# What Does Your Life-Jacket Look Like?

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2nd March 2017

# This Session

1. Expectations of the Regulator

2. Stress Testing

4. Staying Afloat

3. Risk Framework

# This Session

1. Expectations of the Regulator

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# Welsh Government Expectations

## Sector Risk Profile March 2016

Llywodraeth Cymru
Welsh Government

**Risk management and stress testing**

The Regulator expects that Boards will:

- Understand the business environment they operate in and associated risks
- Have in place a fully considered business plan and robust risk and control framework
- Assess, manage and, where appropriate, address risks to ensure the long-term viability of their organisation.
- Implement robust business planning assumptions combined with sensitivity/stress testing
- This should include multi-variation analysis to stress test the business across the whole organisation to demonstrate the extent to which it can cope with a number of changing factors.
- Stress testing will help underpin the Boards' understanding of where the risks lie and inform their consideration and planning for remedial action if the risks crystallise either singly or in combinations.

# Welsh Government Expectations

## Sector Risk Profile March 2016

**Asset and Liability registers**:

- Understand their housing assets, security position and associated liabilities
- Have access to this information quickly in decision making and risk management.

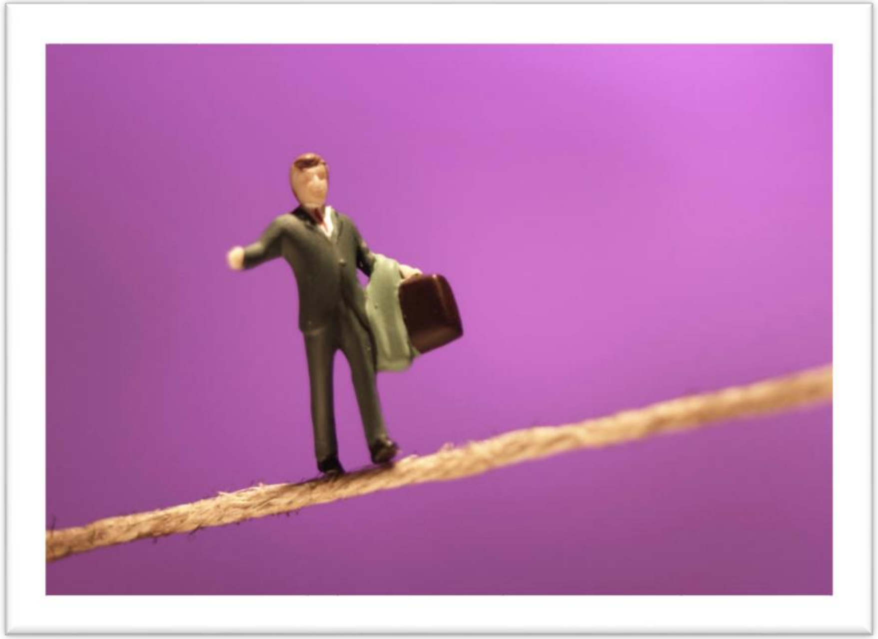
- **Delivery outcomes:**
- Demonstrate they are meeting the 'Delivery Outcomes' set out in the Regulatory Framework.
- Adhering to the standard of governance that the RSL has adopted

# Where are we now?

## Welsh Government Sector Risk Profile March 2016

- Rent increase formula
- Welfare Reform - LHA Cap
- Supported Housing
- Cost control
- Pensions
- Differential inflation rates
- Managing development programme
- Diversification
- Housing market sales exposure

- Existing stock
- Counter party risks
- Liquidity
- New / existing debt
- Hedging / Mark to Market risk
- Service delivery risks
- Accounting issues – FRS 102
- Asset & Liability Register
- ONS Classification



# Risk Based Approach


- WG will prioritise risks in terms of:
  - The **likelihood** a risk will materialise
  - The **impact** - scale and significance - if it did
  - The **ability** of the housing association **to manage** and deal with the risk

# Risk Based Approach

Views on the ability of a Housing Association to manage and deal with risks will be informed by:

- The Association’s track record in managing change and improvement, handling challenging issues and making difficult decisions.
- Confidence in the Board and the senior management team.
- The Association’s track record in dealing with other issues that have been raised as a result of previous contact.

# Welsh Government Regulatory Judgements

Summary of published judgements as at the end of February 2017:

| Financial Viability | | |
|---|---|---|
| | June 2016 | February 2017 |
| Pass | 32 | 32 |
| Pass with closer regulatory monitoring | 4 | 4 |
| Percentage pass with closer regulatory monitoring | 11% | 11% |

# HCA Regulatory Judgements

Summary of published judgements as at the Mid-February 2017 (compared to end of March 2016)

| Governance | | | Viability | | |
|---|---|---|---|---|---|
| | March 2016 | February 2017 | | March 2016 | February 2017 |
| G1 | 209 | 202 | V1 | 198 | 200 |
| G2 | 26 | 27 | V2 | 40 | 36 |
| G3 | 3 | 8 | V3 | 1 | 1 |
| G4 | 1 | 1 | V4 | 0 | 0 |
| % G2 | 11% | 11% | % V2 | 17% | 15% |

# This Session

2. Stress Testing

# Stress Testing Process

To identify the Financial Risk tolerances

- Develop base plan
- Test individual plan sensitivities
- Model combined (multivariate sensitivities)
- *Look at what will break the plan*

# Possible Stress Testing Issues

| | | |
|---|---|---|
| Housing market | Outright sale & shared ownership | Rent increase assumptions |
| Security valued at EUV | Security valued at MV-T | Costs of working capital |
| Interest rates | Stand-alone swaps | Cross-default |
| Funding market disruption | Counterparty failure | Contract performance |
| Loss of major contract | Joint venture failure | Welfare reform |
| Welfare cap | Volatility of cashflows | Costs / income inflation |
| Values & volumes | Wages and costs | Low inflation |
| Pensions | Impairment including Investments | Housing Finance Grant and security |

# Current Treasury Risks

- The effect of falls in Gilt rates, particularly for those with Mark-to-Market exposure.
- Further cuts to the UK's credit rating which could affect the rate at which associations can borrow
- Possible differential income / cost inflation
- Rising pension deficits which are linked to Gilt rates
- Temptation to borrow speculatively – ensure that the cost of holding cash is considered
- The possibility of labour shortages post Brexit, increases in the cost of materials, restricted access to European Union markets
- Care and support  - labour costs and availability
- House prices / volumes falling  post Brexit across open market and shared equity
- UK GAAP /FRS102 covenant issues

# Breaking the Plan – “The Perfect Storm”

- Individually, **NONE** of these result in a breach
- However, **IN COMBINATION**, these movements together result in:

# How would the Plan "Get Broken"?

## What do we mean by broken?

- Reduction in Surplus?
- Out of Cash?
- Breaching loan covenants?

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# Breach Implications

- Lenders could call in debt and seize assets
- Most likely implication would be an increase in costs
- There would be reputational implications for future borrowing requirements.
- Further pressure on the business plan?
- Long term viability?
- Regulatory action / takeover?

# This Session

3. Risk Framework

# How do you use the outputs?

You have done your stress testing.

You have identified the key risks for the business.

What are they?

What are you doing differently as a result?

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# Risk Management

# Key Areas of Risk

# Risks That Can Lead to Failure

1. Financial Risk – Material Unplanned Fall in Income
2. Financial Risk – Material Unplanned Increase In Costs
3. Financial Risk - Running Out Of Cash
4. Serious Health & Safety Breach
5. Business Continuity issue
6. Regulatory Intervention

# Risks That Can Lead to Failure

## 1 Financial Risk – Material Unplanned Fall in Income

**Main Reasons:**

- Changes in benefit rules
- Changes to rent setting
- Development delays
- Property market fluctuations

**Controls:**

- Regulatory update and horizon scanning
- Stress testing of scenarios
- Regular reporting on developments
- Managed exposure to sales risk

**KPI's:**

- Interest cover
- Sales KPIs
- Schemes with negative NPV
- Management accounts variance analysis

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# Risks That Can Lead to Failure

## 2 Financial Risk – Material Unplanned Increase In Costs

**Main Reasons:**

- Changes in legislation impacting capital spend
- Increase in development cost of labour and raw materials
- Impairment of housing properties
- Fraud

**Controls:**

- Active property team in place
- Fixed price design & build
- Managed exposure to development risk

**KPI's:**

- Interest cover
- Capital spend variances to budget
- Development variances to budget
- Suspected frauds

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# Risks That Can Lead to Failure

## 3 Financial Risk – Running Out Of Cash

**Main Reasons:**

- Poor record keeping
- Poor cash flow forecasting
- Poor communication between development and finance

**Controls:**

- Revolving credit facilities in place
- Agreed level of cash headroom in place
- Security in place for additional borrowing

**KPI's:**

- Liquidity/quick ratio
- Debtor/creditor days
- Uncharged properties
- Capital spend against budget

# Risks That Can Lead to Failure

## 4 Serious Health & Safety Breach

**Main Reasons:**

- Gas
- Fire
- Care/Support failures
- Legionella, solid fuel, employer H&S

**Controls:**

- Zero tolerance on all H&S legal duties
- Monitoring of mandatory training on care/ support
- No HSE investigations

**KPI's:**

- % gas services / FRA's complete
- % of mandatory training in care/support
- Number of safeguarding cases

# Risks That Can Lead to Failure

## 5 Business Continuity Issue

**Main Reasons:**

- Damage to housing due to fire or flood.
- Loss of key services at head office due to a disaster
- Major system failure or IT security breach

**Controls:**

- Business continuity plans in place.
- Insurance in place.
- Penetration testing and up to date anti-virus software

**KPI's:**

- BCP audits
- System downtime
- Number of successful security breaches

# Risks That Can Lead to Failure

## 6 Regulatory Intervention

### Main Reasons:

- Complaints
- Poor quality or late data submissions
- Financial viability concerns
- Serious detriment

### Controls:

- Governance & monitoring framework
- Zero complaints unresolved at Stage 3
- Checking and sign off of returns

### KPI's:

- Complaints satisfaction %
- Number of active stage 3 complaints
- 100% accuracy in regulatory returns

# This Session

4. Staying Afloat

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# Early Warnings

- KPIs are the triggers / early warnings that let you know the worst case scenario is coming
- How are you measuring these triggers?
- When do you pull the plug?
- Who has the authority to make the decisions?

# What can you do?

- Suspend uncommitted development
- Stop discretionary spending
- Delay major repairs and maintenance
- Close down loss making subsidiaries
- Sell assets

# Asset & Liability Integrated Approach

Stress Testing

What liabilities could crystallize?

Assets and Liabilities Register

How big could the cash requirement be?

What assets would be realized quickly?

Assets and Liabilities Register

# How can you prepare?

- Keep the Asset & Liability register up to date
- Know which assets are un-securitised
- Keep property valuations up to date
- Be aware of contingent liabilities

# In Summary – Be Prepared

- Understand risks and impacts
- Agree KPIs and thresholds
- Build into decision-making processes
- Investment return and exit strategies
- Worst case scenario - options
- Revise delegations & check urgency powers

# COMMENTS & QUESTIONS

# Good luck!

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- Finance
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