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Welsh Government

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Sector Risk Overview - Challenges, Risks and Regulatory Expectations

February 2022

RSL Sector Challenges and Risks – February 2022

The purpose of this paper is to provide Housing Associations with an update on key risks and challenges faced by the sector as a whole and to set out high level expectations as to how Boards should respond.

Since the last edition of Risks and Challenges, we have all had to contend with the Covid-19 pandemic. The many challenges of the pandemic illustrated once again how strong governance is critical in ensuring Registered Social Landlords (RSLs) are able to identify and correctly respond to the risks they face. It also reinforced the need for robust business planning and assurance frameworks to ensure Boards make good, well informed decisions as well as the need for robust business continuity, contingency and disaster recovery plans.

We set out what we currently consider to be the main risks and challenges facing the sector in Wales at the moment. RSLs and their Boards should be actively considering these risks in the context of their organisations, putting in place appropriate mitigation measures, ensuring they are doing “the right stuff” ([The Right Stuff - improving housing association governance 2018](#)).

Individual RSLs will also have additional specific risks and Boards must ensure both those and the sector risks are appropriately assessed and managed.

In the main, the assessment of the key risks and challenges are written from the perspective of potential impact on compliance with the 9 regulatory standards which underpin Regulatory Judgements. We also provided some “think points” (Appendix A) which have no regulatory status but may assist risk conversations for some RSLs.

The role of regulation

RSLs have a significant impact on the whole of the Welsh economy as well as their tenants and people who use their services.

Regulation is concerned with protecting tenants and communities as well as safeguarding public investment. The operating environment is changing as a result of the pandemic as is the regulatory environment. The regulatory changes are set out in the revised [Regulatory Framework for Housing Associations Registered in Wales 2021](#).

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Sector Challenges and Risks

In response to the challenges and risks set out, the regulatory expectation is for all RSL boards to consider:

- Do we understand our exposure to the risks set out? Which are material for our business, are they within our assessed capacity and risk appetite and do we have assurance how the risks will be mitigated?
- What are our monitoring and data arrangements and do they provide us with reliable and up to date information to effectively control / manage the risks?
- Do any of the risks set out materially change our risk profile? Do we need to reassess our exposure, assumptions, areas of spend, policies and procedures as a result of this?
- Are there any opportunities presenting from the sector challenges and risk narrative?

Coronavirus

The Covid-19 pandemic is having a huge impact across the world and is expected to affect our lives into the medium-term future. The position is volatile and it is unclear how severe the impact will be on businesses and their workers. Research has found that people from minority ethnic groups, those who are low-paid and those who are disabled are most likely to have been adversely affected in relation to employment¹, while people of working age and those with dependent children were most likely to have experienced a negative impact on their finances². It is likely that the financial position of many registered social landlord (RSL) tenants will be adversely affected as a consequence of the pandemic and the mental health of residents is also likely to be affected if it becomes necessary to, once more, isolate from loved ones in order to reduce the spread of the disease.

A further challenge to the sector is that staff availability is likely to be reduced by staff being off sick, being required to isolate due to contact with infected individuals or having to care for children who are ill. This could make it difficult to maintain key services, including responsive repairs and care / support provision. The Welsh Government has published [guidance](#) for employers, businesses and organisations which is updated as the situation changes. [Specific guidance](#) for RSLs, particularly those providing supported living services and / or working with homeless people is also available. Effective risk management (RS2) should include specific consideration of the many potential impacts of the pandemic across the business, including particularly business contingency and continuity.

¹ [Coronavirus: Impact on the Labour Market, House of Commons Library, 20th December 2021](#)

² [The Impacts of Covid-19 on Clarion Housing Residents: A longitudinal study – part 3 of 4, October 2021](#)

Development

Financial capacity / appetite

There is unmet housing need across the country and RSLs are expected to use some of their financial capacity to help meet that need through developing new affordable homes. The degree of risk involved will need to be limited by adjusting the level of ambition of each RSL to reflect the available skills and financial capacity. With the introduction of the new variable grant regime, a significant element of the cost of new homes will be funded by debt. This may be supported by cross-subsidy from shared ownership or market sales, which then gives rise to further risks. Dedicating too much financial capacity to new development could result in a liquidity failure or a breach of loan covenants.

Market Housing

Many RSLs have taken on housing market risk in order to generate additional capacity to deliver more social rented housing. House prices have risen consistently in Wales over the last ten years, with particularly strong growth since the onset of the pandemic. On the basis of data from HM Land Registry, prices rose by an average of 15.5% in the year to October 2021; much higher than earnings or general inflation. However, there is a risk that this trend may be reversed due to problems in the domestic or global economy or because of affordability issues created by these price increases. This would result in a combination of lower house prices and longer sales periods, significantly reducing the cashflow for organisations with a significant sales programme.

Availability and cost of labour and materials

Global supply chains have been severely affected by the Covid-19 pandemic, while international trade is also affected by the UK's withdrawal from the EU's single market and customs union. These factors are reducing the availability and increasing the cost of materials for development, as well as creating a shortage of skilled labour. There is therefore a possibility that development programmes will be delayed and costs will be greater than forecast.

Cost control

Development expenditure represents a large proportion of the cash outflow for many RSLs, making effective cost control particularly important. With RSLs increasing the proportion of land-led development in response to changes in the planning system and strong competition for land from both the private and the public sector, there is a risk of paying more for a site than its value. These risks are increased when purchasing land without planning permission.

Quality control

Failing to ensure that new homes comply with the [Welsh Development Quality Requirements](#) (WDQR) could result in a poor customer experience,

increased health and safety hazards for tenants plus increased maintenance costs for the RSL. These requirements take into account the suitability of new homes over the longer term, taking into account the effects of climate change and the need to achieve net zero carbon, as well as addressing the issue of fuel poverty.

Other risks of which RSLs should be aware

- Changes and delays to the planning system
- Availability of grant funding
- Partnerships and joint ventures
- Competition for opportunities
- Modern methods of construction.

Regulatory Standard 1

The organisation has effective strategic leadership and governance arrangements which enable it to achieve its purpose and objectives

The social landlord:

- a) Has a strategy which reflects its vision, culture and values and sets out how the organisation will achieve its core purpose as a social landlord*
- b) Complies with its own governing documents and meets the requirements of an appropriate Code of Governance*
- c) Sets and delivers measurable, evidence based commitments across all areas of its business in relation to equality, diversity and inclusion (including anti-racism and tackling hate crime) reflecting the diversity of the communities it works in and with*
- d) Has a diverse Board, reflecting the communities the RSL works in and with, and has the skills and knowledge required to be effective*
- e) Makes logical decisions based on clear, good quality information which includes assessment of risk and, where appropriate, the views of tenants*
- f) Enables and supports tenants to influence strategic decision making*
- g) Complies with all relevant legislation, regulatory requirements and statutory guidance and communicates in a timely manner with the regulator, including on material issues that relate to actual or potential non-compliance.*

Challenges and Risks

Effective governance arrangements

The assets of RSLs are held for the public good, to provide housing for those whose needs are not met by the market. They have benefitted from significant government subsidy. A failure in governance could result in those assets being used inefficiently, in a deterioration in their quality, or in a failure to meet the financial and other liabilities that arise from the ownership of those assets. Ineffective governance could also result in a failure to comply with statutory or regulatory requirements.

Governance failures may result from a failure of the board and the executive team to understand its risk profile and to effectively manage those risks. Other potential drivers of poor governance are poor performance monitoring, making poor decisions based on ambiguous or incorrect data, or failing to bring data together from different areas of the business to obtain a full picture of the situation.

Strategic choices

RSLs face a number of competing demands for their financial capacity, whilst at the same time they must ensure they remain within their agreed risk appetite, providing sufficient headroom against loan covenants.

A failure to agree an appropriate allocation of investment could result from not taking proper account of the views of residents or other partners, or failing to adjust the strategy in response to changes in the external environment.

Diversification into new business streams may help to generate additional financial capacity and / or deliver against social objectives. However, this will also result in exposure to additional risks which may not be fully understood or the capacity to manage is not in place. Failure to control additional risks effectively could result in damage to viability and put social housing assets at risk.

Poor governance may damage the reputation of the RSL and the wider sector. For example, conflicts of interest among board members or excessive executive pay are likely to result in public concern and adverse media coverage.

Equality, Diversity and Inclusion

Research suggests that “more diverse boards are associated with improved financial performance, enable good corporate governance and facilitate better decision making by bringing different perspectives to support constructive and challenging dialogue....” (Source – EHRC 2016). Its important to note however, improving Board diversity is only one of the elements of furthering EDI goals.

Inaction on EDI can present significant risks and missed opportunity to an organisation’s effectiveness, leadership and decision making. Failure to set and deliver EDI commitments across all aspects of the business including in the Board itself, can easily result in policies, services and homes which do not meet the diverse needs of communities and different groups.

Other risks of which RSLs should be aware

- Failure of the board to operate at the strategic level.
- Ineffective monitoring of services, including those provided by third parties.

Regulatory Standard 2

Robust risk management and assurance arrangements are in place

The social landlord:

- a) *Has an effective framework for risk management, internal controls and assurance that enables it to successfully identify and manage existing and emerging risks which threaten delivery of its strategy or compliance with legislative or regulatory requirements*
- b) *Does not put social housing assets or tenants at undue risk*
- c) *Maintains accessible and up-to-date business continuity, contingency and disaster recovery plans.*

Challenges and Risks

Effective Risk Management

Lack of an effective risk management framework could result in a failure to identify, evaluate or manage key risks, including ensuring that critical controls are in place and effective. In turn, this could result in a failure to achieve strategic objectives or a breach of statutory or regulatory requirements.

Failure to ensure the organisation remains within its risk capacity could result in a liquidity crisis or a breach of loan covenants. This could arise due to agreeing a corporate strategy that is beyond financial or managerial capacity, failing to maintain a sufficient buffer against risk materialisation or failing to identify and rectify a significant deterioration in operational and / or financial performance.

Employer Health and Safety

RSLs have a duty of care for the health and safety of both residents and staff, in their capacity as both landlord (see Regulatory Standard 3) and employer. Hazards relating to the employer role include personal safety, especially for lone workers, and stress. RSLs also have safeguarding responsibilities for vulnerable people, especially those receiving care / support services.

Data security

A failure to maintain the security of data could result in harm to tenants, a breach of trust between the RSL and its stakeholders, damage to services, and financial penalties. The move to greater remote working and online service delivery during the pandemic has created more opportunities for phishing, malware, and ransomware attacks.

Regulatory Standard 3

High quality services are delivered to tenants

The social landlord:

- a) Keeps tenants safe in their homes and promptly identifies and corrects any under-performance or non-compliance on landlord health and safety matters*
- b) Delivers services which meet the diverse needs of tenants*
- c) Achieves and maintains high levels of tenant satisfaction with services*
- d) Makes landlord performance information available to tenants.*

Challenges and Risks

Performance monitoring, including tenant satisfaction

RSLs must monitor their performance against a range of indicators, including tenant satisfaction. Risks include the selection of an inappropriate suite of indicators, either too few or too many, or focusing on the wrong issues.

Failing to monitor and understand tenant satisfaction performance could result in decisions being taken without understanding what is important to tenants. Failing to understand and tackle the drivers of poor performance could result in a further deterioration in outcomes and tenant satisfaction.

Landlord Health and Safety

Since the Grenfell Tower disaster in 2017, social landlords owning blocks of flats, particularly high-rise blocks, have been engaged in a process of fire safety remediation, removing and replacing unsafe cladding with suitable materials.

This work has been impacted due to the limited number of specialist contractors and consultants in this field, compounded by the pandemic and shortages of materials and is, in some cases, still ongoing. In some instances, investigations have revealed other fire safety defects in buildings, such as breaches of compartmentation. There has also been a consequential impact on leaseholders, including shared owners, who have been unable to sell or re-mortgage their properties while also having to meet the cost of interim measures, such as a waking watch. It is currently unclear how long it will take for these works to be completed and in the meantime, the capacity for new development or other investment or improvements to the stock of those affected is impacted.

In addition, there is a risk that RSLs fail to ensure that their new and existing homes have effective controls in place against a number of health and safety hazards. In relation to fire safety management, this includes fire risk assessments, evacuation policies, waking watches, fire doors and smoke alarms. Other significant landlord health and safety hazards include gas, electricity, asbestos, lifting equipment, and substances hazardous to health.

The regulator has zero tolerance for material health and safety compliance failures, including those arising from data integrity issues. Any such failure is likely to lead to an “under review” notice which, if substantiated, will result in an adverse regulatory judgement.

The [sector overview on landlord health and safety for RSLs](#), published in October 2018, highlights the issues of poor data integrity and the lack of formal involvement of tenants in health & safety (see Regulatory Standard 4).

Good practice

RSLs are operating in an environment that is constantly evolving, both through changes in the external environment, the development of new approaches and models of service delivery. Not keeping up to date with good practice and anticipating future trends can lead to stagnation and a failure to meet emerging needs.

Meeting housing need

RSLs should use their assets and their lettings and allocations processes to help meet local housing need. A failure to work effectively in partnership with local authorities, or to house people with diverse needs, including homeless and people threatened with homelessness, would indicate a failure in this area.

Failing to help vulnerable people to sustain their tenancies can contribute to further homelessness issues and adversely impact on communities.

Care and support

With an ageing population, there is an increasing need for care / support services, although providing these services to a high standard can be challenging as has been the case during the pandemic when staff absence for some was much increased. It has also become more difficult to attract staff into the sector due to a shortage of labour in the economy. Failure to provide adequate care and support services may result in severe impacts for supported housing tenants, including very vulnerable people.

Regulatory Standard 4

Tenants are empowered and supported to influence the design and delivery of services

The social landlord:

- a) Creates a culture which values and promotes tenant involvement*
- b) Enables tenants to understand the organisation's approach to tenant involvement, how they can get involved and how the organisation will listen to and act on tenants' feedback and learns from complaints*
- c) Provides opportunities for tenants to be involved, can demonstrate that tenants are satisfied with them and can demonstrate the difference involvement is making*
- d) Can demonstrate diverse tenant views and expectations inform the development and review of housing and related services, and the response to any under-performance.*

Challenges and Risks

Learning from the Grenfell Tower disaster

The Inquiry into the 2017 Grenfell Tower disaster in London has highlighted both that tenants were not properly consulted on plans to refurbish the tower and that their complaints about the standard of the work were ignored. In 2019, the Regulatory Board for Wales published [*The Right Stuff – Hearing the Tenants' Voice*](#) which sets out a high level framework to help understand and undertake meaningful tenant involvement. This document takes into account these findings and those of the [*Independent Review of Building Regulations and Fire Safety*](#), led by Dame Judith Hackitt. These reports highlight the impact of not listening to tenants and the need for greater transparency of information, much greater consultation and involvement in decision making processes. This will particularly apply to building safety remediation and decarbonisation programmes that RSLs will be implementing over the next few years.

Health & Safety

Meaningful tenant involvement in health & safety matters is an essential requirement for compliance with this standard (see Regulatory Standard 3).

Responsiveness to complaints

A good source of information about the quality of the organisation's services is complaints. A failure to respond effectively to complaints, or to learn from them, will result in a decline in tenant satisfaction and referrals to the Public Service Ombudsman for Wales (PSOW), potentially with further adverse reputational impact.

Typically most formal complaints from the tenants of RSLs relate to maintenance issues³, with many of the most serious cases involving problems that have persisted for a long period of time or that are so severe that the tenant is forced to move out of their home. The health and safety of residents, together with the reputation of the organisation and the wider sector, is at risk when RSLs provide a poor quality of accommodation or do not respond effectively to tenant complaints.

For tenant engagement and complaints handling to be effective, appropriate mechanisms must be in place to oversee complaints and to ensure that these are an effective source of learning. The PSOW has published a report setting out [the lessons learned from poor complaint handling](#).

Other risks of which RSLs should be aware

- Inappropriate staff attitudes
- A complaints system which is inaccessible to some people.

Regulatory Standard 5

Rents and service charges are affordable for current and future tenants

The social landlord:

- a) Ensures all applicable rules and statutory guidance (including the current rent agreement) are complied with.*

Challenges and Risks

Rent and Service Charge Standard

On 19th December 2019, the Welsh Government published an updated [Rent and Service Charge Standard](#), which allows increases in social housing rents of CPI + 1% for five years from April 2020, provided that CPI is between 0% and 3%. RSLs need to balance the positive impact of above inflation rent increases on financial capacity with the adverse impact on affordability of applying the permitted increase in full.

The Rent and Service Charge Standard requires social landlords to set service charges that are reasonable, affordable and provide value for money to tenants.

Boards are also expected to “demonstrate how they would deal with the impact of rent and service charges changes on their tenants’ incomes”. This is particularly challenging during periods of sharp increases in household costs, including energy. However, this must be balanced with the RSL’s capacity to develop new homes and invest in its existing stock, services and communities.

A failure to set rents correctly or inappropriately applying exceptions would lead to tenants being overcharged.

³ [Public Service Ombudsman for Wales, Open Data](#)

An unexpected requirement to reduce rents and refund overpayments could have an adverse impact on the financial plan and would damage the reputation of the RSL.

Service charges

Many tenants, especially those living in flats, are required to pay material service charges in addition to their rent. RSLs face the challenge of ensuring these additional charges do not place tenants in hardship and are accurate in terms of the cost of services provided.

Tenant income

The incomes of many tenants have been under pressure over recent years due to welfare reform, including the overall benefit cap. In addition, there has been an increase in insecure and low paid employment, including “zero hours” contracts. There is therefore an increasing onus on RSLs to provide accommodation which is affordable for tenants.

The aggregate financial position of tenants is likely to have been negatively impacted by the pandemic, particularly following the withdrawal of the £20 per week uplift to Universal Credit. Tenants are also more likely to become unemployed due to the negative impact of Covid-19 and any new variants on some sectors of the economy.

Regulatory Standard 6

The organisation has a strategic approach to value for money which informs all its plans and activities

The social landlord:

- a) Determines its strategic approach to value for money, ensuring the approach relates to its social purpose and makes strategic and operational decisions in line with it*
- b) Can demonstrate to stakeholders, including tenants, that it achieves value for money in delivering its strategy and services.*

Challenges and Risks

Strategic approach to VFM

A [Value for Money report](#) issued by the regulator in March 2017 identified that value for money was a key element of good governance, good decision making and strategic thinking, sitting firmly in the board room.

The report highlights that value for money is not only about reducing costs but is also concerned with the delivery of strategic objectives, while improving the quality of service delivery and maximising customer satisfaction. RSLs are expected to make optimal use of their resources to achieve intended outcomes and to demonstrate this to stakeholders, including tenants, regulators and local authorities. Key areas where value for money may be improved include treasury management, the delivery of social value, making effective and efficient use of the assets (including the disposal of poorly-performing assets), the service delivery model and organisational structure.

Four key elements of value for money were identified in a [report](#) from Community Housing Cymru (CHC) and HouseMark in 2016:

- Economy – providing a service for the lowest cost
- Efficiency – delivering the best service for a given cost, eliminating waste
- Effectiveness – achieving planned outcomes and improving customer satisfaction
- Equity – meeting the diverse needs of tenants.

A suite of value for money measures has been developed and adopted by the sector. The sector's aggregate performance against these metrics is reported in the [CHC-Global-Accounts-2020](#), while individual associations are encouraged to publish their performance against these metrics on the grounds of transparency and accountability.

An RSL without value for money as an overarching principle will inevitably spend more than necessary to achieve its objectives. This will result in lower surpluses, reducing the capacity available for investment in new or existing stock, or in other community benefit activities. It may also result in a reduction in credit ratings and higher borrowing costs.

Regulatory Standard 7

Financial planning and management is robust and effective

The social landlord:

- a) Sets financial plans which enable it to deliver its strategy and achieve its social purpose, and there is appropriate reporting to the Board against these plans*
- b) Is financially viable in the short, medium and longer-term, and maintains sufficient funding and liquidity to support this*
- c) Monitors, reports on and complies with all covenants it has agreed with funders*
- d) Identifies and effectively manages risks to the delivery of financial plans including appropriate stress testing, scenario planning and use of internal thresholds*
- e) Has an effective treasury management strategy and associated processes.*

Challenges and Risks

Overview of financial planning and treasury risks

Whilst there is a common set of risks that RSLs face, the impact of those risks is specific to each organisation. The board needs to ensure its business planning takes the following into consideration:

Rent collection

Rent collection rates have held up well through the welfare reform process, e.g. the introduction of Universal Credit and through the pandemic to date. Increased pressure is expected in this area due to the end of the emergency Covid support measures, including the furlough scheme and the £20 per week uplift to Universal Credit.

Supported housing and care

The RSL sector generates considerable social value through the provision of care and support services to people who are vulnerable or who have special needs. However, the financial performance of this business stream is significantly weaker than general needs provision.

Services are generally funded through a combination of Housing Support Grant (HSG) and Housing Benefit (HB). Local authorities may decide to reduce the funding for a particular service or to commission alternative provision. Although the UK government decided against a proposal to cease funding supported housing costs through Housing Benefit in 2018, there remains a possibility that this may change over the longer term.

Care and support activities are also subject to upward pressure on costs, due to the introduction of the national living wage, while the availability of labour is constrained by both the pandemic and the withdrawal from the EU single market. The pandemic has also resulted in increased costs due to, for example, the need for enhanced hygiene measures.

Pension costs

Associations with defined benefit pension schemes face a significant risk that liabilities will increase above the forecast level, both due to an increase in contribution rates in the future and because catch-up payments are required to reduce historical scheme deficits. The exposure of each RSL will depend on the specific nature of the scheme or schemes to which they belong. Increased contribution rates and deficit payments arising from the September 2020 valuation of the SHPS scheme are already known, but there remains a risk that these could be further increased in the future.

Cost control

At the time of publication, inflation was rising sharply. Prices in key areas for RSLs, such as maintenance costs, may rise faster than CPI. RSLs also face rising costs due to the re-profiling of spending previously delayed by Covid-19 restrictions, alongside planned remedial safety works and energy efficiency improvements to existing stock.

Increases in Interest Rates

Although the Bank of England base rate has increased recently, rates remain historically very low. Rates are expected to rise further over time, and this increase may be faster than previously forecast if high inflation persists. There is a possibility that underlying interest rates may be significantly higher than the assumptions in the financial plan, although this risk is often mitigated by holding most of the RSL's debt at fixed rates.

The basis of variable rate loans changed from LIBOR to SONIA at the end of 2021. The margin charged will be strongly influenced by the lender's assessment of the RSL's creditworthiness, which can be expected to take account of lender concerns about the cost of building safety and decarbonisation works. It will also be driven by factors such as interest cover, debt, exposure to the housing market, the rate of planned investment in new and existing stock, plus the historical performance against its objectives and financial plans.

Loan covenants

The active monitoring of financial covenants is an essential part of effective treasury management. Boards need to be assured that all covenants are correctly calculated. Although breaching a loan covenant may not in itself break a business plan, it may significantly weaken an RSL's financial position, removing the control over its loan portfolio and impair its ability to negotiate with its funders.

Liquidity and the availability and cost of new finance

A key requirement for any business is the management of cashflow. RSLs are responsible for setting appropriate minimum liquidity levels and ensuring that these are met at all times. Significant cash outflows will be experienced as a result of development and major repairs activities and there is a risk that insufficient facilities are available to meet these obligations because, for example, the required loans have not yet been finalised or because security is not yet in place to enable agreed loans to be drawn down.

RSLs are long-term businesses, so a significant proportion of their funding needs to be long term. While the majority of banks ceased offering loans for more than ten years after the global financial crisis of 2008/9, there remains strong demand for long-term investment in RSLs through the capital markets, either through own-name bond issues, bond aggregators or private placements. Each of these options has advantages and disadvantages. There is a risk that an RSL chooses the wrong option, which may result in higher than necessary borrowing costs or terms that are not aligned with their objectives or which exceed their risk appetite. Looking further ahead, the appetite from investors for exposure to RSLs may reduce, particularly if credit ratings fall below investment grade.

RSLs are increasingly being encouraged to enter into funding deals on an ESG basis, in which preferential terms are given due to the borrower's high standards in relation to environmental, social, or governance issues. These may take different forms, typically either limiting the uses to which the funds may be put or requiring the achievement of specific goals in order to qualify for a reduced interest rate. There is a risk that the costs of complying with these requirements may outweigh the benefits in terms of reduced interest costs.

RSLs with a limited number of lenders / investors may be exposed to significant refinancing and concentration risks, where a large proportion of debt matures at the same time and they are reliant on a few counterparties to provide replacement funding.

A failure to maintain good relationships with existing lenders or to develop relationships with new potential funders could exacerbate these risks.

Complex or novel funding structures

Lenders or investors may offer complex or novel funding structures which contain a variety of risks and benefits, for example standalone derivatives or leaseback arrangements. RSLs may enter into these deals without fully understanding their exposures, giving rise to new risks that may be beyond their capacity to control.

Scenario planning and stress testing

The base case for an RSL's business plan will be prepared using a set of assumptions agreed by the board. In reality, the economic environment in which the plan is delivered will not be exactly in line with those assumptions. Certain combinations of factors, such as high inflation, high interest rates and falling house prices, could create a situation in which financial viability would be threatened. A failure to identify these situations or to adequately prepare for them would make it difficult for the RSL to survive an adverse scenario, potentially leading to the loss of social housing assets and damage to the sector's reputation.

Financial planning assumptions

The use of unrealistic assumptions such as the achieving of efficiency savings without a firm plan on how to achieve them can give a board a false impression of an RSL's viability. This also applies to the assumptions in the financial plan in relation to general inflation, differential inflation for key costs such as maintenance, house prices, salary increases, bad debts and so on.

Taxation

RSLs may become subject to unexpected increases in taxation, for example the recent increase in National Insurance. They may also have inefficient structures for tax purposes, reducing the overall value for money generated.

Regulatory Standard 8

Assets and liabilities are well managed

The social landlord:

- a) Has an accurate and up to date understanding of its assets and liabilities*
- b) Maximises the use of assets to achieve its social purpose and the objectives of the organisation*
- c) Uses accurate information about assets and liabilities to inform strategic and financial decisions.*

Challenges and Risks

Asset management strategy

Without an effective asset management strategy which informs strategic decision making, an RSL may invest in the wrong properties at the wrong time, leading to poor value for money and / or a deterioration in the standard / value of certain homes and therefore the overall stock. The efficiency of large, dispersed RSLs may be reduced if some properties are distant from maintenance hubs and offices from which they are serviced. Customer satisfaction may be improved and unit costs reduced, through transferring stock to another RSL, possibly as part of a swap deal.

Stock condition

RSLs face challenges in terms of assessing and accurately recording the condition of their properties, while ensuring the integrity of this data and quantifying the expenditure required over the long term to maintain them. A failure to undertake these processes effectively would result in additional expenditure, due to the need to rectify faults or bring properties up to the required standard. This could create financial pressures that reduce the ability to deliver other aspects of the business plan.

Loan security

Not maintaining accurate up to date property records can result in avoidable delays to providing the necessary security to access loan funding could lead to cash shortages (see Regulatory Standard 7).

Regulatory Standard 9

The organisation provides high quality accommodation

The social landlord:

- a) *Ensures publicly funded homes meet all applicable standards, rules and statutory guidance issued in connection with quality of accommodation, including the current Welsh Housing Quality Standard (WHQS).*

Challenges and Risks

Welsh Housing Quality Standard

The [Summative evaluation of the Welsh Housing Quality Standard](#), published on 30th June 2021 states that, when “acceptable fails” are taken into account, 6.9% of social housing stock in Wales was not compliant with the WHQS on 31st March 2019, with the main cause being poor energy performance.

There is a risk of failing to comply with the WHQS and / or other legislative requirements in relation to particular properties. Changes in the legislation applicable to the maintenance and safety systems of residential buildings in response to the Grenfell Tower tragedy are ongoing.

Failing to keep up with these changes or to make available sufficient resources to ensure compliance could result in the RSL facing legal and / or regulatory action, as well as damage to its reputation.

Climate change / net zero carbon

RSLs will have to comply with the Welsh Government requirements including the [Net Zero Carbon Budget](#), published in October 2021, which states that the social housing sector will be expected to lead the way to set the highest standards. This includes a requirement that all new affordable homes will achieve net zero carbon by 2025. In addition, a new and updated version of the WHQS is being developed, which will retain many of the core elements which have driven the high standard achieved to date, but will also drive forward tackling affordable warmth and decarbonisation.

This will require substantial investment to improve the energy efficiency of RSLs' existing stock and to decarbonise the sources of heating and lighting. There is currently significant uncertainty as to the total cost of this programme and the availability of government funding towards this expenditure.

Appendix A

Sector Challenges and Risks – Think Points

The following “Think Points” may help to inform risk conversations and questions as assurance around the sector risks and challenges is considered by boards and executives.

Pandemic

- Monitor the position with regard to the pandemic on an ongoing basis, ensuring that processes are amended as necessary to maintain compliance with legal requirements and government guidance as these are updated
- Review contingency plans for significant levels of staff absence to ensure that key services can be maintained, especially for people who are vulnerable
- Consider what additional support tenants may need, particularly if it becomes necessary for further lockdowns to be implemented

Development

- Undertake an analysis of financial capacity and current exposure in order to determine the size of the current buffer against risk materialisation
- Ensure that development plans and activities remain within the risk appetite (see Regulatory Standard 7), including limits on overall growth and maximum exposure to the housing market
- Monitor the position with regard to the availability and cost of labour and materials, implementing contingency plans where possible and amending forecasts for the cost and timescale of development schemes in response to the latest information
- Monitor progress with delivery of the development programme, ensuring that costs are in line with the work actually completed and taking action to mitigate any cost overruns.

RS1

- Demonstrate the highest quality governance and leadership in every aspect of the business, ensuring governance arrangements support the values, culture and behaviours set themselves and which reflect the values expected of RSLs in Wales including the specific requirements in relation to equality, diversity and inclusion.

- Require robust assurance on progressing EDI commitments based on good quality data and engagement with staff, tenants and other stakeholders. Consider equality impacts of decisions and key strategic plans and publish commitments, key data and indicators used to assess progress.
- Ensure that the membership of the board and executive team provides the necessary skills, knowledge and experience to effectively manage the size and shape of the risks the RSL is taking
- Require robust assurance that the information used to judge the performance of the RSL, and on which decisions are based is accurate, comprehensive and up-to-date
- Fully consider the competing demands on the RSL's financial capacity as a key element of the strategic planning process and agree an appropriate division of resources based on clear criteria, using complete and accurate information and taking into account the agreed risk capacity and appetite
- Communicate the results of this exercise with stakeholders, explaining the basis of the decisions made and how the views of residents, local authorities etc. have been taken into account
- Ensure the quantum and nature of the risks associated with proposed diversification into new business streams are understood and effective arrangements are in place to manage those risks before commitment
- Robust arrangements in place to identify conflicts of interest between the RSL and its board members and to tackle these quickly and effectively
- Ensure that executive pay is reasonable, taking account the requirements of the position and the nature of the sector, taking particular care to avoid committing to excessive severance packages.

RS2

- Ensure that a robust risk management framework is in place and that it is regularly reviewed and updated
- Take a clear view on the risks the RSL may and may not take and obtain frequent assurance that unauthorised risks are not being taken (see Regulatory Standard 7 for more detail on Risk Appetite).
- Require robust assurance that the RSL is complying with its health, safety and safeguarding responsibilities, including ensuring that all areas of its work are covered by risk assessments and that these are reviewed regularly and any actions arising from them are implemented on a timely basis
- Require robust assurance that effective data protection and security arrangements are in place, commissioning penetration testing of the systems, taking into account the large scale adoption of working from home/hybrid working.
- Ensure that the roles and responsibilities of the people involved in risk management, from the Board to individual members of staff, are clearly defined, with no gaps or duplications.

RS3

- Ensure that an effective landlord health and safety management system is in place to provide for the safety of tenants and residents at all times.
- Select an appropriate set of key performance indicators to monitor service quality, paying particular attention to tenant satisfaction
- Monitor performance against those indicators, benchmarking against peers and investigating areas where service quality falls short of agreed standards and ensuring that the causes of such failures are tackled quickly and effectively
- Use complaints as an important source of information about performance, addressing the issues raised robustly and ensuring that changes are made to processes and / or systems to prevent recurrence
- Monitor the operating environment on an ongoing basis, looking out for changes in trends and the development of new approaches that could improve outcomes and deliver greater value for money
- Ensure that the RSL continues to improve the efficiency and effectiveness of its services in response to performance information, complaints and external trends, being prepared to innovate and improve practices on an ongoing basis
- Work closely with partners including local authorities to address housing need in their areas of operation, bringing homeless people into secure housing and supporting vulnerable tenants to maintain their tenancies wherever possible
- Ensure that care / support services meet regulatory standards and deliver high levels of customer satisfaction, taking prompt and effective action to address any deficiencies.

RS4

- Understand the outcomes being sought from tenant engagement and review the current arrangements and culture to ensure they are providing the right opportunities for tenants to be involved in decision making
- Ensure that tenants are involved in drawing up programmes of major works to the existing stock, including building safety remediation and moving towards net zero carbon
- Ensure that there is meaningful tenant involvement in all aspects of landlord health and safety, both at the policy level and in relation to specific buildings
- Ensure that a responsive complaints process is in place and that data from this process is used as a learning tool and to drive changes in systems and processes across the business
- Ensure that responsibility for tenant engagement and complaints is at a senior level, with regular reporting on complaints handling, lessons learned, and changes made, to Board members.

RS5

- Review policies on rent and service charge setting to ensure that they are affordable to tenants, taking into account factors such as inflation levels, welfare benefit changes, household debt levels and average incomes in the area

- Obtain robust assurance that rent increases comply with the Rent and Service Charge Standard and that any errors or omissions are quickly corrected.

RS6

- Agree a strategic approach to value for money which focuses on delivering an appropriate balance between the delivery of social and financial benefits and the level of resources employed
- Report to stakeholders and partners, including tenants, on value for money performance, identifying areas for improvement and setting out how that improvement will be delivered
- Review and publish performance against the agreed value for money metrics, giving an honest appraisal of the reasons why performance is poor or declining in any area and setting out the measures to address these
- Regularly review major areas of expenditure such as interest costs, asset management programmes, staffing structures, and the approach to service delivery, with a view to maximising value for money.

RS7

- Agree an appropriate risk appetite and ensure that financial plans and outturn performance remain within that appetite
- Ensure that robust stress testing is undertaken on the financial plan before agreement, using unlikely but credible adverse scenarios.
- Identify those scenarios that would result in the RSL breaching its risk appetite limits, or even breaking loan covenants or a liquidity shortage, agreeing realistic, costed contingency plans that could be employed to mitigate the position within the necessary timescales, also considering the impact on tenants should these plans be implemented
- Agree the trigger points that would be used to detect the onset of the adverse scenarios considered and to deploy the agreed contingency plans
- Require financial plans to be revised to increase the level of resilience if the results of stress testing indicate that contingency plans would be insufficient to maintain viability under a reasonable level of stress or where such plans would result in an unacceptable negative impact on residents
- Agree prudent assumptions for future rent increases, undertake research to confirm that rent levels are affordable to tenants, and require robust assurance that rent increase processes have been undertaken properly and on a timely basis
- Monitor rent collection performance and ensure that the necessary resources are deployed to tackle arrears and assist tenants with financial difficulties
- Periodically review any care / support provision to ensure that it remains of good quality, is compliant with all regulatory and funding requirements and is financially viable

- Keep pension schemes under review. Identify the risks of, and to, pension provision, and develop effective mitigating strategies, while understanding the longer term cost of remaining in the scheme and undertaking a cost benefit analysis covering a range of options that could be introduced to mitigate the impact of rising costs
- Agree financial plans based on an accurate analysis of current and expected costs and prudent assumptions for underlying and differential inflation
- Undertake stress testing on the financial plan, covering a number of sensitivities and adverse scenarios, identifying trigger points to detect the onset of the scenario and contingency plans that may be deployed to maintain viability in difficult circumstances
- Make prudent assumptions for future interest rates, set limits on the balance between fixed- and floating-rate debt and monitor the outturn to ensure that the portfolio remains within those limits
- Agree a minimum level of headroom against loan covenants as part of the Risk Appetite Statement, monitoring performance against this “golden rule” on an ongoing basis
- Set a minimum level of liquidity and require regular assurance that current performance and cashflow forecasts remain within that limit
- Agree a strategic approach to financing the business, taking into account the cost and maturity profile of existing loans and the various sources of funding available
- Ensure that the financial plan is forward funded for a minimum period as identified in the Risk Appetite Statement or “golden rules”
- Consider the pros and cons of entering into all funding deals, including those with an ESG element, understanding all of the risks and rewards involved before commitment
- Monitor the position with regard to refinancing and concentration risks and maintain good relationships with current and potential lenders / investors
- Ensure that the necessary expertise on treasury matters is available and not to commit to funding arrangements that are not fully understood

RS8

- Regularly review and update the asset management strategy in the light of the latest information on stock condition, internal and external quality standards, and the funding available
- Review the standards applicable to new buildings regularly
- Consider the opportunities to improve customer satisfaction and reduce unit costs through stock rationalization or other means to achieve a more rational geographical footprint
- Ensure that the condition of all properties are surveyed on a regular basis and the information generated is used effectively to inform the asset management strategy

- Monitor the plans for and progress with new legislation relating to assets and liabilities, ensuring that the necessary arrangements are in place to comply with requirements in good time
- Require ongoing assurance that property records are accurate and up-to-date enabling assets to be used for loan security quickly and efficiently when required.

RS9

- Ensure full compliance with WHQS (and any successor) and any other applicable standard. Monitoring compliance on an ongoing basis and approving programmes to bring properties into compliance where required
- Obtain assurance that properties comply with all other current statutory and regulatory requirements and that any exceptions are tackled on a timely basis
- Prepare for the introduction of new legislation as it comes into force.
- Accurately assess the total work and costs required to achieve net zero carbon in accordance with the [Carbon Budget and All Wales Plan](#), making prudent assumptions where costs and potential government support are unknown
- Ensure that appropriate checks are undertaken on the financial strength of key contractors and their competence and capacity to undertake the contracted work, while putting in place contingency plans to ensure critical services are maintained should the contractor be unable to continue to meet their contractual obligations at short notice
- Fully understand the potential circumstances in which the organisation or a counter party has an option to vary or break a contract and put in place mitigations to manage the risk in the event this happens
- Ensure that all material health and safety hazards in homes have been identified, risk assessments have been completed and documented, and that all necessary control measures are implemented within a reasonable timescale
- Monitor the position with regard to the availability and cost of labour and materials, implementing contingency plans where possible and amending forecasts for the cost and timescale of major repairs programmes in response to the latest information
- Ensure effective complaints processes are in place (see Regulatory Standard 4)
- Closely monitor all indicators of the quality of accommodation, including complaints, ensuring that prompt and robust action is taken to tackle any instances of poor quality or health and safety hazards that are not effectively controlled