



**Scottish Housing
Regulator**

Development of Affordable Housing in Scotland

A thematic inquiry

March 2017

About us

We are the independent regulator of social landlords in Scotland.

We regulate:



nearly
200
social landlords



around
160 Registered Social Landlords (RSLs)



32 Local Authorities (LAs)

We safeguard and promote the interests of:



nearly
610,000
tenants

who live in homes provided by
social landlords



around
118,000
owners

who receive services of social
landlords



around
40,000
people and
their families

who may be homeless and seek
help from local authorities



over
2,000
Gypsy/Travellers

who can use official sites
provided by social landlords

Our role

Is to monitor, assess and report on social landlords' performance of housing activities and RSLs' financial well-being and standards of governance. We intervene, where we need to, to protect the interests of tenants and service users.

Our **Regulatory Framework** explains how we regulate social landlords. It is available on our website www.scottishhousingregulator.gov.uk.

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Overview

Introduction

1. This is the report on our thematic inquiry into the development of new affordable housing in Scotland. Our aim is to identify and share positive practice, primarily to help Registered Social Landlords (RSLs) in their approach to development, but the principles may also help those local authorities that are developing.
2. We reviewed the whole development process from taking a strategic decision to develop; to agreeing and managing a programme; through to the final completion of new affordable homes. We considered wider risks and constraints, along with issues around the approval and management of development projects.
3. We gathered evidence from nine social landlords with a recent track record of successful development and from further collective discussions with them and the Scottish Government. The landlords agreed that the most helpful way to share positive practice would be to identify principles that developing RSLs should observe. We used the evidence from our discussions to identify and agree high level principles for development.

The development of affordable housing in Scotland

4. In 2016 the Scottish Government made a commitment to deliver 50,000 affordable homes over the current parliamentary term (2016-2021), with 35,000 of these being for social rent. This was accompanied by a range of measures designed to help facilitate more development, including a commitment of over £3 billion of public subsidy over the five financial years, accompanied by increased subsidy levels, a new Rural and Island Housing Fund to increase the supply of affordable rural housing, support for mid-market rent initiatives and affordable home ownership.
5. These plans require a two thirds increase in the volume of affordable housing development, as just over 30,000 homes were completed over the previous five years by RSLs and local authorities. Many existing affordable housing developers have already decided to grow their programmes to help deliver the targets. Early indications are that some RSLs which have not developed for a considerable number of years, are now taking the decision to start to develop again. Sections 18-26 provide more background information on the affordable housing programme.

Current and emerging issues for developing RSLs

6. Many social landlords have a proven track record in building new homes. We also know from recent experience that a small number of RSLs have faced issues when they have started to develop, either for the first time or after a break, because they have not sufficiently understood the current development environment. There have been considerable changes over the past decade in terms of the risks associated with funding, procurement, capacity and contract management. These issues can potentially have a serious impact on the RSL, on the interests of its tenants and ultimately on the sector as a whole.
7. That said, many social landlords have core skills in development and this is an opportune time to share experiences and positive practice.

8. Alongside a demanding development agenda, RSLs should also be aware of and take into account potential future challenges and risks which may have a direct impact on their ability to develop affordable housing in a sustainable way. These include:

Challenges and risks

<p>Challenges specifically relating to housing development including: land availability, price and assembly issues, costs and delays associated with infrastructure, issues around capacity and issues with the operation of the planning framework.</p> 	<p>Continuing uncertainty over the scale and pace of change to the welfare system and the potential impact of changes.</p> 	<p>The impact of The Office for National Statistics' (ONS) re-classification of RSLs and resultant proposed changes in regulation upon the willingness of lenders to invest in the social housing sector.</p> 
<p>The prospect of increased inflation in 2017 and beyond as a consequence of the sharp fall in the value of sterling in 2016.</p> 	<p>Rising concern from tenants about future rent affordability against a background of many RSLs relying on above inflation rent increases to maintain financial health.</p> 	<p>Other budgetary pressures, staff costs (particularly in the care sector), pensions, and energy efficiency.</p> 

Regulatory expectations

9. Our Regulatory Framework (February 2012) sets out the Regulatory Standards of Governance and Financial Management (the Standards) which RSLs must comply with. Our principles-based [Business Planning Recommended Practice](#) (BPRP, December 2015) focuses on how RSLs can ensure compliance with the Regulatory Standards during their business planning processes.
10. The BPRP notes that the RSL's approach to business planning should recognise its vision for the future, should allow it to explore business growth, should incorporate a strategic and integrated approach to asset, risk and treasury management and should be grounded by robust financial planning.
11. This report identifies ten positive practice principles for development (set out below) which aim to assist developing RSLs comply with the Regulatory Standards and BPRP. The principles should help RSLs to manage and mitigate development risk and achieve value for money (VFM) for their tenants. They will also assist the Scottish Government to deliver more affordable housing and RSLs to achieve their strategic objectives including meeting housing needs, contributing to wider social, economic and environmental aims and building the strength of their asset base.

Positive practice principles

For landlords developing or planning to develop affordable housing.

1 Strategy

Be clear about why you are developing and how development fits within your overall business strategy.

3 Product

Have a robust understanding of housing need and demand for the area where you plan to develop and use this to design and build sustainable homes.

5 Governance

Ensure that your governing body and senior staff have the appropriate skills and experience and that your governance arrangements provide proper oversight of your development programme.

7 Funding

Have an appropriate funding strategy which ensures access to sufficient resources as they are required and have a clear understanding of the impact of development on future cash flows.

9 Procurement

Have a strategic approach to procurement that is kept under review, complies with relevant legislation, is tailored to the particular needs of your organisation and helps you select the most appropriate procurement option.

2 Risk

Be aware of the inherent risks in your plans and identify and manage development risks, including specific risks associated with different tenures.

4 Capacity

Have the appropriate organisational capacity, corporate structures, people and/or partnerships in place to effectively manage new development.

6 Appraisal

Carry out robust appraisals at key stages of the development process to make sure that development proposals are viable, represent VFM and capture whole life costs.

8 Project management

Ensure that appropriate project management processes are in place and integrated across your organisation.

10 Stakeholders

Actively manage and build constructive relationships with your stakeholders including tenants, service users, funders, regulators, local authority/RSL partners, contractors and the Scottish Government.



12. We expand on these principles in our findings and highlight the positive practice that underpins the principles. We also set out some questions we recommend governing bodies ask to help them determine if they are meeting the principles.
13. It is for individual RSLs to consider these principles and how they apply them in a proportionate way that reflects:
 - their size, profile and operating context;
 - the scale and nature of their development programme; and
 - their current organisational capacity.

About this thematic inquiry

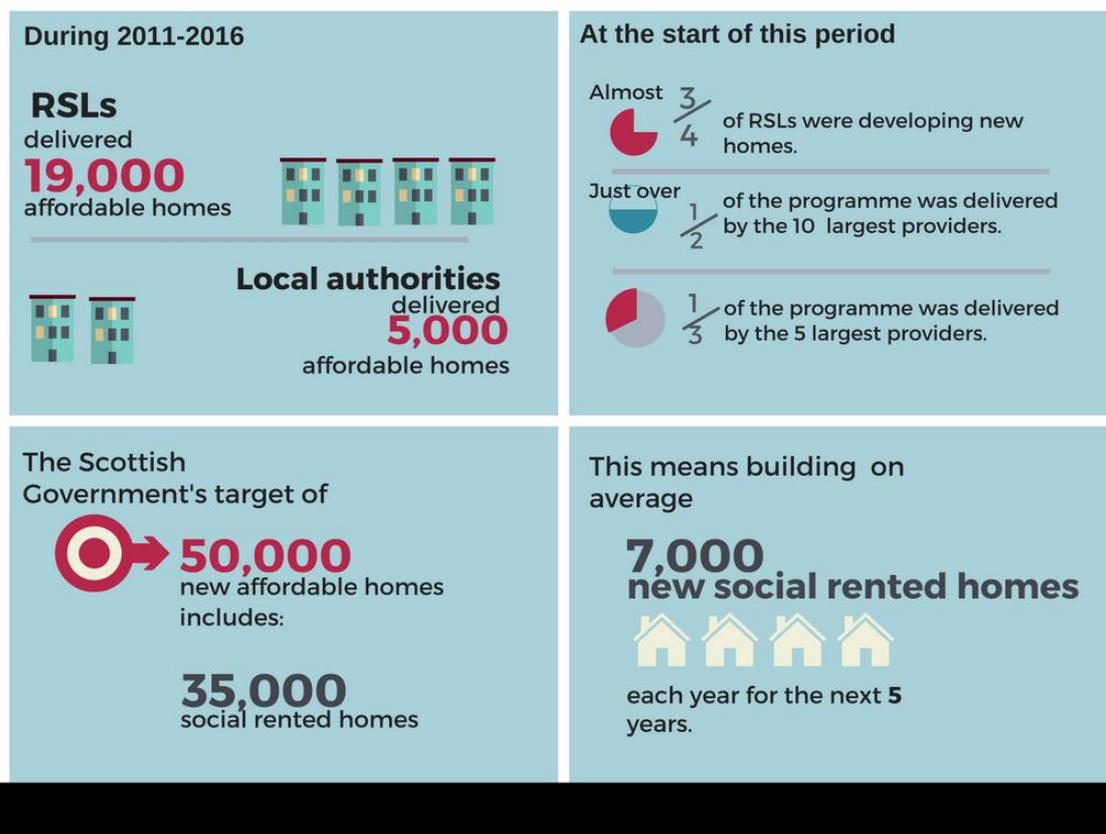
14. The main strands to this inquiry were:
 - in-depth discussions with nine social landlords; and
 - a round-table discussion with them and the Scottish Government to discuss our findings.
15. We spoke to and reviewed information from nine social landlords.

<ul style="list-style-type: none"> ▪ Bield Housing and Care ▪ Clyde Valley Housing Association ▪ Eildon Housing Association ▪ Fife Council ▪ Kingdom Housing Association 	<ul style="list-style-type: none"> ▪ Link Group ▪ New Gorbals Housing Association ▪ Port of Leith Housing Association ▪ Wheatley Housing Group
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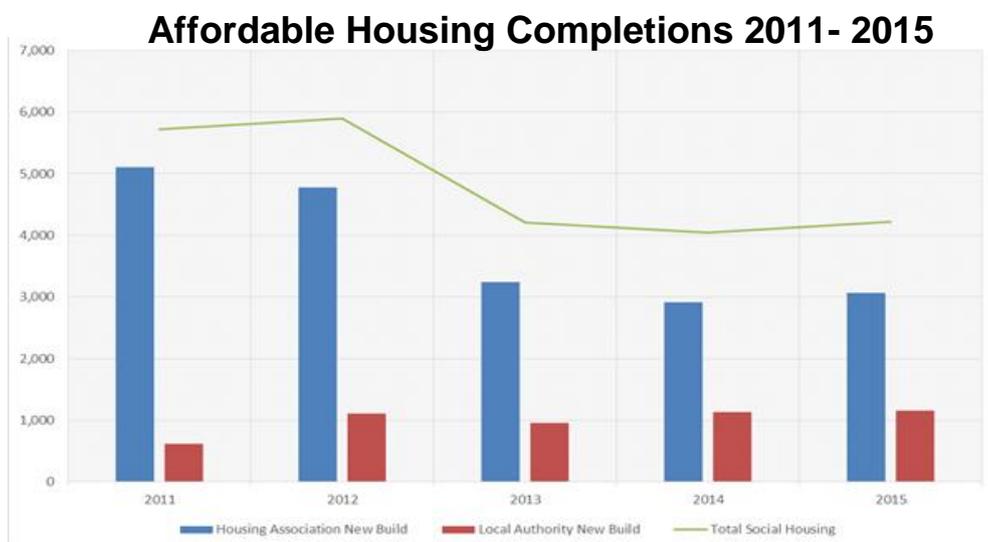
16. All of the landlords have a recent track record of successful development and we included nine to achieve a mix of organisations in terms of size, location (rural and urban), experience of delivering different tenures (including Mid-Market Rent (MMR) and Low Cost Home Ownership (LCHO)) and of delivering specialist housing.
17. We spoke to chief executives and finance, asset management and development staff from the landlords. Eight out of the nine landlords and a representative from the Scottish Government also attended the round table meeting where we presented our findings and highlighted the principles and positive practice that had been identified during our in-depth discussions. The landlords agreed that a principles-based and proportionate approach would be the most helpful and effective way to share positive practice with RSLs who are developing or considering developing.

Past and current affordable housing development in Scotland

18. In this section we provide some contextual information about the scale and focus of the development programme over the past five years (2011-12 to 2015-16) and the projected programme over the next five (2016-17 to 2020-21). This information is taken from RSL Five Year Financial Projections which we collect annually in June.



19. During the period from 2010/11 to 2015/16 RSLs delivered around 19,000 affordable homes and Local Authorities delivered around 5,000. This equates to just under 3,800 RSL homes per annum. RSLs, however, built considerably fewer homes from 2013 onwards as shown in the chart below.



20. At the start of this period, almost three-quarters (72%) of RSLs were developing new homes. Significant changes in the development environment (set out in section 6 above) resulted in a sharp drop in the number of developing RSLs and by the end of the period just over half of all RSLs continued to develop. Over the period the majority of the programme was delivered by a small number of developers; the 10 largest developers (by number of affordable homes developed) delivered just over half (52%) and the five largest developers delivered over a third (36%) of new affordable RSL homes.
21. Whilst the affordable housing programme delivery relies on the continued capacity of these larger developers, many smaller developers also make a significant contribution to the programme. Our regulatory interest is that all developing RSLs are complying with Regulatory Standards and providing VFM regardless of size, scale or operating context.
22. The Scottish Government target of 50,000 homes will require a significant increase in the volume of affordable housing development. In particular, the 35,000 social homes target will require an average of 7,000 houses each year for the next five years. As the affordable housing completions chart above shows, together RSLs and local authorities have been developing around two-thirds of this amount over the past five years.
23. RSLs are already planning to build more new homes. Last year around 80 RSLs (around half of the sector) projected they would build around 18,000 affordable homes in the next five years (2016-2020). This year more RSLs (around 90) told us that they planned to build more homes (around 23,000 units). This equates to a 20% increase in the RSL programme.
24. RSLs provided us with this information in June 2016. Since then the majority will have updated their business plans, including their strategies around new development. Through our on-going regulatory engagement we are aware that RSLs are considering their options and a number have indicated that they are likely to start to develop again soon. Others who are currently developing have also told us that they are considering their capacity and where appropriate are likely to increase their programmes.
25. The local authority 2016 Strategic Housing Investment Plans (SHIPs) have been agreed by councils and early indications are that we are likely to see a significant increase in programmes from a range of RSLs, as well as from the local authority sector. The SHIPs are published on local authority websites and will be updated later in 2017.
26. Given the increase in the number of RSLs developing, and the planned increase in development programmes, this is an opportune time to share positive practice about development.

Findings

27. Here we focus on each of the ten positive practice principles and highlight in detail areas which the landlords agreed represented positive practice. We provide links to the relevant standards and sections of the BPRP, and set out some questions to help governing bodies consider and assess how they meet the standards. RSLs should apply the principles to their organisations in a way that is proportionate, which reflects their size and profile and which considers their current organisational capacity and, if applicable, their scope for partnership working.

Principle 1: Strategy

Strategy: RSLs should be clear about why they are developing and how development fits within their overall business strategy.



Positive practice

28. RSLs need to consider and be clear about why they are developing and how development helps them meet their strategic objectives. The starting point should normally be the RSL's objectives and the business plan that it has in place to achieve these. Any development strategy needs to be consistent with the business plan. Business planning processes should therefore ensure there is sufficient time to consider development opportunities and risks.
29. The RSL's development strategy should also integrate with, and complement, other key strategies as appropriate to the individual organisation. This will depend on the scale and nature of its business but could include financial plans and treasury management, asset management and procurement strategies in particular. It should also complement the RSL's assessment of VFM and affordability.
30. Ensuring that development is an integral part of the business planning process, and is integrated with the rest of the business, is important because this:
- will allow RSLs to objectively and transparently assess development opportunities against their strategic objectives;
 - allows them to consider competing strategic options for allocating resources in terms of the services they provide, the quality of their stock and investment requirements, their contribution to wider social, economic or environmental objectives and the strength of their asset base. Any strategic options appraisal should reflect the pressures, challenges and risks the organisation is likely to face;
 - allows RSLs to look at the impact development has on existing tenants particularly in terms of stock quality (future maintenance expenditure) and affordability (future rent increases); and
 - helps to ensure that organisations grow in a planned and measured way, thereby protecting other parts of the business and the business as a whole. Where RSLs have decided to use resources to develop new homes, they should also consider their financial and organisational capacity to develop and maintain the new homes, and use this to determine the scale and composition of their development programme.

31. RSLs should base their business plans and organisational strategies, including development strategies, on reasonable assumptions which they explicitly state and regularly review (see section 64 below). They should update and refine business plans regularly, as appropriate to the scale and nature of their organisation. Reviews should take on-going learning about development and the RSL's overall business into account, as well as political, economic, social and technical changes to the current operating environment. Changes in these factors can have a significant impact on an organisation's capacity to develop.
32. RSLs should involve stakeholders in their business planning processes, particularly tenants and residents. As well as helping to get it right, this also gives added legitimacy to development programmes. RSLs can involve tenants and residents in a range of ways including tenant/customer panels and by using independent tenant advisors.



The Standards and BPRP also state....

Regulatory Standard 1.1: the governing body sets the RSL's strategic direction. It oversees the strategic and financial plans to achieve its purpose and intended outcomes for its tenants and service users.

BPRP Section 4.1: the approach to business planning should reflect the RSL's vision, mission statement and strategic objectives. It should also allow the exploration of opportunities including business growth and innovation.



Are you meeting the Strategy Principle?

Questions for governing bodies:

- Are you clear about why you are developing new affordable housing and how it contributes to meeting your strategic objectives?
- Do you consider the impact of developing on the rest of your business?
- How do you determine how much to spend on new development compared with other business priorities?
- Do you consider the impact of developing on existing tenants, on rents and on future rent levels and affordability?
- How do you ensure that your strategy is up to date and reflects your current operating context?
- How do you involve key stakeholders, including tenants, in developing your plans?

Principle 2: Risk

Risk: RSLs should be aware of the inherent risks in their plans and identify and manage development risks, including specific risks associated with different tenures.



Positive practice

33. All RSLs face risks and developing RSLs will potentially face a greater range of risks than those that don't develop. The nature of the risks will vary between different RSLs, depending upon the scale and nature of their development programmes, but there is still a range of risks all developing RSLs need to be alert to. For example, a tight business plan can easily be put under pressure by an upward trend in building cost inflation, increases in the cost of funding or changes to the welfare benefit system which impact negatively on income streams.
34. These risks, and details of positive practice mitigation strategies, are set out under each of the remaining development principles. Our discussions with the RSLs, and our own experience, suggest that RSLs should be particularly focused when applying the funding principle (sections 64-68). RSLs should ensure that they have access to sufficient funding to meet their obligations both in the short and the longer term.
35. Securing adequate private finance and having funds in place before committing to a development project is key. RSLs need to understand and monitor how much unencumbered stock they have at their disposal should another risk materialise elsewhere within the business. Access to sufficient funding across the business is vital. RSLs should also carry out comprehensive stress testing and sensitivity analysis on the development risks they identify. There needs to be a clear understanding of the impact of development on future cash flows and the cash flows of all activities in the short, medium and long term need to be adequately planned, monitored and controlled to ensure long-term financial viability.
36. RSLs also need to be alert to new risks which are introduced by the development of different tenures including MMR and LCHO. The successful development of these products requires an understanding of local housing markets and an awareness of commercial risks. RSLs should consider the implications and obligations of having a subsidiary to manage MMR properties and have appropriate subsidiary governance arrangements in place to do this. RSLs also need to be aware of the additional legislative duties MMR properties are subject to under the Private Housing (Tenancies) (Scotland) Act 2016 and also any client group restrictions.
37. Risk appetite is a matter for individual RSLs. We expect them to be aware of the inherent risks in their plans and have adequate risk management and mitigation measures in place. Risks arising from the development programme need to be fully considered as part of the RSL's overall Risk Management Strategy and included in the Risk Register. RSLs also need to understand the key risks across their business and how they impact together.

38. RSLs that effectively manage strategic and development risks do not allow these risks to impair decision-making. Awareness and understanding of risk is used to inform decision-making and the implementation of a robust Risk Management Strategy to mitigate and manage risk. Development risks should be reviewed regularly as appropriate to the RSL, as part of their overall strategic review process.



The Standards and BPRP also state....

Regulatory Standard 3.2-3.3: Risks to the delivery of financial plans are identified and managed effectively. The RSL considers sufficiently the financial implications of risks.

BPRP Section 4.3: RSLs should be able to demonstrate an understanding of the main risks, the trigger points and the effectiveness of the mitigation strategies which are in place.



Are you meeting the Risk Principle?

Questions for governing bodies:

- Do you have a development risk register which focuses on appropriate risks?
- How do you manage the financial risks associated with your development programme?
- Do you carry out sensitivity analysis which flows from your risk register? Do you understand what the consequences would be for your organisation and tenants if the risks came to pass?
- How do you manage the particular governance risks which arise from your non-registered subsidiary organisations which provide MMR, LCHO and private rent?
- Are you clear about the potential for financial liability arising in other parts of the business, where complex or group structures are in place?

Principle 3: Product

Product: RSLs should have a robust understanding of the housing need and demand for the area where they plan to develop and use this to ensure that they design and build sustainable homes.



Positive practice

39. RSLs need to consider and be clear about what they are developing. Owning new houses, letting them and maintaining them brings significant challenges as well as benefits to the organisation. Building the wrong type of housing, in the wrong location, or with the wrong design is a huge risk. The wrong type of house could result in additional management and maintenance requirements in the future. The wrong location could lead to issues in relation to infrastructure costs, provision of utilities and environmental risks such as flooding. RSLs need to make sure that they get the site selection, tenure mix, design, specification and procurement route right at the outset of any project. They therefore need to plan new development carefully to ensure that it is sustainable.
40. To do this, RSLs need to have a robust understanding of housing need and demand in their area(s). This should be underpinned by an understanding of local authorities' Local Housing Strategies (LHS), Housing Need and Demand Assessments (HNDA) and the Strategic Housing Investment Plans (SHIPs) for their area(s). RSLs should also carry out their own more localised needs assessments, to identify and address any local issues and where they intend to develop specialist housing or alternative affordable tenures.
41. Local needs assessments will normally be shaped by a range of inter-connected factors including:
 - **Stock:** the existing housing stock profile and pressures across all sectors. This includes the condition of and demand for existing housing including letting trends and any under or over supply of certain types of stock. Neighbouring RSLs can also work together to develop a more comprehensive local market analysis.
 - **Socio-economic information:** demographic change, household projections, employment and socio-economic trends. This includes the RSL's own customer profile and their changing needs and aspirations.
 - **Rents and affordability:** the RSLs own rents, other peer or local social landlord rents and comparable costs associated with private renting or owner occupation. RSLs' own work on affordability and VFM should also feed into local needs assessment.
 - **Future-proofing:** future proofing occupancy requirements with an appropriate mix of housing is an important consideration. This includes building to appropriate space standards, for example to ensure homes provide a sustainable platform for a family to grow without having to move. It also includes a degree of future proofing for any degradation of a tenant's health.
 - **Specialist housing:** where an RSL intends to provide specialist housing, an assessment should be made of the existing supply and future need for adaptable or specialist housing, and the availability of capital and revenue funding for this.
 - **Impact on existing stock:** the assessment should consider the impact of competition on tenancy choice, for example, the impact on existing (older) assets when tenants transfer and as a result leave a harder to let existing asset.

- **Other local issues:** this could include completing area regeneration, dealing with poor quality owner occupied stock or addressing issues with private rented properties.
42. RSLs need to consider a different range of issues when developing other tenures. A robust knowledge of the operation of the local housing market is key to developing MMR and LCHO. The RSL's mixed tenure needs assessment should incorporate an understanding of the local private housing market (including for example land prices, house prices, market rents for comparable products, location factors and private sector provision) and use this to tailor the product to meet demand.
 43. RSLs have successfully employed staff with commercial backgrounds (for example in residential letting, factoring and sales) to ensure that they are able to consider and assess demand and local issues. For RSLs which are involved in MMR and LCHO, it is also important to develop a strong brand which is consistent with and protects the reputation of the RSL.
 44. The design and quality of new homes also needs to ensure longevity and to create sustainable neighbourhoods people want to continue to live in. RSLs need to consider interlinked cost, quality/design, VFM and timing issues at the very outset of any project. Here, the sustainability of the product should be a key factor. A flexible 'design guide' can be used to incorporate all development policies and procedures. It is positive practice to regularly update and refresh the design guide with all of the RSL's learning on development, along with its on-going experience across its business.
 45. RSLs should use all of the intelligence they have on their stock to make sure it is built to last. It is positive practice to adopt a whole-life asset management approach to considering any new development. RSLs should pull together all of their corporate intelligence on asset management, financial management, procurement, maintenance, housing management and residents' feedback. Collaboration between teams or people who work in development, finance, asset management and housing management can help make this happen.
 46. Acquisition of existing properties also forms a part of some RSLs' development programmes. This includes, for example, tenement rehabilitation, conversions of existing buildings and bringing strategically important or listed buildings back into use. Rehabilitation programmes can be more costly and take more time to complete than standard new build developments. They are often more complex, there are more risks of unexpected problems and they often involve more stakeholders. RSLs therefore need to consider the additional risks associated with acquisition/rehabilitation and factor this into their development appraisals and considerations of quality and design.



The Standards and BPRP also state....

Regulatory Standard 4.1: the governing body bases its decisions on good quality information and advice from staff and where necessary expert advisers, that is timely and appropriate to its strategic role and decisions.

BPRP Section 4.4: the RSL's plans are based on the most up-to-date and reliable data available on tenants, stock, other assets, services, staff, performance, contracts, finance, competitors and the external operating environment. Informed strategic asset management decisions will help ensure that resources are used effectively.



Are you meeting the Product Principle?

Questions for governing bodies:

- Do you evaluate the LHS and HNDA and carry out your own local needs assessments to support any new development or acquisition of stock which requires refurbishment?
- If you develop MMR or LCHO, how do you make sure that you understand your local housing markets, tailor the product to the market and get the location right?
- How do you ensure that any new homes are designed to be sustainable?

Principle 4: Capacity

Capacity: RSLs should have the appropriate organisational capacity, corporate structures, people and/or partnerships in place to effectively manage new development.



Positive practice

47. RSLs should ensure that they have the appropriate organisational structures, people and/or partnerships in place to effectively manage new development. Here we use the terms 'people' and 'access to people' to cover both in-house staff and also external expertise commissioned by RSLs. It is for individual RSLs to decide the most appropriate approach for their organisation.
48. As noted above, there are clear benefits to adopting a whole-life asset management approach and to achieve this there needs to be collaboration or integration of people working across an organisation. This can be achieved in a range of different ways depending on the size of the organisation and the scale of its development programme. It is important that RSLs create structures and/or opportunities for people across an organisation and at different levels of the organisation, to share business intelligence. Collaboration between teams or people who work in development, finance, asset management and housing management at the design stage of any new development can help ensure new homes are built to last.
49. The development environment has changed dramatically over the past decade or so, particularly in terms of funding, procurement and the complexity of projects. RSLs therefore also need to have people, or access to people, who understand the current development system. It can take time to build development capacity and ensure the organisation has access to the range of skills, experience and learning needed to deliver development effectively. RSLs need to consider carefully how they access this knowledge.
50. There is some evidence, from our routine regulatory engagement with RSLs and from the landlords we spoke to, that there are potential development capacity issues in some areas. Getting people with the right mix of skills and experience can be a challenge and this could be an issue for some organisations as existing capacity is likely to be stretched by the increase in development activity in response to the Scottish Government's targets. This may also lead to higher costs.
51. Collaborative working and sharing services may be one way of helping to overcome this issue. We use the term 'collaboration' to cover a range of relationships from: RSLs sharing services, or providing development services, or coming together in a development hub or cost-sharing group, to more formal partnership working arrangements, for example where one developer procures properties on behalf of other RSLs. In this situation, housing is developed in accordance with the developing RSL's design guide, and its development policies and procedures, as part of the formal development agreement.

52. Collaboration, and tapping into an existing strong reputation, could bring a wide range of benefits, from reducing risk for inexperienced developers, to achieving economies of scale and VFM and delivering additional social benefits. A collaborative model does however require trust, shared objectives and a close working relationship, and this can take time to establish.
53. RSLs which are new to development, or have not developed for some time, should consider how they access the support they need to effectively deliver a development programme. Different models of support will be suitable in different circumstances and it is for RSLs to consider what is most appropriate and effective for them. Where collaboration takes place, it is important that there is a shared understanding and formal agreement of the rights and responsibilities of each of the parties. At all times each RSL remains responsible for ensuring that it complies with Regulatory Standards. This responsibility cannot be delegated or transferred to another organisation through a collaborative arrangement.
54. There is consensus from the landlords we spoke to that there is a need to think differently about how affordable housing is delivered in future and collaborative arrangements could have an important role to play in this. It has also been suggested that RSLs could explore more use of private sector expertise.



The BPRP also states....

BPRP Section 4.1: RSLs should have a whole organisation approach to business planning, with an understanding and ownership right across the RSL.



Are you meeting the Capacity Principle?

Questions for governing bodies:

- How do you ensure that people or teams across your organisation can collaborate throughout the development process?
- How do you identify the skills and experience your organisation needs to manage new development?
- Do you consider different options for accessing the right people (for example, recruiting staff, employing consultants, sharing services, working collaboratively etc.)?
- Have you considered all of the delivery options available to you, including the benefits of working in partnership with other RSLs?
- Where you are collaborating with partners (including one or more RSLs) are you satisfied that there is a shared and consistent understanding of the rights and responsibilities of each party?

Principle 5: Governance

Governance: RSLs should ensure that the governing body and senior staff have the appropriate skills and experience and that governance arrangements provide proper oversight of the development programme.



Positive practice

55. The governing body and leadership team in a developing RSL should have an appropriate set of skills and experience to ensure that they are able to provide for proper oversight of development. RSLs that are developing can benefit from recruiting governing body members with a broad range of skill sets and experience and/or by providing specific training for their governing body members. Areas to consider are asset management, technical skills (like surveying, architecture or planning), project and programme management, financial management, commercial marketing and treasury management.
56. As well as ensuring adequate oversight of the development programme, this is also important in terms of securing the confidence of others. Funders are increasingly keen to see that the composition of governing bodies reflects the scale and nature of the business but will also seek assurance from the skills and experience of the staff delivering the development.
57. Governing body consideration and approval of the development strategy should be built into the RSL's business planning process. It is important to get the balance of information to the governing body right. RSLs often use strategy days or development days to do this. Governing bodies should actively seek and be provided with sufficient information to allow them to consider the overall capacity for development, set the development strategy and approve individual development proposals.
58. Governing bodies should also seek the right level of information about delivery and progress of projects and programmes, particularly against budgets. Whilst staff are responsible for on-going operational monitoring of development projects, the governing body will need to oversee progress through regular reports on the overall programme and on individual projects where required. These reports will normally include information on progress (for example red, amber, green (RAG) status), particularly against budgets, and key performance indicators (KPIs).
59. These reports should be refined to take into consideration the governing body's risk appetite and needs. The frequency of reporting should also be reviewed in line with risk levels to allow the effective management of development risks; for example, if the risk level in relation to a specific project increases, then the frequency and amount of information provided to the governing body should increase proportionately.
60. RSLs with an internal audit function should use it to consider whether the risk management, governance and internal control processes are operating effectively in relation to the development programme. RSLs which don't have an internal audit function should satisfy themselves that they are able to get the independent assurance that internal audit provides from other sources.



The Standards and BPRP also state....

Regulatory Standard 6: the governing body and senior officers have the skills and knowledge they need to be effective.

BPRP Section 4.6: the governing body and senior staff are engaged and supportive of business and financial planning. They have an appropriate mix of experience and objectivity enabling effective strategic direction.



Are you meeting the Governance Principle?

Questions for governing bodies:

- How do you ensure your governing body members have the skills and knowledge they need as leaders of a developing organisation?
- How do you ensure that development decisions are taken with the best and most up to date information available and in light of the potential risks?
- Do you ever use expert advice for particular issues, for example, complex funding arrangements?
- How do you know if your development programme is on track?
- If you have an internal audit function, has your internal auditor reviewed your development programme? If so what did they find and what actions were taken on the basis of the findings?
- If you don't have an internal audit function, are you confident that you are getting the type of independent assurance that internal audit can provide from another source?

Principle 6: Appraisal

Appraisal: RSLs should carry out robust appraisals at key stages of the development process to make sure that development proposals are viable, represent VFM and capture whole life costs.



Positive practice

61. Following a strategic decision to develop, and after fully assessing need and demand, RSLs will then need to carry out a detailed investment appraisal on each individual development, and link this to their assessment of the impact that the development programme has on the overall business plan.
62. RSLs require strong and robust systems of control to provide assurance that new developments are viable, sustainable and provide VFM. The development design guide often incorporates procedures for detailed financial appraisal of programmes and individual projects.
63. RSLs should carry out appraisals at appropriate stages of each project. Traditional appraisal stages include: feasibility, acquisition, cost-plan, tender and post-completion. It is for RSLs to determine the appropriate stage, depending on the procurement route they choose for individual projects. The appraisal process should allow RSLs to assess the viability of projects at as early a stage as possible, to minimise wasted effort and resources. The acquisition appraisal should include appropriate due diligence and should demonstrate that a project can be viable prior to a site being purchased.
64. The information considered at each stage will differ, as costs and proposals are firmed up, but common appraisal elements should include:
 - **Lifetime impact:** development appraisals take place in the context of the wider business plan, and the RSL's ability to support borrowing across the entire organisation. Appraisal should therefore look at the lifetime impact of the development programme, and individual development projects, on the business plan both before and with development.
 - **Appraisal assumptions:** these include assumptions around rents, voids, arrears, management and maintenance costs, development costs, capital costs, funding costs, changes in subsidy levels and the availability of welfare benefits. RSLs should set their appraisal assumptions based on their appetite for risk, their desire to develop, current performance/expenditure and forecast future performance. It is therefore critically important for assumptions to be based on realistic and up-to-date information which has been independently validated. New build assumptions should also be consistent with the assumptions which are used in the RSL's business plan, or if different, the rationale for this should be clearly set out and agreed. Assumptions should also be reviewed regularly.
 - **Financial viability:** projects should be appraised to ensure long-term financial viability, which could be determined by payback year, Net Present Value (NPV) and/or Internal Rate of Return (IRR). Development costs (including management costs and fees etc.), income, subsidy and private finance requirements should all be factored into the appraisal.

- **Value for money:** projects should demonstrate VFM, and value engineering can be used to enable this. Whole-life costs should be factored into VFM assessment. RSLs should also consider how they can drive down their costs and extract maximum VFM.
- **Tenures:** financial appraisal should be split by tenure (social rent, MMR and LCHO), as different tenures carry different risks and assumptions. For example, LCHO appraisal should consider the carrying costs (interest charges, advertising costs, Council Tax, maintenance etc.) and the impact if properties are not sold on completion.
- **Rent affordability:** the rent assumption has a huge impact on determining viability. It is also affected by the need to operate in line with government guidance on benchmarks as well as the RSL's own rent policy. RSLs should consider affordability when setting the rent assumption. Increasing rents in real terms every year should not be a default position.
- **Risk:** a robust risk assessment should be carried out at each appraisal stage. The risks associated with individual developments may change as the project progresses and this should be reflected in any appraisals.
- **Key performance indicators (KPIs):** to further control risks RSLs should use development KPIs and/or set criteria to determine that projects can be viable.
- **Development cost benchmarking:** appraisals should incorporate benchmarking of the cost of developing new homes. Efficiencies in economic management that can be achieved through cost and resource benchmarking will free up financial and staff resources to deliver elsewhere for the business.
- **Post-completion review:** this stage is important in terms of pulling together the lessons learned from all key stakeholders particularly tenants, staff, contractors and the governing body. This review should then feed into the on-going reviews of the development policy and procedures / design guide.



The Standards and BPRP also state....

Regulatory Standard 3: the RSL has effective financial controls and procedures to achieve the right balance between costs and outcomes. The RSL bases its financial forecasts on appropriate and reasonable assumptions and information.

Regulatory Standard 4.1: the governing body bases its decisions on good quality information and identifies and mitigates risks to the organisation's purpose. The governing body is able to evidence any of its decisions.

BPRP Section 4.3: Evidence-based planning should be used to clearly demonstrate that there are sufficient financial resources available to undertake the planned activities, to deliver the desired objectives, to sustain services and to maintain assets. It is for each RSL to demonstrate both internally and to its tenants that VFM is being achieved.



Are you meeting the Appraisal Principle?

Questions for governing bodies:

- Do you assess the impact of development on the rest of your business?
- Do you test if projects are financially viable and provide VFM?
- Do you test and review your investment assumptions regularly?
- Do you include an assessment of rent affordability in appraisals? Do you understand the impact your development programme has on rent levels?
- Is a real terms increase in rent each year the default position?

Principle 7: Funding

Funding: RSLs should have an appropriate funding strategy which ensures access to sufficient resources as they are required and have a clear understanding of the impact of development on future cash flows.



Positive practice

65. When we engage with RSLs around business planning one of our main objectives is to get assurance that the business plan is sustainable not just in the short term but also in the medium and longer term. RSLs should ensure that they have access to sufficient funding to meet their obligations both in the short and the longer term. Securing adequate private finance and having funds in place before committing to a development project is as important to delivery as the offer of grant. RSLs also need to have a clear understanding of the impact of development on future cash flows.
66. Access to financial planning and treasury management skills is essential. Re-financing issues can cause significant delays to projects and could result in a heightened risk of insolvency. Funding risks need to be clearly articulated and considered and approved by the governing body. Governing bodies may need expert support and advice to be able to make these decisions.
67. RSLs also have a duty to their tenants to spend money wisely. Developing new housing uses the financial capacity of the business so RSLs need to use funds efficiently. Non-utilisation costs can have a significant impact on the financial assessment of a project and in the worst case may impact on the overall financial capacity of an organisation. Close integration of finance and development staff can help mitigate against this risk.
68. It is also important for RSLs to have a good working relationship with their funders and for RSLs to actively manage this. This can have a positive impact on their ability to procure funding in future. RSLs should be clear on what their lender will be looking for and what type of relationship they are seeking. The lender is going to be an important stakeholder for the RSL going forward so it is important to make the right choice. Price is an important consideration but it is not the only consideration.
69. RSLs also need to ensure that they are aware of any funding conditions attached to both private finance and offers of grant. Effective systems should be in place to monitor and report regularly to the governing body on covenant compliance. RSLs should be aware of funders' timescales for testing covenants and ensure that the implications of any breach are understood. Information systems should be in place to detect any material risk of breach as soon as possible.



The Standards and BPRP also state....

Regulatory Standard 3: the RSL has effective financial and treasury controls and procedures to achieve the right balance between costs and outcomes. The RSL ensures security of assets, the proper use of public and private funds and access to sufficient liquidity at all times.

BPRP Section 4.3: Evidence-based planning should be used to clearly demonstrate that there are sufficient financial resources available to undertake the planned activities, to deliver the desired objectives, to sustain services and to maintain assets. It is for each RSL to demonstrate both internally and to its tenants that VFM is being achieved. The cash-flows of all activities in the short, medium and long term should be adequately planned, monitored and controlled to ensure viability.



Are you meeting the Funding Principle?

Questions for governing bodies:

- Do you seek assurance that your planned borrowing is affordable, sustainable and prudent?
- Have you got assurance that you have access to sufficient funding to meet your obligations?
- Do you have access to and seek to engage and deploy treasury management expertise if required?
- Do you understand the requirements of your lender(s) and are you clear that you can meet them?

Principle 8: Project Management

Project Management: RSLs should ensure that appropriate project management processes are in place and integrated across their organisation.



Positive practice

70. RSLs should ensure that appropriate project management processes are in place, are integrated across their organisation and are effective at each stage of the development process. These processes should feed into both operational monitoring and also reporting to the governing body. Project management needs to be responsive and fluid to help facilitate decision making. For RSLs with larger programmes, this will allow any slippage to be dealt with timeously and shadow projects to be brought forward.
71. Project management can be carried out in a range of ways, dependent upon the scale and nature of the programme. Some RSLs find it helpful to split the process into pre- and post-contract management, with the pre-contract stage covering from inception to awarding of the contract and the post-contract phase relating to construction. Being extremely rigorous at the more complex pre-contract stage can substantially mitigate risk at the post-contract stage.
72. RSLs should ensure that their information systems can provide sufficient assurance around the delivery of new homes. Some have developed their own bespoke programme management systems which pull together information on all aspects of their programme. Operational monitoring should be carried out regularly and should include an analysis of progress, KPIs and budgets.
73. RSLs should also be mindful of the costs of planning, procuring and managing programmes. These costs can often be buried somewhat in the overall running costs of the organisation and not subject to the same level of scrutiny that the costs of contracts themselves are.



Are you meeting the Project Management Principle?

Questions for governing bodies:

- What systems do you have in place to monitor and manage your development activity?
- Do you monitor the costs associated with planning, procuring and managing development programmes?

Principle 9: Procurement

Procurement: RSLs should ensure they have a strategic approach to procurement that is kept under review, complies with relevant legislation, is tailored to the particular needs of their organisation and helps them select the most appropriate procurement option.



Positive practice

74. Our Asset Management Recommended Practice (2012) notes that RSLs should ensure they have a strategic approach to procurement that meets legislative requirements, is kept under review and is tailored to the particular needs of the organisation. In particular, RSLs need to comply with the Procurement Reform (Scotland) Act 2016 and need to understand the health and safety obligations of being a client as detailed in the Construction (Design and Management) Regulations 2015.
75. RSLs need to carefully consider which procurement route they choose. There is a wide range of options including, for example, off the shelf, design and build (D&B), back-to-back D&B, turnkey, traditional procurement, partnership/collaborative working and framework agreement. In addition to considering the benefits of different routes, RSLs also need to understand the particular risks associated with each route and how they can best mitigate these risks. This includes managing high impact risks like cost over-runs, abortive costs and contractor liquidation.
76. RSLs should ensure that they have access to appropriate procurement expertise (including legal advice), employ the right contractors and use appropriate contract documentation. The success of any development will to a large degree depend on the performance of any contractors or consultants. RSLs need to ensure their consultants and contractors are fit for purpose with experience that is relevant to individual projects, for all aspects of the development process. RSLs also need to be able to manage contractors properly and monitor how they perform.
77. RSLs therefore need to get the contract documentation right at the start of the process and ensure that they retain appropriate control. The contractual environment is highly sophisticated and an understanding of the causes of past problems will help to avoid similar problems in future. This can be critical in a situation where a contractor goes into liquidation. RSLs therefore need to have access to procurement experts who understand the contract environment and have experience of negotiating and managing complex contracts.
78. RSLs should also be able to demonstrate that new developments are achieving VFM and are being provided at or near the lowest cost possible for the quality required. The approach to procurement should create the optimum balance between cost and quality in the RSL's own context.
79. RSLs also need to be mindful of the levels of community benefits that need to be delivered alongside any new housing (a requirement of the Procurement Reform (Scotland) Act 2016 for contracts over £4 million).



The BPRP also states....

BPRP Section 4.3: Procurement Strategies should aim to build flexibility into contracts and achieve the best VFM.



Are you meeting the Procurement Principle?

Questions for governing bodies:

- Do you have a procurement strategy that complies with legislation, is tailored to your needs as a developing organisation and is kept under regular review?
- Is everyone who makes spending decisions aware of costs and thinking about how to get the most from them?
- Do you consider more collaborative working arrangements to get best value from procurement and your development programme?
- Are you able to demonstrate to tenants and to yourselves that work is done at the best possible balance between cost and quality?

Principle 10: Stakeholders

Stakeholders: RSLs should ensure they actively manage and build constructive relationships with their stakeholders including tenants, service users, funders, regulators, local authority/RSL partners, contractors and Scottish Government.



Positive practice

80. RSLs should actively manage and build constructive relationships with their key stakeholders throughout the development process. Key stakeholders will include tenants and residents, other service users, funders, the government, other RSLs (including those involved in development partnerships), other regulators, local authorities, developers and contractors.
81. RSLs should understand the needs and aspirations of their tenants and service users and use this information to ensure that future development meets needs and is sustainable. RSLs should also have a good understanding of lender requirements and should work to strengthen and manage these relationships. It is also beneficial for RSLs to build constructive relationships with contractors and developers and these relationships need legal clarity from the outset.



The Standards and BPRP also state....

Regulatory Standard 2.3 and 2.4: the RSL seeks out the needs, priorities and views and aspirations of tenants, service users and stakeholders. The RSL is open, co-operative and engages effectively with all its regulators and funders, notifying them of anything that may affect its ability to fulfil its obligations.

BPRP Section 4.2: the RSL should understand how it is perceived by key stakeholders and use the business plan and business planning process to provide assurance to them.



Are you meeting the Stakeholder Principle?

Questions for governing bodies:

- How do you ensure that your plans are aligned to the priorities and plans of your key stakeholders?
- How do you actively manage and build constructive relationships with your key stakeholders about your development programme?

Further reading

Strategic Asset Management Recommended Practice, Scottish Housing Regulator:
<https://www.scottishhousingregulator.gov.uk/publications/recommended-practice-asset-management>

Business Planning Recommended Practice, Scottish Housing Regulator:
<https://www.scottishhousingregulator.gov.uk/publications/recommended-practice-business-planning-december-2015>

Regulatory Standards of Governance and Financial Management, Scottish Housing Regulator:
<https://www.scottishhousingregulator.gov.uk/publications/our-regulatory-framework-regulatory-standards-governance-and-financial-management>

Scottish Social Housing Charter, Scottish Government:
<http://www.gov.scot/Publications/2012/03/2602/0>

More Homes Scotland Strategy, Scottish Government:
<http://www.gov.scot/Topics/Built-Environment/Housing/reform/more-homes-scotland>

Review of the Planning System, Scottish Government:
<http://www.gov.scot/Topics/Built-Environment/planning/Review-of-Planning>

Joint Housing Policy and Delivery Group, Scottish Government:
<http://www.gov.scot/Topics/Built-Environment/Housing/reform/jhpdg>

Housing in Scotland, Audit Scotland:
http://www.audit-scotland.gov.uk/docs/local/2013/nr_130711_housing_overview.pdf

Affordable Housing Need in Scotland, Scottish Federation of Housing Associations, Chartered Institute of Housing Scotland, Shelter Scotland:
http://scotland.shelter.org.uk/_data/assets/pdf_file/0009/1190871/7909_Final_Housing_Needs_Research.pdf/_nocache

Terms we use in this report

Asset Management	Ensuring that current and future assets (houses, land, garages, shops etc.) fully support the organisation's objectives – working towards having the right assets, of the right quality, in the right place, at the right time generating appropriate value to the business plan and 30 year cash flows.
Business Plan	A document setting out a landlord's aims and objectives and its financial plans and resources for a specific period.
Cash Flows	An accounting term that refers to the amounts of cash being received and spent by an organisation during a defined period of time.
Design Guide	A document or suite of documents which includes the RSL's development policies and procedures, and other related policies and procedures.
Design and Build	A procurement route where a main contractor is appointed to design and construct the works, as opposed to a traditional contract, where the client appoints consultants to design the development and then a contractor is appointed to construct the works.
Evidence Based Planning	Enables a more accountable and sustainable approach to developing policies and strategic plans. It also helps build credibility into planning and decision-making processes.
Financial Forecast	A projection of the organisation's expected financial position based on expected conditions.
Internal Rate of Return	A metric used in capital budgeting measuring the profitability of potential investments.
Key Performance Indicator	A measure of how an organisation is achieving its objectives or performing in particular activities. Performance indicators can be compared with a pre-set standard (a benchmark) or with other organisations.
Local Housing Strategy	Local Housing Strategies are the strategic documents on housing and housing related services across the local authority area including homelessness, housing support and fuel poverty.
Low Cost Home Ownership	Tenures which offer those eligible the opportunity to purchase part of their home and begin building their own equity.
Mid-Market Rent	Tenures which help working households on modest incomes to access affordable rented accommodation
Mission Statement	A formal short written statement of the purpose of an organisation which has been approved by the organisation's governing body.
Net Present Value	The difference between the present value of cash inflows and the present value of cash outflows. It is used in capital budgeting to analyse the profitability of a projected investment or project.
Options Appraisal	A structured process for considering alternative choices against appropriate evaluation criteria in order to optimise the achievement of strategic objectives.

Payback	Payback period for investment is the time it takes for cumulative returns to equal cumulative costs.
Private Finance	Funding borrowed from a private sector lender such as a bank or building society.
Procurement	The way an organisation obtains services or materials from other organisations or agents.
Registered Social Landlord (RSL)	A social landlord registered and regulated by the Scottish Housing Regulator, such as a housing association or co-operative.
RAG Status	RAG status reporting is used when project managers are asked to indicate how well a project is doing using the traffic light series (red, amber, green).
Risk Management	The process of defining and analysing risks, and then deciding on the appropriate course of action in order to minimise and mitigate these risks.
Sensitivity Analysis	Investigation into how projected performance varies along with changes in the key assumptions on which the projections are based.
Stakeholder	Any person or organisation using a landlord's service, affected by the landlord's actions or having an interest in the landlord's activities, i.e. an interested party.
Strategic Housing Investment Plans	Are part of the Local Housing Strategy process and set out the key development priorities in each local authority to inform Scottish Government housing investment decisions.
Strategic Objective	A target that an organisation should achieve to make its strategy work.
Stress Test	A test that looks at the impact on an organisation's business plan of a major change in one or more variables in order to see what impact this would have.
Treasury Management	A policy governing the way an organisation manages borrowing and investments.
Value Engineering	A systematic method to seek out the optimum value of goods, products or services over the short, medium and longer term.
Value for Money (VFM)	Value for money is about obtaining the maximum benefit with the resources available.

