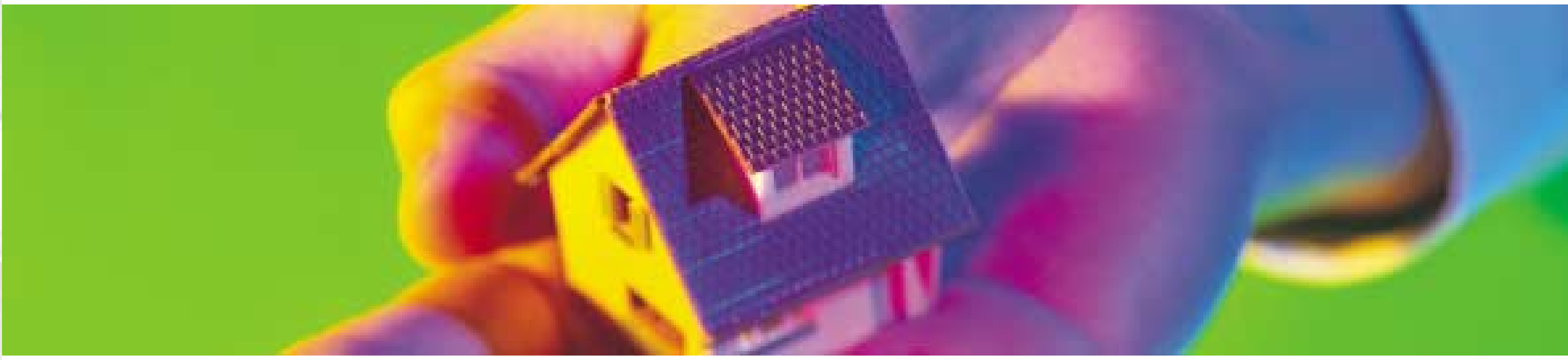
Regulating housing associations' management of financial risk



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 399 Session 2000-2001: 19 April 2001

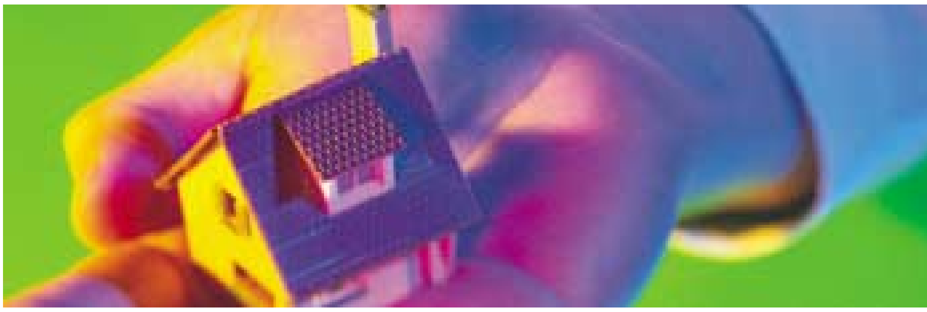
Ordered by the
House of Commons
to be printed on 9 April 2001

LONDON: The Stationery Office
£0.00

executive summary

Background and main findings

1 The Housing Corporation (the Corporation) is a non-departmental public body sponsored by the Department of the Environment, Transport and the Regions (the Department). The Corporation has two main functions - paying grants to housing associations and other registered social landlords[1] (RSLs) to provide social housing; and regulating RSLs' governance, financial performance and their development and provision of social housing in order to protect the interests of tenants and taxpayers. This report focuses on the Corporation's regulation of RSLs' financial performance, and particularly their management of financial risk.



2 RSLs are either registered charities, industrial and provident societies or companies registered with the Corporation to provide housing at affordable rents for the homeless and people on low income or with special needs. Set up as not-for-profit organisations, there are now some 2,100 RSLs. Between them they own or manage some 1.45 million homes, a third of the social housing stock in England, housing some 3.2 million people. Some £24 billion of public money has been invested in RSLs' housing assets and annual grants to RSLs are planned to rise from £811 million in 1999-00 to £1.2 billion in 2003-04. Since 1992-93, the sector has also raised some £20 billion in private finance and continues to borrow between £1.5 billion and £2 billion a year from private lenders such as banks and building societies.

3 In managing these resources, RSLs face a variety of financial risks and are responsible for the day-to-day management of them, while the Corporation is responsible for regulating how well they do this. The Corporation has the complex task of seeking to ensure that tenants' homes and taxpayers' investments are protected while also avoiding restriction on RSLs' scope to engage in well-managed risk taking. Our main findings are:

The Corporation and the sector have a good record in avoiding RSL financial failure. The Corporation has helped to engineer rescues of the few RSLs that have got into serious financial difficulty. As a result, no RSL has become bankrupt and no tenants have lost their homes in the last 10 years.

1 *Most registered social landlords (RSLs) are housing associations, but RSLs also include trusts, co-operatives and companies. Some housing associations choose not to register with the Housing Corporation and do not receive public funds.*

However, the sector is growing and becoming more complex and the risks are changing. RSLs are having to work their finances harder and increase their use of private finance, and many are diversifying into new business activities and partnerships with other organisations.

In response, the Corporation has embarked on a "regulation revolution" to make regulation less prescriptive and more targeted on areas of greatest risk. As this initiative moves forward, we recommend that the Corporation:

- strengthen its financial ratio analysis and ensure that, in replacing its performance standards with a new regulatory code, it identifies and focuses on good management of the key risks in the sector;
- collect and use more relevant and reliable information for its regulatory assessments, without increasing the regulatory burden on RSLs;
- improve the training and qualifications of regulatory staff, so that they may better regulate the sector as it grows and becomes more complex; and
- remedy problems more quickly, and make its regulatory assessments more transparent to the various stakeholders in the sector.

These main findings are elaborated on in the rest of this Summary.

Detailed findings and recommendations

4 The Housing Corporation has recently embarked on a "regulation revolution" to change the way in which it regulates the RSL sector:

- **Regulation will focus on financial management and governance**, to help prevent RSLs from getting into financial difficulty. The Corporation intends to target its efforts on those RSLs presenting the greatest risk. It also plans to allow RSLs more freedom to manage, with regulation focusing on outcomes rather than compliance with detailed procedural requirements. Greater emphasis will be placed on RSLs' own risk appraisals and the way in which RSLs propose to manage the risks identified.
- A newly introduced system of **Best Value and inspection will focus on the service delivered to tenants**, and will aim to encourage continuous improvement in these services. This will be similar to the Best Value regime which applies in local government and in relation to local authority housing.

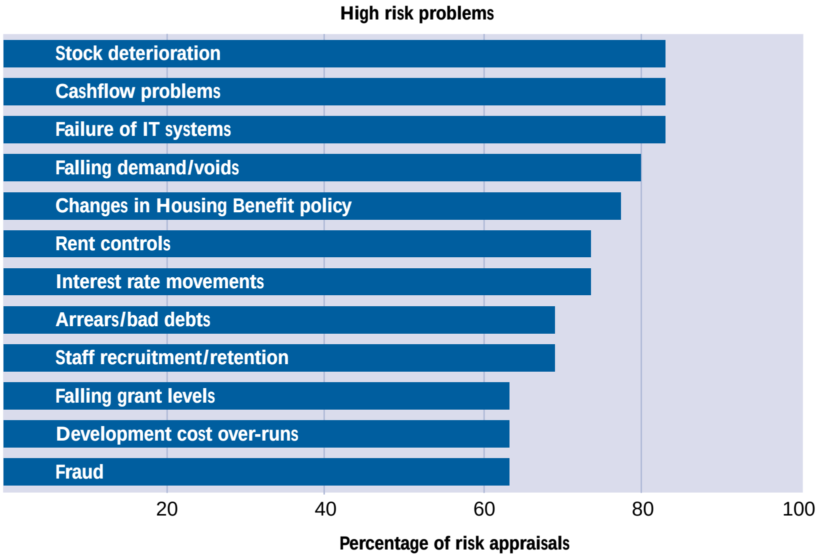
Our main findings and recommendations below are relevant to the regulation of financial management, and take into account this shift in regulatory approach.

On focusing on the key financial risks in the sector

5 Guidance issued by the Housing Corporation in May 1998 identified 20 potential risks facing RSLs but did not quantify the extent of those risks or how likely they were to materialise. The guidance accompanied the Corporation's introduction of a mandatory requirement that all RSLs with 250 or more homes carry out their own annual risk appraisals and report the results to their Boards and the Corporation. The risk appraisals of 42 RSLs we examined identified 12 common threats (see **Figure 1**). RSLs have direct control over some of these risks, such as stock deterioration, cash flow problems and failure of IT systems, and other risks are determined externally such as changes in Housing Benefit policy, rent controls and interest rate movements. If any of these risks mature, they have the potential to impact on an RSL's cash flow, causing loss or financial failure. Ultimately, severe financial losses could result in higher rents or poorer living conditions for tenants. A financial failure might also jeopardise grant monies or an RSL's ownership of publicly funded assets.

1 **The 12 most common high-risk problems identified in RSL risk appraisals**

The most common and highest risks identified in RSL risk appraisals were associated with RSL's traditional business activities.



Source: *National Audit Office review of a selection of 42 RSL risk appraisals*

6 To date, the Corporation and the sector have been successful in preventing the key risks of RSL insolvency and loss of tenants' homes. There have been no RSL insolvencies over the past 10 years resulting in losses of tenants' homes, despite an increase in the size and complexity of the sector. In the handful of cases each year where RSLs have encountered severe financial difficulties, the Corporation has helped engineer the transfer of their properties and tenancies to other financially stronger RSLs.

7 The Corporation issued performance standards setting out detailed requirements on how RSLs should be governed and how their finances should be managed. The Corporation is replacing these prescriptive, detailed standards with a new regulatory code setting out the key attributes of an RSL that is performing well. This code will be mandatory and will focus on the outcomes RSLs are expected to achieve rather than the former approach of specifying the processes needed to achieve them. RSLs are expected to identify their own key risks and to make their own arrangements for managing them. At the same time regulatory attention is shifting towards those RSLs that present the greatest risk, by placing greater emphasis on the lead regulation of the largest RSLs and profiling and scoring RSLs according to the risks that they pose. The