Briefing Paper

Business Planning in the Housing Revenue Account

December 2015

Flats at Byker, Newcastle-on-Tyne.

Introduction

This briefing paper addresses the following question:

What needs to be done to produce a high quality, fit for purpose housing revenue account business plan?

And considers:
- Strategy - how to do the analysis and determine the strategy
- Finances - how to do financial projections and 'crunch the numbers'
- Asset Management
- Risk Management
- New Build
- Value for Money
- The impact of recent changes in government policy

It is often considered that a business plan has two important elements:
- An analysis of the business and its environment that leads to the identification of a strategy
- The production of a financial plan

Resource Accounting and Self-Financing

Local authorities were first required to produce housing revenue account business plans in 2001 as part of the introduction of resource accounting. At that time the government said that:

"Business Planning will be a key part of the new financial framework for local authorities... It will be an important tool for improving decision-making by authorities and ensuring that the resources devoted to local authority housing are used in the way in which they best preserve and enhance housing assets and ensure social housing provision which meets the needs of tenants."

At that time the government provided guidance regarding what made a business plan 'fit for purpose' and specified that a business plan should include the following elements:

- Strategic Context
- Effective Consultation
- Stock Condition
- Current Performance
- Resources
- Priorities
- Options
- Action Plan
- Progress to Date
- Accessibility
- Conclusions

The implementation of self-financing in 2012 has allowed local authorities to plan ahead with more certainty leading them to produce more robust business plans and asset management plans. Members and tenants are able to consider their long-term priorities around such matters as housing and environmental improvements, how often components such as kitchens are replaced, the green agenda, redevelopment, regeneration and new build.

In 'Implementing Self-Financing for Council Housing' Communities & Local Government said:

"It will also require local authorities to have a long-term business plan for housing which includes the costs of borrowing (under the current system, movements in interest rates are absorbed by the government). By separating out housing debt, treasury management decisions can be made which support the housing business plan without an impact on other parts of the local authority, and vice versa."

It is clear that local authorities are responding differently to the challenges and opportunities that have been provided by self-financing. Some are focusing on achieving and maintaining the decent homes standard while balancing the housing revenue account; and others are considering how to use their surpluses.

Many councils, especially those that had been 'debt free' prior to self-financing, initially intended to repay their debt as soon as practicable. However, in view of the relatively low rates of interest at which councils were able to borrow, many of these have since decided that repaying debt is a lower priority in the short to medium term than spending the money on improvements or new build.

The Chartered Institute of Public Finance & Accountancy considers that the business plan is, and will continue to be:

- The main tool to manage the housing landlord business financially.
- The main source of financial advice for planning the strategy for the housing business and the interaction with the council's strategic housing role.
- A tool to inform and be informed by the asset management strategy, creating the boundaries for investment.
- Developed in consultation with tenants on the balance in the use of resources between investment in new and existing stock and day-to-day services.

- The main tool for accountability to tenants on performance and value for money of services.

Business Planning Strategy

There are three important questions to ask in preparing a business plan strategy.

First, what environment are you operating in? This question is often answered by carrying out a 'PEST analysis that looks at the political, economic, social & technological factors that influence the organisation and how these are likely to change in the future. At the present moment a 'PEST analysis' for a local authority housing service would be likely to include changes to government policy (political), the increasing lack of affordability of housing (economic), demographic change (social) and developments in information technology (technical).

Second, what are you trying to achieve? This would include looking at factors including political & corporate objectives, the Housing Strategy and the Mission of the Housing Service.

Third, how prepared is your organisation? This question is often answered by carrying out a 'SWOT' analysis that looks at the strengths and weaknesses of the organisation and the opportunities & threats that it faces.

Many social landlords focus their business plans on the core business of owning and managing the housing stock. However, others seek to do more than this by providing services that 'shape places' and support individuals. An example of such a landlord is Impact Housing Association, where I used to be Chair, whose mission is summarised as follows:

Improvement through Action:
- Great Homes - Extra care & dementia, repairs & maintenance, affordable homes
- Poverty Reduction - Furniture services, digital inclusion, employment opportunities, money matters, fuel poverty, benefits information
- Transformational Services - Foyers, domestic abuse, employment, community hubs, young people, vulnerable people, personalised services
- Raising Aspirations - Financial opportunities, digital inclusion, volunteering, employment, training, personalised services, community hubs.

Business plans should ideally be prepared in consultation with partners and residents. Consultation with partner organisations should help to establish the Strategic Context in which the service operates, and the opportunities that exist for joined-up working including the packaging of contracts.

Consultation with tenants and leaseholders should cover the following issues:
- Strategic Context – what strategic objectives are seen as important by residents?
- Level of satisfaction with current performance
- Views on relative priorities for action
- Selection of Options
- Monitoring progress
- Accessibility of documentation – documents should be capable of being easily understood by a wide audience. Tenants and Leaseholders need to understand the process and the models
- Active tenant and leaseholder representatives may wish to be closely involved in the process whereas other residents may wish to have limited involvement – for example through completing a questionnaire.

Financial Forecasts

The business plan should demonstrate that the Council can balance income and expenditure in the long-run avoiding an illegal cumulative deficit while meeting capital financing costs and other obligations and achieving and maintaining the decent homes standard. Councils will therefore need to consider:

- Interest rates, inflation, level of service and investment
- Rents & service charges, stock numbers, voids and arrears including:
    - The effect of rent reductions, inflation and options around social and affordable rents
    - The effect on stock levels of ‘right to buy’, sale of high value council homes and ‘pay to stay’
    - Whether service charges are fully recovered
    - Control of voids and bad debts in the light of welfare reform
- The scope for generating commercial income
- Debt financing & repayment
- Right to buy sales and capital receipts
- Efficiencies in management and maintenance budgets, service reconfiguration, performance improvement
- The need for balances going forward.
- Long term asset management investment proposals
- Sensitivity Analysis
- Whether zero based budgeting would be appropriate
- Whether ‘headroom’ is needed in the housing revenue account to provide resources to support the capital programme

A sustainable housing revenue account business plan will consider the following with regard to capital expenditure:

- ♦ Expenditure
    - A Robust stock condition survey is required to identify what capital investment is required in the housing stock.
    - Consultation with tenants on a local standard is required to identify the standard to which homes will be improved and maintained.
    - New Build – what level of new build programme is to be carried out and what it will cost.
- ♦ Financing
    - The Major Repairs Reserve is now financed through depreciation and is available to finance major repairs
    - Support from the Revenue Account for prudential borrowing or revenue contributions may be required
    - The level of Capital Receipts needs to be estimated and decisions taken about their use. This may have an effect on other programmes
    - Government Grants and other contributions may be available especially if it is intended to build new homes or carry out regeneration schemes

The Chartered Institute of Public Finance & Accountancy has identified the following key issues for local authorities to consider when developing their business plans:

- Consult with tenants on resource allocation
- Link to the asset management plans and the treasury management strategy
- Use an iterative process to balance resource utilisation
- Sculpt the funding and debt repayment [plans to fit to the investment profile.

- Make the best assessment of assumptions made.
- Ensure that the housing revenue account does not have an overall deficit.
- The plan is likely to be stressed in the early years.
- Debt needs to be kept within the 'cap'
- Sufficient reserves need to be built up to repay debt.
- Clarify the interface with the general fund.
- Value for money and increased efficiency deliver dividends.
- Opportunities should be considered for the medium to longer term.
- Revisit regularly and update (probably annually).
- Ensure full buy-in from all parts of the authority and the arms length management organisation (if applicable).
- Understand the risks.

In 2001 the then Office of the Deputy Prime Minister issued a business plan financial model for local authorities to use. However, since then most local authorities have developed their own models usually using spreadsheets. Effective Models have:

- ♦ Consistent internal logic and arithmetical accuracy
- ♦ Inter-relation of different elements
- ♦ Neither too complex nor too simple – comprehensive but understandable
- ♦ Reliability – use integrity checks and perhaps external validation
- ♦ Flexibility – to test different assumptions and scenarios
- ♦ Owned by the organisation rather than consultants

Effective Models also demonstrate how the authority will

- ♦ Balance the Housing Revenue Account
- ♦ Finance the Capital Programme at the Decent Homes Standard at least

Value for Money

One objective of the business plan should be to assess the extent to which 'value for money' is currently being achieved and what should be done to secure improved 'value for money'.

The Kensington & Chelsea Tenant Management Organisation has defined 'Value for Money' as follows:

"*The correct balance between Economy, Efficiency and Effectiveness. Value for Money at Kensington and Chelsea Tenant Management Organisation is considered by the Tenant Management Organisation to be high when there is an optimum balance between all three, with relatively low costs, high productivity and successful outcomes in terms of service delivery to residents."*

Economy, Efficiency and Effectiveness are defined as follows:

Economy - This relates to minimisation of the costs of inputs (For example, reducing the salary costs of a staff team working in a call centre or the cost of a new Information Technology system).

Efficiency - This is concerned with maximising the outputs produced from these inputs (For example, increasing the number of repairs completed by each operative every week, or the number of calls answered by a Call Centre worker)

Effectiveness - This relates to achieving the desired outcomes. In the housing context these should be the outcomes desired by customers (For example, are residents happy that a call centre dealt with their query at the first time of asking or are repairs done to the customers satisfaction).

Inputs, Outputs and Outcomes are defined as follows:

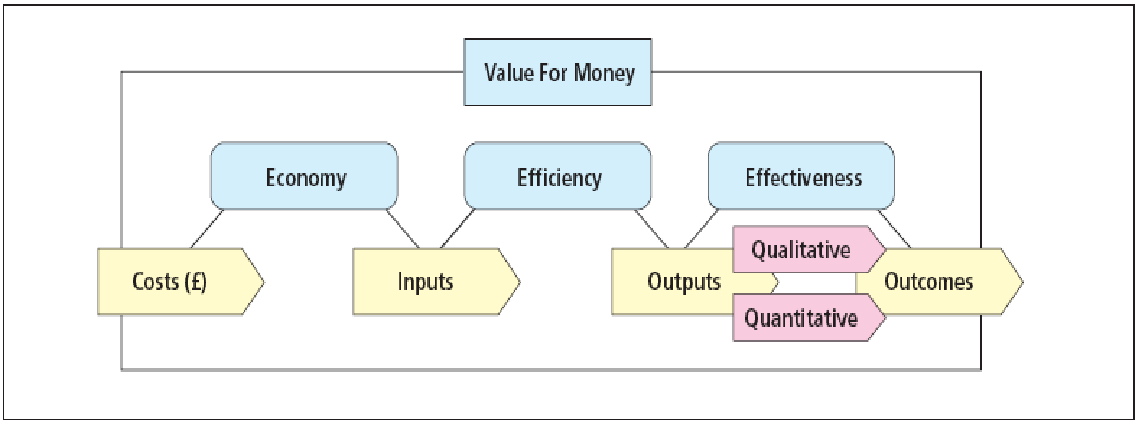
Inputs – These are the resources used to produce the actions that produce the outputs. Input measures are not just about quantity as the quality is just as important.

Outputs – These are the goods or services, their quality, quantity or level, produced by an organisation. Output measures support the daily management of services

Outcomes – These are the impacts of the organisation's actions. Outcome measures show how well the organisation is achieving its objectives and whether the underlying problems still exist or have changed. Outcomes can also refer to impacts of people's behaviour or attitudes so qualitative measures are also relevant. Outcomes can be hard to measure, or data hard to collect, especially where the impact is in the future or it is hard to quantify the organisation's contribution to changes in the environment.

Processes – These are the actions that create or deliver outputs. Process measures can help to identify how well actions contribute to outputs; where problems are developing, targets are not being met and how resources could be targeted better.

These concepts are illustrated diagrammatically below (source: audit commission):



Asset Management

The Business Plan should be closely integrated with the Asset Management Plan. The National Housing Federation has defined asset management as follows.

"Taking a comprehensive approach to managing a housing association's physical assets with the aim of achieving particular objectives, usually to make best use of the housing stock and achieve value for money. It covers the construction, operation, maintenance, modification, replacement and disposal of housing and other buildings"

The Asset Management Plan is often considered to be the foundation of the business plan. It should therefore be kept under review. In particular the:

- Identification and analysis of housing and non-housing assets including their condition and future maintenance needs.
- Achievement and Maintenance of the Decent Homes Standard and other agreed local standards including:
    - The Stock Condition Survey

    - The Replacement of components linked to Depreciation
- Appraisal of assets to inform consideration of Demolitions, Disposals and Renewals
- Potential for Regeneration schemes and New Build.

Councils should bear in mind that the self-financing settlement is designed to fund the maintenance of existing homes to the decent homes standard, environmental and open space management and aids and adaptations. However, the settlement took no account of an backlog of decent homes works, non-dwelling maintenance, improvements, structural repairs, asbestos removal or green initiatives.

In the past Housing Associations have tended to have more dynamic asset management plans than local authorities but this is now changing. There is a need to manage the stock pro-actively, asking which stock should be retained or disposed of; what to invest in the retained stock and what new stock to acquire. Typically a housing association will look to divest themselves of low value, low demand, low density, high cost-in-use properties either through disposal or redevelopment; and to invest in or redevelop other properties to meet changing needs. Some landlords will have regeneration schemes where they will have to consider refurbishment, infill, partial redevelopment and full redevelopment options.

New Build

Many local authorities have ambitions to build new council homes. Councillor Gary Porter, Conservative Leader of the Local Government Association and of South Holland District Council has said that:

"Councils have the appetite and the capacity to play a greater role in building new homes. Councils understand local housing markets and needs far better than central government. Councils… can provide excellent value for money in building new homes – about £10,000 less per home than housing associations."

In its guide to self-financing, the Chartered Institute of Public Finance & Accountancy said:

"Reprovision, new development or regeneration are calls on monies within the business plan. They are only possible when debt is being serviced, need for investment in the homes is being satisfied and investment in services provides value for money and is agreed with tenants.

"To make most developments viable, active asset management, using land or garage sites as part of the funding, or accessing Homes & Communities Agency grants may be an option... It may be more effective to work with a partner… Consultation with tenants on any proposals would need to be the start of the process, and the authority will need to undertake a full investment appraisal analysing costs and incomes and the associated risks and rewards.

"Affordable rent schemes… will be available for new build… Other constraints on developments (include) the cap on borrowing."

Social Housing Grant is available to local authorities to part-fund new build but at low rates and it is tied to 'affordable rents'. Local authorities can borrow to fund new build but this is limited by the 'borrowing cap' imposed as part of self-financing. There has been an increase in the local authority borrowing cap of £150million in 2015/16 and £150million in 2016/17. This is distributed through Local Enterprise Partnerships as part of local growth deals. Government estimates it will allow an additional 10,000 homes to be built. However, these are small increases compared to the £7billion requested by the Local Government Association.

We now have a new Government with a new approach but the 'housing crisis' continues. Councils want to build new homes – but government policies are not always helpful. There are a variety of delivery vehicles and funding options available and many councils are setting up special purpose vehicles to develop new housing. There is a need for effective appraisal of delivery options and individual schemes.

Risk Management

The Audit Commission has defined risk and risk management as follows:

"Risk is the threat that an event or action will adversely affect an organisation's ability to achieve its objectives and to successfully execute its strategies. Risk management is the process by which risks are identified, evaluated and controlled".

In its guide to self-financing the Chartered Institute of Public Finance & Accountancy said:

"Risks are being transferred with the settlement from central government to authorities and the risk management arrangements need to be re-assessed to ensure that they are robust enough.

"The self-financing HRA will more closely resemble the finances of housing associations, with similar associated risks. It would therefore be appropriate to have the same type of risk management framework in place."

The key sensitivities to test in the business plan that have been identified by the Chartered Institute of Public Finance & Accountancy are:
- Inflation increase or decrease.
- Cost inflation out of synchronisation with the retail price index.
- Right to buy levels and receipts in the light of the revitalisation of the right to buy scheme.
- Rent arrears and the impact of benefit changes.
- Interest rate increases.
- Performance decline, such as void levels and increase in cost and volume pof responsive repairs.
- Local issues, such as tendering of Supporting People or other services and reduction in Supporting People Grant.
- Alternative rent policies adopted by the authority.

The Risk Management Strategy needs to be kept under review. Some authorities have concluded that housing revenue account reserves should be increased because of the greater uncertainty and risk created by self-financing.

Current Position

There is currently a positive picture with housing revenue account business plans:
- Sensible prudent decision making is taking place to get 'over the line' – there is a cautious approach
- Some local authorities are pushing ahead straight away with new build programmes
- Many are taking time to review asset management in more detail – bearing in mind the reforms to 'right to buy'
- Most have considerable resources to invest
- There are still issues for some – hence stock transfer is a possible option – mainly because of the debt cap.

Local authorities with council housing have responded appropriately:

- All have business planning models & plans
- Two thirds have updated their asset management strategies
- Two thirds are planning annual business plan updates
- A number of stock retention local authorities have established management boards

Prudent and sensible assumptions to make in business planning include:

- Planned rent increases to convergence (where permitted under the new rent policy)
- Increased provisions for bad debts
- There are low interest rates across mixed portfolios that demonstrate some flexibility to respond to changing circumstances

Most local authorities are investing wisely:

- They are securing the existing stock through diversified asset management plans
- 71% have new build in their top three priorities
- Many also have regeneration schemes.

Housing revenue account business plan essentials include:

- Putting the Financial plan at the centre
- Also having a vision, mission, tenant involvement, good governance and good risk management (there is not much movement on tenant empowerment at the moment)
- Effective Value for Money, standards set by the Homes & Communities Agency and repairs strategies
- Addressing debt financing, treasury management and rent increases (changes in 'right to buy' and rent policy reduce the ability to fund debt)
- Ambitions on refurbishment, the green agenda, regeneration and development

Government Initiatives

Recent government initiatives that are leading local authorities to review their business plans include:

- ♦ Right to Buy for Housing Association tenants
- ♦ Sale of High Value Council Homes
- ♦ Rent reductions of 1% a year for four years
- ♦ Near market rents for tenants on high incomes
- ♦ Welfare Reform

The Conservative manifesto of May 2015 pledged that:

"We will extend the Right to Buy to tenants in Housing Associations to enable more people to buy a home of their own. It is unfair that they should miss out on a right enjoyed by tenants in local authority homes. We will fund the replacement of properties sold under the extended Right to Buy by requiring local authorities to manage their housing assets more efficiently, with the most expensive properties sold off and replaced as they fall vacant. We will also create a Brownfield Fund to unlock homes on brownfield land for additional housing."

Brandon Lewis MP, the Minister for Housing said that:

"It is right that as high value council homes become empty they should be sold to fund new affordable house building in the same area. The proposals in the Queen's Speech will do that and more, extending 'Right to Buy' level discounts to over a million housing association tenants, with the homes sold replaced on a one-for-one basis. This is part of our wider efforts to help anyone who works hard and wants to own their own home achieve their dream."

The government plans to make its own calculation of the number of council houses in each area that are 'high value' and the number that would be sold and to require councils to make payments to the government based on these estimates rather than actual sales. If the government defines a high value council house using regional average data in the same way as the Policy Exchange did in 2012 when they first proposed the sale of high value council homes there will be an uneven spread of high value council homes. Examples follow of the proportion of stock that would be considered to be high value in some local authority areas:

- Westminster 100%
- Kensington & Chelsea 93%
- Harrogate 59%
- Woking 38%
- Cambridge 25%
- Leeds, Sheffield 4%
- Manchester, Nottingham, Slough 1%
- Croydon, Northumberland, Portsmouth 0%

In practice the government may select a broader definition. There is therefore a need for local authorities to estimate the payments that they will be required to make, consider their policy on disposing of high value council homes, and estimate the loss of stock and the capital receipts that may arise; as part of the business planning process.

In the budget of July 2015 the government announced a change in policy on social and affordable rents as follows:

"The government will reduce rents in social housing in England by 1% a year for four years, requiring housing associations and local authorities to deliver efficiency savings, making better use of the £13billion annual subsidy they receive from the taxpayer. Rents in the social sector increased by 20% over the three years from 2010-11. This will allow social landlords to play their part in reducing the welfare bill. This will mean a 12% reduction in average rents by 2020/21 compared to current forecasts."

The Local Government Association and Chartered Institute of Housing calculate that Councils will lose £2.6billion over four years, equivalent to 60% of maintenance budgets. They calculate that this will reduce capacity to build by 19,000 homes and that £40billion will be lost over thirty years. This will need to be included in the financial modelling and decisions made about ways of increasing income (for example through service charges or commercial income) or reducing expenditure.

The government also announced in the budget that tenants with incomes in excess of £30,000 a year (£40,000 in London) will be expected to pay 'near market' rents:

"The government believes that those on higher incomes should not be subsidised through social rents… Therefore, social housing tenants with household incomes of £40,000 and above in London, and £30,000 and above in the rest of England, will be required to 'Pay to Stay', by paying a market or near market rent for their accommodation… This will ensure they pay a fair level of rent, or make way for those whose need is greater. Local authorities will repay the rent subsidy that they recover from high income tenants to the Exchequer, contributing to deficit reduction.

"Housing associations will be able to use the rent subsidy that they recover to reinvest in new housing. This could raise up to hundreds of millions of pounds in additional rental income for housing associations. The government will consult and set out the detail of this reform in due course."

It is expected that this will affect 340,000 households and raise £365million by 2018/19. There is a need for councils to estimate how many tenants will be affected and what effect the policy may have on 'right to buy' sales and voids if tenants on high incomes buy their homes or leave them.

The Housing and Planning Bill contains a number of measures that will impact on housing revenue account business plans:

- Part 1 – New Homes in England proposes Starter Homes, Self-Build and Custom House building. It is possible that some local authorities may wish to develop these low-cost home ownership products rather than social or affordable housing.
- Part 4 – Social Housing in England. This part includes the provisions for:
  - Implementing the Right to Buy on a Voluntary Basis
  - Vacant High Value Local Authority Housing
  - Reducing Regulation
  - High Income Social Tenants: Mandatory Rents
- Part 6 – Planning in England. This part relaxes the requirements for developers to provide affordable housing and where such housing is provided allows it to be for low cost home ownership.

The Conservative manifesto of 2015 also proposed that expenditure on welfare would be reduced by £12billion by:

- Ending housing benefit being paid to those aged under 21, except those who are leaving care or who have children.
- Lowering the overall benefit cap from £26,000 to £23,000.
- A two year freeze on working age benefits, including housing benefit.
- Further measures that had yet to be identified (needing to save £10billion).

Following the election the government introduced the Welfare Reform and Work Bill that makes the following provisions:

- Working-age benefits, including tax credits and Local Housing Allowance, will be frozen for four years from 2016/17.
- The household benefit cap will be reduced to £20,000 (£23,000 in London).
- Support through Child Tax Credit will be limited to two children for children born from April 2017.
- Those aged 18 to 21 who are on Universal Credit will have to apply for an apprenticeship or traineeship, gain work-based skills, or go on a work placement six months after the start of their claim.

Clearly, if the government is to reduce its expenditure on welfare there will be a corresponding reduction in the income of benefits claimants, many of whom are tenants of local authorities. This will have an impact on the ability of tenants to pay rent and sustain tenancies, the demand for different types of housing, the need for advice on claiming benefits and managing money, and the need to address poverty among tenants. Local authorities will have to consider the implications of this for their policies and financial projections as part of their business plans.

A Commercial Approach?

Andrew Carlin of Procurement for Housing has suggested that local authorities should adopt a more commercial approach to business planning in the light of recent developments:

"Welfare reform, house building targets and the task of maintaining decent homes standards pose well-known threats. To cope, providers must accept that profit is not a dirty word. Their teams must become commercially astute, harvesting business value from every asset. This is key for communities to thrive, rents to be paid and homes to be built and maintained well."

Conclusions

Business Planning is not just about 'crunching the numbers'. It is also about:

- Strategy
- Responding to external challenges including changing government policy
- Asset Management
- Risk Management

Now is not only a good time to revise and update business plans. It is essential that this be done so that local authorities can be responsive to changing government policy and other significant changes in the environment in which housing services are provided.

Adrian Waite
December 2015

Further information about housing finance is available on our website at: http://www.awics.co.uk/BriefingPapers.asp

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