



THE SCOTTISH  
HOUSING  
REGULATOR

31 August 2010

Dear Chief Executive/Director

## **Regulatory Advisory Note: financial risk and viability**

The purpose of this advisory note is to highlight some key risks that we see emerging for the sector over the next few years. **This is about the sector as a whole and general issues rather than about your individual organisation or circumstances.**

The risks have come to our attention from many sources, including directly through our engagement with various registered social landlords (RSLs) across Scotland. We are aware that many landlords are already considering some or all of these issues. We expect some of these risks to have significant implications for a number of RSLs and we would restate the importance of good forward planning, governance and risk management in the current environment.

### **Key emerging risks**

All RSLs should give due attention to these emerging issues through their ongoing management of risk and business planning:

- increase in the VAT rate from 17.5% to 20% from 4 January 2011;
- increased exposure to, and management of, growing pension obligations (employers' contributions and liability and the auto-enrolment event in 2012);
- uncertainty about projected interest and inflation rate changes;
- more demanding private lending environment (increasing costs of funds, potentially shorter borrowing periods, covenant non-compliance resulting in review and re-financing);
- supply chain management (break down in supply chain / financial stability of private contractors);
- increasing scarcity of public funding and tension with increasing demand from those requiring housing and care;
- the potential for reductions in local authority expenditure in areas that may impact on RSLs, for example, pressures around care financing; and
- potential changes to Housing Benefit; and other welfare benefits.

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There are a number of other potential developments that may introduce further cost pressures or new risks for RSLs:

- increased complexity for risk management where RSLs are setting up trading subsidiaries for mid market rent, social enterprise etc;
- increased pressure upon arrears due to economic circumstances;
- potential use of Consumer Price Index rather than Retail Price Index for, for example, benefits and pension calculations;
- proposed or planned changes to housing policy including the implementation of the housing bill and planned changes to the property management / factoring regime;
- the potential costs of landlords' obligations in relation to climate change targets; and
- update to SORP 2008 and in particular the implementation of component accounting and the potential effect on loan covenants.

Later this year, the Scottish Housing Regulator will publish an analysis of the key risks facing the sector and our assessment of the likely impact of these on performance.

## **Business Planning**

We expect these, and any other relevant risks you have identified, to inform your business planning assumptions and future financial projections, and the strategies you need to consider to deal with the risks your organisation may face. The current economic conditions may also present opportunities for RSLs, for example, through more competitive procurement and RSLs will also wish to factor these in to their planning.

We would draw your attention to our letter and report to you in December 2008 about financial risk and viability and our recently published guidance on business planning. In particular, we expect RSLs to be: assessing any exposure to the prevailing housing and financial markets; revising their financial forecasts to include the risks we are highlighting; considering how cost increases will be funded; managing short-term liquidity; monitoring compliance with financial covenants; carrying out sensitivity analysis and scenario planning; and having a keen eye on cost control.

We will continue to assess risk across the sector and act in a proportionate way with landlords to make sure risks are managed to protect the interests of tenants and maintain the confidence of lenders and funders.

You should copy this advisory note to your chairperson and senior staff. If you would like to talk to us about the issues raised in this note or any other

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business challenges that are emerging for your organisation, please contact Ian Brennan, Head of Business Analysis, on 0141 271 3702 or Linda Scott, Senior Regulation Manager, on 0141 271 3766 or by email [ian.brennan@scottishhousingregulator.gsi.gov.uk](mailto:ian.brennan@scottishhousingregulator.gsi.gov.uk) or [linda.scott@scottishhousingregulator.gsi.gov.uk](mailto:linda.scott@scottishhousingregulator.gsi.gov.uk) in the first instance.

Yours sincerely



**Michael Cameron**  
**Acting Chief Executive**