Briefing Paper

Self-Financing Budgets and Business Plans

July 2013

Introduction

The implementation of self-financing 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.

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.

Self-Financing and Business Planning

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."

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.

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
- Debt financing & repayment
- Right to buy sales and capital receipts
- Efficiencies, service reconfiguration, performance improvement
- The need for balances going forward.
- Long term asset management investment proposals
- Sensitivity Analysis

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.

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.

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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.

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.

Public Services (Social Value) Act 2012

The Public Services (Social Value) Act of 2012 aims to strengthen the social enterprise business sector and make the concept of 'social value' more relevant and important in the placement and provision of public services. Its key provisions are to:

- Place a duty on the Secretary of State to publish a 'national social enterprise strategy' to encourage engagement in social enterprise
- Amend Section 4 of the Local Government Act 2000 so that local authorities are required to include in their sustainable community strategy proposals for promoting engagement with social enterprise in their area. They must also include a statement of the measures suggested to enable social enterprise to participate in implementing these proposals
- Require local authorities, when entering into public procurement contracts, to give greater consideration to economic, social or environmental wellbeing during the pre-procurement stage.

The requirement to consider social wellbeing may prove relevant for social housing. In February 2013, the Housing Associations' Charitable Trust published research on the social impact of housing providers. This concluded that it is possible to put a cash value on things that enhance or detract from people's social wellbeing and that this value is around £1,000 for things like neighbour noise, damp or poor internal lighting. The research also found that a social home provides £1,000 a year more in social benefits than a private rented home. This means that social housing has a greater social benefit than is sometimes supposed. It also means that it should be possible to combine financial and social benefits in the evaluation of options for investment both at national and local level.

Self-Financing in Practice

Some examples of self-financing in practice follow.

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Barking & Dagenham Borough Council

Barking & Dagenham Borough Council has embarked on one of the largest local authority new build programmes in England, despite having only £12million of headroom under the borrowing cap. The number of homes the Council plans to build under the Greater London Authority's affordable homes programme has increased from 762 to 831. The Council has been able to do this because it has used general fund and institutional financing through a commercial arrangement with a fund manager that by-passes the housing revenue account.

The Council is now looking for additional funding of up to £100million for 600 homes through a 'funding competition'. The homes would be mixed tenure – some at market rents and some at affordable rents set at between 65% and 80% of market rents. The development would be carried out through a subsidiary so that it would not involve the housing revenue account.

Ken Jones, Director of Housing Strategy, was quoted in 'Inside Housing' as saying:

"It's had a real change in that we can plan long-term and have a meaningful asset management strategy…Assuming the government does not shift the goalposts on rent policy in the future, you can look at your assets and know you are going to get income from them."

Barnet Borough Council

Tracey Lees, Chief Executive of Arms-Length Management Organisation Barnet Group, was quoted in November 2012 in 'Inside Housing' as follows:

"As an arms-length management organisation our job previously was to see what decent homes money was there, to see what else the government might let us invest over the next twelve months and then prepare a capital programme… We still have a capital programme but this is forcing us – and I see it as a very positive thing – to take a wider look at the assets and what we're doing… We can have better conversations with our tenants and our leaseholders about what we're doing and why we're doing it… Before it always felt like we were blaming somebody else – the government says 'no' - whereas now it's between us as the arms-length management organisation and the local authority. It's simple and straightforward."

Basildon Borough Council

Basildon Borough Council has seen its debt increase but the loss of negative subsidy gives it a healthy housing revenue account. Under prudential borrowing it could have used this surplus to fund borrowing to address the investment required to achieve the decent homes standard. However, it cannot use the surplus in the housing revenue account to finance borrowing because it has very little headroom between actual borrowing and the borrowing cap. Consequently, neither the decent homes standard nor new build will be achieved in the short-term.

Birmingham City Council

Birmingham City Council will take on an additional £342million of debt but its headroom is still sufficient to build 500 new homes per year up to 2014.

Cambridge City Council

Cambridge City Council was one of the original self-financing pilots and has moved from being a debt-free authority to one with £214million of debt. However, it has headroom between actual debt and the borrowing cap of £16million. Having already achieved the decent homes standard the Council is prioritising new build in its business plan. Julia Hovells, Finance & Business Manager at the Council was quoted in 'Inside Housing' as saying:

"This is a new area for many local authorities… The Council has come up with a prudent business and asset management plan which will allow it to build more than 250 homes in the first five years. It also allows for a further 400 homes to be funded in years six to fifteen of the plan, should council members so wish… Cambridge has some headroom in the business plan, which not all local authorities have… We have £16million of headroom which allows us to borrow against that additional headroom… The self-financing regime will make it easier for Cambridge to make plans to meet housing needs."

Hammersmith & Fulham Borough Council (Tri-Borough Partnership)

In November 2012 the tri-borough partnership between Hammersmith & Fulham, Kensington & Chelsea and Westminster Councils announced a zero net cost housing scheme that is designed to create jobs and help those on low incomes. Writing in the 'Local Government Chronicle', Cllr. Philippa Roe (Conservative), Leader of Westminster City Council said:

"Following recent reforms to the Housing Revenue Account and the Localism Act, local authorities now have greater powers and responsibilities in managing their housing assets and greater flexibility over the allocation of social housing.

"Housing Revenue Account reforms provide the opportunity to take a strategic view of the commercial potential of local authorities' housing portfolios. In the tri-borough area this portfolio has a tenanted market value of £2.4billion but is still relatively under-geared.

"The tri-borough is a prosperous location in terms of average income and wealth per capita. However, that overall prosperity masks some underlying issues which affect the economic opportunities that its residents face:

- *There is a relative lack of accommodation affordable to those on lower average incomes.*
- *There is an abundance of jobs yet there are pockets of high levels of worklessness.*

"The pilot aims to create a virtuous circle between housing and employment. It will apply Housing Revenue Account funding capacity to build additional homes for tenants on lower average salaries; it will recycle a proportion of the resulting surpluses into supporting social housing tenants into employment. This could include topping-up existing programmes or providing support to overcoming barriers to work.

"In this business case we have shown a pilot of 300 homes, requiring £50million of funding capacity can deliver the following:

- *Create net surplus to the Housing Revenue Account of £0.5million a year.*
- *Engage 1,350 tenants in an employment programme and support 370 into employment over five years.*
- *Generate 700 jobs in the construction of new housing.*

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"The pilot makes more active sue of public sector land and unrealised funding capacity. It delivers economic growth and reduces benefit dependency. And all of the above benefits can be delivered at zero cost net to the public sector.

"It is a win-win for central and local government and delivers positive outcomes for those in housing need and those with employment aspirations."

Islington Borough Council

Islington Borough Council has borrowing headroom of £67million and plans to build 1,800 new affordable homes in partnership with housing associations by 2014.

Lambeth Borough Council

Lambeth Borough Council does not plan to use its headroom to borrow to meet the decent homes standard because it considers that this would not be affordable in the housing revenue account.

Leeds City Council

In October 2012 Leeds City Council announced plans to build 325 homes at a cost of £12.9million over three years. The scheme is to be financed through £9.5million housing revenue account borrowing, £1.9million of right to buy receipts and 1.5million from the new homes bonus. The scheme includes bringing 150 empty homes back into use. The new homes will be let on 'affordable' and 'social' rents.

Lincoln City Council

Lincoln City Council find themselves with £7million of headroom but is consulting with tenants before deciding on its use. As the Council has achieved the decent homes standard the options that are put before tenants include repayment of debt, new build, improved security, improvements including fencing and door entry systems and the restoration of services that have been curtailed in an effort to find resources to fund the decent homes programme.

Manchester City Council

Manchester City Council began self-financing with debt of £124million that it has decided not to seek to repay in the foreseeable future. The Council's capital financing costs are £4million a year but this still leaves an annual surplus in the housing revenue account of £12million. This is being used to fund a £46million capital programme over three years. Major schemes include £20million for the regeneration of the Collyhurst estate, £6million on new build homes for the housing revenue account and £6million for energy efficiency work that the Council expects will be match funded by energy companies under the energy company obligation. However, the Council does not intend to use all of its £60million borrowing headroom because of uncertainty created by welfare reform.

Newcastle on Tyne City Council

Newcastle City Council has £6million of borrowing headroom and its arms-length management organisation – Your Homes Newcastle – plans to build 144 affordable homes and 344 private homes by 2016.

North Tyneside Borough Council

In January 2013, North Tyneside Council's cabinet approved its 2013-15 Housing Revenue Account business plan. Over thirty years, the programme will see £1.4billion invested in council homes across the borough. In 2013/14 work will begin on the Quality Homes for Older People project that will deliver improvements and replacement of the authority's sheltered housing stock; and during the year £16.7million will be spent on maintaining properties to the Decent Homes Standard.

In addition, new council homes will be built on the former Wallsend Boys Club site and at Byrness Court. Longer-term plans will create 810 new homes for rent. Mayor Linda Arkley said she was delighted that national financial arrangements had enabled the council to begin to build new properties for the first time. She said she would be writing to representatives of all political parties to acknowledge their contribution in bringing the new approach to fruition over the last ten years and freeing local authorities to build new housing again.

Southwark Borough Council

Southwark Borough Council has had £200million of debt written off and has headroom of £126million between its actual debt and borrowing cap but finds itself worse off. This is because actual rents are significantly below the levels that are assumed in the self-financing settlement while the cost of existing loans is relatively high. Consequently, there is no capacity in the revenue account to take advantage of the theoretical opportunity to borrow to fund improvements, regeneration and new build. The Council does not intend to borrow anything for at least five years. This is especially frustrating as the Council has not achieved the decent homes standard and has received insufficient capital funding from the Homes & Communities Agency.

The Council is now raising rents by the maximum allowed under the rent restructuring system, but is concerned about social rent policy after 2015 and also about the effects of welfare reform on rent collection, arrears and bad debts.

Councillor Ian Wingfield, Cabinet Member for Housing Management at Southwark Borough Council was quoted in ‘Inside Housing’ as saying:

“Our baseline is unable to support the cost of any additional borrowing for the next five years at least… We are paying a higher interest rate than anyone else because of the time that we got the money… And now is probably not the best time to re-finance… We are not opposed to the system but… it is going to be pernicious in the short-term.”

Gerri Scott, Director of Housing & Community Services added:

“We are cautiously optimistic about self-financing but the problem we have is that we have historically very low rents.”

However, the Council has set itself a target to build 1,000 new council homes before 2020. The target is seen as a significant step to address the council's priority for delivering more high quality, social and genuinely affordable housing in the borough.

The plans aim to make use of sites around Southwark, and will utilise spaces that are underused, vacant or problematic for large-scale development, such as garage spaces. The new housing will be council-funded and managed, allowing greater control over rent levels and management. It is proposed that this could also potentially allow for local lettings - where new housing is let to local residents in priority need, enabling the council to re-let existing homes and create better mobility on estates.

The provision of specialist housing such as accessible or wheelchair adapted homes can also be addressed with the council managed model that will respond to the need for properties suitable for disabled people as well as larger properties for families.

The first proposed site for new homes to be built is at the former Borough and Bankside housing office site on Long Lane, SE1. Consultation on the building of 25 to thirty new homes will begin after a report is submitted to the council's cabinet in around July 2012.

Councillor Peter John, Leader of Southwark Council, said:

"We are absolutely committed to delivering more high quality, genuinely affordable council homes for Southwark, which is why we have ambitious plans to build 1,000 in Southwark by 2020. Over the past year we have already delivered 600 affordable homes in Southwark, but no one else is talking about building council homes on this scale. It makes economic sense to use the returns from our successful regeneration and development projects to invest in council housing. This will provide a secure and sustainable answer to the problem of an ever-rising housing waiting list. It will also mean we can avoid a situation where Southwark residents have to move out of the borough to find an affordable property."

In October 2012, Southwark Borough Council received a report that it had commissioned. It found that the stock was of 'poor quality' and was 'ageing fast'. One option that it put forward is for the Council to reduce its stock from 39,000 homes to 20,000 and to use the capital receipts from the sales to fund refurbishment and new build.

Stockport Borough Council

Stockport Homes has adopted a wider social agenda and an approach to asset management based on environmental sustainability and thermal efficiency. Mark Hudson, Technical Services Director at Stockport Homes was quoted in 'Inside Housing' as saying:

"We've always known the right thing to do but now we have the flexibility to do it. We're trying to lower costs for customers in their homes, create jobs for them and give them a great deal of support in their lives. The days of the old traditional landlord are gone and we're doing everything we can to get our customers more economically active and robust ready for the next few years."

Schemes have included one to install photo-voltaic panels on 2,000 homes plus schools and council buildings. The scheme will reduce tenants' heating bills by about £130 a year and a surplus of between £9million and £11million is expected over 25 years from the feed-in-tariff and by selling electricity to the national grid. The surplus is being used to part-fund an external wall insulation scheme and four biomass district heating boilers to serve 1,000 homes and a school. 25% of the funding is from Stockport Homes and 75% from British Gas. Further schemes are expected.

Stroud Borough Council

Stroud Borough Council took on an additional £92million in debt, but its capital financing costs at £3.2million a year are £3.6million less than the £6.8million negative subsidy that it paid in 2011/12. The Council is using the surplus to fund a capital investment programme that includes £15million on building 100 new social homes, £35million on improvements to existing stock and £18million on energy efficiency. Ian Garrett, business accountant for the housing revenue account at the Council was quoted in 'Inside Housing' as saying:

"We are trying to do additional capital work to address the under-investment during the subsidy system… These options would not have been available to us at all before. It's meant a significant change in the scale of what we can do."

Wandsworth Borough Council

An exception to the usual approach is Wandsworth Borough Council. The Council paid the government £434million as part of the self-financing settlement that it funded by borrowing £224million from the public works loans board and using £210million of its own resources. The Council now plans to use any spare resources to clear its debts over twelve years before using them for purposes including improvements, regeneration and a modest new build programme. These payments will actually be less than the £26million a year that the authority paid in negative subsidy in 2011/12. However, due to the availability of loans at low rates of interest the Council borrowed £224million rather than £150million from the public works loans board and diverted the balance of £73million to fund regeneration schemes at the Winstanley and York Road estates. It is unlikely that these regeneration schemes would have happened without self-financing. Councillor Paul Ellis, Executive Member for Housing was quoted in 'Inside Housing' as saying:

"The thing has to stack up financially. We have seen what happens when you go off spending willy-nilly."

Waverley Borough Council

Waverley Borough Council in Surrey finds itself in a slightly better position. Under the housing revenue account subsidy system the Council had to hand over 50% of its rents to the Treasury (£12.5million a year). With self-financing the debt increased by £188.8million at an annual cost of £8million. The Council therefore has an additional £4million a year of surplus in the housing revenue account but has no borrowing headroom. The Council has therefore prepared a business plan based on different approaches in the short, medium and long term. During the first five years there will be no repayments of principal and the surplus in the housing revenue account will be divided evenly between new homes and refurbishment of existing homes. From year's six to ten the surplus will be divided evenly between loan repayments, refurbishment and new build and during years eleven to thirty, half of the surplus will be used for debt repayment and 25% each for refurbishment and new build. Angela Smithers, Head of Housing, was quoted in 'Inside Housing' as saying:

"We have been quite starved of cash… We didn't meet the decent homes standard, but now we've geared up for it we are using the investment to meet the standard by 2015… We were so used to having no money to spend. Now we have the opportunity to invest in our stock and increase it… we will be a bit busy."

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Wolverhampton City Council

Shaun Aldis, Director of Property Services at Wolverhampton Homes has taken the building cost model used to make bids for arms-length management organisation decent homes funding and has developed it into a cash flow forecasting model. He said:

"It's provided us greater freedoms to consider the sustainability of individual properties and groups of properties and estates to enable us to make informed decisions… We've always had neighbourhood profiles but one of the things for me is that we're developing that further with housing management colleagues to get indices about specific estates… The idea is that if one of them is not performing well, why would you want to go in there and spend loads of money on it when what you want to do is put some intervention in there first, some greater estate management presence or even further feasibility work before you commit any expenditure. It's a different thought process and you're also widening the amount of people and local knowledge that have an impact on your strategy."

Adrian Waite
June 2013

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!

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