Housing Business Planning Assumptions and Uncertainties – Briefing Paper

October 2017

Cressingham Gardens in Lambeth.

Introduction

In 2011, the Chartered Institute of Public Finance & Accountancy advised that:

"The real power of self-financing develops over the medium to longer term as the surpluses increase due to real terms rent increases outstripping inflation on costs. The revenue surpluses… are the used to address investment needs and service debt."

However, the increasing surpluses have not materialised, mainly because of the policy of reducing rents in cash terms by 1% a year between 2016 and 2019. Furthermore, the certainty that self-financing was meant to introduce to facilitate long-term planning has not occurred either.

The new uncertain environment requires a different approach to business planning. In the past, it was usual to produce a single strategic plan and financial forecast that represented what the Council expected would happen. This is no longer sufficient. There is a need to treat this business plan as just one of a number of possible scenarios. There is a need to stress test this base business plan to establish how it would respond to changed assumptions; and then to develop contingency plans to address any issues that arise. To date, this approach has been developed further in housing associations than in local authorities with the Homes & Communities Agency promoting 'stress testing' through 'Regulating the Standards'.

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This briefing paper examines the assumptions that local authorities can make surrounding the key uncertainties that affect business planning. Some of the discussion is also relevant to housing associations.

Inflation

The Welfare Reform & Work Act 2016 removed the long-standing link between inflation and rent increases and thus exposed local authorities to significant risk if, as is currently expected, rates of inflation increase. The risk of increased inflation is most acute in the case of maintenance costs.

For example, in August 2017, Brian Berry, Chief Executive of the Federation of Master Builders told 'Inside Housing' about research that the Federation had carried out:

"Material price increases have left builders under severe pressure. This research shows that following the fall in the exchange rate, timber is the material that the majority of builders say has increased most in price but the problem doesn't end there – everything from insulation to windows to bricks and blocks are soaring in price."

Furthermore, any restrictions on the free movement of labour are likely to result in labour shortages and increased costs.

The latest inflation forecasts published by the Office for Budgetary Responsibility were made in March 2017 and are as follows:

	2017	2018	2019	2020	2021
Retail Prices Index	3.7%	3.6%	3.1%	3.1%	3.2%
Consumer Prices Index	2.4%	2.3%	2.0%	2.0%	2.0%

Housing business plans have traditionally been based on an inflation rate in the retail prices index of 2.5% on the basis that this is likely to be the long-term average rate. However, the Office for Budgetary Responsibility considers that inflation will exceed that level over the next five years. Furthermore, other forecasters consider that rates of inflation may be even higher with the National Institute for Economic & Social Research forecasting an increase in the retail prices index of 4.1% in 2017.

If the forecasts of the Office for Budgetary Responsibility are correct, an increase in rents at the level of the consumer prices index plus 1% is likely to result in a rent increase that is lower than the retail price index.

Housing business plans have traditionally assumed that inflation in management and maintenance costs would exceed increases in the retail prices index by 1% to 2% a year. This matter is considered further in the sections on management and maintenance costs below.

Dwelling Rents

Until recently, rents were the largest single uncertainty in a housing revenue account. However, in October 2017 the government announced that for five years from 2020, social rents would increase by no more than the rate of the consumer prices index plus 1%.

However, forecasting rent increases may not be as straightforward as expected and the government's words 'no more than' may prove to be critical. There is a need to consider the relationship between rent increases and increases in the entitlements of tenants who are eligible for housing benefit. With many benefits 'frozen' there is a need to identify whether any tenants would not be able to claim full benefit on their rents and whether this would be likely to result in a decision to limit rent increases. There may also be a need to consider the affordability of rents for tenants who are not eligible for housing benefit.

The government's rent policy will come to an end in 2024. There is therefore a need to consider what level of rent increases should be modelled for 2025 onwards. A continuation of the policy of increasing rents by the level of the consumer prices index plus 1% may be expected, but a range of alternative scenarios should be modelled as part of the sensitivity analysis.

Rent policy is a critical area to 'stress test'. There is also a need to consider options around changing the mix of tenures between social, affordable and market rents.

Service Charges

The Chartered Institute of Public Finance & Accountancy has advised that:

"It is an opportune time for authorities to consider or reconsider decisions regarding un-pooling of service charges from the rent. Service charges are a source of income for the business plan that should be reviewed, although in these straitened times they may be seen as an unacceptable financial burden for tenants."

Service charges are an integral part of landlords' work in financing value for money services and sustaining customer satisfaction. Housing Associations have traditionally levied service charges with most local authorities in England introducing them in the 'noughties'. In Wales, local authorities and housing associations have introduced service charges as part of the Welsh government's new rent policy. In Scotland service charges are also significant. The rolling out of Universal Credit is having an impact on benefit entitlement for service charges.

While most local authorities have now introduced service charges there is considerable evidence that they are often insufficient to recover the full costs of the services that are provided. Furthermore, many authorities do not have sufficiently robust financial systems to be able to identify the costs of providing services accurately or to calculate what an appropriate service charge should be. These matters need to be addressed as part of the business planning process.

AWICS has devised a service charge 'health check' that offers social landlords a comprehensive high level review of special and communal services and service charges to establish their robustness, effectiveness and sustainability and that offers recommendations for improvement.

The 'health check' asks and answers the following questions:
- What do services cost to provide and is income maximised?
- Does the service comply with legal requirements and good practice?
- Does the service offer value for money?
- How good is the property data?
- How good are the accounting systems and charging mechanisms?
- How good is the input and monitoring from residents?
- Could further charges be de-pooled?

This is a useful check for landlords who would like to establish the strength of their existing approach to services and service charges and whether and how that approach can be improved.

We have developed a methodology for introducing and de-pooling service charges that enables us to identify the scope for new and / or increased service charges and to develop options for their introduction. Our methodology includes:

- Considering what to charge for based on statute, case law and the provisions of leases and tenancy agreements
- Identifying the merits of fixed or variable service charges
- Identifying all appropriate costs
- Identifying options for apportioning costs between schemes, leaseholders and tenants based on the best available information
- Ensuring charges represent Value for Money
- Keeping it Simple
- Consulting residents and providing complete information

This is a useful process for landlords who would like to examine the scope to introduce new service charges or to vary existing service charges as part of a strategy to maximise income or improve value for money.

Information about how AWICS can provide advice and assistance with service charges can be found on our website at: http://awics.co.uk/schsadvice

Voids and Bad Debts

Income recovery rates can vary significantly due to changes in levels of voids and bad debts. Changes in the economic environment are likely to affect demand for different types of property and levels of rent collection in ways that are difficult to predict. For example, the roll-out of Universal Credit is likely to increase arrears and bad debts; while restrictions on eligibility for housing benefit could reduce demand for supported housing and increase demand for shared accommodation from young people. Different scenarios will need to be modelled.

Housing Business Plans have traditionally been based on recent levels of voids and bad debts continuing in the short-term with improvements modelled in the medium-term if current levels are high. The government used to assume 2% for voids and bad debts in the housing subsidy calculation and it is often assumed that landlords should reduce their voids and bad debts to 2% of they are not already at this level. Since 2010, many housing business plans have included provision for increased voids and bad debts as the government's reforms to the welfare system are introduced.

It is probably advisable to consider voids and bad debts separately.

High levels of voids can be caused by low demand for certain properties or by delays in making voids re-lettable. It is important to consider whether demand for any properties is likely to change during the life of the business plan. For example, the 'under-occupation penalty' led to a reduction in demand for two-bedroom flats in some areas; while the capping of housing benefit at the level of the local housing allowance is likely to reduce demand for properties where rents plus service charges exceed the local housing allowance. There is a need to carry out an assessment of future demand, devise strategies for managing it, include realistic estimates of voids in the business plan, and model variations in voids as part of the sensitivity analysis. If high levels of voids are caused by long void turn-around times there is a need to consider whether these turn-around times can be reduced.

The level of bad debts can be affected by the financial position of tenants and by the effectiveness of the landlord's debt collection processes. Tenants (and leaseholders) are likely to face increasing financial problems moving forward caused by reductions in benefit entitlements and real reductions in incomes caused by inflation and low growth. It may therefore be advisable to consider the financial position of tenants (and leaseholders), consider how effective money advice and debt collection services can be maintained, include realistic estimates of bad debts in the business plan and model variations in bad debts as part of the sensitivity analysis.

Non-Dwelling Rents

The Chartered Institute of Public Finance & Accountancy has advised that:

"Whenever the rentals of non-dwellings are reviewed it is crucial that the costs of operating them are recovered… Each class of assets should be considered separately when projecting income forward as there are differing influences on their potential rent income."

Housing business plans have traditionally assumed that non-housing rents would increase in line with inflation. However, this may no longer be realistic in the current economic situation. There is also a need to consider non-housing assets carefully as part of the asset management strategy (see below). The income that they generate may represent a low return when the costs of management and maintenance are considered; and there may also be a significant 'opportunity cost' in that land used may have the potential to generate capital receipts or to become sites for new housing. Council housing should not be regarded as a 'static' service and this should include reviewing the portfolio of non-housing assets.

The business plan should include a realistic assessment of future income flows and, if appropriate, the financial implications of plans to dispose of assets or to use them differently. Any risks should also be considered as part of the sensitivity analysis.

Other Income

The Chartered Institute of Public Finance & Accountancy has advised that:

"The financial position of schemes that rely on Supporting People grants must be transparent and decisions on the options for the future must be fully evaluated and discussed with the tenants who are affected. Similar critical appraisal should be made if any other service is supported through external grant.

"Rechargeable repairs can be a regular income source, as can other reimbursements of costs such as court fees and insurance claims… Authorities will need to review both their policies and income collection rates… It is a prudent approach to include within the business plan these income sources at a level that is representative of the monies to be generated for the service and that the processes used for recording and collection offer value for money.

Supporting People Grant is being withdrawn, leaving landlords with the challenge of how to fund housing support services. Options include ceasing to provide services, reducing the costs of services, funding them from the general rent pool or introducing service charges for intensive housing management. In the business plan there is a need to be realistic about future levels of Supporting People Grant and to devise a strategy for how this situation is to be managed. Assumptions about reduced costs and / or increased service charges need to be realistic and the risk that they are not achieved needs to be considered as part of the sensitivity analysis.

The same principles apply to rechargeable repairs.

Management Costs

The Chartered Institute of Public Finance & Accountancy has advised that:

"In compiling the cost of services paid for within the housing revenue account the main considerations are:

- *Accounting for the ALMO management fee, if the authority operates an ALMO, over a thirty-year period and any changes expected in the fee as a result of changes to the agreement or other revisions.*
- *Ensuring that for services subject to charges, the income covers costs in each of the thirty years.*
- *Ensuring that services provided through other parts of the authority represent value for money. (Self-financing) could be an opportunity to revisit the policy on charges to the housing revenue account from the general fund to validate the value provided and re-examine the potential for efficiencies to the housing revenue account and general fund. Putting in place a more formal service level agreement may assist in clarifying what services are being delivered and at what level. The test for whether a cost should be in the housing revenue account is 'who benefits?' If it is of wider benefit than solely to tenants then there should be an appropriate split of costs.*
- *Assessing services subject to reimbursement from tenants to ensure that reimbursement levels are set correctly.*
- *How these costs compare to the uprated management allowance."*

Most management costs are usually staffing costs. Traditionally, housing business plans have assumed that management costs will increase more rapidly than general inflation on the basis that local government pay awards will represent real increases in pay in the long-term. However, this has not been the case recently and may not be the case in the foreseeable future.

Between 2011 and 2013 there was a two-year pay freeze for all public-sector workers earning an annual salary of £21,000 or more, which was expected to reduce public expenditure by £3.3 billion by 2014–15. In subsequent years a public sector pay cap resulted in annual public-sector wage increases being effectively capped at 1% for 2013–16, extended to 2020 in the 2015 budget. During the 2017 general election the Conservative Party proposed retaining the cap until 2020. In September 2017, the United Kingdom government announced the raising of the cap in England and Wales but pay increases are expected to be lower than the general level of inflation.

In June 2017, the Office for National Statistics reported that average weekly earnings – adjusted for inflation - fell by 1.2% in the public sector and 0.5% in the private sector in the three months to April 2017 compared to the same period the year before. Inflation had increased to 2.9% - more than the growth of basic pay in the United Kingdom in the three months to April, which was 1.7% year-on-year. When bonuses were included growth in wages was 2.1% - still below inflation. The Office for National Statistics stated that:

"This is the first annual decline in total real average weekly earnings since 2014."

Nominal average weekly earnings - excluding bonuses - increased by 1.1% in the public sector and 2% in the private sector.

Also in June 2017, Unison, Unite and the GMB, who between them represent more than 1.6million local authority employees, submitted an improved pay claim for 2018/19. The claim seeks to move the lowest paid staff onto the real living wage of £8.45 an hour (£9.75 in London) and insists all employees should receive a 5% pay rise. This follows years of pay freezes and an official 1% pay increase cap on public sector wages introduced by the previous Conservative government in 2015.

However, Councillor Sian Timoney (Labour), Member of Luton Borough Council and Local Government Association chair of the National Employers, told 'Public Finance' that the organisation would be consulting councils and unions about pay and the 'challenge' of the government's proposed national living wage and that:

"We recognise that public sector workers have had lower than average pay awards for a few years now, but local government continues to face significant financial challenges so we are surprised that the unions are seeking such an ambitious pay award. Local government has lost more than half a million jobs in recent years and meeting this claim would result in many more such job losses."

The Office for Budgetary Responsibility forecasts the following increases in average earnings that would result in real reductions in average earnings until 2020.:

	2017	2018	2019	2020	2021
Average Earnings	2.6%	2.7%	2.9%	3.4%	3.6%
Retail Prices Index	3.7%	3.6%	3.1%	3.1%	3.2%
Real Variation	1.1% -	0.9% -	0.2% -	0.3% +	0.4% +

There is therefore a need to decide, for housing business planning purposes, whether real increases or real reductions in salary costs should be included in the financial model. While most forecasters expect real reductions in the short-term it may be prudent to plan for real increases in the long-term – or certainly to consider the effects of increased staffing costs as part of the sensitivity analysis.

Repairs and Maintenance

The Chartered Institute of Public Finance & Accountancy advised in 2011 that:

"The introduction of self-financing and the funding for backlog repairs and expected to result in an improvement in the overall quality of the homes. For most authorities their homes will reach the decency standard in the early years of the business plan. The regulator is then expecting all providers to maintain their homes at this standard. Where this is the case a judgement has to be made as to whether, having the homes at this standard, it will have an impact on the monies required for responsive repairs or re-letting costs.

"When the evaluation is completed, how this compares to the uprated management allowance used in the settlement should be considered."

While there was an expectation that the achievement of the decent homes standard would reduce the need to spend on responsive repairs and even on planned maintenance and void works, there is little evidence that this has been the case. If anything, raising the standard of homes to the decent home standard has raised tenants' expectations and therefore increased the demand for responsive repairs and other revenue repairs and maintenance.

There are likely to be increases in the costs of building maintenance and construction due to the reduced value of sterling and increased difficulties in recruiting labour from outside Britain.

Traditionally, housing business plans have assumed that there would be real increases in the costs of building maintenance based on the fact that construction costs generally increase faster than the general level of inflation in the economy.

The total value of net imports of building materials and components from the European Union was £4.9billion in 2015, according to the Office for National Statistics; and Construction materials are estimated to have increased by between 6% and 12% since Britain voted to leave the European Union, putting building firms under pressure.

Ted MacDougal, Development Director for Forrest, told delegates at a session at Housing 2016 on the European Union referendum that these price rises would put contractors under pressure:

"Six to 12% in a five-day period is worrying, especially when you are poor contractor. Where is it going to come from: contractor's margins? Normally the trade is done at the point of purchase but the deals are in transit but I would predict between 6% and 12% typically. In the short to medium-term there will be a lot of contractors, us included, under a lot of financial pressure. We've just got to get on with it but be very fleet of foot, very capable, very efficient."

And Angela Jameson, a business and finance journalist wrote in the 'New European' that:

"House builders and construction related stocks have seen their values plummet on the stock market in the months after Brexit. Now Travis Perkins, which has builders merchants nationwide is saying that it is closing thirty branches, hitting 600 jobs in the face of uncertain trading."

The construction industry operates on a pan-continental basis (remember 'Auf Wiedersehen Pet'?) with many British construction companies currently dependent on labour from other European Union countries. Any restrictions on the free movement of labour (as proposed during the European Union referendum) would have an adverse effect on their ability to provide construction, major repairs and revenue maintenance services to local housing authorities at a reasonable price.

Brian Berry, Chief Executive of the Federation of Master Builders told 'Inside Housing' that the United Kingdom construction industry is heavily reliant on migrant workers from Europe and 12% of British construction workers are of non-United Kingdom origin. He said that it was the government¹s responsibility to ensure that the 'free-flowing tap of migrant workers from Europe was not turned off.

There is therefore a need to decide, for housing business planning purposes, whether real increases or real reductions in building maintenance costs should be included in the financial model. It may be prudent to plan for real increases in the long-term – or certainly to consider the effects of increased building maintenance costs as part of the sensitivity analysis.

Efficiency Gains

There are differing views about the extent of the scope for further efficiencies in management and maintenance. It is often said that the scope for such efficiency gains has already been exhausted. However, others take the view that was famously taken by Sir Peter Gershon that efficiency gains of at least 2% a year should be achievable on a permanent basis. Still others argue that the scope for efficiency gains is greater than this. In practice, most authorities have ensured that their financial projections 'balance' by making whatever assumption is required about future efficiency gains. This may no longer be an appropriate approach moving forward.

The justification behind Sir Peter Gershon's argument was that, if productivity in the economy in general was growing by 2% a year (which it was at the time that he produced his report in 2004) it could be expected that the same opportunities would exist to increase productivity in the public sector. However, productivity in the economy is no longer increasing by 2% a year and it could also be argued that it would not be prudent to assume efficiency gains without identifying specifically how they could be achieved. It may therefore be prudent to include efficiency gains in the business plan forecast only where specific measures have been identified with consideration being given as part of the sensitivity analysis of the risk that these efficiency gains may not be achieved.

Capital Financing Costs

Capital financing costs are significant especially following the increase in debt in 2012 at the time of the self-financing settlement. Currently, interest rates are at an 'all time low' with the Bank of England's base rate being set at 0.25%. Government policy is to maintain interest rates at a low level in an effort to boost demand by encouraging borrowing and discouraging saving. However, with the rate of inflation increasing, most commentators are predicting that interest rates will increase soon; with most expecting an increase in the Bank of England base rate to 0.5% in November 2017.

It can be expected that in the long-run interest rates will return to a rate somewhat above the inflation rate. However, most economists do not expect this to happen for some time with typical forecasts suggesting periodic increases of 0.25% with interest rates reaching 1.25% in 2022.

Interest rates are currently very low by historic standards and, as they are lower than the rate of inflation represent negative interest rates. This means that the interest that people receive on their investments does not compensate them for the reduction in the value of their investment due to inflation. This is the intention of the government and the Bank of England who want to provide an incentive for people to spend and a disincentive for them to save. This policy has been adopted to persuade households to reduce their saving and increase their borrowing thus maintaining demand in the economy despite the current low levels of commercial investment and exports. This approach is resulting in a ballooning of private debt and does not appear to me to be sustainable. It was a similar ballooning of debt that caused the banking crisis and economic recession in 2008.

I am sceptical about the economic forecasts that have been produced and think that interest rates may increase sooner and more significantly, because:

- The Bank of England has been set a target of maintaining inflation at or below 2%. It is now almost twice that level. Furthermore, increasing inflation increases the gap between inflation rates and interest rates and increases the incentives for households to spend rather than save.
- Sterling has been under pressure since the referendum on Britain's membership of the European Union and has declined in value by about 15%. It has been the policy of successive United Kingdom government's over at least the last 100 years to maintain Sterling at as high a value as possible. Policy since 2016 has been a departure from this approach and it is not clear how far the current United Kingdom government is prepared to let the value of sterling fall before they act to support it. Further pressure on sterling may force the government and the Bank of England to raise interest rates to encourage international investors to buy sterling rather than to sell it.

Local authorities can, and do, protect themselves from the possibility of increases in interest rates by borrowing long-term at fixed rates of interest. This means that even a large and sudden increase in interest rates would have a relatively gradual effect on capital financing costs in housing revenue accounts.

There is therefore a need to provide for increased interest rates in business plan projections and to consider the impact of significant increases in interest rates as part of the sensitivity analysis.

Different authorities have different attitudes towards debt with some wishing to maximise debt so that they can maximise capital expenditure while others wish to repay debt so that they can reduce revenue expenditure. Treasury Management strategy is therefore an important part of business planning and changes in interest rates are certainly a variable against which sensitivity analysis is required.

Stock Levels

Council housing is no longer a static service. Stock levels can reduce because of ‘right to buy’ and other disposals; but can also increase because of new build, buy-backs and regeneration schemes. Variations in stock numbers affect both income and the need to spend on management, maintenance and major repairs. Capital programmes are often underpinned by capital receipts from ‘right to buy’ sales. This needs to be factored into the business plan model, assumptions need to be made regarding which costs should be fixed or variable, and stress testing needs to be carried out around uncertainties such as the number of ‘right to buy’ sales and levels of maintenance expenditure.

Once the capital programme is set (see below) it should be possible to estimate the number of new dwellings that would be brought into the stock each year and the numbers of any that would be disposed of through regeneration schemes. However, the number of ‘right to buy’ sales is more difficult to predict. Traditionally, housing business plans have assumed that ‘right to buy’ sales in the early years would mirror recent experience with the numbers reducing in the medium- to long-term. In the current uncertain environment there is a need to estimate the number of ‘right to buy’ sales and then to carry out a sensitivity analysis to assess the impact that increased or reduced numbers would have on the business plan.

It is no longer expected that the government will implement the provisions of the Housing & Planning Act 2016 regarding the sale of high value council homes. However, it may be prudent to model the effects of this as part of the sensitivity analysis.

Capital Programmes

Capital programmes are funded through a combination of borrowing, capital receipts, grants, the major repairs reserve and revenue contributions. The future availability of all these funding streams needs to be modelled.

The need to spend on the capital programme will be derived from the stock condition survey and the asset management plan (see below).

There is a need for the business plan to demonstrate that there will be sufficient resources to fund the required capital programme; and as part of this sensitivity analysis is required around the risk that expenditure may be greater than anticipated and / or that available resources may be fewer than anticipated.

There is therefore a need to model all these sources of funding, to assess the minimum level of capital programme required and to carry out stress testing around the Council's ability to continue to fund its capital programme at the level required to meet statutory and other obligations including maintaining the decent homes standard.

Prudential Borrowing

The 2003 Local Government Act introduced 'Prudential Borrowing' and changed the way in which support was provided to local authorities' capital programmes. From 2004 to 2012 authorities were free to borrow as much as they wished as long as they could afford to meet the debt repayments. The rules that cover this are included in the 2003 Local Government Act and the prudential code of accounting.

With self-financing the system of prudential borrowing continues but government no longer provides financial support for borrowing and has introduced the borrowing cap that is a limit on the total amount of borrowing that a local authority is permitted to do.

The prudential borrowing system allows authorities to borrow freely for capital investment, subject to controls that ensure that borrowing is affordable and consistent with the Government's fiscal rules. The main elements of this approach are:

- Councils have freedom to borrow against the revenues in the General Fund and Housing Revenue Account, subject to prudential limits
- Since 2012, borrowing has also been limited by the 'borrowing cap' and this looks likely to continue unless the government decides to proceed with the idea of entering into deals with individual authorities to allow increased borrowing to fund new build.

In preparing a business plan there is therefore a need to consider the amount of borrowing that the Council will do. This will be dependent on what is affordable under the prudential borrowing system and what is allowable within the borrowing cap. Some authorities will also have ambitions to repay debt. All of this will be included in the Treasury Management strategy that is included as part of the annual budget setting process.

Capital Receipts

Capital receipts are dependent on the level of 'right to buy' sales and other asset sales and this in turn is dependent on government policy, the availability of land and property for the council to sell and the state of the property market. Many commentators are forecasting a downturn in the property market.

In preparing a business plan there is a need to estimate the number of 'right to buy' sales. This is referred to above in the section on stock numbers. These assumptions should also be the subject of appropriate sensitivity analysis.

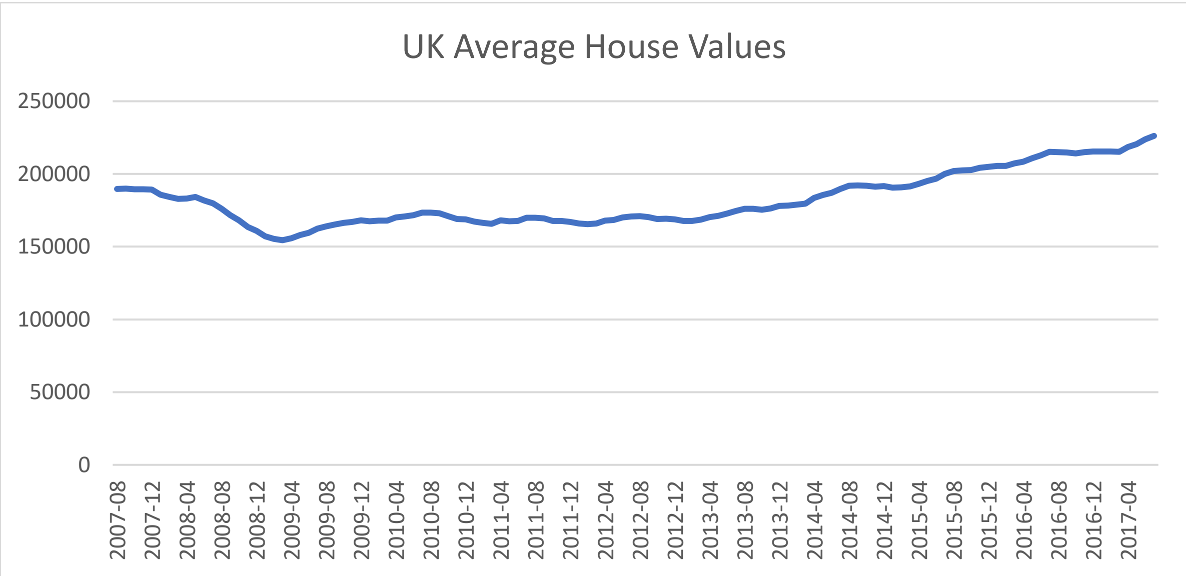
Receipts from Right to buy sales are applied as follows:

- The council may deduct certain costs, namely: an amount to cover the housing debt supportable from the income on the additional Right to Buy sales; transaction and administration costs; and an amount that reflects the income the council might reasonably have expected from Right to Buy sales prior to the new scheme;
- The council must also pay the Government an amount that reflects the income that the Treasury expected from Right to Buy sales prior to the new scheme;
- Once these costs are deducted, the remaining receipts (the 'net receipts') are available to fund (and must be applied to) replacement affordable rented homes.

The way in which 'right to buy' receipts can be applied is therefore prescribed by government and they cannot be indifferently applied to support the capital programme. To avoid having to transfer capital receipts to the government, councils must ensure that they spend them on new build and that they fund only 30% of the cost of development with the other 70% being met from other sources.

Other capital receipts arise from the sale of land and property outside the 'right to buy' scheme. This includes the sale of land, non-housing assets such as garages and shops and housing assets that are sold on the open market. One of the outcomes of the asset management strategy (see below) should be the identification of surplus assets for sale. This should then lead to the creation of a forecast of capital receipts based on the value of the surplus assets and the timetable for their sale.

The graph below shows how house prices have moved in the United Kingdom between 2007 and 2017. It is taken from the Land Registry's United Kingdom House Price Index:



It will be seen that from July 2007 to March 2009 house prices fell due to the recession caused by the financial crisis. However, since March 2009 prices have increased, returning to 2007 levels in August 2014. Since then values have continued to increase but the rate of growth has slowed since the summer of 2016, especially in London. In September 2017, Nationwide reported the first fall in London property values since 2009.

However, in October 2017, the Royal Institute of Chartered Surveyors stated that British house prices faced the weakest outlook since 2016, largely reflecting the prospect of further falls in house values in central London. They forecast price falls over the next three months, and growth over the coming year is predicted to be the weakest since June 2016, when surveyors feared voting to leave the European Union would trigger broad-based decline. The Royal Institute of Chartered Surveyors said that activity in the property market was slowing. Both the number of sales and enquiries by new buyers fell at the fastest rate since July 2016.

Simon Rubinsohn, the Chief Economist at the Royal Institute of Chartered Surveyors told Reuters that there was a big difference between London and southeastern England - where prices are falling and expected to decline further - and most of the rest of the United Kingdom, where prices are rising:

"We are continuing to see evidence of shortage of stock… Against such a backdrop, prices are likely to remain elevated and ... continue to rise over the medium term in most parts of the country… In part, this is a reflection of affordability constraints hitting the higher priced segments of the market. It is perhaps also indicative of ... the increasing possibility of the first hike in base rates in over ten years,"

One risk to consider is that the expected capital receipts will not materialise if assets are not sold at the expected price, at the expected time or at all. The sensitivity analysis should include an assessment of the implications of capital receipts not being realised. This is very relevant in cases where business plans include regeneration schemes that are dependent on property sales.

Government Grants and Contributions

Some capital expenditure that local authorities incur on housing is financed directly by the Government. This includes some expenditure on regeneration – in particular, estate renewal and investment programmes. Government grants must be spent on the specific purposes for which they are given.

Government grants to support the Decent Homes Programme have come to an end, and grants to support new build regeneration are limited despite the recent announcement of an additional £2billion for the national affordable housing programme (see above).

Contributions are sometimes available from third parties such as property developers, especially as part of regeneration schemes. If there is an economic downturn, such contributions are likely to become fewer.

In preparing the business plan there is a need to assess the financial support that will be available from central government and contributions.

Revenue Contributions

The ability to support the capital programme through revenue contributions to capital outlay depends on the surpluses that can be generated in the housing revenue account. If there are increased pressures on the housing revenue account (see above) the capacity to make revenue contributions to capital will be correspondingly reduced.

Major Repairs Reserve

From 2001/2002 to 2011/12 all local authorities received a 'Major Repairs Allowance' that was paid as part of the Housing Subsidy. It was paid into the Major Repairs Reserve through the making of a depreciation charge. Funds that are in the Major Repairs Reserve were available for the authority to spend on Major Repairs.

The Major Repairs Allowance has been abolished with self-financing although councils still make transfers to their major repairs reserve to meet the costs of major repairs. The major repairs reserve is therefore also dependent on the housing revenue account.

Conclusion

When preparing their housing business plans, local authorities will have to consider the key issues outlined in this briefing paper.

Adrian Waite
October 2017.

Housing Business Planning in an Uncertain Environment - Seminar

We are holding seminars on 'Housing Business Planning in an Uncertain Environment' during November 2017. These seminars will look in depth at how local authorities can update their housing revenue account business plans.

Business Planning has been an important element of the management of council housing for some time. However, we are now operating in a very uncertain environment. There is a minority government; the Housing & Planning Act will not be implemented in full; the future funding of supported housing is under threat; and the implications of the vote for Britain to leave the European Union are not clear.

The public finances are weak; welfare reform - including reform of housing benefit - is a 'work in progress'; government policy on rent reductions, 'right to buy', new development and the integration of housing, social care & health are all unclear. Demographic change continues to put pressure on housing services. This requires a new way of business planning including a robust approach to the development of strategy, financial forecasting, sensitivity analysis, risk management and contingency planning.

The seminar will address the following questions:

- What are the key elements of a good quality housing revenue account business plan?
- What is the political, economic, social and technological environment in which local authority housing services operate? What are the key uncertainties?
- How can councils develop effective self-financed business plans that will address the new uncertain environment in a robust way? What assumptions should be made in the financial model? How can uncertainties be managed?
- What business planning techniques are now required including for strategy, financial forecasting, sensitivity analysis, risk management and contingency planning?

Who should attend?

- All those with an interest in business planning in local authority housing, including Managers in Local Authorities and Arm's Length Management Organisations, Elected Members, ALMO Board Members, Housing Accountants and Tenant Representatives.

The session is interactive, includes specific practical examples and is accompanied by a very useful book entitled: "Housing Business Planning in an Uncertain Environment"

Venues and Dates:

- London: Novotel Hotel, Waterloo – Tuesday 7th November 2017
- North: Novotel Hotel, Leeds – Tuesday 21st November 2017

The price of the seminar in London is £250 plus Value Added Tax, a total of £300. The price of the seminar in Leeds is £195 plus Value Added Tax, a total of £234. However, there is a £20 discount for people who book a month or more in advance making the cost £230 plus Value Added Tax in London and £175 plus Value Added Tax in Leeds.

For further information or to make a booking, please click here: http://awics.co.uk/housing-business-planning-in-an-uncertain-environment

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Other AWICS Seminars:

Our next seminars are as follows:

- Welfare Reform 2017: The Implications for Housing
- All You Want to Know about Service Charges in Social Housing in Wales.
- All You Want to Know about Service Charges in Social Housing in England.
- All You Want to Know about Local Authority Housing Finance.

Information about all our seminars can be found at: http://awics.co.uk/seminars2017 and http://awics.co.uk/seminars-2018

About 'AWICS'

'AWICS' is a management consultancy and training company. We specialise in providing support in finance and management to clients in local government and housing in England, Scotland and Wales. We are well known for our ability to analyse and explain complex financial and management issues clearly.

Our mission statement is 'Independence, Integrity, Value'. We therefore provide support to clients from an independent standpoint that is designed to help the client to achieve their objectives. We are passionate about working with the utmost integrity. We believe that we offer the best value for money that is available today!

For more information about our services and us please visit our website at www.awics.co.uk or contact Adrian Waite at Adrian.waite@awics.co.uk. Services that we offer include:

- Management Consultancy – http://www.awics.co.uk/ManagementConsultancy.asp
- Interim Management – http://www.awics.co.uk/interimmanagement.asp
- Regional Seminars - http://www.awics.co.uk/seminars2017.asp
- In-House Training - http://www.awics.co.uk/inHouseCourses.asp
- Webinars - http://www.awics.co.uk/webinars.asp
- Independent Residents' Advice – http://www.awics.co.uk/IndependentTenantAdvice.asp
- Technical Books - http://www.awics.co.uk/publications.asp
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