Scottish Housing Regulator

Internal Procedure Note – Business planning and systemically important RSLs

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Procedure Note – Business planning and systemically important RSLs

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1. INTRODUCTION

Our Regulatory Standards of Governance and Financial Management require that:

- the governing body sets the RSL's strategic direction. It agrees and oversees the organisation's business plan to achieve its purpose and intended outcomes for tenants and other service users (RS1.1); and
- the RSL has a robust business planning and control framework and effective systems to monitor and accurately report delivery of its plans. Risks to the delivery of financial plans are identified and managed effectively. The RSL considers sufficiently the financial implications of risks to the delivery of plans.(RS3.2)

This procedure note details the different processes to follow when engaging with any RSL about its business plan and its business planning process.

Some RSLs would present more significant challenges if they experienced business failure, for example, because of how many tenants they provide homes for or the size of the debt they have. Given this we consider these RSLs to be of systemic importance. This procedure note therefore also sets out the additional information and assurance we require from these RSLs in relation to their business plans and financial sustainability.

2. BUSINESS PLANNING

We published our most recent Business Planning Recommended Practice in 2015 to support RSLs in Scotland in their approach to business planning. It is targeted at RSL governing bodies and management teams.

This focuses on key regulatory messages and is principles-based, less prescriptive and more succinct than the previous version we published in 2012. It aims to help RSLs comply with the Regulatory Standards of Governance and Financial Management. It also takes account of SHR's experience in regulating RSLs, key risks and issues identified by stakeholders and business planning good practice. The

Recommended Practice provides a framework for our assessment of business planning and the key risks to be considered.

The business plan is a key strategic document which communicates an organisation's vision and objectives, and how it will achieve those objectives. The business plan should be central to, and clearly articulate, the organisation's strategic decisions. In turn, operational decisions should be consistent with the strategy set out in the business plan. Reporting and monitoring systems should be designed to allow managers and those charged with governance within the RSL to judge the extent to which the strategic aims are being achieved and to make any necessary adjustments in a timely manner. It is for each RSL to decide how best to achieve this, based on its own circumstances.

An RSL's ability to deliver good services for customers, provide a solid platform for improvement and demonstrate long term financial viability depends on its ability to make the most of its property assets. The business plan should be underpinned by a robust approach to strategic asset management. Strategic asset management should therefore be developed alongside and complement the business planning process. The Business Planning Recommended Practice should therefore be read in conjunction with our Recommended Practice on Strategic Asset Management . While this was produced in 2012, the principles about asset management are still relevant, risk based and reliable.

Engaging on business planning and information requirements

Through our annual risk assessment, we assess and prioritise the risks landlords face and then decide what our regulatory engagement will be. Where we decide that we need additional assurance from a landlord about its business plan and its business planning process, we will set this out in the engagement plans that we publish for individual landlords.

When we are assessing business plans, we would normally expect to consider the following information:

- its business plan and the report to the Board on this;
- information on the landlord's approach to managing risk and its risk register;
- 30 year financial projections consisting of statement of comprehensive income, statement of financial position and statement of cash flow complete with assumptions and explanatory narrative;
- a comparison of projected financial loan covenants against current covenant requirements;
- financial sensitivity analysis which considers the key risks, the mitigation strategies for these risks and a comparison of the resulting covenant calculations with the actual current covenant requirements;
- the report to the Board in respect of the approved 30 year projections, sensitivity analysis and covenant compliance; and
- evidence of how it demonstrates rent affordability for its tenants.

These information requirements may be amended/ added to if we identify specific risks during the risk assessment process where we need additional assurance.

It is the responsibility of the SHR engagement plan lead officer for each landlord to ensure that we receive all the necessary information on business planning from the landlord when it is due. Details of the information required and due dates will be reflected in the engagement plan.

The SHR lead officer will also require to liaise with colleagues in Finance to:

- share the business planning and financial information with them when it is received;
- agree the scope of the review required, the outputs and the timescales for delivering this; and
- agree the timescales and format of any feedback to/discussions with the landlord.

Usually RSLs will develop a business plan covering three to five years. This means there is an annual refresh of the strategy rather than a full business plan review during that three or five year period. We would, in these circumstances not complete a review of the business plan each year but carry out a more limited review to get assurance that their agreed strategy is on track and being properly monitored by management and reported to Board. Financial information and projections will be updated each year.

Portal access

We expect landlords to submit this information to us through the portal. To do this, the RSL will need to have access to the portal and have at least one appropriate user set up who can amend records and send information. In most cases, the RSLs admin user should be able to do this. The RSL should confirm that they have an appropriate user set up on the portal, and in cases where they do not, we should speak to the BI team to set this up for them.

In exceptional cases, the RSL may be sharing confidential or sensitive information with us, for example on business transformation proposals. In these cases, it may be more appropriate for the RSL to email this directly to the engagement plan lead officer who will store this securely in line with our records management policy.

Assessment

The SHR engagement plan lead officer for each RSL is responsible for compiling an assessment of the business plan. Any assessment will need to consider compliance with the Regulatory Standards of Governance and Financial Management.

In assessing a business plan, it is also important to refer to our Recommended Practice on Business Planning which sets out the key areas that a business plan should consider and good practice in approach. When we are assessing a business plan, we should consider the following key areas:

1. **Developing the plan**
    - Who was involved in developing it? Board, staff, stakeholders?
    - Does the organisation own the plan? (Or did an external third party develop and present it to the governing body? If that's the case how can the RSL demonstrate ownership?)
    - Has it been communicated to stakeholders including importantly the landlords' tenants?

2. **Reporting and monitoring**
    - Consider frequency, scope, format, quality and content of reporting. Is it sufficient?

3. **Context and operating environment**
    - Vision, mission, objectives and values - are they clearly identified and appropriate?
    - Are the strategic objectives measurable?

4. **Risks**
    - Are these understood and articulated?
    - Are the key risks identified and do they flow from the strategic objectives and any SWOT or PEST analysis?
    - Are the risks linked to the sensitivity work on the financial projections?
    - Do the risks cover both strategic and operational risks to delivery of the business plan objectives?
    - Is it clear how risks will be managed and who has responsibility for each? Does the governing body have oversight of these?

6. **Key building blocks for the Business Plan**
    - Is the business plan underpinned by good quality information?
    - Stock - is there an asset management strategy and plan? Does the landlord know if it has any failing/underperforming stock? It is especially important to have good stock condition information. Have the outputs from this been packaged into costed programmes of work and factored into projections?
    - Growth plans - does the landlord understand the impact new development (either its own or adjacent landlords') might have on demand for its stock? Reference should be made to our Development Thematic when considering this.
    - Financial/Treasury Management - are the financial forecasts realistic/underpinned by reasonable assumptions? Are the forecasts supported by appropriate sensitivity analysis and a statement on the outcomes of this work?
    - Has work been done to assess rent affordability and have findings been factored into financial projections? What risks are posed from current types of borrowing? Is new borrowing needed? When?

The engagement plan lead officer is responsible for recording our assessment of the business plan and saving this on the landlord record on Insight. Examples of previous assessments for individual RSLs are available on each RSL's record on Insight.

Normally any feedback to the RSL is done face to face, in a meeting with the senior officer. The SHR lead officer is responsible for producing a record of these discussions. This should be shared with the landlord and saved on Insight. If there's specific feedback relating to finance the Regulation Manager (Finance) will normally attend the feedback meeting.

3. SYSTEMICALLY IMPORTANT RSLs

Each year as part of our annual risk assessment, we review the criteria we use to identify systemically important RSLs and use this criteria to determine which RSLs we consider to be systemically important. The analysis for this work is led by one of our Regulation Managers (Finance) who then presents the findings to the Assistant Directors for agreement. This analysis is stored in the annual risk assessment folder on Insight and the most recent analysis can be found here - systemic importance analysis 2018.

Normally we consider the following criteria:

- Number of Units owned
- Turnover
- Peak housing debt over a period of time
- Debt (excluding other long-term liabilities) per unit

We consider the projected debt per unit to reflect the capacity that a rescue partner might have to generate funds should they be required, or to secure future financial viability through development.

We rank RSLs against these criteria so for example in terms of the number of units, we rank RSLs from the largest to the smallest. We do the same for the other criteria and RSLs are selected as being systemically important if they score in the top ten in any one of the first three criteria. We also do some analysis to look at the position when these criteria are combined and rank RSLs on this. In addition, an RSL could be classed as systemically important based upon the nature of its business, the degree of community dependence, or if they are the parent of a systemically important RSL.

Peak turnover during the whole Five Year Financial Projections (FYFP) period is also considered to capture the effect of future development on the selection of RSLs.
All data is initially taken from the FYFP returns with a review once the AFS data is available.

As a result of this approach, some RSLs will move in and out of systemic importance. So where an RSL is currently systemically important but does not then meet the criteria in the following year, they will remain systemically important for the remainder of that year for consistency. If that RSL fails to meet the criteria in the following year, it will no longer be systemically important.

Systemically important RSL information requirements

We engage with systemic RSLs because the impact of any business failure on their part would/could have more far reaching consequences than if it was a smaller RSL. These RSLs tend to be the bigger players in the sector and most perform well. They are also carrying the most risk in the sector and are normally the first to get involved in innovative business activities, eg approaches to getting new funding. Our engagement is therefore normally focused on understanding their business and their management of risk rather than because we have identified problems.

We require additional information and assurance from systemically important RSLs in relation to their business plans and financial sustainability. The individual requirements for each systemically important RSLs will be set out in our published engagement plans. Normally we would expect to receive the following standard information for the systemically important RSLs:

- the RSL's current business plan and the report to the Board on this;
- the RSL's risk management strategy and up to date risk register;
- 30 year financial projections consisting of statement of comprehensive income, statement of financial position and statement of cash flow complete with assumptions and explanatory narrative;
- a comparison of projected financial loan covenants against current covenant requirements;
- financial sensitivity analysis which considers the key risks, the mitigation strategies for these risks and a comparison of the resulting covenant calculations with the actual current covenant requirements;
- the report to the Board in respect of the approved 30 year projections, sensitivity analysis and covenant compliance; and
- updated evidence of how it demonstrates affordability for its tenants; and
- copies of its Board and audit committee minutes as they become available.

We may tailor our standard information request where we have received assurance in a particular area or where we have identified specific additional risks.

Because most systemically important RSLs are also significant developers, we would normally expect these RSLs to also:

- tell us if there are any material, adverse changes to its development plans which might affect its financial position or reputation, in line with our notifiable events guidance; and
- send us an update on its development programme normally by 31 October each year. This will include details of the scale and tenure types to be

delivered, timescales, completions and any material delays or changes to the programme.

This information will then need to be considered in the context of our overall assessment of the business plan.

Portal access

Again we expect landlords to submit this information to us through the portal. To do this, the RSL will need to have access to the portal and have at least one appropriate user set up who can amend records and send information. In most cases, the RSL's admin user should be able to do this. The RSL should confirm that they have an appropriate user set up on the portal, and in cases where they do not, we should speak to the BI team to set this up for them.

In exceptional cases, the RSL may be sharing confidential or sensitive information with us, for example on business transformation proposals. In these cases, it may be more appropriate for the RSL to email this directly to the engagement plan lead officer who will store this securely in line with our records management policy.

Assessment

We will normally:

- review the minutes of the Board and audit committee meetings and liaise as necessary;
- review the business plan and financial projections;
- meet with the RSL's senior staff and Chair at least once a year to discuss the business plan, the financial information and any risks to the organisation;
- observe a governing body meeting once a year; and
- review the development update in quarter three.

We may need to tailor the engagement with the Chair and governing body to reflect any specific risks that we have identified through the annual risk assessment. As a minimum, we should meet the Chair and observe at least one governing body meeting each year unless there has been no significant change on the governing body from the previous year and no new risks identified in the annual risk assessment.

When observing a governing body meeting, reference should be made to this template. This was developed prior to the implementation of our new Regulatory Framework but will be a useful tool to consider when observing a governing body. It is not expected however that we carry out a full assessment against all of the regulatory standards at each Board observation. The focus of any assessment will be determined by the key risks identified in the business plan assessment.
It is the responsibility of the lead officer to ensure that any analysis of this information and records of discussions with RSLs are saved on the landlord file on Insight.

Approach to Groups

Where an RSL is the subsidiary of another Scottish RSL, we publish a single engagement plan for the group and we will publish a single regulatory status for the Group.

When we ask for information in relation to business planning for any RSL including systemically important RSLs, we will normally focus our discussions around this with the parent RSL.

When we are assessing the risks associated with Groups, we need to be aware that often Groups have both registered and non-registered subsidiaries. We should be looking at what each part of the group does to come to a judgement about the risks it poses. These might be financial or reputational. We then need to assess what additional assurance we require. We need to be proportionate here. For example, we may initially ask to see the group business planning and financial information. If the group information highlights a risk with non-registered aspects of the Group activity we may then follow this up with the parent.