Scottish Housing Regulator

Summary of Registered Social Landlord Financial Projections 2022/23 - 2026/27

December 2022

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About this report

This report provides an overview of the aggregate financial forecasts and business plan data submitted to the Scottish Housing Regulator (SHR) by all Registered Social Landlords (RSLs).

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

We derived the data in the report from the FYFPs submitted to us by RSLs in May 2022 for the period from April 2022 to March 2027 as it relates to the first five years of RSLs' business plans.

The business plans should set out their aims, objectives, and financial plans. They should also set out how the RSLs will resource those plans for a specific period at a given point in time and as such there can often be substantial changes made to forecasts between years.

This year has seen several key factors impacting RSLs' business plans that are likely to have led to RSLs making significant changes to their financial projections since they submitted them to us. These factors include:

1. Scottish Government intervention on rent setting;
2. the increasing requirements to address the quality of homes, including on energy efficiency and decarbonisation;
3. the ongoing economic uncertainty and volatility including – high inflation, rising interest rates and ongoing supply-chain disruption, including from the war in Ukraine; and
4. the lasting long-term impact of Brexit and the Covid-19 pandemic.

As we highlight above, the current context for RSLs means that they are likely to have made significant changes to their financial projections and business plans since they submitted them to us in May. It is important to read this report with that in mind.

Highlights

RSLs' projections show aggregate financial performance should remain robust.

At an aggregate level RSLs forecast:

- continuing surpluses;
- turnover to increase by 0.4% more than operating costs over the next five years;
- net assets to grow by an annual average of 5.0% over the five years, with modest but steady growth from 3.3% in 2022/23 to 6.0% in 2026/27, taking aggregate net assets to £5.41 billion by 2026/27, with net housing assets up to £18.77 billion over the same period;
- significant, but reducing cash reserves, with an aggregate closing balance of £892 million at 31 March 2022, dropping to £562 million by 2027;
- interest cover remaining healthy;
- rent arrears peaking at 4.7% in 2022/23 before returning to more historic levels of between 3.0% and 3.5%;
- significant capital expenditure on existing homes of £1.7 billion over five years, an average of more than £5,000 per property; and
- more than 30,000 new homes, up by 1,000 from the 2021 FYFPs, with funding of £2.44 billion from social housing grant (49.5% of total cost) and £2.07 billion from private finance (41.9%).

RSLs submitted their projections at a time when the economic outlook remained extremely uncertain and volatile, and since then, the outlook has worsened considerably. RSLs have faced uncertainty in the national and global economy which has contributed to the cost-of-living crisis, alongside significant cost increases, higher energy costs, continuing supply chain disruption and labour scarcity.

The Scottish Government has also introduced emergency legislation to bring in a freeze on increases in rents until at least the end of March 2023, with the possibility of this being extended into the following year. Scottish Ministers will advise landlords on what happens after 31 March 2023 by 14 January 2023. We estimate that a rent freeze in 2023/24 would remove almost £60 million in rental income in that year from RSL business plans.

Interest rates have risen from a record low of 0.1% to 3.0%, their highest level in 14 years and are forecast to rise further. We estimate that every 1% rise in interest rates, could put RSLs' aggregate debt servicing costs up by £13 million a year. Rising interest rates are likely to result in a reduction in interest cover for many RSLs.

It is in that context, that RSLs are looking to deliver on building safety, decarbonisation and stock quality commitments as well as continuing to invest in building new homes. This planned activity will result in a further reduction in RSLs' forecast interest cover. A reduction in financial headroom will likely reduce some RSLs' capacity to manage any additional financial shocks.

Around 27% of total RSL loan debt outstanding at 31 March 2022 is on a variable interest rate, highlighting the importance of governing bodies ensuring they manage risks from existing debt and understand the sensitivity of business plans to increases in interest rates. Further analysis of RSLs' annual loan portfolio returns at March 2022 can be found in our annual loan portfolio report for 2022

Voids, arrears, and bad debts remain key performance indicators in assessing the efficiency of RSLs' letting and rent collection. Each of these are forecast to either remain around the previous years' levels or show some improvement, demonstrating the positive impact of the work done by RSLs to manage these. However, as the financial pressures on tenants increase, RSLs may see increases in arrears.

Analysis of the FYFP inflation assumptions compared to the forecast figures published by the Office for Budget Responsibility in November 2022 shows aggregate rents increasing by less than both CPI and RPI in Years 1 and 2 of the projections.

The building of new homes remains a key priority for the Scottish Government and RSLs continue to play a key role in delivering this. The total number of new homes RSLs forecast to build is over 30,000 at a cost of more than £4.9 billion. Engaging in development brings its own set of risks and the level of volatility and uncertainty in the economy is likely to impact RSL development programmes. There is the potential for further interest rate rises, higher inflation, scarcity in materials and labour costs to impact on the number of new homes RSLs can deliver. This highlights the importance of effective oversight and management of development programmes by RSLs. RSLs should refer to our development thematic when making decisions about whether to undertake a development project.

The Next Five Years – Projections to 2026/27

Statement of Comprehensive Income

The headline from the 2022 FYFPs is that RSL turnover at an aggregate level is forecast to increase by more, on average, than operating costs over the next five years and therefore, at an aggregate level RSLs expect to continue generating surpluses.

An average annual rise in turnover of 4.5% across the projections period (2021, 4.1%), compares to a 4.1% average increase in operating costs over the same period (2021, 3.7%). Overall, the sector forecasts turnover increasing by 24.8% (2021, 22.2%) to £2.28 billion by Year 5 in 2026/27 and operating costs by 22.1% (2021, 19.5%) to £1.79 billion.

The result, as seen in Table 1 below, is that the aggregate operating surplus is forecast to increase each year, from £343.6 million in 2022/23 to £507.4 million by 2026/27. An increase in interest rates and outstanding loan debt means debt servicing is set to rise too, with interest payable projected to increase from £198.3 million in 2022/23 to £256.5 million by 2026/27. However, the aggregate net surplus is also rising, up from £132.0 million in 2022/23 to reach £305.2 million by 2026/27.

	2022/23	2023/24	2024/25	2025/26	2026/27
Turnover	1,938.7	2,024.7	2,145.2	2,236.7	2,279.9
Operating costs	1,590.6	1,629.3	1,677.4	1,731.2	1,782.2
Operating surplus	343.6	387.7	438.9	499.6	507.4
Interest payable	198.3	214.5	232.3	247.3	256.5
Net surplus	132.0	218.4	236.5	273.4	305.2

Table 1: Turnover & costs

RSLs have consistently forecast turnover to increase by more than operating costs, driven by the assumption that, on average, gross rental income will increase at a faster rate than costs. That assumption has been maintained across previous FYFPs; however, the impact of the current economic climate has seen RSLs' in general showing restraint in their rent increases. This is reflected in the current year's projections, with an average rent increase assumption in 2022/23 of 0.6% below inflation, against an average increase in operating costs of 0.1% above inflation. Average rent increase assumptions exceed operating cost increase assumptions for the remaining years, but level out at an average increase of 0.2% above inflation for both rent and operating costs across the projections period.

The aggregate projections forecast that the total increase in turnover will outstrip the increase in operating costs in three of the five years, with costs set to increase by more in Year 1 (22/23), a 9.0% increase against a 6.1% increase in turnover, and in Year 5 (26/27), a smaller 2.9% increase against only a 1.9% increase in turnover.

For 2022/23, this is most likely the lasting impact of the Covid-19 pandemic in 2021/22, when RSLs were unable to carry out their full maintenance programmes, meaning catch-up repairs were reprofiled into later years. Ongoing issues, particularly in relation to labour and material shortages, mean that the need for expenditure on catch-up repairs in 2022/23 could yet stretch into 2023/24 and beyond. Given the level of catch-up required, RSLs should continue to be aware of any impact on their interest cover covenants.

Over the five forecast years, the total operating surplus is forecast to be £2.18 billion. This is a marginal decrease of just £0.01 billion (0.5%) when compared to the first five years of the

2020 projections. Chart 1 below shows that there has been minor change in the five-year operating surplus profiles across recent FYFP returns with those from 2021 showing the largest movement from Year 1 to Year 5.

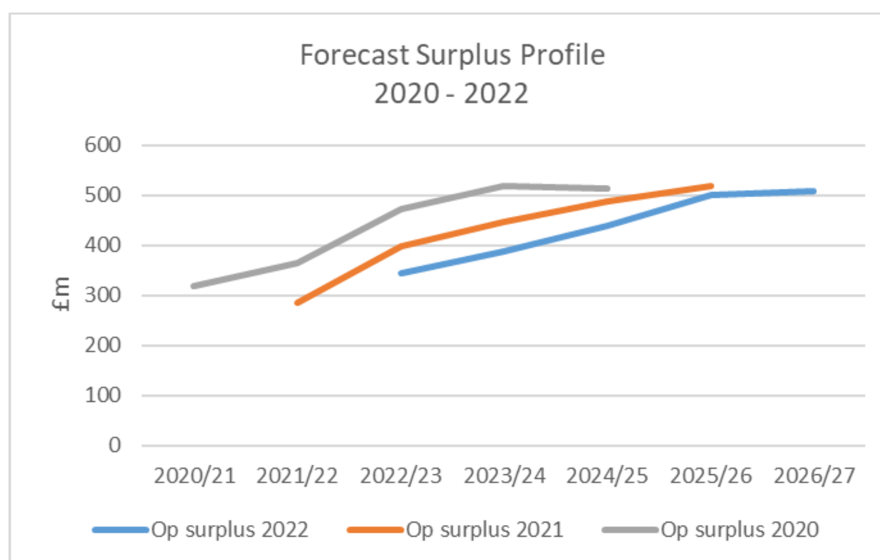

Chart 1: Operating surplus as per FYFP returns for 2020, 2021 and 2022

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

2022 projections	2022/23	2023/24	2024/25	2025/26	2026/27
Net rents and service charges	78.7%	79.8%	79.1%	79.5%	81.0%
Developments for sale income	0.3%	0.3%	0.2%	0.2%	0.0%
Grants released from deferred income	9.4%	8.9%	9.7%	9.6%	8.0%
Grants from Scottish Ministers	0.9%	0.7%	0.8%	0.5%	0.5%
Other grants	0.6%	0.5%	0.5%	0.5%	0.5%
Other income	10.1%	9.8%	9.7%	9.7%	10.0%

Table 2: Forecast split as % of turnover

The release of grants remains a steady driver of turnover. This does not generate additional cash but is instead dictated by accounting policy choices and reflects developing RSLs adopting the performance method of grant accounting, where rather than releasing grants over the useful economic life of the properties they fund, they are released in full as the properties are built.

Other income comprises mainly care and support activity which is still key for a number of RSLs. On average though around 64% of aggregated other income will come from only eight RSLs, all of whom employ more than 50% of their staff in a care and support role.

Statement of Financial Position

Aggregate net assets are projected to grow by an annual average of 5.0% (2021, 4.8%) over the five years. Growth is forecast to be modest but steady, increasing each year from 3.3% in 2022/23 to 6.0% in 2026/27 and taking aggregate net assets to £5.41 billion by 2026/27, with net housing assets up to £18.77 billion over the same period.

Rent arrears are forecast to increase sharply in 2022/23, in monetary terms and as a percentage of net rent and service charges. The monetary value is projected to fall back in the middle years, before rising to more than £60 million in 2026/27. This is more in line with historical levels expressed as a percentage of net rent and service charges. The increase projected for 2022/23 reflects the pandemic, more specifically the end of the Job Retention Scheme in October 2021, as well as the cost-of-living crisis. It is noted that these are net figures after a provision for bad debts. It is for RSLs to determine their own policy on debt provisions and therefore difficult to compare arrears figures without knowing the detail of those individual policies.

At an aggregate level RSLs continue to project the availability of significant cash reserves. However, from the 2021/22 AFS returns closing balance of £892.2 million, cash is projected to drop quite substantially to £544.2 million over Years 1–4, recovering marginally to close Year 5 at £562.0 million (see Table 3 below).

2022 projections	2022/23	2023/24	2024/25	2025/26	2026/27
Net rental receivables	72.1	58.5	57.8	59.3	60.3
Other short-term receivables	176.8	180.3	157.6	134.5	140.5
Cash at bank and in hand	670.7	565.8	545.6	544.2	562.0
Loans due within one year	(193.8)	(124.1)	(173.5)	(147.3)	(155.9)
Other short-term payables	(436.5)	(437.9)	(440.4)	(442.9)	(446.8)
Net current assets	289.1	242.6	147.1	147.8	160.0

Table 3: Net current assets

The movement in net current assets sees it drop from £289.1 million in 2022/23 to £160.0 million by 2026/27 (see Table 3 above). The higher 2022/23 figure is driven by cash, a combination of the prior year unutilised drawn down debt and the more recent impact of the pandemic, when RSLs found themselves restricted in carrying out significant parts of their routine day to day business.

Outstanding loan debt is forecast to rise by 26.8% to £6.67 billion. Increases of more than 7% in 2022/23 and 2023/24 slow down in the middle of the projections, with later years projecting an average increase of less than 2% as development activity tails off. The split of the outstanding loan debt balances is shown in Table 4 below.

	2022/23	2023/24	2024/25	2025/26	2026/27
Loans due in 1 year	193.1	123.3	172.6	146.4	155.0
Loans due after 1 year	5,474.2	5,970.2	6,257.4	6,432.2	6,511.1
Total loans due	5,667.3	6,093.5	6,430.0	6,578.6	6,666.1
Percentage change	7.8%	7.5%	5.5%	2.3%	1.3%

Table 4: Split of short and long-term debt

Statement of Cash Flows

Cash will always be crucial to any RSL business and generating sufficient cash remains key to their financial viability and ongoing longer-term sustainability, and to that of the sector. We are interested where and when that cash is to be spent, whether maintaining the smooth running of day-to-day operations or sustaining a significant development and investment programme.

The headline figures from the aggregated cash flows are set out in Table 5 below.

	2022/23	2023/24	2024/25	2025/26	2026/27
Net cash from operating activities	551.7	660.0	741.0	805.8	824.9
Returns on investment and servicing of finance	(197.6)	(213.3)	(231.0)	(248.4)	(253.7)
Capital expenditure and financial investment	(927.9)	(964.4)	(866.0)	(710.4)	(637.6)
Net cash from financing	395.8	416.1	332.8	154.6	84.6
Increase/(decrease) in net cash	(178.2)	(101.5)	(23.2)	1.7	18.2

Table 5: Extract of statement of cash flows

Net cash outflows are forecast for the first three years of the projections, with the largest in Year 1 (22/23). This is not entirely unexpected as RSLs continue to catch up on work delayed by the restrictions imposed by the Covid-19 pandemic. The figures from the quarterly returns received from RSLs across 2021/22 showed an aggregate cash balance that initially increased from £990.6 million at March 2021 to £1.06 billion at June 2021, before falling back to £983.4 million at September 2021, and to £897.9 million at December 2021, increasing marginally to £892.2 million at March 2022.

This profile suggests RSLs had not yet achieved the level of catch-up work required through 2021/22, with significant expenditure anticipated across 2022/23 being consistent with cash flow projections. Given the uncertainty around inflation and future, possible rent caps there is now a real risk that many RSLs will have chosen to pause some of this catch-up work given the potential for a cap on their rent increases beyond March 2023.

Table 5 above shows net cash from operating activities increasing significantly to £824.9 million by 2026/27. This is consistent with earlier comments that turnover is, on average, projected to increase at a faster rate than operating costs. There is a reduction of 10.5% projected for 2022/23, as RSLs continue with catch up work delayed by the pandemic; however, this is followed by a steep increase of 19.6% in 2023/24. Smaller increases in the remaining years give an average annual increase of 6.5% over the five years.

Interest payments are projected to increase across the five years. Lower levels of increase in the earlier years of the projections period reflect a profile of smaller increases in outstanding loan debt, but the sharper rise in Year 5 reflects the expectation of higher interest rates. Six months on from the projections being submitted, successive interest rate rises have taken the Base Rate from 0.1% to 3.00%, with forecasters expecting further increases taking it to a short-lived peak of around 5.0% during 2026/27, in a continued attempt to control inflation.

With interest rates rising and around 27% of outstanding loan debt on variable interest rates the sector is more exposed to the impact of those rate rises than it has been for several years. It is estimated that a 1% increase in reference interest rates could increase annual debt servicing costs by more than £13.0 million.

The ratio of cash generated from operations to interest paid had been falling in previous years. Although the pandemic reversed that trend in 2020/21, and current forecasts have it rising further through the first half of the projections (see Table 6 below), we now expect recent rises in interest rates to have a negative impact on this ratio going forward.

	2022/23	2023/24	2024/25	2025/26	2026/27
Net cash from operating activities	551.7	660.0	741.0	805.8	824.9
Interest paid	200.4	216.5	234.5	252.1	257.4
Ratio (%)	2.8	3.0	3.2	3.2	3.2

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

The most volatile cash flow figure is for the construction and acquisition of housing properties, which shows an increase of 18.9% in 2022/23, before dropping to only a 1.8% increase in 2023/24, which is followed by year-on-year decreases of 21.2%, 27.9% and 23.7% respectively across the second half of the projections. This reflects the necessary re-profiling of expenditure because of the restrictions during the pandemic, but also the reduction in size of development programmes in the later years of the projections period.

Financial Assumptions

As part of the FYFP return RSLs provide key financial assumptions used which form the basis of the sector's short, medium, and long-term financial projections. Data collected in the 2022 FYFPs gives an insight into how RSLs saw the operating economic climate at that time and Tables 7 and 8 below share some of the information around key planning assumptions on inflation and rents.

General inflation	2022/23	2023/24	2024/25	2025/26	2026/27
Sector	3.9	3.6	2.8	2.4	2.3
Minimum	0.0	0.0	0.0	0.0	0.0
Median	4.0	3.1	2.5	2.0	2.0
Maximum	8.0	8.0	6.0	5.4	5.4

Table 7: General inflation

	2022/23	2023/24	2024/25	2025/26	2026/27
Sector	3.2	3.7	3.1	2.7	2.6
Minimum	0.0	0.0	0.0	0.0	0.0
Median	3.4	3.7	3.0	3.0	2.9
Maximum	6.0	7.5	6.0	5.0	5.0

Table 8: Gross rent increase

RSLs continue to face an extremely uncertain and volatile operating environment and governing bodies must ensure they are stress testing changes in underlying assumptions to understand the impact on their business and mitigate against unforeseen movements.

Rent Increases and Inflation

Analysis of the FYFP inflation assumptions compared to the forecast figures published by the OBR in November 2022 shows aggregate rents increasing by less than both CPI and RPI in Years 1 and 2 of the projections, before returning to inflation plus in the second half of the period as inflation forecasts drop. The full five-year forecast figures are shown in Table 9.

	2022/23	2023/24	2024/25	2025/26	2026/27
Average rent increase	3.2	3.7	3.1	2.7	2.6
CPI	10.1	5.5	(0.0)	(1.0)	0.8
RPI	13.0	8.3	0.5	(0.5)	1.6
Eligible rent growth assumptions for RSLs	2.7	4.5	4.4	5.0	3.7

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

CPI is currently forecast to peak at 11.1% during the second half of 2022/23, before dropping sharply towards zero during 2024/25. From there it is now forecast to dip into a deflationary position for a spell in 2025/26, before settling at the 2.0% long term target during 2027/28. In addition, the eligible rent growth assumptions for RSLs used by the OBR to inform housing benefit forecasts are currently more than forecast average rent increases from 2023/24 onwards.

At an individual RSL level, Table 10 shows the spread of rent increases compared to inflation.

Rent increases	2022/23	2023/24	2024/25	2025/26	2026/27
Average rent increase	3.2	3.7	3.1	2.7	2.6
CPI or less	146	130	7	0	7
CPI to RPI	0	16	0	0	1
RPI or more	0	0	139	146	138

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

As can be seen in Table 10 most RSLs anticipate increasing rents by less than CPI in the first two years. This is in part due to the lasting impact of the pandemic but also the current impact of the cost-of-living crisis on tenants and their ability to absorb a higher level of rent increase. We should also consider that the most recent forecasts were produced well in advance of the issues identified more recently as contributing to the rapid rise in inflation.

In previous years we could expect most RSLs to assume RPI plus rent increases, particularly in the earlier years. However, more recently we have been seeing a marked switch to rent increases referencing CPI. Any increase above CPI, particularly in the current economic climate, is likely to increase the pressure on affordability for tenants.

The drivers of rent increases can be many and complex, with some beyond the control of RSLs. RSLs face a hugely conflicting challenge, between keeping rents at levels their tenants can afford but continuing to provide all the tenant services and maintenance whilst also building the necessary financial headroom for the risks they face.

Tenants are finding it increasingly more difficult to afford their rent. Our National Panel of Tenants and Service Users reported in August 2022 that:

- 61% feel their financial circumstances are worse now than prior to the pandemic, including 25% who feel significantly worse off, increased cost of living and higher rents being the biggest contributors to financial difficulties;
- 25% are not currently managing well financially, with 14% in financial difficulty;
- 62% struggle with unexpected expenses, with 32% telling us they often delay or miss paying a bill (up from 21% in the 2021 survey);
- 28% have experienced difficulty affording their rent in the last year, an 11-percentage point increase on 2021, with feedback linking this to increasing rents, heating costs and other living costs in general;
- as many as 71% were concerned about the future affordability of their rent
- 58% have experienced difficulty heating their home, with 31% having difficulty at the time of the survey;
- energy costs were the main factors contributing to difficulties heating homes – 85% mentioning this is more than double the proportion in 2021; and
- 26% have had energy efficiency improvements to their home in the last two years, most commonly heating system and/or insultation upgrades

Inflation plus, rent increases have become increasingly less affordable as tenants' incomes are squeezed harder by other pressures. Rising food and energy prices and real wage cuts all contribute to the current cost of living crisis and as a result it has never been more important that landlords:

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

Efficiency and value for money remain crucial to keeping rent affordable. Considerable work is done in this area but RSLs need to critically challenge themselves to ensure everything that can be done to be efficient and drive costs from their business is being done, before passing them onto their tenants.

Financial Ratios

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

	2022/23	2023/24	2024/25	2025/26	2026/27
Interest cover (%)	276.7	306.3	317.5	321.1	321.9
EBITDA MRI (%)	207.0	228.8	244.2	265.2	258.3
Gearing (%)	114.2	120.3	121.9	118.3	112.9

Table 11: Interest cover and gearing forecasts

Interest cover forecasts remain healthy; however, since these projections were received interest rates have risen to their highest level in 14 years and are forecast to rise further. We estimate that every 1% increase, will have potentially increased annual interest charges by £13.2 million. Rising interest rates are likely to result in a reduction in interest cover for many RSLs.

Steady increases take interest cover to 321.9% by 2026/27, with an annual average of 308.7%, which compares favourably to the 302.0% average from the 2021 FYFPs. Interest cover continues to be of interest to lenders and remains a common ratio for covenants. We know the calculation can vary from RSL to RSL and from lender to lender, and it can be difficult to draw meaningful comparisons, but we also know that whatever the nuances of the calculation, the aggregate position will strengthen in the short to medium term.

Earnings Before Interest Taxation Depreciation & Amortisation, Major Repairs Included (EBITDA MRI) is impacted by capitalised maintenance costs and due to catch-up repairs, the figure for 2022/23 is lower. Many RSLs will have this as a loan covenant and should monitor it closely. If RSLs risk a covenant breach, they should have an early dialogue with lenders. RSLs should also submit a notifiable event for a potential breach to SHR through the Social Landlord Portal.

Increasing gearing over the first half of the projections reflects increasing borrowing. Loan debt is expected to rise over the remaining years, albeit at a slower rate, so with increased net assets gearing levels fall. Gearing reflects the sector, reliance on private finance and on Government grant funding, with Scottish RSLs traditionally in receipt of a higher state contribution than Registered Providers in England and Wales.

With 27% of total RSL loan debt outstanding at the 31 March 2022 on a variable interest rate governing bodies should ensure they are managing risks from existing debt. RSLs' should ensure they continue to have robust stress testing in place to help them understand the sensitivity of business plans to increases in interest rates. Further analysis of RSLs' annual loan portfolio returns for the period April 2021 to March 2022 can be found in our annual loan portfolio report for 2022.

Alongside improving interest cover and earnings, other key profitability ratios also project a broadly upward trend throughout, as can be seen in Table 12 below.

	2022/23	2023/24	2024/25	2025/26	2026/27
Gross surplus (%)	17.7	19.2	20.5	22.3	22.3
EBITDA to revenue (%)	21.2	24.2	26.4	29.3	29.1
Net surplus (%)	6.8	10.8	11.0	12.2	13.4

Table 12: Profitability forecasts

As the sector continue to recover from the pandemic, we will continue to monitor the impact of the cost-of-living crisis, particularly on voids, arrears, and bad debts. Table 13 below sets out the projected aggregate sector position.

	2022/23	2023/24	2024/25	2025/26	2026/27
Voids (%)	1.6	1.6	1.5	1.4	1.4
Arrears (%)	4.7	3.6	3.4	3.3	3.3
Bad debts (%)	1.4	1.4	1.4	1.4	1.3

Table 13: Voids, arrears, and bad debt forecasts

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

As can be seen in Table 13 arrears are forecast to peak in 2022/23, possibly reflecting tenants experience of cost-of-living pressures while real wages fall. Beyond that they are expected to return to more recognised historic levels. There is no similar spike expected for bad debts, suggesting that RSLs feel their mitigating actions are continuing to work and that the longer-term risk of tenants not being able to pay their rent is in fact not dissimilar to pre-pandemic levels.

Investment in Existing Stock

RSLs continue to forecast significant capital expenditure on their existing properties. In total, they are forecasting expenditure of £1.7 billion over five years, for an average of more than £5,000 per property.

RSLs have significant additional investment requirements in relation to the Energy Efficiency Standard for Social Housing (EESSH) and to any pre-1919 stock they may have. In total, they anticipate capital and revenue spend of £330.8 million on EESSH and £341.3 million on pre-1919 properties. From information provided on the number of pre-1919 properties, this equates to around £9,200/unit, and a reduction in spend of £89.4 million, or around £2,500/unit, compared to the 2021 figures.

On fabric costs of £12,800 per flat alone, applying this to the total units at April 2022 would add £3.8 billion of cost to the Scottish sector to 2030. For a 3-bed house at £25,600 per unit, that figure would be £7.6 billion. Table 14 illustrates further, showing that to fund £3.8 billion of costs from rent, RSLs would need to increase rents annually by 35%. £7.5 billion of costs would need close to 67% increases.

	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	Total	Difference
Current gross rent	1,474.1	1,562.5	1,641.1	1,717.2	1,784.1	1,839.4	1,896.4	1,955.2	13,870.2	
35% increase	1,474.1	2,027.0	2,141.8	2,241.5	2,339.4	2,408.6	2,483.2	2,560.2	17,675.7	3,805.6
67% increase	1,474.1	2,507.5	2,649.5	2,772.8	2,893.9	2,979.5	3,071.8	3,167.1	21,516.1	7,646.0

* Current gross rent inflated by 3.1% per annum from 2026/27, the average increase across the FYFP

Table 14: Rent increases required to fund potential de-carbonisation costs

Put into perspective, using a base rent level of £100 for 2022/23, the rent increases in the FYFPs, and the average increase from 2026/27 of 3.1%, rents would increase by 22.0% to £122 by 2029/30. If those rents were to increase by 35% each year, that would be £817, or an increase of 717.2% and if they were to increase by 67%, they would reach £3,623 by 2029/30, up an incredible 3,522.6%.

Clearly RSLs could not fund such increases through rents alone, but even the option of additional borrowing would require higher rent increases if only to cover increased debt servicing costs. As a result, RSLs could face pressure to redirect grant funding from new development to investment in existing stock.

It is important that RSLs fully understand the condition of their stock and what investment is needed to maintain it. This includes any additional requirements to ensure they meet tenant and resident safety obligations. A good asset management strategy, with clear links to financial projections and business plans, will help to increase confidence in the long-term viability of the RSL. RSLs should refer to our Asset Management Recommended Practice when looking to develop and improve their approach to asset management.

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

Net Zero-Carbon

Further significant investment will also be required to de-carbonise stock towards net zero and there is still only limited information on the potential cost of achieving this.

The Scottish Government has set a target of net zero carbon by 2045. To help achieve this, significant investment in existing stock will be required by RSLs; to improve energy efficiency but to also move away from fossil fuel-based heating.

Analysis of RSLs projections has been carried out to assess the extent to which decarbonisation costs have so far been incorporated into financial forecasts. There is currently limited data on how much additional investment will be required. In a report commissioned by the National Housing Federation, Savills estimated a cost range from £24k for a flat to £37k for a 3-bed semi-detached house in England. Both estimates include non-fabric costs of £11.5k.

In Scotland, pre-1919 tenements will be one of the more difficult property types to achieve net zero carbon. During a pilot project to retrofit 8 tenement flats to Passivhaus standard, Southside Housing Association spent £37k per flat on energy efficiency measures out of a total cost of £88k.

- based on the latest stock returns, RSLs own more than 25,000 pre-1919 tenements. Taking account of the energy efficiency costs incurred by the Southside Housing Association pilot, this would indicate a cost to the sector in the region of £932 million. The initial aggregate figure included in the FYFPs for total capital and revenue expenditure on pre-1919 properties was only £341.3 million.

- whilst this estimate is likely to be much higher than required, it is still clear that significant additional investment beyond what is currently forecast will be required, leading to the likelihood of further pressure on the Scottish Government to provide additional grant funding and pressure on rents to increase at a faster rate than currently anticipated.

Recognising the importance of this area and its potential impact on RSL financial health, we asked some additional questions in the most recent FYFP return. We asked if RSLs had considered de-carbonisation and if so, how much of a cost estimate, if any, had been included in their financial projections. The outcomes from this are considered below:

- 35 RSLs indicated that they considered de-carbonisation as part of their business planning process, representing 25% of all RSLs. Of those 35, 10 have not yet considered the cost impact on their forecasts but did provide a comment on their reasons. A further 14 answered ‘no’, adding a comment to explain their reasoning, with most indicating that they were awaiting further information before including any costs.

- of the 25 RSLs who included a cost estimate, these ranged from £23 to £2,607 per unit with a median of £684 per unit. These estimates fall well short of those from the studies detailed above, but most RSLs provided a comment to give further context, with most indicating that the costs provided related to specific projects rather than the total estimated cost for all properties.

- whilst the number of RSLs who answered, ‘yes’ to whether de-carbonisation has been considered or did not add a comment when answering ‘no’, is less than hoped for, there will be many reasons why this is the case. The wording of the question may have led people to select ‘no’ if they have not considered what costs to include.

- the comments from those selecting ‘no’ indicate that all have at least started to consider de-carbonisation. Taking this into account, they could all have answered ‘yes’, and input costs included as zero. This would take the number of RSLs who answered ‘yes’ to 49, or 35% of all RSLs.

- where costs are zero, most comments indicate giving them further consideration over 2022/23. There is also an underlying theme of consultants currently being engaged and that further work is required to increase expertise and the capacity of the sector to meet decarbonisation targets.

- where comments have been input by RSLs who have included costs, a number indicate that the costs relate to specific projects rather than to the whole cost of de-carbonisation. Therefore, the costs are not necessarily an accurate reflection of what will be required to ensure timely progress is made towards net zero carbon by 2045.

Achieving net zero carbon is likely to become a key driver for RSLs in determining investment requirements in the medium term. The relatively low response rate to the questions in this year's FYFP suggests that planning is still at a very early stage.

Future Development

2021 marked the end of the of the Scottish Government's commitment to deliver 50,000 affordable homes. Following the Parliamentary elections in May 2021, a new commitment for the delivery of 110,000 affordable homes by 2032 was announced, incorporating a target of at least 70% of those being available for social rent. A summary of the new units projected to come out of the current development plans is shown in Table 15 below.

	2022/23	2023/24	2024/25	2025/26	2026/27
New social rent properties added	7,710	6,026	5,154	3,792	3,003
New MMR properties added	1,041	976	1,199	695	503
New LCHO properties added	123	77	53	32	0
New other tenure properties added	72	133	34	0	0
Total affordable housing units added	8,946	7,212	6,440	4,519	3,506

Table 15: Forecast development numbers

In looking at the projected development plans, it is important to bear in mind that whilst some RSLs will include aspirational plans, many more will take a more cautious approach, only including those projects where there is a clear commitment to develop. The projections would appear to reflect this latter approach, with forecast completions tailing off towards the end of the projections period.

The total number of units forecast for development, at more than 30,000, is up on the 29,000 projected in the 2021 FYFPs. The new units are expected to be funded primarily by social housing grant (£2.44 billion, or 49.5% of cost) and private finance (£2.07 billion, or 41.9% of cost). A full breakdown of the forecast development funding is shown in Table 16 below.

	2022/23	2023/24	2024/25	2025/26	2026/27
Housing Association Grant (HAG)	570,690.5	619,155.5	554,294.1	390,140.6	308,935.5
Other public subsidy	8,978.8	957.2	1,877.2	591.5	12.0
Private finance	508,622.4	512,088.9	455,970.3	344,767.4	246,957.1
Sales	21,396.7	20,800.9	21,598.8	13,453.0	2,572.9
Cash reserves	64,417.2	71,718.2	75,540.5	53,805.4	58,408.6
Other finance	2,927.8	100.1	110.0	100.0	100.0
Total cost of new units	1,177,033.4	1,224,820.8	1,109,390.9	802,857.9	616,986.1

Table 16: Forecast development funding

In addition to the traditional methods of funding, some RSLs will also look to use sale proceeds. Forecast sale proceeds can be seen in Table 16 above. Whilst those numbers are smaller in Scotland, when compared to RPs in England, the risk attached is greater as it relies on RSLs being able to sell at a high enough price and volume to cover the required investment in new properties.

Although forecast development levels are marginally up, a relatively small number of RSLs continue to be responsible for most of the proposed new build development but there is also nearly always a few RSLs looking to develop for the first time, or at least the first time in a long time, and they can refer to our development thematic when making decisions on whether to take on a project.

Covid-19 meant a significant disruption to development. That, and the increased development risk that it brought, is still being felt through delays, cost increases, supply chain disruption and changes to working practices. The economic slowdown also increases the risk of business failure, especially true in the construction sector, and to reflect this and other financial challenges RSLs have forecast that the development cost per unit will rise by more than 30%, from around £131,600 in 2022/23 to £176,000 by 2026/27. It is therefore important that RSLs have appropriate plans in place to try to mitigate as best they can against these risks.

Since these forecasts were submitted the economic picture has materially changed. And we expect that continuing supply-chain pressures and associated cost inflation will lead to further changes to development plans and costs in the next round of projections.

Against this backdrop is the Scottish Government 2032 new homes target. Funding of £3.2 billion across the current parliamentary term has already been committed to this. However, RSLs are mindful of the competing pressures of net zero carbon and the real prospect of government funding potentially being redirected towards that in the years ahead.

In addition, when looking at the recent outturn development figures the sector has only achieved annual completions in excess of 5,000 units three times in the last seven years, averaging around 4,700 new units across that period. (See Table 17 below).

The pandemic had a significant impact on completions in 2020/21, but there has also been a pattern of over-forecasting and prior to 2021/22, outturn completions had been consistently more than 20% down on forecast since the 2017 FYFPs were submitted. So, to achieve the 2032 target of at least 77,000 affordable homes across the next decade, an annual average of 7,700 homes would need to be delivered. Some of this will be delivered by local authorities.

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Year 1 forecast	3,723	3,603	5,325	6,358	7,064	6,025	8,234
Outturn	3,755	3,494	3,914	5,054	5,314	3,412	7,947
% Difference	0.9%	-3.0%	-26.5%	-20.5%	-24.8%	-43.4%	-9.9%

Table 17: Outturn development numbers compared to forecast

Projected borrowings

Our analysis shows that RSLs expect to increase loan debt to £6.67 billion by the end of 2026/27, a net increase of £1.3 billion across the five-year period and some way above the £6.3 billion that was forecast in the 2021 returns to the end of 2025/26. This is also despite the forecast for new private finance for 2022/23 being more than £20 million lower this year than the equivalent figure from the 2021 projections.

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

At the time of writing, the Bank of England has raised its Base Rate further, from an historic low of 0.1%, with an eighth successive increase taking it to 3.0% in November 2022 amidst pressure from inflation. The OBR forecast that Base could increase further, reaching a short-lived peak of 5.0% in 2023/24, before falling back to 3.6% by the second half of 2027/28. This will impact on the interest rates applied to new borrowing and we would expect RSLs to incorporate this into their long-term business planning assumptions and any associated sensitivity analysis.

Glossary

Audited Financial Statements (AFS) return	The annual return collating data from the audited annual financial statements of RSLs
Care organisation	An organisation employing greater than 50% of their FTE staff in a care role
Consumer Prices Index (CPI)	The benchmark inflation rate calculated by the Office of National Statistics (ONS) and used by the Bank of England to determine monetary policy
EBITDA MRI (Earnings before interest, tax, depreciation, amortisation, major repairs included)	[(Operating surplus + depreciation + impairment – capitalised maintenance costs) / interest payable]. A version of interest cover commonly used as a loan covenant.
Energy Efficiency Standard for Social Housing (EESSH)	The Energy Efficiency Standard for Social Housing (EESSH) aims to improve the energy efficiency of social housing in Scotland. It will help to reduce energy consumption, fuel poverty and the emission of greenhouse gases.
Five-year financial projections (FYFP)	The annual return collating data from the 5-year financial projection submissions from RSLs
Gearing	[(Total outstanding debt – cash & cash equivalents)/net assets]. Commonly used as a loan covenant, the calculation used by SHR cannot generally be compared to covenant calculations as it does not adjust for grants held as deferred income in the statement of financial position
Housing Association Grant (HAG)	Grant funding provide by the Scottish Government to part finance the development or purchase of social housing by an RSL.
Interest cover	[(Net cash from operating activities + interest received) / interest paid]. Commonly used as a loan covenant, the calculation used by SHR cannot generally be compared to the covenant calculations as it is based on figures from the cash flow rather than the statement of comprehensive income
Loan Portfolio (LP) return	The annual return collating data on the private borrowings held by RSLs.
Office for Budget Responsibility (OBR)	Non-departmental public body funded by the UK Treasury, and established by the UK government to provide independent economic forecasts and independent analysis of the public finances.

Performance method	Accounting policy choice allowing release of capital grant as deferred income when related performance criteria are met. Can only be used where housing assets are valued using revaluation method.
Registered Social Landlord (RSL)	As registered under the Housing (Scotland) Act 2010 to provide Scottish Secure Tenancies. This does not include Local Authorities.
Retail Prices Index (RPI)	RPI is another ONS inflation rate, this one including housing costs.
Stock / unit numbers	The unit numbers entered into the Annual Financial Statements, or AFS, return that we require each RSL to complete.

Scottish Housing Regulator