



Regulator of  
Social Housing

# Focus report: Lease-based provision of Supported Social Housing

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## Introduction

Since the near-failure of First Priority Housing Association in 2018, we have engaged extensively with landlords who are primarily or exclusively delivering lease-based Specialised Supported Housing (SSH) (see Annex 1). This note explains our view of the risks and benefits of delivering SSH in this way

### Regulatory approach and expectations

We regulate for a viable, efficient, and well governed social housing sector able to deliver quality homes and services for current and future tenants. We regulate at the landlord level to drive improvement in how landlords operate. We set standards which state outcomes that landlords must deliver, and expect them to be able to do so independently. We regulate based on our view of the level of risk. We consider risks that apply to all or groups of landlords as well as risks that individual landlords face. We are particularly concerned about risks that threaten:

- the safety or quality of tenants' homes
- the financial viability of the landlord
- how well run a landlord is, which impacts on how well it delivers its services
- its ability to effectively manage risks
- transparency and accountability to tenants

We consider that boards of landlords are responsible for ensuring their organisations are managed effectively and that they deliver the outcomes of our standards, including independently maintaining the viability of the landlord for the short and long term and managing risk.

## Lease-based provision of Specialised Supported Housing

SSH is a specific type of supported housing designed or adapted for people who require specialised services so that they can live independently rather than in a care home, and where the level of ongoing support provided is high and approximately the same as that provided by a care home. SSH is exempt from rent regulation, although the rent on a property must be below market levels if the home is to meet the statutory definition of social housing. To qualify for the SSH exemption, the home must be provided by a private registered provider under an agreement with a local authority or with the NHS and there must have been no or negligible public assistance (other than by way of loan). [Further information about the rent standard is available on our website.](#)

In lease-based SSH provision, a freeholder (or superior landlord, but for simplicity we will just use 'freeholder') owns property and leases it to a private registered provider landlord on a long-term basis (at least 10 years and often longer). The private registered provider landlord then lets the home to an individual tenant, usually put forward by a local authority or care provider through a nomination arrangement. As part of the exemption criteria for SSH, the private registered provider landlord must ensure the home is designed or adapted to meet the tenant's needs that the care provided through the agreement is approximately the same as a care home.

Leases between the freeholder and the registered provider landlord are typically on terms that oblige the registered provider landlord to take responsibility for repairing and insuring the property (sometimes referred to as leasing on a FRI basis). The lease typically incorporates a regular and inflation-linked increase in the lease payments. The increase is usually annual and linked to either the consumer price index (CPI) or the retail price index (RPI). The registered provider landlord usually funds lease payments, management and maintenance costs, and overheads from the rents it receives from the occupying tenants.

The rent payable by the occupying tenant is set by the registered provider landlord. This rent is a charge to the tenant for the right to occupy the property. In addition to rent, the registered provider landlord usually charges the occupier for specific property-related services as set out in the tenancy agreement or licence. These services might include maintenance of communal areas or security. Any service charges should reflect the actual cost of the services provided and the terms of the tenancy agreement or licence. The occupying tenant(s) are responsible for paying the rent and service charges to the registered provider landlord. Where the tenant(s) are eligible to receive housing benefit, the local authority administers housing benefit payments on behalf of the Department for Work and Pensions and will review claims made to ensure that they are not unreasonably high.

Typically, the local authority also commissions a care package for the tenant. The care package is usually in place for three- to five-years at a time. The local authority will normally pay for an individual's care package, but this transaction is between the local authority, the individual and the care provider.

## **Issues arising with lease-based provision**

For the registered provider landlord, lease-based provision is asset-light and cashflow based. The landlord does not need to provide capital up-front to bring a home into management, and should receive enough rent to pay for all short and long-term expenses, as well as the lease payments to the freeholder. However, we have regularly noted the following issues with lease-based SSH provision:

### **Sharing of risk and reward between the freeholder and the registered provider leaseholder**

In FRI leases, the registered provider landlord generally takes on a greater share of the risks than the freeholder. The registered provider landlord takes the risk of:

- cost inflation
- ongoing maintenance and renewals
- health and safety and regulatory compliance
- rent variation and arrears
- relets and void periods
- dilapidations.

The freeholder takes an initial risk through the development of the home and ongoing risk of:

- lease non-payment
- ability to let after the end of the current lease.

This uneven sharing of risk could be balanced by the distribution of the rent received from the occupying tenant between the registered provider landlord and the freeholder, and by affording the landlord the option to exit or extend the lease.

Through our regulatory work we have identified cases where the arrangement between the registered provider landlord and the freeholder does not reflect the distribution of risks. In particular cases where responsibility is disproportionately left with the registered provider landlord for potential void periods, when no rent is received but lease payments are still due, and for ongoing renewal costs. In some cases, the initial lease payments to be made by the registered provider landlord and the operating costs were together higher than the initial rent charged to the occupying tenant. In other cases, no consideration had been given to how the registered provider landlord would meet ongoing or potential one-off event costs. If a home does not generate surplus cash throughout the term of the lease from the freeholder, it becomes a drain on the registered provider landlord's business. We have also noted occasions where leases contain no break clauses, or unilateral

break/put options in favour of the freeholder. This restricts the ability of the registered provider landlord to exit contractual arrangements which are not performing as expected.

### **The home and the tenancy should demonstrably meet the SSH rent exemption requirements**

Qualification for the SSH rent exemption depends on, amongst other factors, the needs of the individual tenant living in the home. That is true throughout the life of the home, so if there is a change of tenant, or of the support needs of the tenant, the status of the home may change. In most cases, the amount of rent the registered provider landlord would be permitted to charge for the property would be very much lower if the home did not qualify for the SSH rent exemption, with obvious implications for the registered provider landlord's income stream and ability to meet its operating costs and lease payments to the freeholder.

Through our engagement we have identified cases where landlords could not evidence that the homes or tenancies met the SSH rent exemption requirements, and yet were relying on the SSH rent exemption. We have identified some cases where there is also a contractual requirement on the registered provider landlord to ensure that the home qualifies for the SSH rent exemption. The home should be in a lettable condition, including any adaptations, and preferably tenanted.

### **Void risk**

Any interruption in rental income from occupying tenants affects the registered provider landlord's ability to make lease payments to their freeholder. Starting with a void period puts a home immediately in deficit and increases the risk that the home will be loss-making in future. Through our work we have identified cases where homes were taken on and then found to need work, or portfolios of homes were taken on without identified tenants, leading to void periods and increasing cashflow pressures.

### **Mitigations for alignment risks should be identified**

Experience shows that changes of tenant, the need for further adaptations, and void periods are common for homes in respect of which SSH rent exemptions are claimed, even though SSH is intended to be bespoke and long-term. The length of leases from the freeholder do not usually match care package commissioning periods for individual tenants, thus creating a risk of void periods. Future rents payable by occupying tenants may also change. Through our work we have identified cases where void cover was absent or not paid; suitable alternative tenants could not be found; or local authorities had required lower rents on re-let or withheld housing benefit during negotiation. All of these increase cashflow pressures for the registered provider landlord who remains obliged to make payments to the freeholder.

## **Provider-level concerns**

Our regulatory expectation is that a landlord should manage its own risk and be capable (independently or as part of a group) of delivering the outcomes required by our regulatory standards on an ongoing basis. This includes having effective governance, maintaining standards for tenants, meeting health and safety requirements and ensuring the financial sustainability of the landlord. Exclusively delivering lease-based SSH or doing so at scale creates particular challenges for registered provider landlords in meeting those regulatory expectations.

### **Good governance is essential**

All landlords should have boards and executives with the necessary skills to manage the activities and risks of the business. Effective decision-making and risk management processes should be in place and there should be a clear understanding of assets and liabilities. From our work we identified many cases where boards and executives of registered provider landlords who were predominantly delivering lease-based SSH did not have appropriate skills, and risk management was weak or non-existent. Frequently there was a lack of understanding of the scale of lease liabilities, a poor investment appraisal process and a lack of willingness or ability to challenge contractual arrangements to improve the registered provider landlord's position.

### **Cashflow shortfalls need to be managed**

Many landlords starting up or growing by primarily providing lease-based SSH have minimal capital compared to their long-term liabilities and hold little cash. Consequently, any disruption to cashflows (such as through voids, arrears, increasing costs, or inflation) will affect the ability of landlords to meet their commitments as they fall due. While for a time it may be possible to meet the cashflow deficit on one home with the surplus from another, this is not sustainable for the long term. In some cases, registered provider landlords have tried to reduce this risk by increasing the number of homes they provide. This is because new homes from freeholders can come with an initial incentive payment, but also due to the assumption that the impact of an individual underperforming home is less if it is part of a larger pool. However, from our work we note that this approach tends to become unsustainable reasonably quickly, as over-optimistic assumptions lead to cumulative deficits. This can then mean insufficient provision being made for longer-term repairs and renewals.

### **Lack of flexibility and dependency on third parties can threaten viability**

SSH homes are intended to be adapted or built for specific clients, and depend upon nominations of suitable tenants from local authorities and care providers. They have limited alternative use without further capital investment, because a change in client or client needs will alter the nature of the specialised support required. Initial and future rent levels are subject to determination by local authorities and rent levels recoverable from the home will be significantly lower unless the provision qualifies

for the SSH rent exemption. A landlord exclusively or predominantly providing lease-based SSH is therefore highly dependent on local authority and care providers for its ongoing sustainability (because of its own ongoing commitments under its leases from freeholders) and has limited ability to manage key elements of business risk (because they are so dependent on the decisions of third parties). We have identified cases where care providers have been unable to identify all the tenants needed for registered provider landlords' schemes and have withheld void cover payments, and where local authorities have not agreed to the registered provider landlord's proposed rent levels or associated housing benefit payments. In several cases, this combination led to landlords becoming unviable and ultimately to the de-registration of the registered provider landlord because it did not meet registration requirements.

Leases are contractual commitments, expected to be negotiated once by the registered provider landlord at the outset to protect its interests in the long term. These leases typically absorb the vast majority of the registered provider landlord's rental income. Our expectation is that registered provider landlords should independently be able to maintain their financial viability under a range of circumstances while meeting their contractual commitments and maintaining standards for tenants. The range of potential actions a registered provider landlord predominantly delivering lease-based SSH can take to maintain its viability is more limited. That is because its business is largely cashflow-based and its ability to persuade a freeholder to amend the terms of its lease is dependent upon the agreement of the freeholder.

We have identified several cases where maintaining viability has not been possible due to the cumulative effect of many low-margin or underperforming homes, and other cases where this risk to long-term viability could not be managed effectively. In some cases, the only mitigations available to registered provider landlords seeking to maintain their viability has been either expecting freeholders to forgo lease payments, or handing back properties to freeholders. While freeholders have sometimes tolerated the build-up of significant arrears, it is not safe to rely upon this as a mitigation – not least because there is little scope in a restricted cashflow environment to catch up the arrears. The failure to make lease payments results in a landlord ceding control to the freeholder who will then act to protect the freeholder's commercial interests. The freeholder's commercial interests may at times include forbearance on lease payments, but could also involve moving leases to other landlords or starting recovery actions and insolvency proceedings. Landlords also need to be mindful of the disruption to tenants caused by changes of landlord, and the regulatory requirements to consult and communicate with tenants about significant changes to the management of their homes. It may not be in the power of the registered provider landlord to manage that disruption, or comply with those regulatory requirements, if power has effectively been ceded to the freeholder.

### **Independence and conflicts of interest need to be managed.**

A concentration of leases to the registered provider landlord from a small number of freeholders increases the risk of undue influence on the registered provider



landlord's decision-making. This is compounded where landlords rely on freeholders' flexibility and forbearance to maintain their viability (for example as described in the previous paragraph). We have identified instances where there have been related party or other close relationships between registered provider landlords and freeholders and conflicts of interest have not been managed. This has resulted in landlords taking on unfavourable lease terms, partially occupied developments, and unsuitable homes.

### **Growth can exceed management capacity**

To deliver the outcomes required by the regulatory standards, registered provider landlords must maintain a good understanding of the condition of their homes and manage and maintain them to an appropriate standard. From our work we have identified cases where landlords predominantly delivering lease-based SSH have rapidly assembled portfolios spread across very large geographies, without understanding the condition of the homes or having clear and effective management in place. This increases the risk that the landlord is not providing adequately for longer term maintenance needs, and of homes being difficult to re-let. In other cases, landlords have not had a good understanding of their tenants and their particular needs. This is a particular concern in SSH, where tenants have more acute and specialised support needs, and where a good knowledge and understanding of the home and the tenant is required to keep the tenant safe and in order to ensure that SSH rent exemptions are not being wrongly claimed.

### **Government policy and wider economic environment**

Landlords that predominantly deliver lease-based SSH, and SSH itself, exist as a result of government policy decisions around support for people with particular needs, housing benefit and rent policy. While the policy environment has been stable for a number of years and SSH has not been affected by recent rent reductions and caps affecting general needs social housing, there is no guarantee that the position will not change.

In addition, the wider economic environment can significantly impact upon the delivery of lease-based SSH. For instance, inflation in the social housing cost base has been significantly higher than reflected in general inflation measures. This puts further pressure on margins and cashflows in lease-based SSH provision.

## Regulatory experience

Our experience over the last few years of working with registered provider landlords that predominantly provide lease-based SSH has been mixed. We have identified cases where the model has delivered individual homes effectively to date. These cases tend to have:

- a clear commissioning relationship with a local authority for an identified individual or group, reducing void risk
- effective mitigations in place, such as reliable void cover
- a closer match between the registered provider landlord's lease length and commissioning periods
- a more equitable sharing of risk and reward in the lease arrangements between freeholder and registered provider landlord
- adequate provisioning for future expenses
- more opportunities to break or adjust lease terms
- effective landlord governance and management.

Tenant satisfaction measures show relatively high overall satisfaction among tenants of some landlords, and effective management and maintenance.

However, lease-based SSH provision relies on registered provider landlords' portfolios performing in line with assumptions and contractual terms established at the outset. These assumptions and contractual terms are continuing to prove problematic in many cases. A number of landlords have become financially distressed or insolvent as a result of the crystallisation of cashflow, void and management risks as we identified in '[Lease-based providers of specialised supported housing](#)'.

We have observed that amongst landlords predominantly delivering lease-based SSH, lease arrears and void levels are often high, suggesting that the tailored and long-term nature of provision is questionable. While there is some evidence of freeholders tolerating arrears for a period, this has generally been to give time to identify an alternative registered provider landlord to take on leases and maintain returns for the freeholder. This moves risk around rather than resolving it, and demonstrates that the freeholders' main interest is in maintaining their cashflows rather than supporting individual registered provider landlords or taking decisions in the best interests of the tenants occupying the homes.

In other cases, our regulatory intervention has prevented problems becoming more acute through encouraging or enforcing more effective governance and decision making, but the imbalance of risk and reward between the landlord and the freeholder may remain in such cases, due to the length of leases already entered into by the registered provider landlord.

Some landlords have made some progress in addressing the most egregious conflicts of interest between the landlord and the freeholder, and some landlords can show clearer evidence of informed decision-making in taking on new homes. We have also observed that more recent leases from freeholders often have shorter terms, more break clauses, higher margins in favour of the registered provider landlord and additional protections such as force majeure clauses and linkages between rent collected and lease payments. While welcome, these measures do not in themselves deliver the outcomes required by the standards, as explained earlier in this note, and it remains the responsibility of landlord boards to consider and manage the specific risks that they take on.

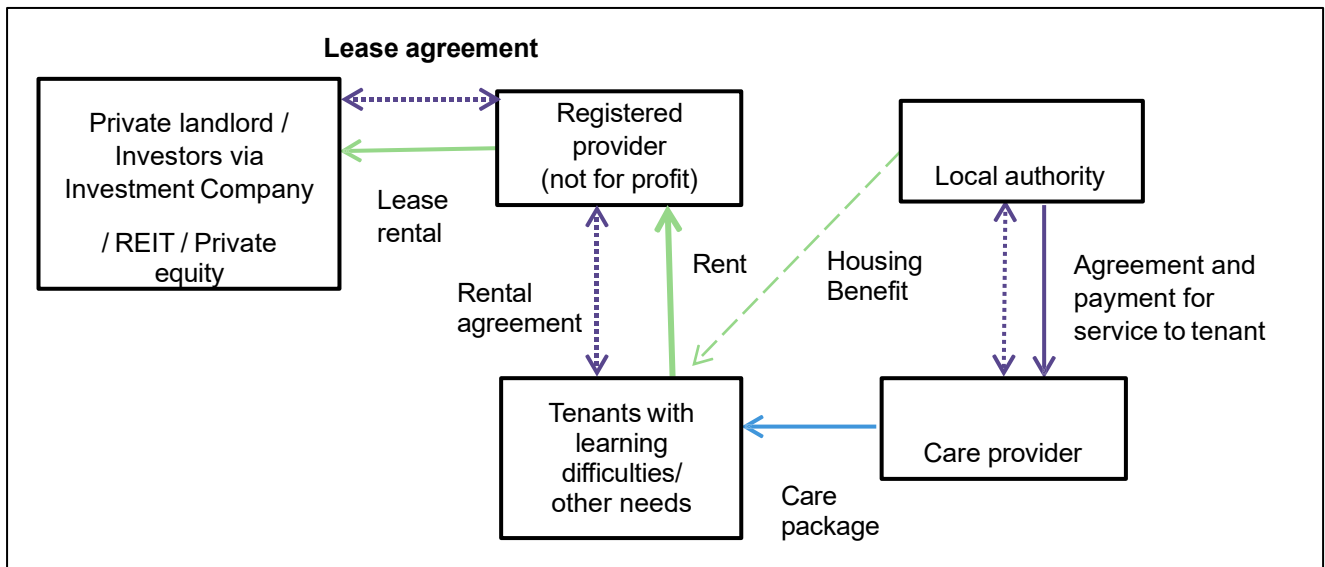
We remain concerned that very few landlords have demonstrated that they are currently delivering lease-based SSH at scale – including dealing with historic issues – in a way that consistently delivers the outcomes required by the regulatory standards. This is principally because there is insufficient flexibility in current structures to manage risk – particularly viability risk – effectively and independently, and in some cases a lack of good governance and management willingness and capacity to make needed changes. Our experience suggests that without significant movement on the part of freeholders in this sector, the challenges described in this note are likely to remain.

We will continue to engage actively with the landlords who are failing to deliver the outcomes of our standards and will keep a range of regulatory interventions under review where these will help deliver a return to compliance.

# Annex 1

Lease-based provision schematic

**Figure 1: Specialised supported housing – lease-based provision**





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