Specialised supported housing: How increasing regulatory scrutiny of the market is creating a more stable environment for investors

Specialised supported housing (SSH) is a form of social housing aimed at providing a suitably adapted home for people with specialist care needs, such as those with physical or learning disabilities. In recent years, private investment in the development and purchase of property of this kind has increased, with investors drawn to the rising demand for community-integrated specialist care options and the potential of stable, inflation-proofed yields. This article discusses the relationships between landlords, housing managers, care providers, and the regulator. We outline the potential risks and mitigation strategies for investors looking to develop SSH provision, and look at the recent trend of increased regulatory oversight by the Regulator of Social Housing that mean the market is likely to be a more stable space for investors going forward.

To be defined as SSH, buildings must be designed or adapted for occupation by residents who require specialised services or support to enable them to live independently in the community. Research by UK charity Mencap estimates that there were between 22,000 and 30,000 units of SSH in the UK in 2018, and this is predicted to rise to between 29,000 and 37,000 units by 2027/28. SSH is a rapidly growing model of housing and care, largely due to its cost-effectiveness and the move towards more independent living settings for those with specialist care needs.

The SSH housing and care package must offer support that approximately equates to the level of support delivered in a care home setting. In recognition of the additional costs involved in modifying and maintaining these properties, SSH properties are classified as 'exempt accommodation', and are not bound by local caps on Housing Benefit that define rent rates in 'general needs' social housing. SSH must be provided by a Registered Provider (RP), an organisation registered with the Regulator of Social Housing (RSH) to manage social housing. These can be operated by local authorities, independent not-for-profit organisations, or private for-profit organisations. The tenant pays rental fees and service charges to the RP, which acts as the landlord and property manager. Rent and service charges are paid for by the tenant's Housing Benefit entitlement, and there is generally also an arrangement with an external care provider, funded by the local authority under their social care budget and/or by the NHS where the tenant has a defined healthcare need.

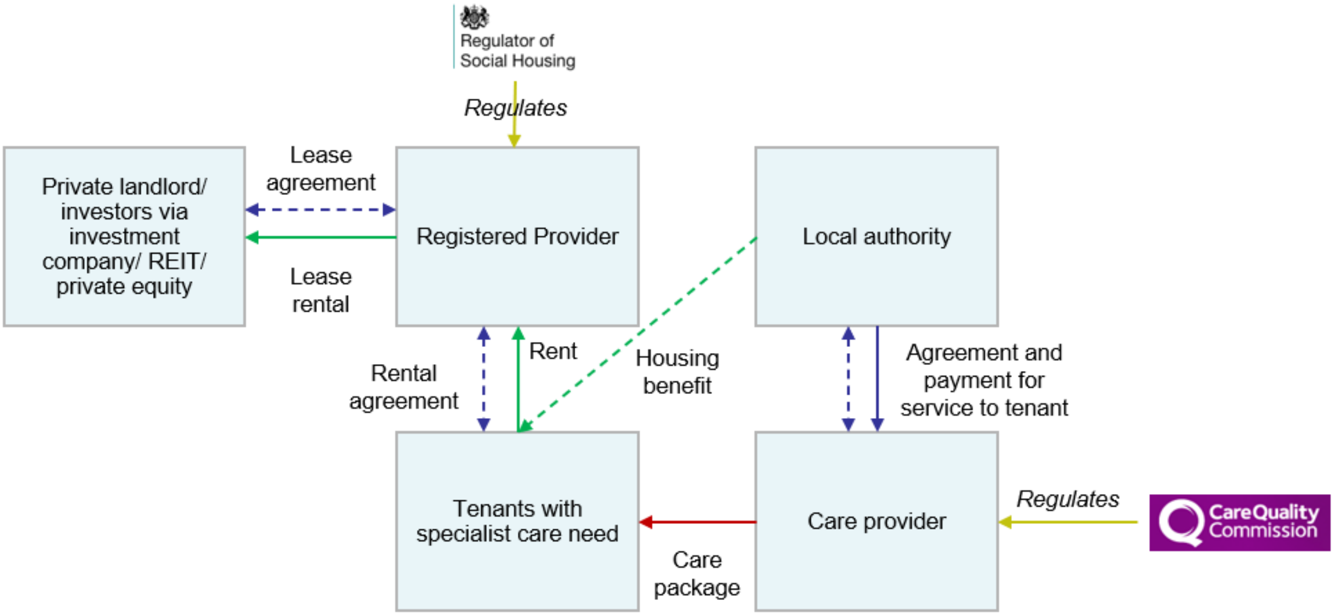

Figure 1: Structure of the lease-based model in specialised supported housing. Source: RSH

Investor interest

The fundamental principles of specialised supported housing have proved attractive to investors, who are conscious of the growing demand for this type of provision from local authorities that must meet their statutory obligations to house vulnerable adults. Demand for specialist care is on the rise given increasing survival rates of those born with disabilities, and also due to ongoing efforts linked to the Transforming Care Programme, with most inpatient discharge plans aiming to move individuals into supported housing.

Recent years have seen the rise of institutional investment in SSH through what is known as the 'lease-based' model. In this model, investors such as REITs or private equity firms provide capital to purchase and modify or develop SSH properties, which are then leased to RPs. The RP charges rent and service charges to the tenant in order to cover their lease payments, as well as maintenance and management costs (and a margin for profit, if they operate on a for-profit basis). They should also allow a margin to cover any potential rental voids, for which they are generally liable. For many RPs, particularly smaller ones, this arrangement is popular as they may not have the capital to purchase their own property.

The model allows for RPs to grow very rapidly, although this growth can come with issues. Deep cuts in government grants and stretched council budgets mean that local authorities and housing associations are often unable to meet demand by developing SSH themselves, hence the growth of RPs specialising in managing supported accommodation on leases from investors. The lease agreements between investors and the Housing Association average 25 years in length, and rental payments are inflation-linked.

SSH is an attractive option for local authority commissioners as a model of care that can be cheaper than both residential care and hospital beds. An average SSH placement requires state funding of £1,569 per person per week for care and housing, compared to £1,760 per week for a residential care placement, and £3,500 per week for an inpatient place. Local authority commissioners are also incentivised to use SSH as rental costs are taken from the central government budget (via tenants' Housing Benefit entitlement), rather than from their own stretched social care budget. Figure 2 shows how this further decreases the funding burden on local authority budgets. Commissioners often cite this as a motivating factor for using SSH, with one we spoke to

Average weekly cost of adult specialist care in different care settings, 2018

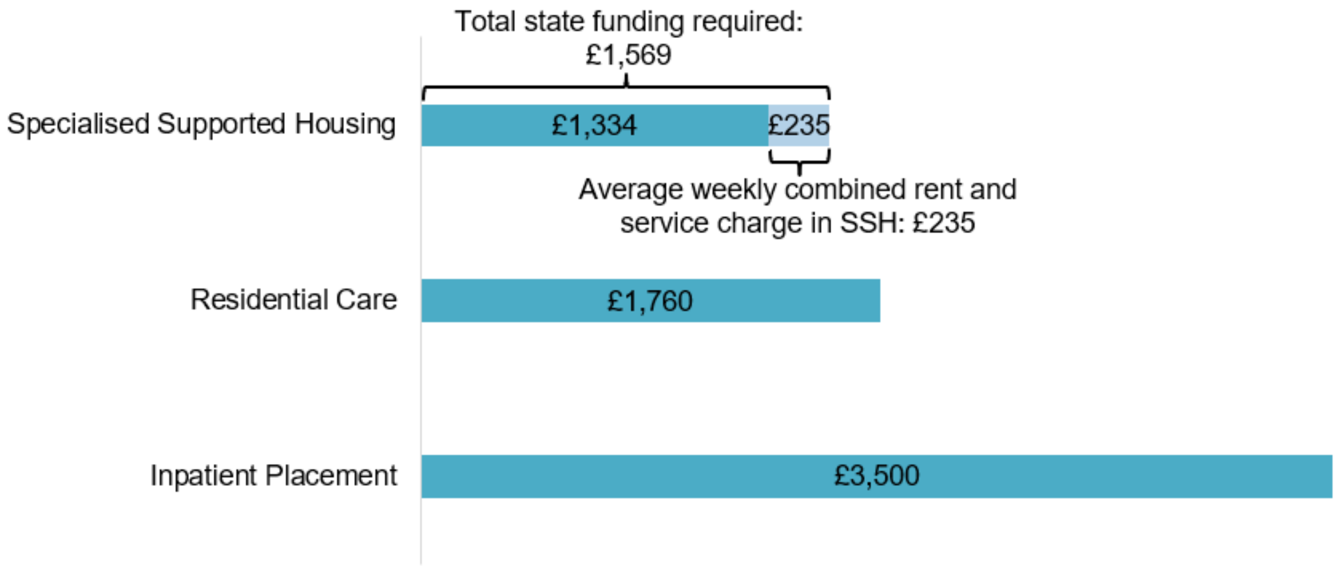

Figure 2: Average weekly costs of adult specialist care in different settings. Source: Mencap and Housing Lin, 2018

stating: '*on a selfish commissioning note, SSH and supported living tenants are able to claim Housing Benefit and all of the hotel costs, which normally with residential care would have to be funded by social care within the fee.*'

The lease-based model encourages sufficient supply whilst also providing clear separation of accommodation and care, which is a key priority within social care under the personalisation agenda. The tenant has their own lease arrangement with the RP, and separately receives care from an external provider, giving them the opportunity to change care providers whilst maintaining their tenancy, helping to ensure that the property that they live in is a 'home for life'. The home for life principle in SSH is appealing to investors looking to achieve sticky contracts with reliable, government-backed income sources.

Concerns about the lease-based model and how investors can mitigate risk

The near collapse of First Priority Housing Association in 2018 led to the lease-based model coming under greater scrutiny by the Regulator of Social Housing. First Priority began leasing properties from several investors from 2015 onwards, growing from 50 units to over 1,000 units in the space of four years. During this time, the group's void rate rose to 26.5%, over five times the English average of 4.7%. In 2018, First Priority began experiencing problems collecting rents and managing properties, and it was accused of managing properties poorly, falling behind on repairs, and not collecting rents. The RP was deemed non-compliant in February 2018, with the RSH stating that it was not meeting the Governance and Financial Viability Standard. This led to First Priority losing 100 leases between January and July 2018, with multiple investors transferring the management of their properties to other RPs.

The case resulted in the RSH publicly expressing doubts about the sustainability of some lease-backed RPs, and in 2019 the RSH contacted dozens of Housing Associations which it identified as having similar lease-based financial arrangements, and downgraded a number of RPs to a non-compliant grading due to poor governance and financial instability. The case of First Priority, and the concerns highlighted by the RSH, may lead to investor hesitancy around working with potentially unstable RPs to provide SSH. However, there are ways that investors and landlords can mitigate financial risk. Greater due diligence of First Priority's finances and growth strategy by landlords may have helped the organisation grow at a steadier pace that did not compromise property management and rent collection.

There have also been cases of other RPs that have been unable to make lease payments as their rental income has been suspended by local authorities, who disputed whether their properties properly met the requirements of 'exempt accommodation'. It should therefore be kept in mind by investors that Housing Benefit entitlement under the exemption is only secure for providers that offer properly designed and adapted property for cohorts that undeniably require SSH. This is clearer-cut in the case of properties for those with severe physical disabilities, learning disabilities or autism, but less so in the case of people that are homeless or victims of domestic abuse, who may not necessarily require significantly adapted housing. At the time of development or adaptation of a property, careful thought should also be given to design in order to minimise compatibility issues between clients of the particular cohort that the SSH intends to cater to in order to reduce the risk of potential rental voids.

It should be noted that non-payment of leases by RPs is a relatively rare occurrence. The RSH takes a close interest in financial and operational management given the potential impact that the failure of an RP could have on the vulnerable tenants living in SSH provision, and in the event of an RP being unable to fulfil its obligations to the local authority or the landlord, an alternative RP with stronger financials can be brought in to replace them. Despite this, landlords should be aware of risks, have mitigation plans in place, and ensure that the RPs that they choose to work with have strong governance processes in place.

Increased regulation of lease-backed Registered Providers

There are clear signs of greater regulatory oversight into the finances and governance of RPs that operate SSH provision. The RSH acknowledges the important role of private investment in the development of SSH, and has committed to scrutinise the finances and management of RPs much more closely to bring about greater financial stability, having already downgraded several SSH RPs operating through the lease-backed model under their Governance and Financial Viability Standard. The RSH has also issued advice on this to local authorities, meaning that commissioners are likely to be more aware of the risks surrounding the lease-based model.

This tightening up by the RSH is part of a broader movement towards greater scrutiny of social housing providers and managers, broadening the scope and power of the RSH. Although the Social Housing Regulation Bill that is currently going through the parliamentary report phase primarily relates to consumer rights and housing quality standards, it also points towards greater regulatory oversight of the management and governance of housing associations. For example, one amendment to the Bill, announced on February 26th 2023, will require all social housing managers to have a minimum level of professional housing qualifications.

This increased regulation of the SSH market should enforce higher standards and promote the financial resilience of the sector, and therefore reduce the risk of the financial failure of RPs, making the SSH market a more secure space for investors. Conversely, RPs may now push more firmly for lower lease payments and shorter lease terms as part of more cautious financial contingency measures.

Conclusions

Supply and demand dynamics for investors in SSH provision are strong, and the private financing of this type of housing aligns well with budget constraints faced by local authorities, as well as the key current commissioning agendas in specialist care, including the personalisation of care, the concept of a 'home for life', and the separation of housing and care. Past issues with the lease-based model can be mitigated readily by landlords through greater diligence of the financial sustainability and governance of RPs that they work with, and by ensuring that their properties qualify as SSH provision and are therefore eligible for exempt accommodation rates. There are signs that regulators are scrutinising RPs and care providers to a greater extent in an attempt to make sure that tenants receive high-quality, consistent care in stable homes. Increased regulatory oversight from the RSH should also benefit investors and landlords, as it means the RPs that they work with will have to meet financial and managerial standards that should decrease the risk of financial failure, making the SSH sector a more stable space for investors.

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