



# FINANCIAL PLANNING: A GUIDE FOR BOARD MEMBERS

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## **1 INTRODUCTION**

- 1.1. All Boards should carry out an annual review to confirm the overall strategy and objectives of their association. Very often, the starting point is a review of the strengths, weaknesses, threats and opportunities (SWOT) to the business which can extend to the broader context of political, social, economic and technological factors (PEST). Most RSLs then publish a formal Business Plan which sets out the key aims and objectives, generally for the next 5 years. A key part of the Business Plan is the financial plan which should demonstrate how the aspirations will be met from a financial perspective and translates aims and objectives into financial forecasts.
- 1.2. Audit Commission inspections in particular look for a joined-up approach to the Vision, Objectives and Plans of organisations and for the “golden thread”. This means that you should be able to follow a link from the vision through the objectives, team plans and budgets, down to the individual objectives and performance indicators. In addition the Companies Act 2006 places a statutory duty on boards to demonstrate that when making decisions, they have considered the long term effect of those decisions on their company, their staff, their suppliers and the environment. The long-term financial plan is one of the ways in which a board can demonstrate this.
- 1.3. This document focuses on the *financial* plan explaining why it is essential for RSLs and the key areas which should be included. It gives advice to Members on how to challenge and analyse financial plans as well as how to set targets for the future. Finally it includes a useful checklist to enable greater understanding and constructive challenge in Appendix A.

## **2 WHAT DO WE MEAN BY A FINANCIAL PLAN?**

- 2.1. RSLs, in line with all other businesses, will approve an annual budget each year setting out the estimated expenditure for the next 12 months and where the funds to meet that expenditure will come from. A financial plan looks further ahead and is of necessity closely linked to the strategy and objectives of the business.
- 2.2. Effective financial plans should be made up of two key areas. Firstly, Members need to see the anticipated income related to the business’s present stock. This will identify whether the current portfolio is able to support the expenditure requirements for the future, including stock

condition requirements, using reasonable assumptions for future inflation, interest rates etc. Secondly, estimates of any new business or plans need to be included.

- 2.3 Given the number of assumptions included, financial plans are not therefore as detailed as annual budgets. Often, they are presented at a much higher level e.g. in tens or hundreds of thousands rather than in pounds, reflecting the fact that they are high level strategic documents. The main consideration is the forecast *trends* of the business rather than the detailed figures themselves.

### 3 WHY PRODUCE PLANS?

- 3.1 There are many reasons why RSLs need to produce medium to long term financial plans and the key reasons are identified below:

- *To confirm ongoing financial viability*  
Confirmation that future income streams will be sufficient to meet expenditure requirements is critical. If this cannot be demonstrated with sound assumptions, action will need to be taken to correct any shortfalls and Members will be unable to sign off the association's annual accounts as a 'going concern'. Note that external auditors also consider such plans before signing off accounts each year.
- *To demonstrate they can finance their key objectives*  
Organisations should have discussed and agreed their priorities for the future and a financial forecast is required to demonstrate that they will have sufficient income to meet their objectives. These will include regulatory requirements, e.g. achievement of Decent Homes and rent restructuring, any transfer promises made to residents and repayment of loans borrowed.
- *To evidence ability and capacity to grow and develop*  
Financial plans enable consideration of various options to be modelled. This should assist in demonstrating that the business has sufficient capacity to develop or resources available for further growth in services.
- *To demonstrate value for money*  
Including target efficiencies in the plan ensures that VFM objectives are embedded in the plan and can be monitored in the future.

- *To identify potential threats and risks to achieving objectives*  
Using the plan to model various different assumptions and scenarios can assist in identifying critical risks enabling action to be taken to mitigate these. The top 5 key risks should be tested in the model.
- *To confirm that all loan covenants will be met*  
Where associations have borrowed substantial loan funding, there are generally key financial covenants which must be achieved. It is important for Members to be sure that future plans do not result in possible breaches to covenants and potential withdrawal of loan facilities.
- *To meet funder and rating agency requirements*  
Many banks and building societies have built into loan documents that financial plans should be updated annually and submitted to them by a specific date. Members should be aware of these requirements and ensure that business and financial planning work is completed in sufficient time to submit an approved plan.
- *To meet regulatory requirements*  
The Regulatory Code and Guidance published by the Housing Corporation in August 2005 says that:
  - “1.1 Housing associations must operate viable businesses, with adequate recourse to financial resources to meet their current and future business and financial commitments:
    - 1.1.1 based on a coherent and robust business plan;
    - 1.1.2 fulfilling their loan-agreement covenants.

This will still apply to regulation under the TSA until a new regulatory framework is introduced.

The Housing Corporation/TSA collects and reviews financial forecast information from housing associations in both electronic format and via review of associations' own business plans.

Associations owning and/or managing 1,000 units or more at the start of their accounting period are required to submit an FV5/Capacity Model. There may however, by exception, be cases where the Regulator considers that an association with between 250 and 999 units should be regulated on a risk basis, in which case an FV5 may be requested."

An FV5 collates data in a standard format, covering income and expenditure, the balance sheet for the association and a cash flow forecast covering a five-year forecast plus an estimate of their previous year's actuals. Where an organisation plans to develop or own at least 100 new units, it is required to submit a Capacity Model. The Capacity Model is a complex 30-year business plan summary showing all aspects of financial data for the housing association, including development and funding assumptions. It is constructed in a manner such that various aspects of different assumptions, such as level and cost of development, property sales, interest rates and inflation rates, including differential levels for various elements of cost, can be flexed to assess the likely effect upon the association's viability and funding requirements.

Associations with less than 1,000 units which have development ambitions may be required to complete an abbreviated version that only requires the 'Business Plan Accounting Data' sheet to be filled out.

## **4 WHAT TIME PERIOD SHOULD BE USED?**

- 4.1 As a rule of thumb, financial plans should be prepared for at least the next 5 years to evidence ongoing viability. This should cover all ongoing day to day income and expenditure as well as planned developments and capital projects over the period. However housing is a long-term business with lengthy cost cycles and most larger and developing associations also produce 30 year plans. In fact the regulator requires all developing associations to produce and submit such plans every year. For stock transfer associations (LSVTs), the length of the financial model is often dictated by funders, who wish associations to demonstrate that they have sufficient net income to enable repayment of loans within agreed timescales. Generally these are over 25 years with a few debt free years at the end of the plan.
- 4.2 It is important to note that 30 year plans are clearly broad brush estimates as they comprise a significant number of assumptions. However they are valuable to demonstrate trends and in particular to identify any potential refinancing or reinvestment needs for the future.

## 5 WHAT SHOULD BE INCLUDED?

- 5.1 Where possible plans should start from actual brought forward balances extracted from the association's accounts. The first year of the plan should therefore be the current year and should be very similar to the approved budget for the year. Note that it is important for this first year to be as realistic as possible as generally future years' income and expenditure will use this as the base. It is therefore helpful to review previous plans and assumptions – how well did these compare with actuals and did the association deliver what it aimed to?
- 5.2 To this base, reasonable assumptions should be applied e.g. RPI, LIBOR, increases in staff costs, maintenance, house prices, new build costs etc. Minor changes can have a material impact in future years so should be carefully selected. Members should be involved in the approval of these key assumptions which should be reviewed annually. A checklist of the types of assumptions required is included in Appendix A for guidance
- 5.3 The impact of any proposed development should then be added and care taken to ensure that all relevant costs are included. Smaller associations will probably include specific known schemes but larger developing RSLs may use average numbers and costs. If assumptions are going to be made about future unknown developments, average costs, grants and sales income should be used.
- 5.4 Some associations may have approved sales programmes which should be included and Members will also need to consider whether there is a need to include any additional capital expenditure – for example replacement IT systems or office refurbishments. Finally the impact of any reduced grants or any proposed increases in services should be costed and included.
- 5.5 A key check on the plan is to question whether any material items have been excluded. Where group structures exist, it is particularly important to have a financial plan for all subsidiaries to ensure a complete overall picture.

## 6 WHAT SHOULD BE PRODUCED?

- 6.1 Most financial plans are built on spreadsheets which enable Finance staff to complete the complex calculations and model various different options and sensitivities. Many models are individual to the RSL concerned – in the case of transfer RSLs, many still use the original model which staff have amended over time to include changes since transfer. However, it should be noted that these models are generally valuation models rather than ongoing financial models and may therefore not be the most appropriate tool to use.
- 6.2 In many cases, calculations are carried out outside the model and figures then simply entered into the relevant cells. It is important that Members have confidence that the model itself is accurate. This could be achieved through an audit of the plan and its outputs – this would be more cost effective if done in house although it is possible to obtain an external validation if required.
- 6.3 Some associations use standard financial planning models which are not so easily changed or amended (the most commonly used are the Weedon Grant model and the Brixx software). This can give an element of comfort, particularly in complex modelling – remember however that the output from any plans is only as good as the raw data and assumptions entered.
- 6.4 As a bare minimum, the financial plan should include a balance sheet, income and expenditure account and estimated cashflow. Although some Members with financial expertise may welcome the opportunity to review the figures, it is not essential for Members to see the detailed figures to approve the plan. The Finance Director should however, prepare a report on the plan which identifies the following key areas:
- The key assumptions used in the construction of the plan
  - Annual surpluses or deficits - this can be shown in a graphical format to ease understanding
  - Balance sheet trends for assets, loans and reserves
  - A cashflow forecast highlighting annual loan drawdown requirements

- Whether loan covenants are met for each year of the plan (and if not what action can be taken to correct this)
- Whether the association's current loan finance will be sufficient to meet objectives (and if not, when new monies are required)
- An analysis of the stock profile at the end of each year
- If the lenders stopped any new loans, whether the current loans could be repaid within the terms by stopping growth/new development and how much leeway (capacity) there is within the plan
- Any other performance indicators which Members have stated they wish to see (e.g. surplus targets, asset ratios, debt repayment etc.)

6.5 Associations may find it useful to agree various parameters which can be used to demonstrate viability more easily. The table below gives an example of the types of indicators which could be used – however it is important to stress that the actual indicators must be agreed by each RSL dependent on its own loans/costs etc. Members are encouraged to identify no more than 3 or 4 targets which can be tracked in all future budgets and financial plans. Careful thought needs to be given to these targets, which could be determined from covenant requirements, by comparison with other similar organisations (using benchmarking data) or accounting ratios.

	<b>Red</b>	<b>Amber</b>	<b>Green</b>
Gearing –SHG + reserves to loans	>80%	75-80%	< 75%
Interest cover	>1:05:1	1.1:1	1.2:1
Average interest rate	>7%	>6.5%	6%
Maintenance/investment costs per unit per annum	>£1,500	£1,400	£1,200
Management costs to turnover	>23%%	22%	20%
Surplus turnover	<0%	2%	5%
Cash surplus: turnover	<2%%	5%	10%

6.6 Where the plan fails to achieve the 'green' targets and is highlighting some amber areas, Members would wish to question how to strengthen

the overall financial position. If the plan is showing 'red' areas, Members may decide not to approve the plan but carry out further analysis or review before proceeding further.

## **7 SENSITIVITY ANALYSIS**

- 7.1 As the financial plan is made up of a large number of assumptions over a lengthy period, it is important for the impact of these assumptions to be understood. Sensitivity analysis demonstrates the impact of different assumptions on the plan (and in particular on the annual surplus/deficit and loans borrowed).
- 7.2 Each association must determine the areas it needs to see analysed and this will depend on the nature of its own business. It is particularly useful to use the 5 key risks which have been identified as areas for modelling. For example an RSL involved in shared ownership may need to see the impact of delays to sales or reduced valuations: an RSL with a significant proportion of variable rate debt, will need to assess the impact of increases in LIBOR or Bank Base rate: an RSL with significant amounts of supported housing may want to model reduced grant income. Other areas to model could include increases in staff or maintenance costs, changes in RPI, reduced SHG or increased maintenance requirements. In addition, the impact of no further development (beyond that already committed) is often asked for by funders and the regulator.
- 7.3 Some models enable multiple variables to be altered at the same time which gives more of a real-world scenario enabling inter-related items to be varied e.g. a fall in property values would reduce sales income but could also delay sales. Whilst altering a single variable gives the best indication of risk for that variable, altering inter-related issues perhaps gives the best and most likely outcomes.

## **8 HOW CAN MEMBERS DEBATE AND CHALLENGE FINANCIAL PLANS?**

- 8.1 There are a number of areas where Members can question officers to ensure that they fully understand the plan before it is approved. If these have not been included in the Finance Directors report, Members should ask the following:

- Does the plan reflect the overall direction in which the association wishes to move, i.e. is it a financial interpretation of the objectives and vision?
- How has the plan been constructed; have finance staff worked closely with business staff and does the proposed plan have the approval of all directors?
- Have the outputs been checked i.e. has the model been audited or checked?
- Do costs and income reflect the current position and if not why not?
- Have all income and expenditure streams been included?
- Are assumptions reasonable without being too optimistic?
- Where improvements are assumed in current costs, what evidence is there to back this up? Similarly, where reduced voids and bad debts are forecast, how will this be achieved?
- Are all income streams contributing to the bottom line? If not what action is being taken to address this?
- What tolerance or headroom is built into the plans to enable the RSL to deal with new requirements or adverse changes?
- Does the model reflect accounting practice e.g. have auditors agreed any proposed capitalised repairs and is the impact of any changes in accounting practice included?
- Is there a need to consider any impairment to assets given the economic climate?
- What are the key sensitivities which could throw the RSL off course? How likely are they to occur?
- What is the impact of the key risks and opportunities of the SWOT and PEST analyses on the financial plan and what is their probability?
- How easily does the plan meet the required loan covenants and if it is close, what headroom is there in place? This is particularly important for associations which are 100% debt funded.
- Is there sufficient loan finance in place to meet the needs of the plan and if not when will new funds be needed and is there sufficient spare security to attract loans?

- Is there anything included in the plan which cannot be funded from the RSL's current borrowing? (e.g. certain types of expenditure may be excluded from some loan facilities)
- Are there any tax implications to the plan which need to be included/considered?

## **9 REVIEWING THE PLAN**

9.1 As medium to long-term plans with high level assumptions, the plan should generally not be reviewed for a year once approved. However, there are some instances when Members may wish for a further report back on the plans on a more regular basis:

- Where a major change is proposed in the plan e.g. a proposal for a new development which will have a material impact on the plan
- In times of economic and financial volatility e.g. where there are significant changes in interest rates or RPI, particularly where these were not anticipated in the original assumptions
- Where achievement of loan covenants is known to be tight (or the association is working to amber targets)
- Where actual performance for the year is showing material adverse variance against budget which is likely to be ongoing
- Where there is material external change which could affect the plan e.g. taxation changes or reduced grant rates.

## **10 CONCLUSIONS**

10.1 Board Members can make a real contribution to the financial plan by being critical friends. In particular, they should understand the importance of the financial plan and be clear on the links between the Business Plan objectives and the financial forecasts. This will provide assurance that the business is viable now and in the foreseeable future and enable them to confirm that the organisation is a 'going concern' to auditors and funders as required.

### 11 KEY FEATURES OF RSL PLANS – CHECKLIST

This gives a brief overview of the types of information which should be discussed and agreed by Members before being included in the financial plan. Note that the figures included in the plan should be those which are material to the bottom line, as the plan's aim is to demonstrate trends and high level viability and results are generally shown in £'000s or £'000,000s. Each board therefore needs to agree which assumptions are most material to its own business.

#### **RPI –**

Generally associations use 2.5% as a long term rate although this could vary in the early years, dependent on the latest economic indicators.

#### **Properties**

The model should include all current properties, with increases for new homes into management and decreases for properties sold under RTB or staircasing.

#### **Rents**

Average rents rise by RPI plus whatever is needed to achieve target rents in line with the rent plan. This may need to include different tenure types and agreements - account should also be taken of any movements/trends towards target rents and any transfer promises.

#### **Service and support charges**

This should be in line with regulatory guidance of no more than RPI plus ½%.

#### **Void and bad debts**

Assumptions here depend very much on the stock and location. Care should be taken not to assume significant improvements on current figures unless there are clear action plans in place to achieve this.

#### **Property sales**

Net Sale proceeds from RTB or staircasing together with any planned disposals. It is also now necessary to include the potential first tranche sales of shared ownership properties. Where there is a programme of proposed sales, this should also be included with a reasonable estimate of the potential timing of receipts. Care should be taken when assuming real increases in property values in the current economic climate.

#### **Other income**

Generally increased by RPI only unless this is material with known growth.

**Management costs**

This covers a large number of areas and is generally increased by RPI plus a small element of growth. Some associations calculate a management cost per home which is applied to total stock numbers and increase this by inflation.

**Maintenance and investment (including capitalised repairs)**

Check this against building trade inflation websites and you may use a different assumption for properties depending on their age and geographical location. Be prudent in your capitalisation as high levels of capitalised repairs are rarely agreed by external auditors.

**Depreciation and impairment**

This should reflect the association's depreciation policy for each group of assets.

**Interest and loan repayment**

Shorter term assumptions should be based on advice from treasury advisers and you must remember to include your actual loan margin costs. In the long term, security and headroom is built into plans by having as high a rate of 'real interest rate' (i.e. the difference between interest rates and RPI) as you can accommodate. Often funders look for at least 3% differential, so if you are using RPI of 2.5% you should use at least 5.5% interest rates for all new borrowings.

**Other costs**

Generally increased by RPI only unless this is material with known growth.

**Efficiencies**

Many associations include target efficiency savings or attempt to increase costs by less than RPI. Care should be taken that any such assumptions are not overly optimistic and are backed up with planned actions.

**Development of new properties**

If you have separate development assumptions as part of your scheme appraisals, it is important to use these in your financial plan too. Be realistic around development periods and in particular on potential sales proceeds.

**Other capital expenditure**

Don't forget to include assumptions about the replacement of assets e.g. offices, IT, vehicles etc, at the end of their useful lives.

Details about the CIPFA RSLs Panel and its activities can be found on the Panel website [www.cipfa.org.uk/panels/RSL](http://www.cipfa.org.uk/panels/RSL)

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### **Comments**

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