DTP VIEWS

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Will social housing providers prove resilient to inflation risks?

– Andy Gladwin, Director, DTP

For registered providers of social housing, inflation is probably the number one factor bearing down on their business plans right now. Think of inflation almost as the hub at the centre of a wheel – with the spokes of the wheel representing a series of risks. Rising prices are the ultimate cause of each of these risks, and providers must weigh up how best to mitigate against them.

It's no easy task, and a balance must be struck between the needs of its key stakeholders – the tenants who rely on providers for the roof over their heads – and their own viability as a business. And while the challenges are almost unique, certainly in the period I have worked in the sector, they are hopefully not insurmountable. The sector has displayed remarkable resilience in the past – not least when it was faced with a 1% rent cut a few years ago. I'm confident it can show similar resilience in the potentially difficult years ahead, if we plan for and manage circumstances appropriately.

I certainly have confidence that housing associations themselves can weather the storm, but we can't shy away from the impact the cost-of-living crisis is having on many of their customers, especially those at the very bottom of the income spectrum.

I don't intend to dwell on the causes of the current high inflation environment here. They've been well documented elsewhere, and instead I want to focus on some coping strategies which RPs can adopt to see them through the next 12 months and beyond. I also want to make the case for acting now: prompt and decisive action is needed sooner rather than later and before the worst effects of inflation are felt.

So let's start with the risks – those spokes in my wheel analogy.

The first of these is rising input costs which are most keenly felt when it comes to the repair/refurbishment side of the business, and on new build development. This is already painfully familiar to many of the RPs we work with who are paying more for everything from timber to concrete to labour. Some I have spoken to have told me of contractors who have signed on the dotted line for a new build development but have then had to renegotiate costs as a start date approaches.

In my view, RPs need to stand firm in situations like these. If not, schemes which were originally appraised as sound investments could be deemed unviable and fail to get off the ground. Providers should be prepared to re-tender a contract if necessary or at least revisit it to ensure everything is done to keep it within the original budget. If necessary, be prepared to delay starting work to ensure you are getting value for money.

The other key risk is around RP's main revenue stream: income from rents. In recent weeks, housing association boards have been setting the rents their tenants will pay from April this year – in England, based on last September's CPI rate of just over 3%. Most RPs I am aware of have gone for the full CPI + 1% permitted by the government. This time next year the decision may be a lot more difficult given the CPI figure for September this year is forecast somewhere between 6% and 7%. Affordability, already a key consideration, will then be absolutely critical. I suspect many will struggle to justify charging the full September CPI +1%, especially if headline inflation has perhaps fallen back to 3 – 4% at that point.

Tenants will have effectively had a full year of energy price rises by next spring, plus soaring costs for other household essentials including food. Many housing association tenants are just not able to absorb these shocks and boards are acutely aware of this.

This means other risk-mitigation strategies are now 'mission critical" for RPs. By finding other ways to build in some resilience to inflation they can hopefully spare their tenants further pain and avoid unprecedented rent rises next spring.

Treasury and financing is an area where quick wins can be achieved. High inflation of course means we are now entering an era of higher interest rates (or more normal rates some might say). The Bank of England has already raised rates twice since December, and only intervention by the central bank's governor Andrew Bailey prevented a rise to 0.75% in February. Rates were held at the meeting on February 4th at 0.5%, but further rises are a near inevitability as the year progresses with the possibility of a base rate around 2% in the next 12 months.

At DTP we are advising RPs to act now to improve their borrowing cost position. Where a provider is thinking about going to market for new funding our advice is: don't wait. This applies even If you are holding back making a decision on a new loan until security is in place. If you have a break clause in an existing loan, look carefully to see if it is worth paying off the loan and incurring the break cost. It may well be because current attractive loan rates won't be around for long.

Staff remuneration is the other risk which may potentially bear down on RPs, however the jury is still out on what impact rising inflation will have on wages. Whether staff will heed the Bank of England governor's controversial call for workers not to ask for large pay rises remains to be seen. The labour market generally in the UK remains tight and unemployment is low, all of which could add to wage pressures for RPs.

This area of risk, along with the others I have identified, highlights again the importance of stress testing for RPs. Even in the best of times, regularly revisiting the dynamics and the inter-relationships of all your main business planning makes sense. Against the current backdrop of a period of huge global and domestic uncertainty it is absolutely essential. DTP is here to provide expert advice with all aspects of business plan stress testing, so do get in touch if you think your organisation could benefit.

It's a hugely challenging time for everyone and a lot of uncertainties remain about how the next year will pan out. There is an emerging consensus that the worst impacts of inflation will begin to ease during 2023. Let's hope so, and that this bout of inflation turns out to be transitory; no more than a bump in the road for the UK social housing sector. Time will tell.