

NHF Code of Governance 2020

The NHF Code of Governance (the 'Code') has been updated and published in November 2020. The Code is built around the key values of accountability, integrity, openness, equality, diversity and inclusion (EDI) and puts tenants at the heart of all strategic decision making. The Code continues to adopt the 'comply or explain' approach.

The Code allows each housing association the flexibility to decide how best to achieve compliance with each principle:

- **Principle 1** - Mission and values: this section has been split into a number of areas with the requirement for resident focus to be at the core. This has been made explicit in the introduction to the Code. Safety is a theme that runs throughout the Code, particularly the consideration of the safety of residents and staff as well as ensuring that EDI is a key focus of the board.
- **Principle 2** - Strategy and delivery: the new Code places a much greater emphasis on financial, environmental and social sustainability as well as focusing on working with others, understanding the opinions and needs of its workforce and ensuring the group structure is reviewed regularly.
- **Principle 3** - Board effectiveness: this principle is all about creating the most effective board in particular looking at EDI, being transparent about the make-up of the board, and ensuring that there is sufficient rotation with a suggested maximum of six-year tenure for board members.
- **Principle 4** - Control and assurance: the last principle encourages the separation of audit and significant other non-audit services, ensuring effective oversight of the control environment and developing a sound whistleblowing and complaints procedure.

Getting ready for this year's reporting season

The 2020 Code sets out four core principles and stemming from each is a set of requirements with which associations adopting the code must comply, or give a reasoned explanation as to why they do not.

This year, a statement of compliance with the new Code will first appear for those with a 31 March 2022 year end. It is expected that housing associations will have taken the 2021-22 financial year to embed compliance with the Code. Where the housing association is non-compliant with any of the requirements of the Code at the date of assessment, i.e. reporting date 31 March 2022, this must be explained in the annual report.

The NHF Code of Governance provides additional guidance[18] on compliance and some of the areas that housing associations may need to consider as part of year end reporting.

For example, there may be an alternative approach to the requirements set out in the Code which may be justified in a specific instance, if it results in stronger or more appropriate governance in the context of the particular association, and still supports compliance with the relevant overarching principle.

Likewise, some organisations may justify a commitment to achieving compliance with a particular requirement over a specified period of time because of the need to sustain good governance through a period of transition (for instance in matters of board renewal).

Departures from a requirement can be justified so long as there is evidence of proper consideration of why an exception is necessary and of how the relevant overarching principle is observed through other means.

There are several new expectations set out in the Code; including on equality, diversity and inclusion, organisational culture and the renewal of board members. Some areas will require increased reporting for 2022 accounts reporting season so association should set aside sufficient time to review the changes and any related reporting requirements.

We note that many housing associations' board members may still have been appointed with a nine-year term and hence may not meet the requirement in paragraph 3.7(3) of the Code[19]. In those cases, where requirements have not been met, housing associations will need to clearly explain the rationale for the non-compliance as required by paragraph 3.11(2) of the Code.

Please refer to our 2021 Housing sector publication[20] for more details on the Code, as well as links to the checklist and guidance provided by the NHF to help with your compliance assessment this year. We suggest that housing associations make use of the checklist to be best prepared in demonstrating to the board and their auditors in how they have met the requirements of the Code and any areas of non-compliance noted in their assessment which will require to be reported in the annual report.

18 https://www.housing.org.uk/nhf_catalog/publications/code-of-governance-2020/

19 Paragraph 3.7(3) of the Code states that "Maximum tenure will normally be up to six consecutive years (typically comprising two terms of office), but where a member has served six years, and the board agrees that it is in the organisation's best interests, their tenure may be extended up to a maximum of nine years."

20 https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/2021/housing-sector-developments-2021.pdf

Housing Ombudsman Insights Report – July to September 2021

The Housing Ombudsman Insight Report November 2021[21] indicates that between July and September 2021, the top three areas of complaint are;

- property condition (45%),
- Anti-social behaviour(13%), and
- complaint handling(11%).

When the Housing Ombudsman's investigation finds evidence of failure, they issue a finding of either maladministration (ie. service failure) or reasonable redress (ie. the landlord has mechanisms in place to rectify the service failure). Following a finding of maladministration, the Housing Ombudsman may ask the landlord to put things right, including doing the repairs, paying compensation to residents, or taking actions to prevent reoccurrence.

The Housing Ombudsman – Complaints Handling Code

The Housing Ombudsman's Complaint Handling Code published in July 2020 enables landlords to resolve complaints raised by their residents quickly and to use the learning from complaints to drive service improvements. It aims to help to create a positive complaint handling culture amongst landlord staff and residents.

Learning and improvement from complaints – reporting requirements

Paragraph 6.11 of the Housing Ombudsman's Complaint Handling Code requires the landlord to disclose any learning and improvement from complaints in the Annual Report for Tenants.

The Housing Ombudsman recognised that last year it may be difficult for some housing associations to include this information in their 2020/21 Annual Reports for Tenants. However, they would expect to see this information being included in future Annual Reports for Tenants. Hence, it is important for housing associations to ensure that they have the reporting mechanism in place in order to disclose this information in the Annual Reports for Tenants ending 31 March 2022 and going forwards.

The Housing Ombudsman clarifies that the disclosure should cover complaints that were dealt with either formally or informally. There is no standard system for dealing with complaints. It is for each individual landlord to find a system of learning from complaints, which suits them best.

We understand that the Housing Ombudsman has clarified that the above reporting requirements are to be included in the Annual Reports for tenants, though they have stated that housing associations are encouraged to consider making this disclosure in their audited Annual Reports as well.

Housing associations should ensure that they are up to speed on the new requirements and prepared for this year's reporting season.

New Shared Ownership Model

The Government has introduced a new model for Shared Ownership[22], which has become effective from 1 April 2021. The model introduced four key changes:

1. The minimum initial share is reduced from 25% to 10%
2. A new gradual staircasing offer, which allows purchase of additional shares in 1% instalments with heavily reduced fees (ie. the Right to Shared Ownership)
3. A 10-year period during which the shared owner will receive support from landlord for essential major and internal repairs[23]
4. The shared ownership leaseholders are given more control when selling their home

The following features of the new model have potential accounting implications for housing associations to consider further and engage with their advisors on where applicable:

- the landlord's new legal responsibilities in relation to both essential major repairs and internal repairs; and
- the Right to Shared Ownership which gives social tenants the right to purchase additional shares in their existing homes, and hence the potential access to the new shared ownership model.

Under the new shared ownership model, potential additional costs may arise for landlords from:

- major repairs – shared ownership landlords will be responsible for the cost of essential repairs, but only to the extent that the repair is not already covered by any claim made by the tenant under the new build guarantee
- internal repairs – shared owners will remain responsible for repairs inside of the home, but will be eligible to request the carrying out of repairs, or reclaim costs from the landlord for general internal repairs in accordance with the government guidance. Shared owners will be able to claim up to a maximum of £500 in repair costs[24] per year. Shared owners will have the flexibility to roll over a maximum of 1 years' worth of unused repairs expenditure into the following year.

21 https://www.housing-ombudsman.org.uk/wp-content/uploads/2021/11/01.-Insight-report-issue-8-final.pdf

22 For more details on the new shared ownership model, please refer to https://www.gov.uk/government/consultations/new-model-for-shared-ownership-technical-consultation

23 Repairs to the external fabric of the building and structural repairs to walls, floors, ceiling and stairs inside of the home.

24 Those repair costs are either the cost to the landlord to carry out the repair or the cost to reimburse the shared owner for a repair claim.

Right to Shared Ownership (RtSO)

Whilst some tenants may convert to shared owners under the Right to Shared Ownership option, the accounting treatment for the initial recognition of a housing property has not changed and the current SORP requirement should be adhered to. For example, if a property is originally developed for social and affordable rent, the Right to Shared Ownership would not change the initial recognition of this property where this was classified within Property, Plant and Equipment as General Needs property.

However, housing associations may need to assess whether an additional repair provision obligation may arise under the new shared ownership model when RtSO is exercised, which obliges the landlord to cover essential repairs for the next 10 years as well as general internal repairs.

The new shared ownership model may have related accounting implications for the recognition of additional provisions under FRS 102 and Housing SORP 2018 where such repairs costs are considered to be material. Housing associations should assess the impact of the changes under the new shared ownership model and consider whether there is likely to be any material provisions required. Early discussions with your auditors and advisors on the matter is recommended.

At the time of writing this publication, the accounting guidance in this area has not been published by the Housing SORP Working Party. Therefore, this is one area that housing associations may wish to watch out for more guidance on where they may be impacted.

Accounting Direction 2022

Following consultation with stakeholders on a number of issues, the RSH revised the 2019 version and published the 2022 Accounting Direction[25] (AD) which is effective from 1 January 2022. All private registered providers with 31 March 2023 year-end will be impacted. Early adoption before 31 March 2023 is permitted.

The key changes in the revised Direction relate to:

- disclosures on Disposal Proceeds Funds (which ceased to exist from April 2020) are no longer required
- clarification of the rationale and requirements for segmental reporting in Notes A and B, including the distinction[26] between "social housing lettings" and "other social housing activities" for presentation purpose
- minor clarification that the Value for Money narrative reporting requirements apply on the Group level.

In the RSH's view, the changes to the AD are relatively minor. The disclosure requirements on Disposal Proceeds Funds have been removed. No new reporting requirements have been added and further guidance has been provided, which will lead to a net reduction in the regulatory burden placed on providers.

Please refer to the Grant Thornton Housing Sector Model Accounts 2022 which have been updated with changes arising from the Accounting Direction 2022 and expected to be published in March 2022.

25 A copy of the 2022 Accounting Direction can be found here: https://www.gov.uk/government/publications/the-accounting-direction-for-social-housing-in-england-from-january-2022
26 For more information on the distinction, please refer to Annex 1 Glossary of Terms of the Accounting Direction 2022 for the definition of "social housing".

BEIS Consultation – 'Restoring trust in audit and corporate governance'

The Department for Business, Energy and Industrial Strategy had a consultation[27] in 2021 on the future of the audit profession entitled 'Restoring trust in audit and corporate governance.' This follows the recommendations of three independent reviews, the Brydon Review on the quality and effectiveness of audit, Sir John Kingman's review on the Financial Reporting Council and an audit market study by the Competition and Markets Authority. The consultation closed in July 2021. The outcomes are pending at the time of writing this publication. Some of the key points in the White Paper are as follows:

- introduction of a new regulator, the Audit, Reporting and Governance Authority (ARGA), which will have greater powers than the Financial Reporting Council (FRC) including stronger enforcement and monitoring powers over both directors and audit firms
- managed shared audits for larger companies
- operational separation of audit practice and non-audit functions for the larger firms
- new reporting obligations on auditors and company directors around the prevention of fraud
- option for the scope of audit to widen to include other matters, for example climate targets
- greater accountability for directors in a number of areas
- expansion of the definition of a Public Interest Entity ('PIE') beyond publicly listed companies to include the largest private companies.

The government proposes two possible tests to extend the definition of a PIE:

1 Adopt the test used to identify companies already required to include a corporate governance statement in their directors' report. This covers all companies with either:
   - more than 2,000 employees
   - a turnover of more than £200 million and a balance sheet of more than £2 billion.
2 Adopt a narrower test, which incorporates the threshold for additional non-financial reporting requirements for existing public interest entities. This would cover companies with both:
   - over 500 employees
   - a turnover of more than £500 million.

The Government also sought views on whether the definition of a PIE could be widened to include third sector entities, such as charities, universities and housing associations, although with a different threshold to the one set out above. The threshold being discussed for the third sector is the previous Financial Reporting Council (FRC) inspection threshold of incoming resources exceeding £100 million. For those organisations at risk of falling into the scope of new definitions, there are a number of things to consider:

- meeting existing public interest entity regulations, such as in governance matters and additional disclosures in the annual report and an enhanced auditor's report
- meeting any new public interest entity regulations, such as reporting resilience and the audit and assurance policy
- greater restrictions over what non-audit services can be provided to the organisations by their auditors
- reduced choice in audit provider, in that the increased regulations associated with auditing public interest entities lead to greater risk for the audit firm, which may make providing audit services in this space less attractive with the potential for some firms to withdraw from the market, reducing choice and potentially increasing cost.

The NHF has responded to the consultation[28] 'Restoring trust in audit and corporate governance' to say "We support in principle that third sector organisations, including housing associations with more than £100 million of turnover, are of public interest and should therefore be defined as PIEs. However, we have a number of concerns, and have requested a meeting with the Department for Business, Energy and Industrial Strategy to discuss these and to further consider the timetable."

For a general overview of the BEIS proposals and what they mean in practice, please refer to the Grant Thornton insight article "BEIS consultation: corporate resilience"[29] and how organisations can prepare for the widening of the PIE definition.[30]

27 https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms
28 https://www.housing.org.uk/resources/government-consultation-on-audit-reform-our-response/
29 https://www.grantthornton.co.uk/insights/beis-consultation-corporate-resilience/
30 https://www.grantthornton.co.uk/en/insights/beis-consultation-changing-the-public-interest-entity/

Cyber security risks

The use of IT services has become critical to the work of staff and organisations following the impact of the global pandemic. Our increased reliance on technology such as Cloud servers, Teams and Zooms calls, online HR and finance systems have allowed us to continue to work through challenging times.

On occasion our staff and technologies have also been stretched to accommodate change at a pace that has rarely ever been seen before, and unfortunately data governance and IT risks are more present then they've ever been before.

Most charitable organisations including housing associations retain sensitive be it from employees, residents, beneficiaries, and donors. This information needs to be retained in line with GDPR requirements. These requirements can be complex and require appropriate controls and processes to be in place. This complex regulation requires continuous management attention as the expectations of the Information Commissioner's Office (ICO) continue to evolve. And one of the most severe sanctions for a breach of providing effective IT and data governance is for the organisation to be banned from processing any data for a data subject – making it almost impossible to continue to operate.

Cyber security remains a key risk for all entities, including charitable organisations to consider. Cyber-attacks are one of the most profitable types of crime that can be committed, and the UK Governments recent survey on Cyber Security Breaches on charities in the UK found that 26% of charities in the UK report having cyber security breaches or attacks in the last 12 months, with around 23% experiencing them at least once a week.

Despite the pandemic stretching many organisation's cyber security teams to their limits, cyber security remains a priority for management boards. The housing sector has not been secluded from such risks and a number of high-profile cyber-attacks have taken place in the last 12 months.

Grant Thornton's 'Cyber security as a business differentiator' report[31] observed that for an organisation's data governance to be likely to be considered fit for purpose by the Regulator, it must:

- make cyber security the responsibility of a specific individual with an appropriate level of seniority;
- review cyber risks and their management regularly at board level; and
- prepare a cyber incident response plan to rapidly contain and minimise the risk of an attack.

Trends have been positive in recent years, with many boards in charitable organisations placing more importance on cyber security in 2022 than ever before. Many cyber insurers now rank IT and cyber-attack risks as the top risk likely to face an organisation, and so prudent preparation and investment is considered a mandatory mitigation.

The pandemic and remote working has resulted in some organisations being less aware of the breaches and attacks that they are facing – it is harder for organisations to know if staff are following the agreed policies and processes. Continuous assessment and monitoring of the entity's 'data perimeter' is one of the best ways to ensure that the would be criminals are not breaking in, and that precious and valuable member data is not leaking out.

But the good news is that effective cyber security should not be expensive or unintelligible jargon. A couple of minor and inexpensive system changes can dramatically reduce the likelihood of a successful cyber-attack, such as deploying Drive Encryption and Multi Factor Authentication.

For more information on how to assess your cyber security strengths and how to be better prepared for inevitable attacks, please contact Vijay Rathour, Head of the Digital Forensics Group[32].

31 Cyber security as a business differentiator | Grant Thornton
32 https://www.grantthornton.co.uk/en/people/vijay-rathour/

Climate related reporting

FRC Thematic Review – Streamlined Energy and Carbon Reporting (SECR)

The SECR reporting requirements have become effective for large UK companies from 1 April 2019. Housing associations incorporated under the Companies Act 2006 and qualifying as "large" would have included the SECR disclosures in their 31 March 2020 accounts. In September 2021, the FRC published a follow-up thematic review[33] on SECR reporting, which highlights examples of emerging good practice, and sets out FRC's expectations for reporting in future periods. The FRC notes that all entities in their sample disclosed the emissions and the majority disclosed their energy use. However, the FRC identified a number of entity-specific disclosure errors or omissions.

Below is a summary of the FRC expectations for good SECR reporting disclosures in future annual reports and accounts:

- all required information is presented in a form that is clear, understandable and easy to navigate;
- adequate explanation is provided of the methodologies used to calculate emissions and energy use;
- an explanation or reconciliation is provided where ratios provided cannot be recalculated from, or are inconsistent with other disclosures in the annual report and accounts
- describe the extent of any due diligence or assurance over emissions and energy use metrics
- provide an adequate description of energy efficiency initiatives, focusing on those "principal measures" with the most significant impact
- consider the Environmental Reporting Guidelines for how the requirements may be met, and whether additional disclosure (eg. Scope 3 emissions) would be useful to users
- provide clear explanations to help users understand and compare major commitments (eg. net zero target, Paris-aligned strategies, etc.)

FRC Factsheet 8 – Climate-related matters

In November 2021, the FRC published its Factsheet 8[34] on climate-related matters. The Factsheet gives detailed guidance on how specific FRS 102 standards apply to climate-related matters. This Factsheet would be relevant for many housing associations who prepare accounts under FRS 102 and the Housing SORP. It addresses the following matters:

- how general requirements of FRS 102 apply in the context of climate-related risks, uncertainties, judgements and estimations
- how climate-related matters impact the recognition and measurement
- how climate-related matters impact disclosure and what additional disclosures may apply.

The Factsheet also provides a useful reference for the relevant legal and regulatory requirements for housing associations reporting under the Companies Act 2006.

In addition, in 2022 the FRC also expects to have a heightened focus on this area as part of its quality review as to how auditors have considered climate-related risks in financial reporting. We suggest early engagement with auditors and advisors on such matters to ensure that housing associations have sufficient time to prepare and review their accounts for any substantial financial reporting disclosures.

33 https://www.frc.org.uk/getattachment/e3a464de-cf0a-4b5f-9000-656427a863be/FRC-SECR-Thematic-Report-2021.pdf
34 https://www.frc.org.uk/getattachment/63c18c7a-6f3d-42a8-9f6c-ce181c8f287a/Fact-Sheet-8-FRS-102-Climate-FINAL.pdf

FRC Corporate Reporting Review 2020/21 – Climate-related matters

The FRC has recently published its Annual Review of Corporate Reporting 2020/21[35], which is primarily aimed at preparers, auditors and investor users of corporate reports.

Whilst the corporate reporting review focuses on commercial entities, there are many helpful reminders and good practice noted in the FRC report. In particular, the FRC reminds companies to consider the financial reporting implications of climate change, not just narrative reporting. Specifically, the FRC expects to see:

- disclosure of material climate change policies, risks and uncertainties in the front-end reports
- companies consider whether climate change will impact impairment reviews, assets lives and carrying values, decommissioning and restoration provisions, segment reporting, etc.

Task Force on Climate-related Financial (TCFD) Disclosures

The UK government has previously consulted on proposed reporting requirements in line with the TCFD disclosures for certain UK companies and LLPs. The drafted company regulations will extend the TCFD disclosures to the following:

- UK companies that have more than 500 employees and are either traded companies, banking companies or insurance companies
- UK registered companies with securities admitted to AIM with more than 500 employees
- UK registered companies which are not included in the above categories that have more than 500 employees and a turnover of more than £500 million.

It is our understanding that where relevant, the disclosures will be required at a group level. Thus the reporting requirements and scope thresholds will apply on a consolidated basis.

We understand that some housing associations incorporated under Companies Act 2006 may be within scope and would potentially be required to produce TCFD disclosures effective from periods commencing or after 6 April 2022, the date when the draft regulations are expected to become law.

Housing associations that are not companies would not be mandatorily required to produce TCFD disclosures, though still encouraged to do so as best practice.

The draft company regulations require disclosure of how companies assess and manage climate-related risks and opportunities (including internal processes, governance arrangements, etc.).

For more guidance, the FRC has published a report[36] amongst other resources to aid preparers of accounts.

Sustainability Reporting Standards

In November 2020, the ESG social housing working group has published its final report[37] on the sustainability reporting standard for the social housing sector. The Standard is a voluntary disclosure framework for housing providers to report on ESG issues in a transparent, consistent and comparable way. Though not mandatory, many housing providers are choosing to report on ESG issues either in the annual report or separately on their website.

35 https://www.frc.org.uk/getattachment/8430f391-6f44-4ec3-b1f8-c3d6b00c9a1e/FRC-CRR-Annual-Review_October-2021.pdf
36 https://www.frc.org.uk/news/october-2021/preparing-for-mandatory-tcfd-reporting,-including
37 whttps://esgsocialhousing.co.uk/wp-content/uploads/2020/11/SRS_final-report-2.pdf

Pensions and legal rulings

The Pensions Act 2021 (PSA 2021)

PSA21 introduced some changes which will be significant to employers that sponsor defined benefit (DB) pension schemes. The Government's guiding principle has been to prevent repetition of some of the high profile pension failures of recent years, but the new measures in PSA21 include criminal offences and unlimited fines, and could involve a wide range of parties beyond the sponsor itself. Some new measures came into force in 2021 and others will become effective over 2022.

Whilst PSA21 is wide ranging, the specific areas we note below are raised for your attention in connection with private sector pension schemes, which includes schemes administered by the Pensions Trust including Social Housing Pension Schemes (SHPS), Growth Plan, but not public sector schemes such as the Local Government Pension Schemes.

Some of the key areas to be aware of include:

Effective from 1 October 2021

Contribution notices

There are now two new grounds for the Pensions Regulator (TPR) to issue a contribution notice requiring payments to be made to pension schemes. These are the 'employer insolvency test' and the 'employer resources' test, and they now sit alongside the existing material detriment test. Broadly the new tests are triggered if:

- employer insolvency test: if an act or failure to act would have materially reduced the recovery to the Scheme in a theoretical insolvency
- employer resources test: if an act or failure to act materially reduced the value of the employer's 'resources' relative to the Scheme's s.75 deficit. Resources are defined broadly as being normalised profits before tax. An equivalent for social housing employers may be surplus before tax.

The new tests could be triggered by a wide range of employer actions such as selling a division, paying a material dividend, carrying out a group reorganisation or granting security, for example in relation to additional borrowings. Many of these are routine activities for some employers.

New criminal offences and new civil penalties

A broad range of new criminal and civil offences have been created under the new Act. The most serious breaches concern wilful or reckless behaviour, or conduct (including a failure to act) that adversely affects a defined benefit scheme.

This could result in up to seven years' imprisonment and/or unlimited fines, and could be committed by an individual or company, or anyone who helps or encourages the offence – including advisers.

Effective from 1 April 2022

Notifiable events

There will be a new notifiable events regime. The regulations are currently in draft but are expected to come into force in 2022, perhaps as early as 1 April. This will extend the scope of the existing regime to cover additional events that are required to be notified by the employer to the pension trustees and to the Regulator. The new events, which require notification at an early 'decision in principle' stage are:

- the sale of 25% of an employer's business or assets;
- granting or extending security over employer's assets (in priority to the pension scheme); and/or
- deciding to give up control of a scheme employer, or receiving a bid for a scheme employer.

There is also a new penalty regime for non-compliance.

What this means…

The DB regulatory landscape has shifted. There will be more scrutiny of the actions of scheme employers than ever before.

Put simply, employers with DB obligations need to be much more aware of the impact that their corporate actions could have on the employer covenant provided to their DB scheme.

Employers need to be alert to the new obligations they will have to notify TPR and the Scheme Trustees. As one example, extending security as part of a routine refinancing arrangement could require a suitable notification to be made.

Employers (and advisers and lenders) will also need to take particular care that they do not inadvertently fall into the scope of the new criminal offences.

New funding regime

A new DB funding regime is expected to introduce tougher funding standards for Schemes. All else being equal this could see sponsors being required to increase their contributions.

The Regulator has consulted on detailed draft proposals. The timetable for the final revised code is not yet known but it could become effective in late 2022 or into 2023.

‘Endgame’ solutions, and the first Approved Superfund

Many schemes have seen funding levels improve over recent years, to the point that trustees can start to plan for the “endgame”, meaning how to secure members’ benefits, and/or to manage pension risk off the balance sheet. There is a wide spectrum of structures in the market, ranging from running the scheme off “as is”, through a variety of capital backed solutions, to “consolidators” and finally to buyout with an insurance company.

Consolidators, also known as Superfunds, are designed to pool schemes together in a way that secures member benefits but at a lower cost than buying out with an insurer.

The regulatory framework for Superfunds was consulted on by the DWP in 2018. In late 2021 ‘Clara’ was the first superfund to receive Regulator approval, making 2021 a watershed year for Endgame solutions.

Financial Instruments in the housing sector

As the housing sector is increasingly relying on debt financing, it has also become more challenging for management to make good judgement and reflect the appropriate accounting for financial instruments under Sections 11 and 12 of FRS 102 in their financial statements.

On the other hand, as we see ESG loans appearing in the credit market for the housing sector, and that some housing associations may have been affected by the IBOR reform, additional accounting considerations may be potentially complex.

In this section, we focus on two issues that are particularly relevant to the housing sector under FRS 102 – the distinction between "basic" and "non-basic" loans, as well as IBOR reform and its accounting implications.

Basic and non-basic loans under FRS 102

Under FRS 102, whether a loan is carried at amortised cost, or at fair value through profit or loss is based on whether or not the loan meets the definition of a basic instrument. Sometimes this can be simple, and other times can involve complexity. For a financial instrument to be classified as basic, one of the requirements in Section 11.9(aB) of FRS 102 is that the contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that:

- the variation in the new rate is not contingent on future events other than a few exceptions; or
- that the new rate is a market rate of interest.

At the time of writing, the few exceptions as described in Section 11.9(aB)(i) are:

- a change of a contractual variable rate;
- to protect the holder against deterioration of the issuer; or
- changes in levies applied by a central bank or arising from changes in relevant taxation or law.

ESG loans

Although ESG loans are only starting to appear in the credit market for the housing sector, they are likely to become common place in the near future. An ESG loan typically gives a return on the basis of a benchmark interest plus a margin. The margin is tied to the borrower's achievement of predetermined sustainability targets, and as a result the margin in the contract is dependent on whether those targets are met. Despite the variability in return, the loan may still meet the requirements for classification as a basic financial instrument under FRS 102, provided that all the requirements in FRS 102.11.9 are met. As part of this assessment, if the margin changes in accordance with ESG features, it would need to assess whether the change is consistent with FRS 102.11.9(aB) as described above. In the case of an ESG loan, the variability in return is contingent on the borrower's ESG performance, which would not necessarily be considered to be linked to credit risk, although in some cases a credit risk linkage may exist, depending on the terms and conditions of the loan.

If a housing association is party to an ESG loan, a detailed analysis of its terms and conditions would be required to assess whether the loan should be classified as basic or non-basic financial instrument under FRS 102.

IBOR reform

Interest rate benchmarks such as the London Interbank Offered Rate (LIBOR) are being reformed, and LIBOR as we knew it is no longer available as of December 2021. LIBOR, has now been replaced with the Sterling Overnight Interbank Average Rate (SONIA) from 31 December 2021. SONIA is the effective overnight interest rate paid by banks for unsecured transactions in the British Sterling market.

The FRC made amendments to FRS 102 to cope with the interest rate benchmark reform. The amendments were made in two phases:

- **Phase 1** amendments were specific to the hedge accounting requirements in Section 12 and provided relief that will avoid unnecessary discontinuation of hedge accounting, during the period of uncertainty. These amendments are effective for accounting periods beginning on or after 1 January 2020
- **Phase 2** amendments effective for accounting periods beginning after 1 January 2021 amended both section 11 and section 12 as follows:
  - The phase 2 amendments to section 11 provide a practical expedient for changes in financial assets or liabilities as a direct result of the interest rate benchmark reform. This means that when changes to the contract are a direct consequence of IBOR reform on an economically equivalent basis, then FRS 102.11.19 applies meaning there is no immediate gain or loss arising. As an example, typically when a loan is transitioned from LIBOR to SONIA, there will also be a small change to the margin due to the difference in basis between the two benchmarks. However, when other changes are made to the contract at the same time which are not directly due to IBOR reform then those changes would need to be considered under other guidance under sections 11 and 12 and could lead to complications.
  - The phase 2 amendments to section 12 give more flexibility regarding the redocumentation of hedging relationships and provide other reliefs that avoid disruption to hedge accounting. This allows an entity to amend its hedge documentation to update the information on the hedged item and/or hedging instrument. This change can only be no later than the date the respective financial statements are authorised for issue.

Other considerations – hedge accounting

Although hedge accounting does not appear to be common in the housing sector, we would advise housing associations to get in touch with their advisors early, if they have hedge accounting which may need to be reassessed in the context of changing from LIBOR to SONIA.

In relation to financial instruments, FRS 102 permits entities an accounting policy choice to apply the recognition and measurement requirements of Section 11 Basic Financial Instruments and Section 12 Other Financial Instruments Issues, IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement. The IASB has made similar amendments to IFRS 9 and IAS 39 in response to the reform of interest rate benchmarks.

Tax and VAT

Residential property developers tax (RPDT)

From 1 April 2022 profits arising from residential property development will be subject to an additional 4% tax liability captured through corporation tax submissions. There will be an apportionment for those periods straddling 1 April 2022 and exemptions will be available.

Exemptions include groups with profits attributed to residential property of less than £25 million per year, companies where profits are attributed to the build-to-rent sector and non-profit affordable housing providers, inclusive of their for-profit subsidiaries, it should be noted an exit charge will arise upon cessation of non-profit status. Non-profit housing providers should, thereby, consider the impact of their involvement in any joint ventures upon the joint venture and their own status under RPDT.

Capital allowances

The temporary £1 million annual investment allowance has been extended to 31 March 2023. Companies may also continue to make use of the super-deduction providing allowances of 130% on most new plant and machinery purchases and a first year allowance of 50% on most new special rate qualifying purchases. Both Non-charitable RP's and subsidiary companies may want to consider the possibility of advancing future capital spend to make use of the temporarily rate increases.

Corporation Tax rate increase

From 1 April 2023, the Corporation Tax main rate for will be increased from 19% to 25% for profits over £250,000. A small profits rate will also be introduced for companies with profits of £50,000 or less so that they will continue to pay Corporation Tax at 19%, with a taper rate applied between £50,000 and £250,000. Charitable RP groups may, thereby, wish to make greater use of qualifying charitable donations from non-charitable subsidiaries in order to offset a higher corporation tax rate the subsidiaries would otherwise incur. Likewise, Charitable RP's should consider whether it might be more tax efficient to restructure, undertaking any non-charitable activities currently conducted within the Charitable RP via a subsidiary entity.

Making Tax Digital for corporation tax

Planned extensions to the making tax digital (MTD) requirements to encompass corporation tax (CT) remain forecast for implementation in April 2026. RP's may wish to begin reviewing their systems suitability to the extended MTD requirements in advance of its formal introduction and addressing any potential shortcomings, this may include making use of an expected pilot scheme forecast from April 2024. For more details, please visit our Autumn Budget 2021 report[38].

38 Autumn Budget 2021: real estate response | Grant Thornton

Treatment of electric vehicle charging

With Environmental, Social and Governance ('ESG') matters at the forefront of the sector's mind, the use of electric vehicles is increasing. Within the sector it is becoming more common for businesses to install charging points at business premises (sometimes available for public use) and also for organisations to utilise electric vehicles within day-to-day operations.

Owing to the increased availability of electric vehicles and associated charging points, HMRC has clarified the VAT treatment of electric vehicle charging such that:

- supplies of electric vehicle charging through charging points in public places are charged at the standard rate of VAT, and
- input VAT can be recovered when charging electric vehicles for business purposes (subject to specific provisions).

With regards to the recovery of input VAT incurred on electric vehicle charging, HMRC confirmed that if the vehicle is charged for wholly business purposes, the business can recover the input VAT in full on the electricity incurred. If, however, the vehicle is charged for both private and business use, HMRC will allow the business to recover all of the input VAT upfront but the business will need to account for a deemed supply (by way of an output VAT charge) for any private usage.

HMRC has since confirmed that a review is currently underway to consider the input VAT recovery rules where an employer reimburses an employee for the exact money spent on electric vehicle charging, including considering of other simplification measures that may reduce administrative burdens in terms of accounting for VAT on private use.

Early termination fees and compensation payments

Historically, HMRC's policy was such that early termination fees and compensation payments were generally outside the scope of VAT, as they were not viewed as being consideration for a supply. In early 2020, HMRC announced a change in policy with regards to termination and compensation payments on the basis of the Court of Justice of the European Union's decisions in Meo C-295/17 and Vodafone Portugal C-43/19. This guidance suggested that more often than not, payments received of this nature were generally liable to VAT.

For some time now, however, we have been aware that HMRC have been considering amendments to this new policy and on 7 February 2022 HMRC published Revenue & Customs Brief 2 (2022) detailing its updated policy to be introduced from 1 April 2022.

The revised policy means that most termination fees and compensation payments will be viewed as additional payment for the underlying supply and, where the original supply was taxable, will be subject to VAT. The main exceptions to the policy will be most dilapidation payments and certain other payments where HMRC do not consider there is reciprocity between the supplier and the customer. In brief, the updated policy will see less payments being subject to VAT compared to the policy set out in 2020.

There are some key nuances to the announcement including:

- dilapidation payments made by an outgoing tenant to its landlord at the end of a lease (to compensate for excess wear and tear of the property) will remain outside the scope of VAT. This is provided there is no value shifting or avoidance motive to the payments, and
- despite the very recent judgement of the Court of Justice in Apcoa Parking Denmark C-90/20, which found that parking control fees are standard rated, HMRC are maintaining their policy that some parking fines and penalties levied by private operators can continue to be VAT free, while excess charges remain standard rated.

Tax payers who adopted HMRC's policy from September 2020 may therefore have been disadvantaged. The legal issues around making claims for overpaid VAT are complex, particularly if tax has been paid in accordance with legal principles, but HMRC policy would have allowed concessionary treatment. However HMRC are inviting claims through the error correction process.

Change in the VAT treatment of the construction self-supply charge

When a property has been purchased or constructed at the zero rate of VAT and it be used for relevant residential purpose ('RRP') or a relevant charitable purpose ('RCP'), the owner of said property could be liable to a VAT self-supply charge if, within 10 years, there is a change in use (ie no longer used for an RRP or RCP purpose) or the sale of the entire interest in the property.

There has been a recent change to HMRC's interpretation of the meaning "disposal of an entire interest" following the 2021 Supreme Court case of Balhousie Holdings Limited 2021 UKSC 11. In the case, Balhousie entered into a sale and leaseback agreement where it sold an RRP building within the 10 year period and immediately leased it back to continue using it for RRP purposes. The Supreme Court held that this was not a disposal of Balhousie's entire interest.

As such, HMRC policy has changed such that there will not be a disposal of entire interest where:

- when the property is sold, there must be an immediate lease in place, which is a seamless transaction with no time lapse
- the lease must be for the remaining term of the 10 years from the original purchase date or longer, and
- the property must be continually used or operated for a qualifying purpose, meaning the business suffers no break in trade during the sale and leaseback.

VAT penalty regime reform

HMRC is due to reform the penalty regime for late submissions and late payments of VAT filings. The new penalty regime will work on a 'points based' system such that prior to HMRC issuing a penalty for late submissions of a VAT return, a certain number of 'points' for missed obligations will need to be acquired before said penalty is applied. The aim of the new regime is to ensure that taxpayers who miss an obligation as a one-off will not be penalised to the same extent as taxpayers who persistently miss their obligations. If a taxpayer 'racks up' a certain number of points (determined by VAT stagger and filing frequency) then a £200 penalty will be issued.

With regards to late payment of the return, the system will work such that the penalty is determined by how late the payment is made past the due date. If the payment is made within 15 days of the due date, then no penalty is due; otherwise 2% of the outstanding payment will be assessed. This is followed by a further 4% if the payment remains outstanding after 30 days.

The new regime was due to be introduced in 2022; however, this has now been postponed until the VAT periods beginning on are after 1 January 2023.

VAT liability of installation of blinds

The construction of residential property is zero rated for VAT purposes and this extends to certain building materials used in the construction. The legislation allows for the zero rating of building materials if they are "ordinarily incorporated by builders in a building". Examples of what this covers include: bricks, mortar, kitchen units, and sinks. If any materials are not specifically classed as building materials per the legislation, then a "blocking order" requires the supplier to restrict input VAT on the purchase of said materials if they are onward supplied as a zero rated interest in property.

Historically, HMRC were of the view that fitted blinds were not "building materials" and so they were subject to the blocking order. In May 2021, however, HMRC issued Business Brief 5 (2021) whereby its policy changed to allow the fitting of fixed blinds (other than electronically powered blinds) to be considered as building materials ordinarily incorporated. This was following the First Tier Tribunal ('FTT') case of Wickford Development Co Ltd. The date of the policy change is effective from 5 October 2020 and so HMRC are welcoming backdated claims where VAT was disallowed from this date.

We are encouraging business' that have installed fitted blinds as part of a zero rated supply in property to consider whether any claim for disallowed VAT can be justified.

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