Homes & Communities Agency

The social housing regulator

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HCA Regulatory Judgement on Cosmopolitan Housing Group Limited – L4375

Cosmopolitan Housing Association Limited LH1298
Chester and District Housing Trust LH4291

December 2012

The Provider

Cosmopolitan Housing Group (CHG or the group) was established in its current form in December 2011 when Chester and District Housing Trust (CDHT) joined the group as a subsidiary. The organisation operates in 13 local authority areas, and owns and manages just over 12,500 homes.

Cosmopolitan Housing Group Limited (CHGL) is the parent body of the group and is non-stock holding. It provides strategic direction and corporate services to other members.

The group's registered providers are:

- CHGL, a non-asset holding registered parent which is non-charitable and registered by guarantee.
- CDHT, which was set up to take a transfer in November 2000 of homes from Chester City Council in Cheshire. It owns and manages 6,200 properties in the Cheshire West and Chester area. It is a non-charitable company limited by guarantee. It has one wholly-owned non-registered subsidiary, Chester & District Housing Trust (Property Holdings) Limited which owns Centurion House, CDHT's registered office.
- Cosmopolitan Housing Association (CHA), which has a mixture of social housing and student accommodation. It has charitable status and has approximately 3,400 homes in management throughout Merseyside and Cheshire, including 400 supported housing bedspaces.

The group has two additional unregistered subsidiaries. Cosmopolitan Student Homes Limited (CSH) has a portfolio of over 3,500 units in management in Merseyside, Manchester, Preston, Bradford, Stratford upon Avon and Birmingham, of which 466 are owned by CHA. The remainder are leased by CSH. Cosmopolitan Enterprises Limited (CEL) is a for-profit company limited by shares, established to specialise in commercial initiatives such as build-for sale and market rent.

CHG is governed by a remunerated board of ten members. This is supported by a group audit and risk committee and subsidiary boards at CDHT, CHA, CSH and CEL.

CHA and CDHT, as part of the Cheshire Housing Consortium, originally planned to deliver 730 new homes for rent under the Affordable Homes Programme. They now plan to deliver 287.

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Regulatory Ratings*

- **Viable (V4):**

CHG's and CHA's financial position is of serious concern and is subject to regulatory intervention or enforcement action.

- **Properly Governed (G4):**

The provider does not meet the requirements on governance set out in the Governance and Financial Viability standard. There are issues of serious regulatory concern and the provider is subject to regulatory intervention or enforcement action.

*The regulator's assessment on compliance with the Governance and Financial Viability Standard is expressed in gradings from G1 to G4 for governance and V1 to V4 for viability. For both viability and governance the first two grades indicate compliance with the standard. A G3 or V3 assessment indicates a level of concern with the organisation's performance that is likely to be reflected in intensive regulatory engagement. A G4 or V4 judgement indicates a failure of governance or viability to the extent that the regulator is using its statutory powers.

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Regulatory Judgement

The regulator's assessment of Cosmopolitan Housing Group's governance and viability has been downgraded since the last regulatory judgement published in February 2008 to reflect serious problems with its governance, risk management and financial position. These in turn reflect major shortcomings, including a failure to recognise and manage operational risks, an overly ambitious approach to development and the emergence of failures in internal control dating back some years.

In December 2011, Chester and District Housing Trust became a subsidiary of the Cosmopolitan Housing Group. Board papers and the business case supporting the merger showed that the expanded group demonstrated an awareness of its opportunities to have a positive impact in local communities. Subsequently, links between this vision, operational priorities and programmes in some areas, became obscured by the group's ambition to deliver a large development programme.

Post-merger, insufficient priority was given to the Group Board reviewing existing strategies or previous decisions, placing it in a position where it exercised inadequate control over the direction of the organisation and was unaware of the considerable risks it faced. The quality of reporting to board was inadequate. In particular, the pre-merger group had entered into obligations with non-regulated members of the group putting social housing at risk, but lacked effective mechanisms to identify and manage the exposures.

The Group Board recognised some of these deficiencies. Within a month of the merger it commissioned a review of governance arrangements and an inspection of its customer-facing services. While the inspection recommendations were acted upon, the recommendations of the governance review were not implemented as the series of events exposing the group to risks began to crystallise and placed the board on a reactive footing.

In early 2012 the regulator raised concerns over the group's assessment of risk in respect of its plans for financing its future development aspirations. This brought to light further issues relating to governance, risk management, internal controls, and liquidity management.

The group's approach to risk was based on an over-simplification of presenting issues, coupled with too little scrutiny of new deals taking place after the merger. This, alongside an inadequate control environment, especially in relation to the development function, exposed the group to unacceptable levels of risk. In particular the board's decision to fund its investment programme through a sale and leaseback arrangement was based upon a wholly inadequate analysis of risk and a rudimentary sensitivity analysis, coupled with a failure to consider alternative plans. The quality of information reported to board in support of decision making has been poor. Additionally, the level of challenge of officers by board and sub-committees has been inadequate, and assurances have not been adequately tested.

The group failed to ensure effective controls to protect assets and public funds. The business planning and control framework failed to ensure access to sufficient liquidity, and the group failed to effectively manage the risks to delivery of its plans. Future financial plans included aggressive and ambitious funding assumptions which

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proved over-optimistic.

The group board's oversight of treasury operations was ineffective. Officers failed to bring to the members' attention the increasing pressures on liquidity until a point where the business was reliant on an overdraft that it was at risk of breaching. Cash flow forecasts were inconsistent, sometimes incomplete or inaccurate and failed to highlight material changes.

The failure of parent and subsidiary boards and committees to adequately oversee group wide activities or to monitor liquidity, together with a culture of inadequate challenge allowed the liquidity position to deteriorate rapidly.

As a result the regulator signalled to the group that it was failing to meet the governance and financial viability standard, and that it needed immediately to bring in additional expertise at board and officer level. Despite this strengthening of its capacity, and the completion of an independent review of the group's financial health, the regulator concluded that the group needed further support, and that immediate work was needed to manage concerns and consider the group's future strategy.

To date the regulator has not taken enforcement action, but in August 2012, the regulator agreed a Voluntary Undertaking (VU) with the group to address these issues and to examine the group's future. Among other things, the VU required the group to co-opt new members with suitable skills to its board, increase its financial expertise, improve its cash flow forecasting and reporting, draw up contingency plans to prepare for any further liquidity or other problems, and through external consultants, conduct a strategic review to consider the group's future as an independent organisation and other options. The group has subsequently reconstituted and strengthened its board and has brought in additional interim management and consultancy support to address its problems.

There was no planned review of the group's student housing portfolio immediately after merger. Therefore, despite due diligence at the time of merger, the group only became aware of potential substantial exposures within this operation in September 2012. These were exacerbated by the identification of long-standing contractual arrangements within the group, pre-dating the merger with CDHT, which impacted upon compliance with key covenants within lending agreements by CHA. As a result of the late identification of these obligations, completion of audited financial statements for the year ending 31st March 2012 is delayed, resulting in further breaches of financial covenants by CHA.

The group board has now reviewed its position and resolved to seek a suitable partner to take on its assets and liabilities. CHGL is currently in negotiations to become a subsidiary of The Riverside Group Ltd.

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