Draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023

NHF submission to the Department for Work and Pensions consultation

17 October 2022

Introduction

The National Housing Federation (NHF) is the voice of housing associations in England. We represent almost 600 housing associations that own and manage more than two and a half million homes for around six million people. Our members also provide vital care, support and community services.

This consultation seeks views on the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023. Our response is submitted on behalf of the social housing sector in England. We refer to "us" and "we" in this response in respect of both the NHF and our member organisations.

We have separately responded to The Pensions Regulator's (TPR) first consultation on the defined benefit funding Code of Practice. Noting that TPR's second consultation will build on the Department of Work and Pensions (DWP) Funding and Investment Regulations, we wish to raise a number of concerns and queries about implications of the Regulations as currently put forward.

Summary

Not-for-profit status

The Draft Regulations do not make clear reference to any distinction between pension scheme sponsors from the private sector and not-for-profits and, importantly for our members, between different types of not-for-profit employers.

We wish to engage with the consultation both to make this point, and to draw attention to the fact that when it is rectified, we also consider it crucially important that DWP and the Pensions Regulator understand the unique position within the not-for-profit categorisation in which housing associations stand.

Although housing associations can be set up as charities and not-for-profit organisations, housing associations are very different in structure and prospect. It is important that DWP understands and takes account of that. We have previously engaged with the Pensions Regulator and Regulator of Social Housing (RSH) on understanding our sector and have set out again as part of this response the key characteristics for DWP to recognise.

Low dependency investment and funding strategies

The need to adhere to or plan for a low dependency investment and funding strategy puts pressure on the commercially focussed sponsors of the majority of pension arrangements, and their scope to distribute wealth to shareholders.

However, similar strain on the work of our members effectively puts pressure on their capacity to serve their social purpose and another key governmental aim – the replenishment of the UK's social housing stock.

We would like to ask DWP, as we asked the Regulator, that the scope that exists for not-for-profit organisations be considered uniquely, particularly given the approach to assessing sponsor cash flows that is given in the Draft Regulations. This approach is not at all appropriate for assessing the strength of a not-for-profit entity. We would ask that DWP considers and outlines an approach that is appropriate to non-commercial entities.

To the extent that this is possible, we believe that as housing associations represent an exceptionally strong sponsor, our members should receive both the considerations associated with not-for-profit's whilst also being afforded the benefit of the strong covenants they provide.

Recovery plan affordability

The changes to the existing funding regime clearly outline an explicit requirement that funding deficits must be recovered "as soon as the employer can reasonably afford".

We are concerned that "affordability" is not a term which can be defined. We know from our experience that different pension schemes have different views on what this means – just like different people in similar financial circumstances could take a very different personal perspective on what they can afford or otherwise. In principle, we do not consider that the term "afford" should be hard-coded into Regulation, at least not without an extensive definition, which would in any case be best left to a Code of Practice.

Housing associations are non-distributory, i.e. we do not pay share dividends. Any fundamental pressure behind these Regulations for companies to not distribute simply doesn't exist in the housing sector – all funds stay "in house".

This mean that as currently written, there is a significant risk that resources that would otherwise be directed to the investment in the development of additional social homes and existing homes, as well as the decarbonisation of existing properties, would be channelled towards the funding of pension arrangements, despite the presence of sponsors that are well placed to follow a more measured pace of funding.

The social housing sector is facing pressure on cash flow from the combination of rent caps and rising inflation – if pension costs are unnecessarily increased, this compounds the position and as a consequence housing development will reduce.

We want to be clear that we are not calling for the rate of cash funding to be lower than necessary, but we are questioning what level of risk and therefore funding is necessary given the housing sector's very long-term covenant, social purpose and spending profile.

The Regulations as they are written appear to force a lower risk and higher pace of funding for no material reduction in risk to members' benefits being paid out, and a large reduction in the ability of a housing association to fulfil its purpose of providing homes and support for around six million people all around England.

Low dependency investment and funding strategies – ‘open’ pension schemes in which NHF members participate

A number of housing associations are involved in pension arrangements which are open to accrual and open to new members.

There are requirements for schemes to plan for when they are ‘significantly mature’. This appears onerous in the context of arrangements which are open to accrual and new members, which may not ever expect to become ‘significantly mature’. We would request more clarity on the requirements of the Regulations when significant maturity is not a relevant concept.

Like many such pension scheme sponsors, it appears that the requirements of the new Regulations in cases where arrangements are open to accrual are less onerous – where ‘maturity’ is unlikely to be planned for. We would request more clarity on the requirements of the Regulations when significant maturity is not a relevant concept and in which cases this applies.

Overall, we support the intention to allow open schemes to be more flexible with their long-term funding and risk management. Some housing associations are open to continuing to provide open schemes in order to be employers of choice, to deliver recruitment and retention objectives, and to ensure that lower earners receive what they need in retirement. Many respondents may not have this positive perspective on open Defined Benefit schemes and we hope that their feedback will be considered accordingly.

Multi-employer arrangements and cross-subsidies

Our members generally participate in parts of the UK pension scheme sector that is made up of arrangements which are multi-employer in nature. In some instances, such as The Pensions Trust, schemes are made up of a multitude of participants, each with their own membership and maturity profile. This is particularly true of the Social Housing Pension Scheme (SHPS), which has assets of over around £5bn and over 200 employers, the vast majority of which are housing associations.

In some cases, sponsors with generally young membership profiles generally participate alongside sponsors with more mature memberships. These arrangements often feature ‘orphan’ members whose membership cannot be reliably attributed to any one sponsor.

Some employers are fully open to new entrants, some open to future accrual but closed to new members, and some closed to new accrual.

Accordingly, we have significant concerns about the absence in the draft Regulations about detail on the approach that will be taken to avoid penalising a sponsor whose membership is certainly not mature for being conflated with the membership of a sponsor which is mature. There is risk that the schemes become “lowest common denominator” which will affect their ability to provide pensions in an efficient and consolidated way.

We would ask DWP to provide more detail on the approach that will be taken to multi-employer arrangements, particularly where there are non-associated employers.

What makes the housing sector unique?

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

- Housing associations are strong, independent organisations required by society and backed by government.
- Long term, inflation linked, secure income with demand stretching at least 50 years.
- Ongoing net addition of assets as strategic goal backed by government subsidy.
- Regulated by the Regulator of Social Housing, with many tools including stress testing of 30-year business plans and stringent public ratings of viability and governance.
- Many of our members hold investment graded bonds and continue to be favoured investment destinations of national and international lenders and investors.
- No housing association has ever defaulted on any debt.

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

Our proposals

We propose that DWP and the finalised Regulations allow the Pensions Regulator to:

- Recognise the minimal risk of default from housing associations.
- Formally recognise the significantly longer covenant visibility and resilience to risk of housing associations (for example, this could be supported by existing stress testing required by the RSH) and converts this into suitable funding parameters (for example the level of “significant maturity” and “low

dependency" appropriate to be adopted for any scheme sponsored by our members).
- Understand the significant impact on the development of new housing and the UK's net zero commitments that requiring more money to be directed into pension schemes sooner would have. Some of our largest members have offered to put resource aside for some of their senior people to take DWP and TPR case officers through the fundamentals of a housing association's finances and how this supports the evidence set out here.
- Have a clear approach internally to dealing with schemes sponsored by housing associations to ensure that a consistent approach is taken.
- Enable trustees to have clear guidance that schemes sponsored by our members can work within the principles agreed for housing employers, to enable consistency and efficiency for both TPR and individual housing associations.

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

Pension schemes in the housing sector and scope of this response

Within the sector there are two main types of housing association. Registered Social Landlords and Large Scale Voluntary Transfer. Registered Social Landlords will participate in any of the following:

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

Large Scale Voluntary Transfers will participate in any of the following:

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

There are also a number of mixed groups or mergers.

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

The SHPS is a last-employer standing scheme that is run for the sector and it sits within the pensions trust run by TPT Retirement Solutions. We believe that the principles we are setting out here apply to SHPS, but there are some further considerations in relation to the SHPS which relate to its multi-employer status which do not appear to yet be addressed clearly in this consultation.

The National Housing Federation and which employers we represent

From our largest member, with over 120,000 properties, to our smallest, with a handful of supported housing properties, we represent 96% of all housing associations' (based on number of properties).

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

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

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

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

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

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

Housing associations – a very strong covenant

Housing associations are strong, independent, long-term, anchor organisations needed by society, backed by regulation and partnered by national and local government.

Housing associations produce uniquely high operating margins and surpluses which are used in their entirety in furthering their social purpose and are not distributed to shareholders

A strong, independent regulator

The Regulator for Social Housing (RSH) is a governmental, independent regulator that sits within the Department of Levelling Up, Housing and Communities and aims to ensure the financial stability of the sector.

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

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

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

Zero default record

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

Government backed income

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

30-year investments by (pension) fund managers

The majority of our members' debt has terms of up to 50 years. It is a highly sought-after investment given it is regulated, secure and long term.

Demand forever (or at least 50 years)

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

Beyond this an All Party Parliamentary Group report released in 2019 stated that 630,000 young people could be homeless by retirement age because their pension income will not be sufficient to pay for private rented properties. This was published before the pandemic.

Investment grade credit ratings

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

Long term covenant visibility

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

Housing associations have been in existence since 19th century philanthropists were concerned with the state of housing for their workers. For example, George Peabody built Peabody housing association's oldest block in 1865 in Whitechapel. Since this time the sector has seen over 150 years of wars, economic turmoil and more as more sanguine times. The sector has never contracted over this period, showing steady and consistent inter-generational growth

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

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

Surplus is leveraged partly for development (a £1 reduction in surplus has an asymmetric (x20) impact on capital development. It is vital for the health of the sector (and wider social purpose) that surpluses are protected.

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

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

Even if allowance is made in the regulations for a “bespoke” route to be adopted in line with a strong covenant, all of our members having to take a bespoke route will take up a significant amount of time and cost and is likely to lead to inefficient and inconsistent outcomes.

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

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

We understand that in the Regulations as written the key measures supporting the amount of risk that it is appropriate for a pension scheme to take is the covenant strength, translating to a suitable degree of “low dependence”.

However, where the covenant is so strong that it is difficult to evidence a material risk that the pensions creditor will not be paid in full, we believe that employers should have flexibility, within reason, to agree a long-term funding planning which anticipates future investment returns on return-seeking assets, without specific reference to a “significant maturity” measure as defined.

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

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

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

“Fast lane through bespoke”

We include here for completeness our previous response to TPR’s consultation in 2020 with regards to the implementation of these Regulations via a “Fast track” and “Bespoke” route:

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

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

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

- The nature of our members and their pension arrangements are likely to mean that the “fast track” approach is not suitable. However, the volume of members that will likely seek to follow a similar route through “bespoke” means that we would ask for your consideration of the potential for a “fast lane through bespoke” that may be appropriate for housing associations and other similar organisations.
- Clarity on how much credit can be given for strong informal support offered by the sector given its unique business model.

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

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

For any questions relating to this response, please contact John Butler, Finance Policy Lead.