Effective risk management

The Group's risk appetite sets out the level of risk that we are willing to accept in pursuit of our business objectives.

The Board is responsible for setting the Group's risk appetite and delegates the responsibility for the setting of limits and policies and monitoring of processes, systems and reporting to ensure that the Group is operating within the risk appetite to the Audit Committee.

Risk appetite statements have been created for each Level 1 Risk and Level 2 Risk category and provide an articulation of the Group's tolerance for risk in both qualitative measures and, where appropriate, quantitative terms. Level 1 Risks are defined as Credit Risk, Market Risk, Conduct Risk, Capital & Liquidity Risk, and Operational Risk. Level 2 Risks are sub-sets of each Level 1 Risk.

The definition of risk for the Group has been created following discussions among the Group's Executive Committee and with members of the Audit Committee and the Board. They are used in mapping key risks and assessing their materiality, and ultimately underpin the Group's overall risk management framework.

The risk appetite statements are reviewed formally on an annual basis by the Board as part of planning and budget setting and the review of the Group's medium-term strategy. They combine a top-down view of the Group's overall risk capacity with a bottom-up view of the risk profile requested and recommended by the business area (which will have been previously discussed and reviewed by the Audit Committee).

Throughout the year, all aspects of the risk appetite statements (which are monitored by the Executive Committee) are reported to the Audit Committee and the Board. In particular, the Executive Committee is responsible for assessing the impact on the Group's risk appetite of any changes in circumstances (internal or external) that may warrant a change to the risk appetite statements, and recommending any consequent changes to the Audit Committee and the Board ahead of the scheduled annual review.

Overarching risk appetite statements

Overarching statements as detailed below express the Group's broad risk appetite at a 'whole business' level, whilst underlying limits cover specific aspects of the Group's operations.

We maintain stakeholder confidence – by operating the business in such a way that we deliver against key objectives, both financial and non-financial, and remain within our risk appetite.

We maintain adequate capital and liquid resources – we maintain a sufficient level of capital and liquidity to support effectively the lending and asset management activity of the business and to ensure that all liabilities are met as they fall due under both normal conditions and under a range of stress scenarios and regulatory guidance.

We protect our reputation – we are seen as an organisation that treats all our stakeholders fairly; we have no appetite for material negative or adverse reputational events.

We limit the potential for credit losses – by being aware of and managing key concentrations, lending in markets where we can demonstrate expertise and consistent with risk-adjusted returns.

We manage our operational risks effectively – we have a low tolerance of operational risk failures and ensure that all our people are properly trained, procedures are thoroughly documented, and supervisory controls and reporting methodologies are in place to minimise the impact of adverse operational risk events that disrupt customer service.

We demonstrate high standards of conduct and compliance – we have a low tolerance for material conduct and compliance-related adverse events, or breaches of a regulatory or legal nature, and will operate the business in such a way as to minimise the potential for such adverse events to occur.

Primary board risk appetite metrics & reporting

Periodically, the Board and management review the corporate plan, performance against the plan and the key underpinning assumptions. Reviews can take place more frequently if circumstances change.

The following tables detail risk appetite categories based on the current business plan.

The risk profile is reported monthly to the Executive Committee and bi-monthly to the Board, supported by commentary on an exception basis (Amber and Red indicators) where they are subject to review and challenge.

The metrics in respect of the categories provide both a point in time position (current month 'RAG' status) and an indication of direction of travel versus short- and medium-term plans. As a consequence, the Board and Executive management are better equipped to decide, at an early stage, whether changes to the plan or to levels of risk appetite require further consideration.

Level 1 Risks, their potential impact on the Group and the manner in which those Level 1 Risks are mitigated are shown in the table below. Our core business is the origination and asset management of loans secured against property. The risks set out below are all considered key risks to our core business.

There are other risks associated with general financial uncertainty in the business (or in any other business), e.g. the loss of staff and insurance risk. These have been reviewed but are not considered key or principal risks.

Risk	Explanation of risk	Impact on the Group	Mitigation of risk
Credit risk	The Group is exposed to credit losses if borrowers are unable to repay loans and outstanding interest and fees.	A major loss could have a serious effect on Group profit.	The Group has stringent underwriting criteria which include third party valuations and a full legal documentation pack for each loan written by the Group. Further details of the Group's credit process are set out below.
Market risk	A risk that a change in the Group's funding rates will impact its return from lending.	A potential reduction in earnings.	All loans made by the Group are subject to a floor interest rate, and the interest rates charged move with changes in funding costs or are appropriately hedged, so that the Group does not have interest rate risk.
Capital & liquidity risk	A risk that the Group does not have sufficient capital and/or liquidity to fund its business.	A lack of capital and/or liquidity will result in the business not being able to fund its costs as they fall due or fund its lending to borrowers.	The Group does not commit to any loan to a borrower without clearly identifying how the loan will be funded over its life. The Group maintains a minimum level of liquidity to ensure that its 12-month projected operational costs are fully funded.
Conduct risk	Any action that leads to a breach in the regulatory or legal obligations of the Group.	Failure to comply with regulatory or legal obligations could result in fines being imposed on the Group.	Anti Money Laundering checks are conducted for each loan as part of the Group's stringent underwriting criteria. Third party law firms are appointed on each loan written by the Group and the Group has zero tolerance for any material breaches of law or regulatory obligations.
Operational risk	Any action that leads to an interruption in the provision of business services by the Group.	A failure in the operations of the business may cause harm to the customers of the Group and may have an impact on the income of the business.	The Group seeks to ensure that it remains resilient to operational risk events through the maintenance of a robust control environment and transparent reporting of control failures and risk incidents.

Principal risks & uncertainties continued

GDPR

As a business, we do not rely on significant volumes of third party data, however we do handle personal client information in the process of complying with Anti Money Laundering checks. We have invested in third-party operational reviews to ensure our processes are compliant with GDPR, which came into effect in May 2018.

Credit Committee

The Credit Committee is comprised of Rabinder Takhar (Chairman), Randeesh Sandhu and Daljit Sandhu. The Committee meets once a week, or more frequently if required by the Committee Chairman.

The Committee is responsible for reviewing the credit policy, and monitoring the performance of the credit portfolio with respect to the credit policy and current market conditions. In addition to this, the Committee will oversee new product approval, review of risk models, approval and monitoring of large exposures, and workouts. Recommendations for adjustment of policies are made to the Board as are requests for authorisation of new loans.

The Committee is the second line of defence from a risk perspective, the first line being the underwriting team, which is comprised of underwriters with many years of experience of development finance transactions.

The Credit Committee approves or rejects transactions through a two-stage process. An initial Pre-Credit Approval is required for each transaction after Heads of Terms have been sent to the potential borrower. The Pre-Credit Meeting determines whether there is an initial approval to proceed and, if so, subject to which conditions; otherwise the transaction is declined. Unanimous approval of the Credit Committee is required before a transaction proceeds.

Final Credit meets after full due diligence has been completed, including, but not limited to, full Anti Money Laundering checks, full red book valuation, reports on title, an independent review of construction costs, programme and procurement, and loan facility and security documentation. Final Credit determines whether all Pre-Credit Approval conditions have been met and whether the results of the full due diligence exercise are satisfactory. The transaction is at this stage either declined or approved, subject to final conditions for funding.

Credit risk is key to the Group's business. At the underlying loan level, the Group seeks to mitigate a number of risks through a rigorous credit underwriting process:

Welwyn Garden City, Hertfordshire

Senior debt facility to fund working capital for the Borrower following land acquisition. A high profile site consisting of 10 acres adjacent to the train station, it was formerly the Shredded Wheat Factory which closed in 2008 after 73 years in operation. Part of the former factory and all of the silos are Grade II* listed. The development will comprise 850 dwellings, potentially including up to 80 care home/ assisted living units, various retail, commercial, office and leisure uses, together with ancillary amenity space. Several stakeholders including Tesco, Metropolitan Housing Trust and Welwyn Hatfield Borough Council.

The ZM Land team has delivered over 300 planning consents amounting to over 9,000,000 sq. ft of development in the last 20 years.

GDV: £133.1m

Risk	Mitigating factor	
Planning	• Only fund schemes that have outline or full planning permission in place	
Construction	• Only lend to experienced developers with typically a 10-year + track record in UK development • Due diligence developers and professional team, including its main contractors and sub-contractors	• Drawdowns are paid in arrears only once external project monitors verify the works, values and costs • In-house capability to complete construction of any project – 'step-in' rights
Credit	• 100% of required equity taken up front prior to releasing first tranche of UE loan • Cost overrun guarantees trigger further injection of equity from borrower	• Robust stress-testing of borrower's model • Performance bonds to cover insolvency risk
Sales	• Approval of developer's sales and marketing plan • Facility LTGDV average 67%, (capped at 75%) • Pre-sales prior to funding with large deposits held in escrow – loan value typically lower than pre-sales value • 30–40% fall in prices required to impact on capital – values in London fell by c. 22% during 2007–2009	• Lending in areas with strong rental demand • Only lending on projects with end units priced in line with local market • Requiring minimum 10% deposit, individuals only, UK residents predominantly
Stamp duty changes	• Urban Exposure typically lends on low/mid end-priced developments – these projects have benefited from the recent SDLT reductions	
Housing bubble	• Supply/Demand imbalance in the UK at its greatest since WWII • UK population at all-time high and continuing to rise at record rates	• Sizeable government initiatives and funding support to increase housing supply across the UK (inc. Help to Buy, SDLT reform, Lifetime ISAs, etc.)
Political climate	• Housing is always a key focus of any government given its significance to voters. Focused on areas where demand exceeds supply and lending on projects in line with government policy	• As Brexit nears in April 2019, the government has reiterated its support for the White Paper of 2017, which matches the Company's lending strategy also
Interest rate rises	• Loans typically linked to LIBOR (with LIBOR floor) • UE loans may require the borrower to be hedged against interest rate rises	• End buyer mortgages are currently offered at historic lows, and this is expected to continue for the medium term