Essential housing finance training course
15 February 2024

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Agenda

- Regulation
- Sources of income
- Capital and revenue expenditure
- Budgeting and business planning
- Value for money
- Risk and stress testing
- Management accounts
- Financial statements

Regulation

Social housing sector in England is regulated by the Regulator of Social Housing (RSH)

- Sets standards – **economic and consumer**
- RSH focusing on VfM and financial capacity of social landlords
- **RSH very keen that RPs/LAs submit accurate returns/data by specific dates**
- Governance and Viability Standard https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/919916/Governance_and_Financial_Viability_Standard_2015.pdf
- Code of Practice https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/919918/GandFV_Standard_code_of_practice_2015.pdf

RSH returns for private Registered Providers and LAs

- Statistical Data Return (SDR) – 31 May each year
- Financial Forecast Return (FFR) – 30 June each year
- Quarterly survey – three weeks after each quarter end
- Electronic annual accounts and audit management letter – six months after the year end

- RSH submission timetable https://www.gov.uk/guidance/information-required-from-registered-providers
- Quarterly return https://www.gov.uk/government/publications/quarterly-survey-for-q2-july-to-september-2023-to-2024

There are seven outcome-based standards – three economic and four consumer

1. **Governance and Financial Viability** (2015): Economic – effective governance and resource management
2. **Value for Money** (2018): Economic - ensure the assets and resources deliver the best value possible
3. **Rent** (2020): Economic - setting and charging rents (formula rents and affordable rents)
4. **Tenant Involvement and Empowerment** (2017): Consumer – providing choice and effective communications to tenants (including complaint handling)
5. **Home** (2015): Consumer – ensure homes are safe, decent and in a good state of repair
6. **Tenancy** (2015): Consumer – homes to be let in a fair and transparent way
7. **Neighbourhood and Community** (2015): Consumer – ensuring the wider area is clean and safe, promoting wellbeing and tackling anti-social behaviour

How are the standards monitored and enforced

- Regulatory framework based upon **co-regulation and data**
- Boards and councillors responsible to their tenants for ensuring the business and its services are managed effectively
- Board and councillors must ensure the organisation complies with the requirements of the relevant regulatory standards
- The Regulator has adopted a proactive risk-based approach in enforcing the **economic standards (eg, Rents)**
- Presently the Regulator has a limited approach to enforcing the **consumer standards** – RSH only steps in if serious detriment may occur **BUT this will change because of the objectives of the updated consumer standards**

The new consumer standards are based upon six themes (1)

- **Safety:** Tenants should live in homes that are safe and secure, and landlords should comply with all relevant health and safety legislation and regulations
- **Quality:** Tenants should live in homes that are well-maintained and meet the Decent Homes Standard or higher, and landlords should provide responsive and effective repairs and maintenance services
- **Neighbourhood:** Tenants should live in neighbourhoods that are clean, well-managed, and free from anti-social behaviour, and landlords should work with tenants and other partners to promote community cohesion and social inclusion.

The new consumer standards are based upon six themes (2)

- **Transparency:** Tenants should have access to clear and accurate information about their landlord's performance, policies, and decisions, and landlords should publish annual reports on how they meet the consumer standards
- **Engagement and accountability:** Tenants should have meaningful opportunities to influence and scrutinise their landlord's decisions and services, and landlords should have effective mechanisms for handling complaints and resolving disputes
- **Tenancies:** Tenants should have security of tenure and fair terms of occupation, and landlords should offer a range of tenancy options that meet the needs and preferences of different groups of tenants

Income


40,00
30,00
20,00
10,00
108,0
106,0
104,0
102,0
1990
1995
15,75%
14,73%
CE
%

Income

Rents:

- In England over a four-year period (ie 2016/17 to 2019/20) reduced by 1% per annum
- But from April 2020 increase CPI plus 1% for the next five years – but because the September 2022 CPI was 10.1% there was a cap of 7% for 2023/24 but flexibility on Supported housing. For 2024/25 an increase of CPI + % can be applied which would result in rents rising by 7.7%
- Social rents set at target/formula values and "affordable rent" is 80% of market rents – these must be applied in order to get grant funding
- Market rents

Income ... (cont'd)

- Shared ownership rents (2.75% of the unsold equity) usually increased annually at RPI plus 0.5% but many RPs applied a cap of 7% for 2023/24. For 2024/25 shared ownership rents will rise by 9.4% (i.e. 8.9% + 0.5%)
- Annual rent increases for future shared ownership developments will be CPI + 1%
- PFI rents increased in line with the legal agreements
- Service charges – fixed and variable – only c80% recovery
- Supporting People monies reducing in recent years
- Grants – revenue and/or capital

Income ... (cont'd)

- Other – sales of assets including Right To Buys
- Interest on balances – starting to rise
- Commercial income, eg, shops, leisure clubs, training businesses, gas servicing and investment properties
- Management income on behalf of other landlords and local authorities
- Care activities including care homes
- Shared ownership staircasing sales and outright sales income

Welfare reforms

- Reduction in benefit for under occupation – bedroom tax 14% reduction in HB for one 'extra' bedroom and 25% for two

- Total benefits capped at £25,323 pa per household in Greater London and £22,020 pa outside Greater London

- Council tax benefit reduced

https://www.gov.uk/government/publications/benefit-and-pension-rates-2023-to-2024/benefit-and-pension-rates-2023-to-2024

Welfare reforms ... (cont'd)

- Rents capped at Local Housing Allowance (LHA) levels
- Universal Credit rent benefit paid directly to the claimant, **but** they can request that it is paid directly to their landlord
- At the moment most of the above apply to **'working age social housing tenants' but retirement age is rising**

Rent loss and welfare reforms

- Most social landlords make prudent business plan assumptions about voids and arrears circa 3% combined – but some in the North West are higher

- Social landlords are also trying to reduce operating costs – downsizing, changing how services are delivered and mergers. A number of ALMOs have returned to the Council eg, Northwards Housing (Manchester City Council), Gateshead

- **Are the current inflation and cost of living rises leading to higher arrears figures?**

Expenditure



Types of expenditure

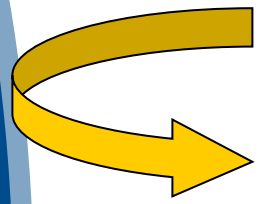
- Employees – salaries, pensions, taxes (eg, employers NIC, VAT, corporation tax)
- Tenant services, eg, repairs, housing management, support services
- Running costs, eg, office costs, transport, training
- Service charges, eg, communal lighting and heating, maintenance of lifts
- Major repairs
- Debt repayments, ie, interest and principal
- Depreciation – **non-cash.** The cost of a capital asset is allocated over its useful life

Capital spend

- Development – social homes, affordable homes, shared ownership, outright sale
- Planned repairs – stock condition survey
- Additions and alterations, eg, new lifts
- IT equipment
- New office
- Vehicle fleet – electric vans
- Community centre

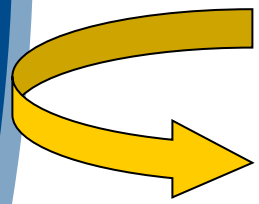
Cash flow

From tenants and Housing Benefit/Universal Credit



Rent, service charge and **other income inc. sales of assets**

Less costs: Management, repairs, services, overheads and interest payments

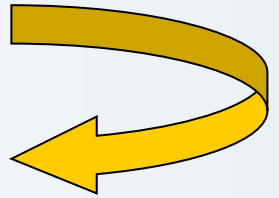


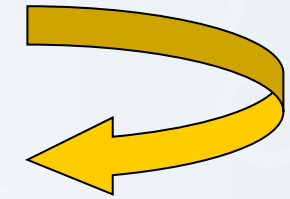
Surplus +

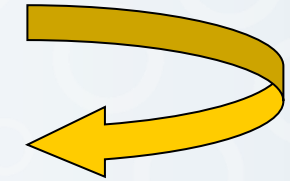
loans and grants are used to fund:

Development and refurbishment

Create new lettings and generate sales proceeds







Overview

- Operating costs tend to be covered by the rental income – there can be exceptions like additional fire safety works
- But sudden economic changes can create issues or opportunities, eg, Brexit, Covid-19 and **differential inflation**
- Development spend is funded from surplus cash, grants and loans

Budgeting and business planning



Budget and business planning

- Budgets – short term (one to three year) financial plans
- 30/35-year business plan – scenarios
- Usually, **incremental budgeting or zero-based** budgeting



Useful information:

https://corporatefinanceinstitute.com/resources/knowledge/accounting/types-of-budgets-budgeting-methods/

Budget setting

- Board/Council sets the budget targets – after consultation with stakeholders, eg, tenants, staff and executives
- Linked to the non-financial objectives and the 30/35-year business plan
- The budget cycle starts in autumn and it's presented to the board for approval in the following January
- It's based upon current activities and operating environment plus new business streams
- Assumptions applied are based upon current performance, anticipated improvements and potential variations

Revenue budget – income and expenditure

Income	£m	Expenditure	£m
Rents	96.7	Management	22.5
Service charges	2.6	Service costs	3.0
Voids	-1.7	Maintenance	19.7
Support services	0.7	Major repairs	6.6
S/O sales	3.7	Bad debts	4.2
Other income	6.1	Depreciation	10.6
RTB surplus	0.8	Impairment	0.2
Sale of assets	1.1	Support costs	1.1
		Cost of S/O sales	3.2
		Interest payable	8.7
		Other	6.3
Total	110.0		86.1
Surplus			23.9

Funding capital expenditure

Capital expenditure incurred and funding sources	£m
Types of capital expenditure:	
Capitalised repairs	10.9
New homes	32.5
Other capital spend e.g. office, new computer system	2.0
Total capital spend	**45.4**
Funded from:	
Surplus	23.9
Add back depreciation	10.6
Grant	1.5
Movement in debtors and creditors	1.4
Loans	8.0
Total funding	**45.4**

Different types of funding

- **Bank debt** – like a mortgage used to be for 30 years, now only short-term loans available
- **Capital markets** – named bonds – repayable over various terms but usually 30 year
- **Private placement** – bond with a large private company, eg, BAE, AVIVA and Rothesay Life
- **Aggregator bond** – lots of RPs issue a bond via an intermediary that administrates the repayments, eg, The Housing Finance Corporation (THFC)
- All funders set targets **(covenants)** and reporting requirements
- Local authorities – **Public Works Loan Board** (PWLB).

Covenants are targets set by funders – trapeze act safety net



Types of covenants set by funders

- Interest cover – adjusted surplus divided by interest (minimum **110%**)
- Asset cover – the value of the stock divided by the outstanding loan (minimum 110%)
- Gearing – loans divided by the value of the homes (cost or current value) **or** by the net worth (fixed assets + current assets less current liabilities) eg, **45%**
- Maximum debt per unit (eg, maximum £37,500).

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Long term business plan

Long term business plan

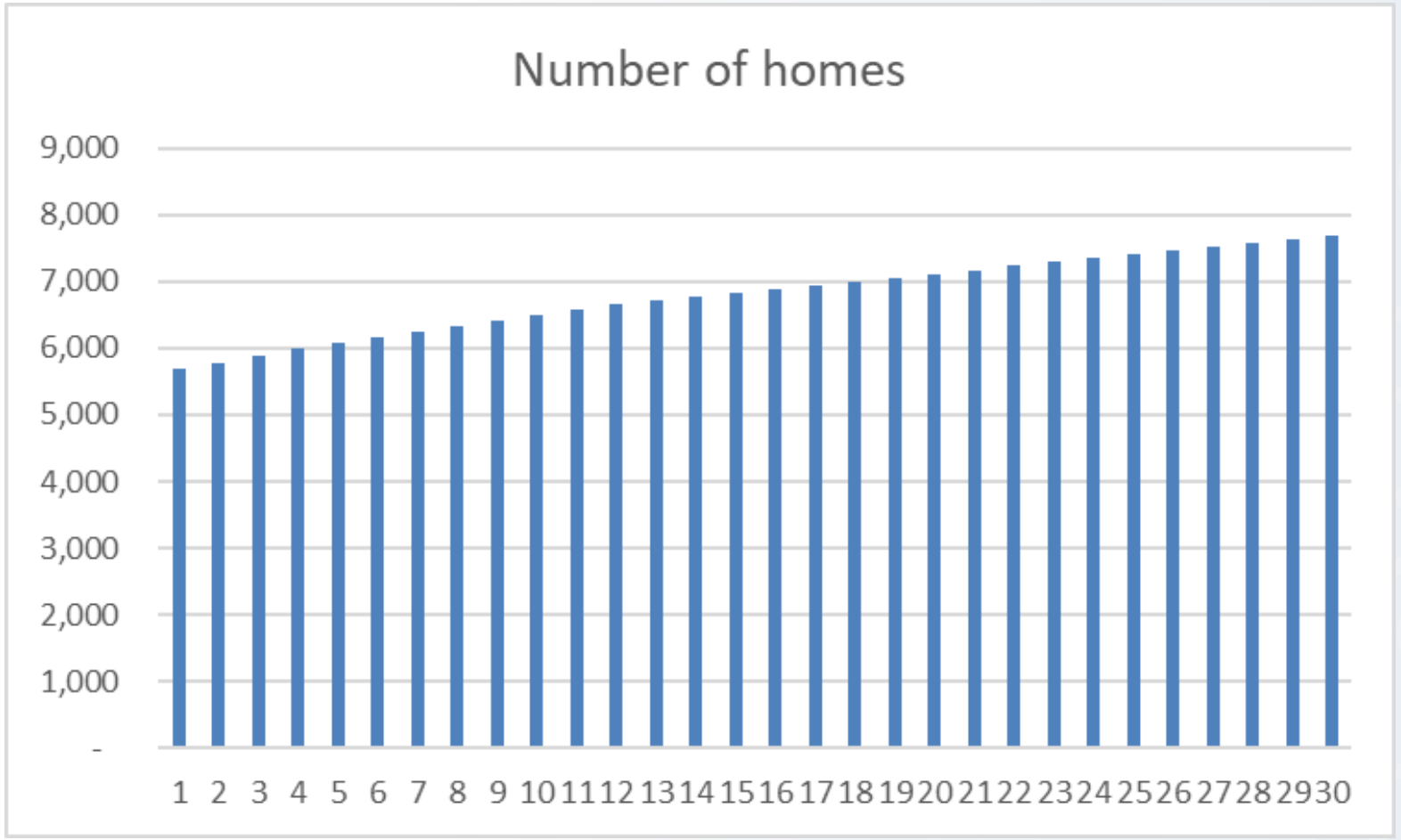
- Starting point is current performance and balances
- Anticipates the outcome of future performance
- Includes the delivery of future objectives
- Projects the future financial position of the organisation

Business plan assumptions

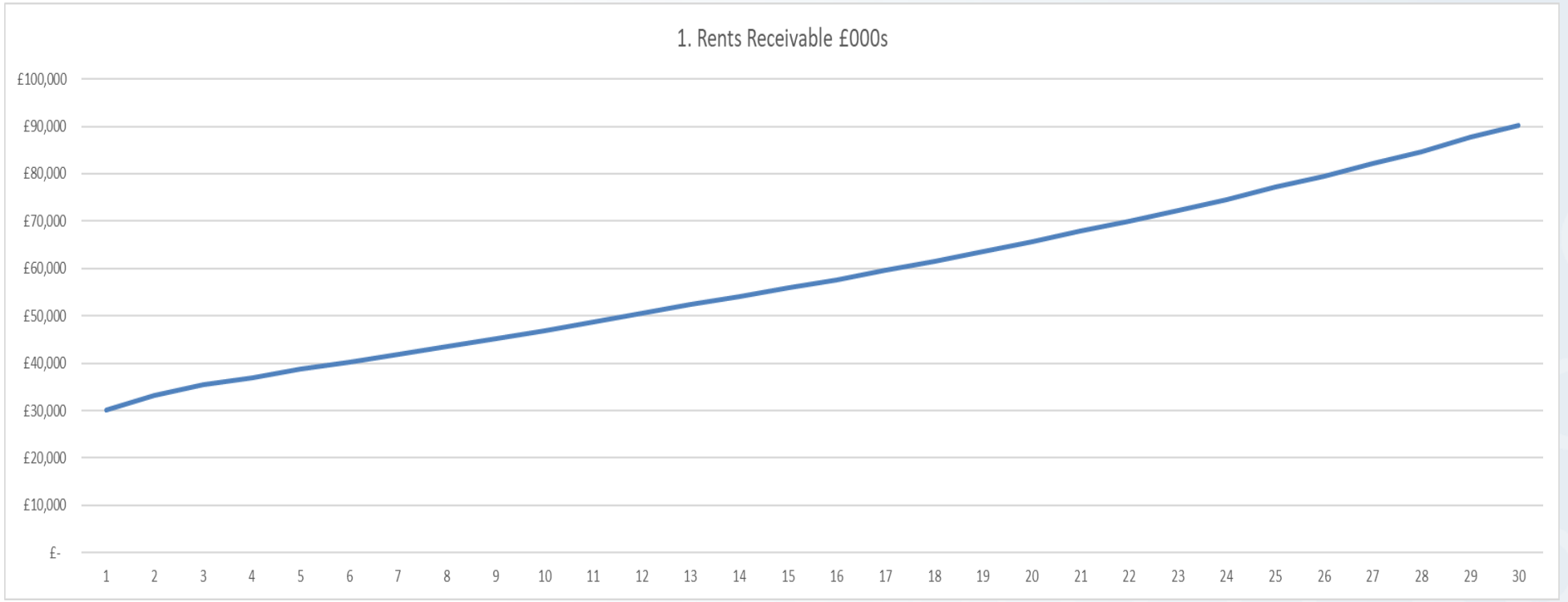
- Rent and service charge levels
- Rent collection and void rates
- Running costs – management costs, support costs and service charges
- Routine repairs
- Planned repairs – stock condition, asset management strategy
- Development programme
- Leasehold management – income and expenditure
- Loan repayments – fixed/variable loans – interest and principal
- Others – minimum cash balances/RtBs
- **RSH requirement to identify risk and conduct stress testing – also good business practice**

Long term business plan

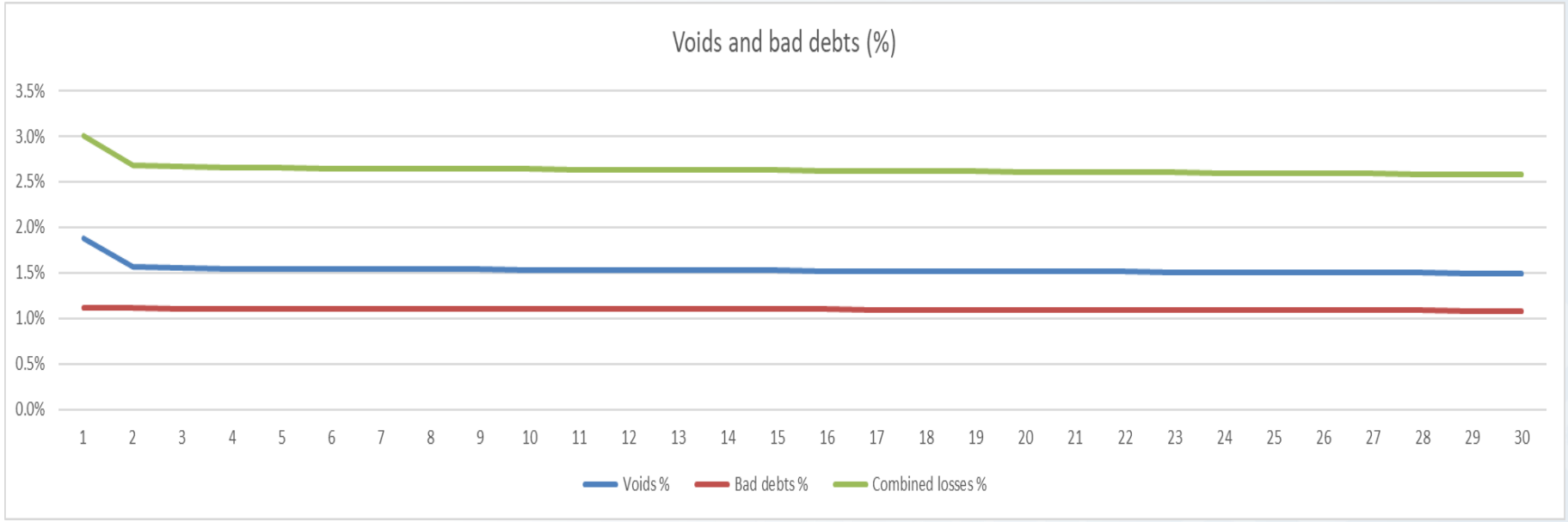
Homes increasing due to development programme



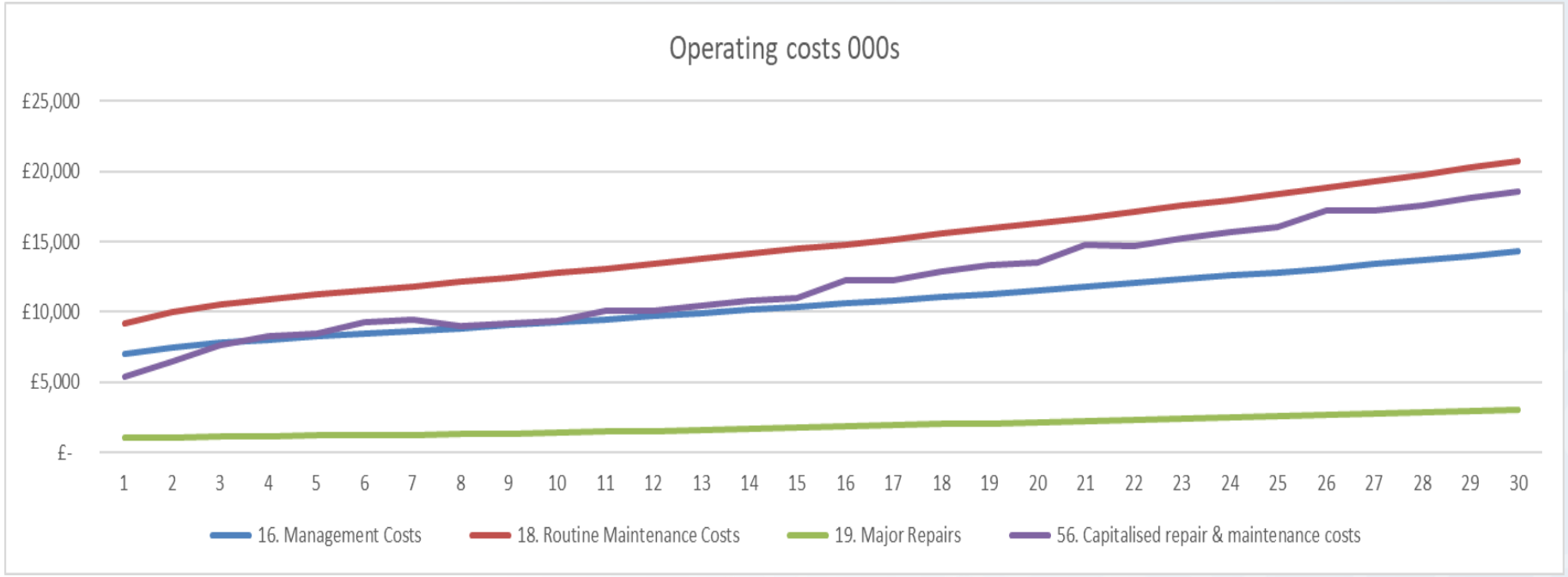
Income – rising annually due to the new homes and annual rent increase



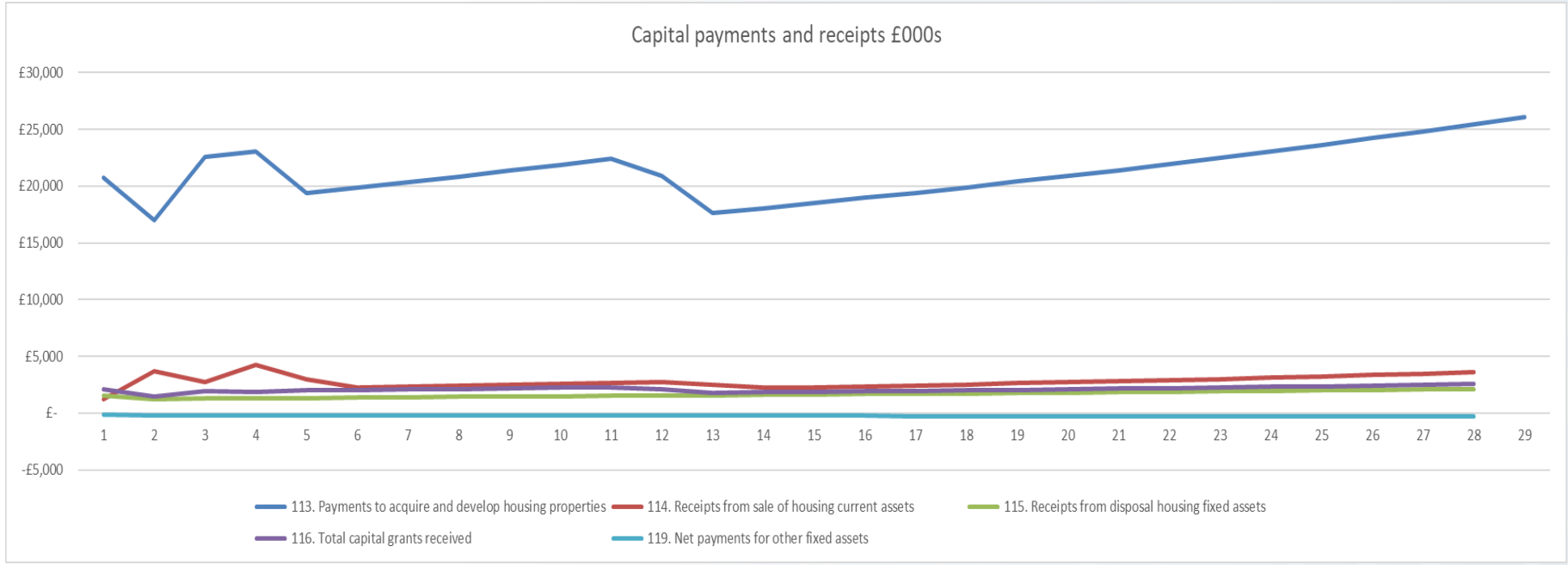
Voids and arrears assumptions



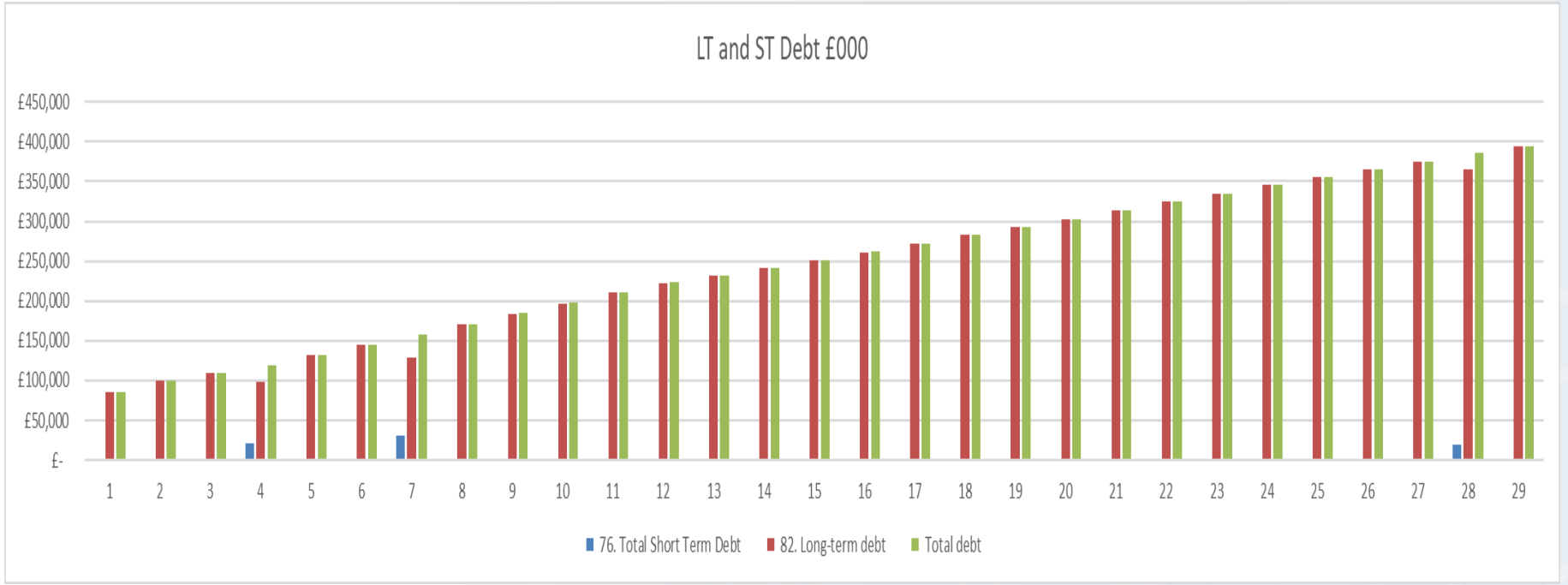
Operating costs



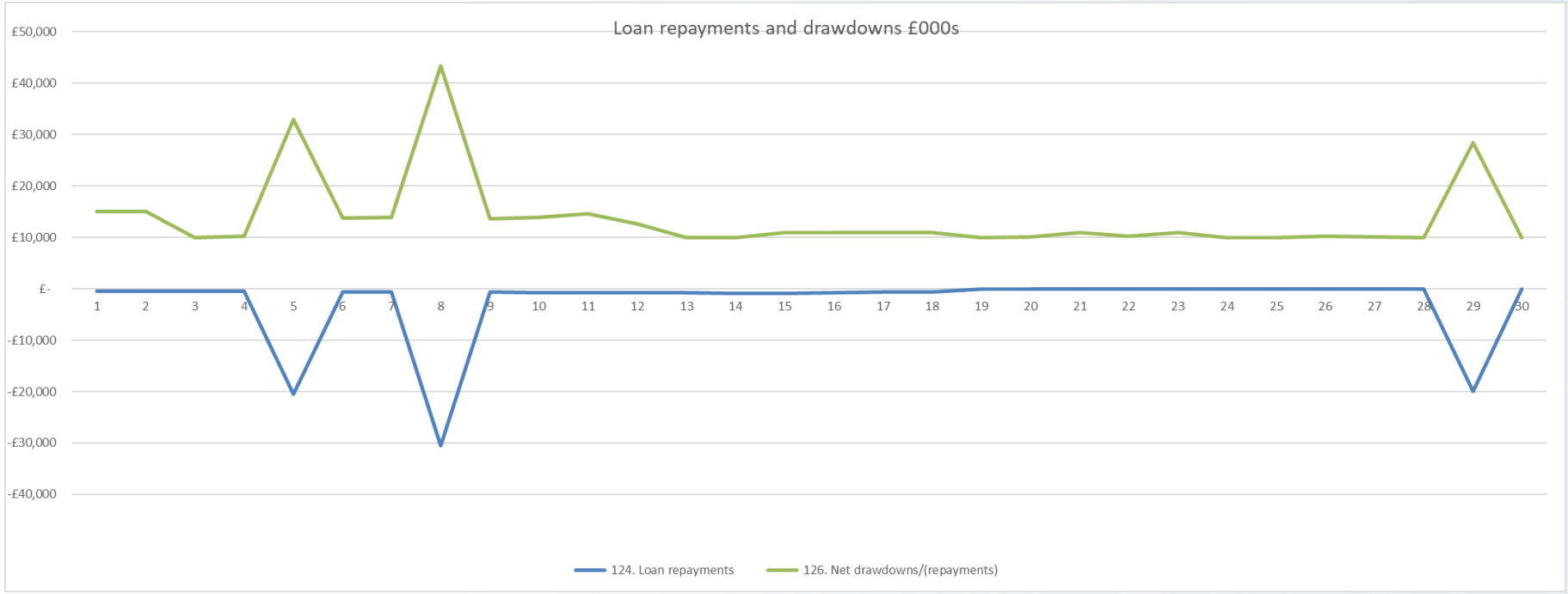
The development programme



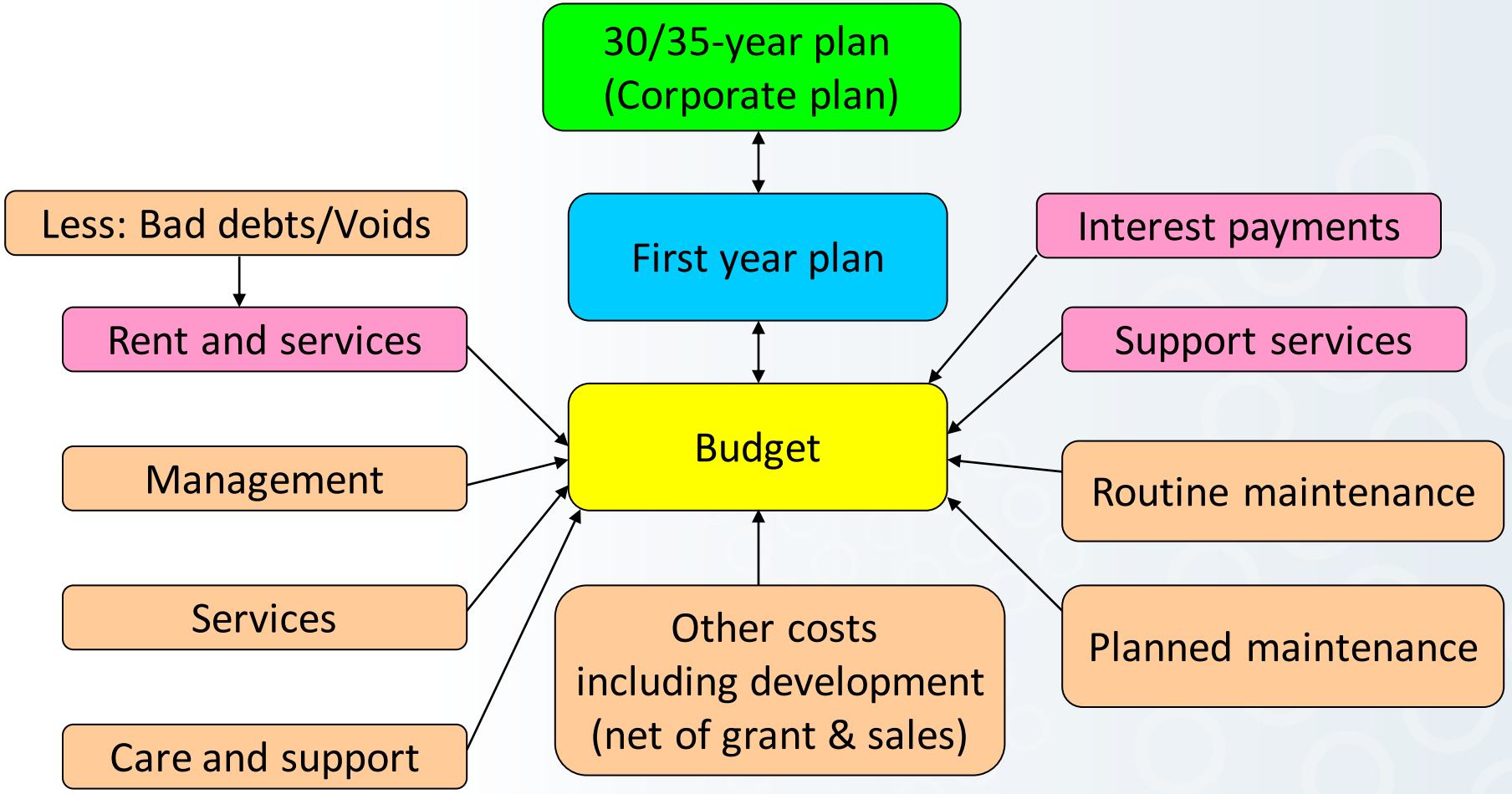
Loans


LT and ST Debt £000
£450,000
£400,000
£350,000
£300,000
£250,000
£200,000
£150,000
£100,000
£50,000
£-
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29
76. Total Short Term Debt
82. Long-term debt
Total debt

Loan repayments and drawdowns



Overview of business planning



Value for money



Why a strategic approach to VfM is needed

- **Customers** are constantly looking for VfM, eg, supermarkets, insurance companies, MoneySavingExpert.com





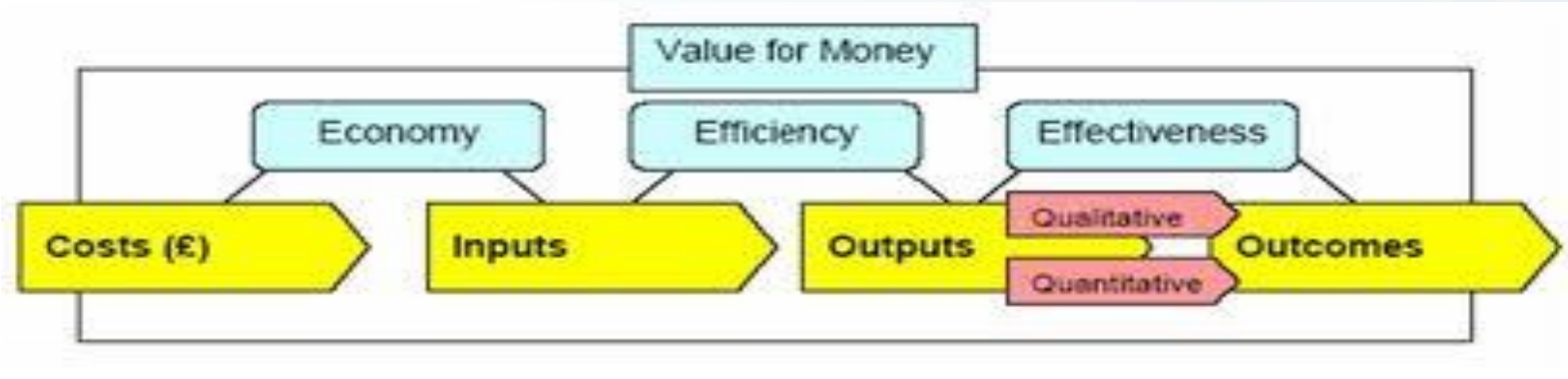


- **Social housing providers need to prove they are delivering VfM to their stakeholders as per the VfM Standard and Code of Practice**

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Traditional definition of VfM

VfM is defined as the relationship between economy, efficiency and effectiveness, sometimes known as the 'value chain'



But VfM isn't just about lower costs

- **Good services cost money**
- Quality isn't always cheap
- **VfM** is high when there is a balance between **relatively low costs, high productivity and successful outcomes**



Social housing VfM

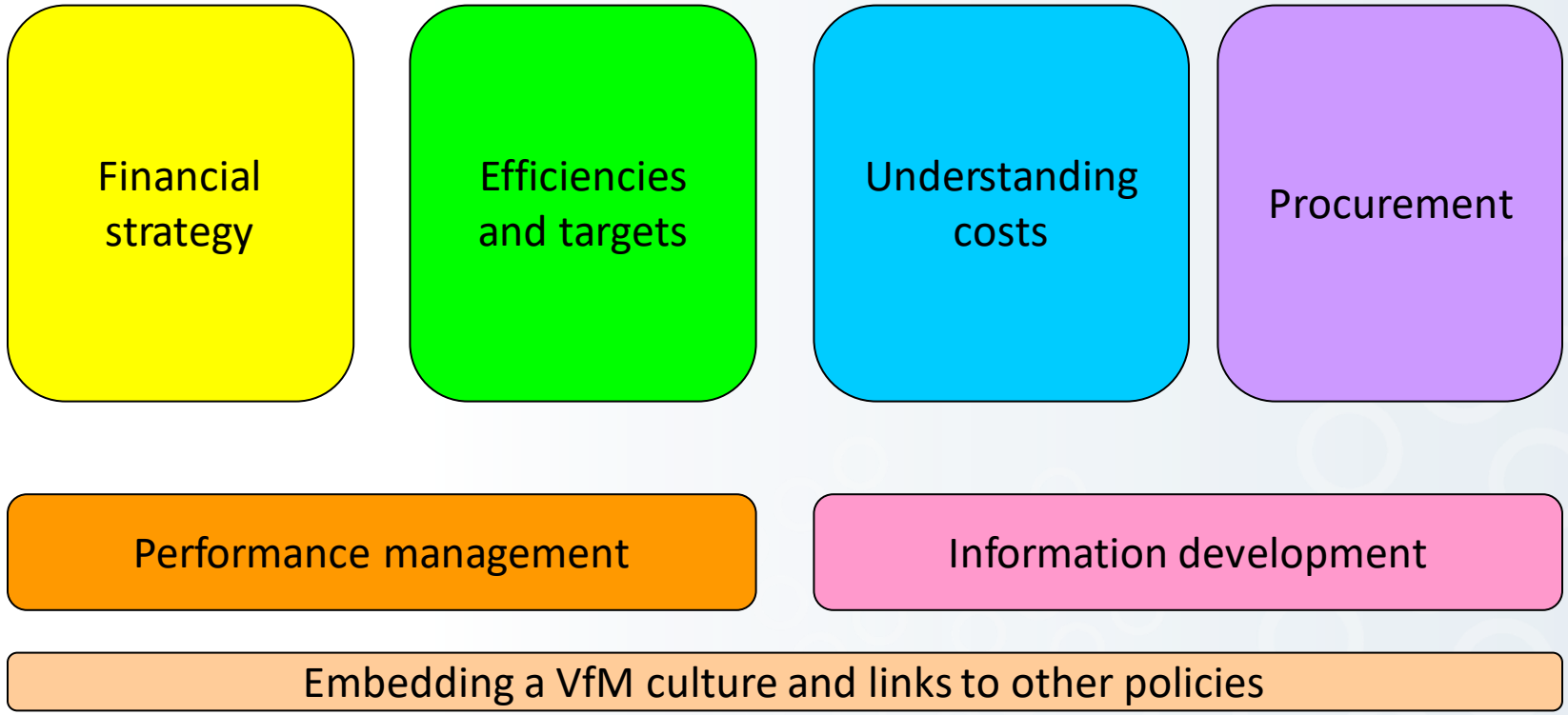
The delivery of an organisation's social objectives and business strategy in the most cost-effective way possible

Social objectives include:

- Work creation schemes
- Social enterprises
- Community facilities



Value for money – the building blocks



Key points from the 2018 VfM Standard

The objectives of the VfM standard – implemented 1 April 2018

Registered Providers must:

- **Clearly articulate their strategic objectives**
- Have an agreed approach to achieving VfM in meeting these objectives and **demonstrate their delivery of value for money to stakeholders**
- Through their strategic objectives articulate their strategy for **delivering homes** that meet a range of needs
- Ensure that **optimal benefit – this also takes into account social value –** is derived from resources and assets and optimise **economy, efficiency and effectiveness** in the delivery of their strategic objectives

How does the Regulator expect RPs to demonstrate compliance?

Registered Providers must demonstrate:

- A robust approach to achieving VfM
- **Regular and appropriate consideration of potential VfM gains. This must include full consideration of costs and benefits of alternative commercial, organisational and delivery structures**
- Consideration of VfM across their **whole business,** including their approach to investment in **non-social housing activity**
- That they have appropriate **targets** in place for **measuring performance in achieving VfM –** *which are regularly monitored*

How does the Regulator expect RPs to demonstrate they are delivering VfM?

Registered Providers must annually publish evidence in the <u>accounts</u> to enable stakeholders to understand the Provider's:

- Performance against its **own targets** and **any metrics set out by the Regulator**, and how that performance compares to peers *– there are seven/nine? Metrics*
- Measurable **plans to address** any areas of **underperformance**

The Global Accounts 2023 and VfM metrics

Global Accounts 2023 headlines – (1)

- Global Accounts 2023 cover the period from 1 April 2022 to 31 March 2023.
- In total, a record £7.7bn was spent on repairs and maintenance, a 20% increase on the 2022 figure. Key drivers were high inflation, backlog repair programmes following the pandemic and improvements (e.g. damp & mould and energy efficiency).
- The operating surplus generated by the sector fell by 9% to £4.0bn, the aggregate operating margin was 16.6%. The 'underlying surplus' fell for the fourth year in a row from £2.4bn to £2.2bn.
- EBITDA MRI interest cover deteriorating by 24% to 103%. Levels of interest cover have deteriorated steadily from a peak of more than 170% in 2018 and are now at the lowest level since 2010.

Global Accounts 2023 headlines – (2)

- Investment in new supply also increased by 11% in the year to £13.7bn. The number of social homes completed in the year increased by 7% to 53,000.
- The sector agreed new funding facilities of £9.9bn in the year to March 2023, increasing total available undrawn facilities to £30.3bn.
- Debt reported on balance sheets increased by £4.4bn (+5%) to £93.7bn in 2023. In aggregate, **79%** of the sector's debt at March 2023 was fixed for one year or more
- Over 90% of the sector's operating surplus was generated through Social Housing Lettings activity.

Global Accounts 2023 headlines – (3)

- Total sales receipts reported by the sector were £7.0bn and housing market exposure remains a key risk for many providers, particularly those reliant on first tranche shared ownership and outright market sale receipts.

- In the recent past, the sector's capacity to invest has benefitted from historically low interest rates. Interest rates are now predicted to remain higher for longer.

- The sector is beginning to make trade-offs to ensure viability is maintained. The latest business plans include 16% fewer units developed over the first five years of projections compared to previous years forecasts.

“Indicative” VfM metrics – 2022/23

Comparators -->	Indicative Median figures	Median figures (Consolidated)
CPU Year	**2022/23**	**2021/22**
Metric 1 - Reinvestment	6.8%	**6.5%**
Metric 2a - New supply delivered (social)	1.30%	**1.4%**
Metric 2b - New supply delivered non-social housing units	0.00%	**0.00%**
Metric 3 - Gearing %	45.5%	**44.1%**
Metric 4 - EBITDA (MRI)	130.0%	**146.0%**
Metric 5 - Headline social housing costs per unit	£ 4,530	**£ 4,150**
Metric 6a - Operating margin (SHL) %	20.0%	**23.3%**
Metric 6b - Operating margin (Overall) %	18.7%	**20.5%**
Metric 7 - Return on capital employed (ROCE)	2.9%	**3.2%**

Other VfM metrics that could be measured

- Routine repairs as a percentage of all repairs
- Net debt per home
- Average interest rate
- Management costs as a percentage of social housing rents and service charges
- Cash in hand and investments per home

Outcomes

- The VfM metrics could lead to a race to the lowest cost – and standards could drop
- Outlier RPs and LAs will come under more scrutiny
- More measures will be developed, eg specific shared ownership CPUs, Scottish Regulator includes CEO/senior staff costs and pension liability per home
- But need to monitor the effect of reducing headline costs on the tenant satisfaction rates
- Major repairs costs could rise due to the rising expectations of tenants and the Ombudsman's findings

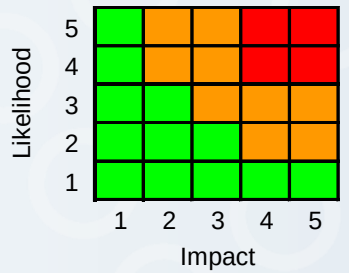
Risk


40,00
30,00
20,00
10,00
108,0
106,0
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1990
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15,75%
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ON
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%

Risk management

- ‘Any event which may affect the organisation’s ability to deliver high quality services to customers as well as to maintain its financial strength, positive public image and the overall quality of its people’

- Day to day responsibility:
  - Ability to minimise the probability and impact on the business
  - Costs and benefits of risk and control
  - Effectiveness of risk management process
  - Risk implications of decisions



- Need to assess a range of risks including strategic, financial, governance, operational and compliance

Sector risk profile 2023 (1)

- **Strategic risks**
  - Macroeconomic and financial environment
  - Delivering against expectations
  - Diversification
  - Access to labour and skills
  - Counterparty risk – contractor failure
- **Operational risks – existing stock and service delivery**
  - Delivering services to tenants
  - Existing stock quality inc. energy efficiency standards
  - Health and safety risk

Sector Risk Profile 2023 (2)

- **Operational risks … (cont'd)**
  - Costs and inflation
  - Rent setting
  - Rental income and arrears
  - Data and cyber security
  - Data integrity
  - Supported housing
- **Development**
  - Low-cost home ownership and market sales
  - Construction process risks and decarbonisation

Sector Risk Profile 2023 (3)

- **Finance and treasury management**
  - Existing debt
  - New debt
  - Alternative funding models
  - Pensions
  - Fraud

Good risk management leads to good stress testing

Stress testing – five key points

- Tests the **resilience of a business plan at breaking point**
- Needs to be **owned by the board/council/committee**
- **Regulators insist on it** – but all businesses now conducting stress tests
- **The scenarios** – may or may not turn out to be correct – they **are a means to get to the breaking point**
- **The mitigation actions are key to identifying that you are managing risk**

Stress test – demonstration

Management accounts



Management accounts

- Summary format for board, council, committee and leadership team
- For managers more detailed by operation, team, department, cost centre
- Year to date figures compared to a profiled budget
- Variances identified and investigated
- Expected out-turn/s

Objectives of management accounts

- It's a position statement
- Backward and forward looking
- Helps to focus on exceptions
- Investigate anything that looks unusual asap
- **Identify actions to get back on target** or reset the target due to circumstances
- Out-turn could be better and allow you to invest in new opportunities, eg, land banking or more IT spend

Management accounts and KPIs - process

- Look at the overall variance – why has it occurred?
- Focus in on the big numbers first
- Is it due to the budget being wrong?
- Is it due to better or worse service delivery?
- Does the projection for the rest of the year need amending?
- If a variance, what recovery actions do you need to take?
- What impact will the variations have on your cash position and loan covenants?

Standard layout – management accounts

Management accounts to 30/09/2020

	Actual £m	Budget £m	Variance £m	A/F	Explanation	FY budget £m	Projected outturn £m	Variance £m	A/F £m
Income									
Rents	44.5	45.0	-0.5	A	Handovers delayed - due to Covid-19	96.7	96.5	-0.2	A
Service charges	1.1	1.3	-0.2	A	Handovers delayed - due to Covid-19	2.6	2.5	-0.1	A
Voids	-0.8	-0.9	0.0	F	Less re-lets	-1.7	-1.6	0.1	F
Other income	3.4	3.4	0.0	_	In line with the budget but expected to be better by year end	6.1	7.0	0.9	F
Surplus on asset sales	0.5	0.4	0.1	F	Higher prices	4.8	5.0	0.2	F
Total income	**48.7**	**49.3**	**-0.6**	**A**	**Total income**	**108.5**	**109.4**	**0.9**	**F**
Expenditure									
Management	11.0	11.5	-0.5	F	Vacant posts	22.5	22.0	-0.5	F
Service costs	1.5	1.6	-0.1	F	Handovers delayed - due to Covid-19	3.0	2.8	-0.2	F
Maintenance	10.0	9.8	0.3	A	Increased activity - catch up	19.7	21.0	1.3	A
Major repairs	3.5	3.2	0.3	A	Higher costs - impact of Brexit	6.6	7.2	0.6	A
Bad debts	2.5	2.2	0.3	A	Impact of more tenants in receipt of UC	4.2	4.5	0.3	A
Depreciation	5.0	5.3	-0.3	F	Less costs capitalised	10.4	10.0	-0.4	F
Impairment	0.0	0.1	-0.1	F	Year end review	0.2	0.2	0.0	-
Support costs	0.5	0.5	0.0	_		1.1	1.1	0.0	-
Interest payable	4.5	4.4	0.1	A	Loans drawn earlier but rates lower	8.7	9.0	0.3	A
Other	2.0	3.1	-1.1	F	Timing issues & impact of Covid-19	6.3	3.2	-3.1	F
Total expenditure	**40.5**	**41.7**	**-1.2**	**F**	**Total expenditure**	**82.7**	**81.0**	**-1.7**	**F**
Net Surplus/(Deficit)	**8.2**	**7.6**	**0.6**	**F**	**Net Surplus/(Deficit)**	**25.8**	**28.4**	**2.6**	**F**

Financial statements



Standard layout

- Background information
- Commentary on the results for the year including VfM review
- Commentary about risk management
- Board/directors responsibilities
- Statement on the systems of internal controls
- Independent auditors report
- Statement of Comprehensive Income – SOCI
- Statement of Financial Position – SOFP
- Statement of changes in reserves
- Statement of cash flow
- Accounting policies
- Notes to the financial statement

Review of the Agenda

- Regulation
- Sources of income
- Capital and revenue expenditure
- Budgeting and business planning
- Value for money
- Risk and stress testing
- Management accounts
- Financial statements

... and finally

Remember ...

