

Integration of strategic planning and financial management in the housing association sector

David Whittaker BA(Hons), ACMA has recently been involved in the process of integrating strategic planning with financial management at Ealing Family Housing Association. In this article he discusses the advantages and the process of implementing business planning techniques in the housing association sector

For those readers who are not entirely familiar with the typical objective of the housing association sector, this can be defined as follows: 'To provide housing and associated services for people who are in need due to age, sickness or disability or people who cannot afford such housing or amenities'. This article specifically addresses the market for rented accommodation, which usually represents the core business.

Key business stakeholders

As with any business the housing association sector has a number of key stakeholders whom the management of the organisation should seek to satisfy.

The associations' tenants are typically looking for quality affordable accommodation.

The government will be continually looking for value for money, ways of reducing the PSBR and promoting competition in the sector.

The associations' lenders will typically be looking for a financially viable association with the objective of ensuring an adequate return and security levels in respect to the funds advanced. There may be some conflict of objective between the above parties.

Environmental threats

There are certain key environmental threats that are apparent in this sector. These include the following:

- There is the threat of the volatility of builders' tenders and land prices. Shortly, local authorities will run out of land which can be offered to housing associations on discounted terms.
- Housing associations have typically received government grants in order to finance the development of its housing needs. However, since the 1988 Housing Act, grant levels have not represented 100% of an association's typical funding structure. There is now the environmental threat of further reductions in housing association grant and other public subsidy levels as the government seeks to further reduce the PSBR (Public Sector Borrowing Requirement). The Housing Corporation and the local authority will continue to promote competition for funds between housing associations. The grant bidding process will determine the amount of grant that an association receives. Obviously, the shortfall will have to be funded by private-sector funding that has an interest rate risk and the need to repay the principal to the lender.
- The Housing Corporation uses rent levels as a criterion for making grant allocations at the bid stage.
- There may be further threats of the government squeezing housing benefit levels as a further attempt to reduce the PSBR.

The business planning implementation process

Figure 1 shows the business planning implementation process.

The first step is to state the problem definition. This can be summarised as follows: 'To meet the strategic objective of providing social housing,

maintaining quality standards, maintaining tenants' affordability and competitive rents whilst remaining financially viable in the long term'.

Step two is to undertake a review of management accounting, reporting and statutory accounts in order to help define a suitable format for the forecast financial statements. This will help to define the main cost classifications and materiality of areas for strategic purposes.

Step three in the business planning implementation process is to map the interrelationships between key variables that drive the business. Here the technique of causal loop diagramming should be adopted. The causal loop diagram is a tool which is used to outline the cause and effect relationship of key factors involved in the business planning problem. Figure 2 shows a causal loop diagram of a housing association's Housing for Rent Strategy. An association's strategic objective

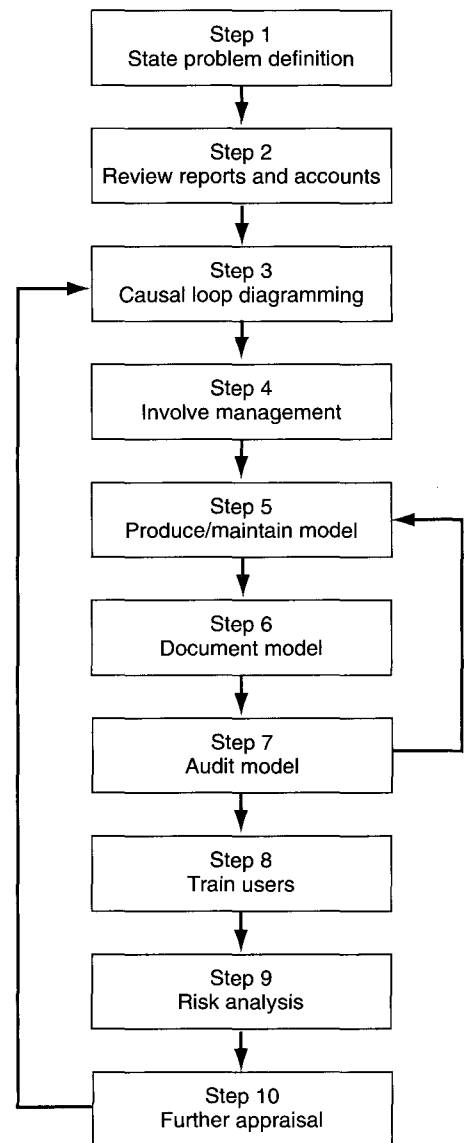


Figure 1 Business planning implementation

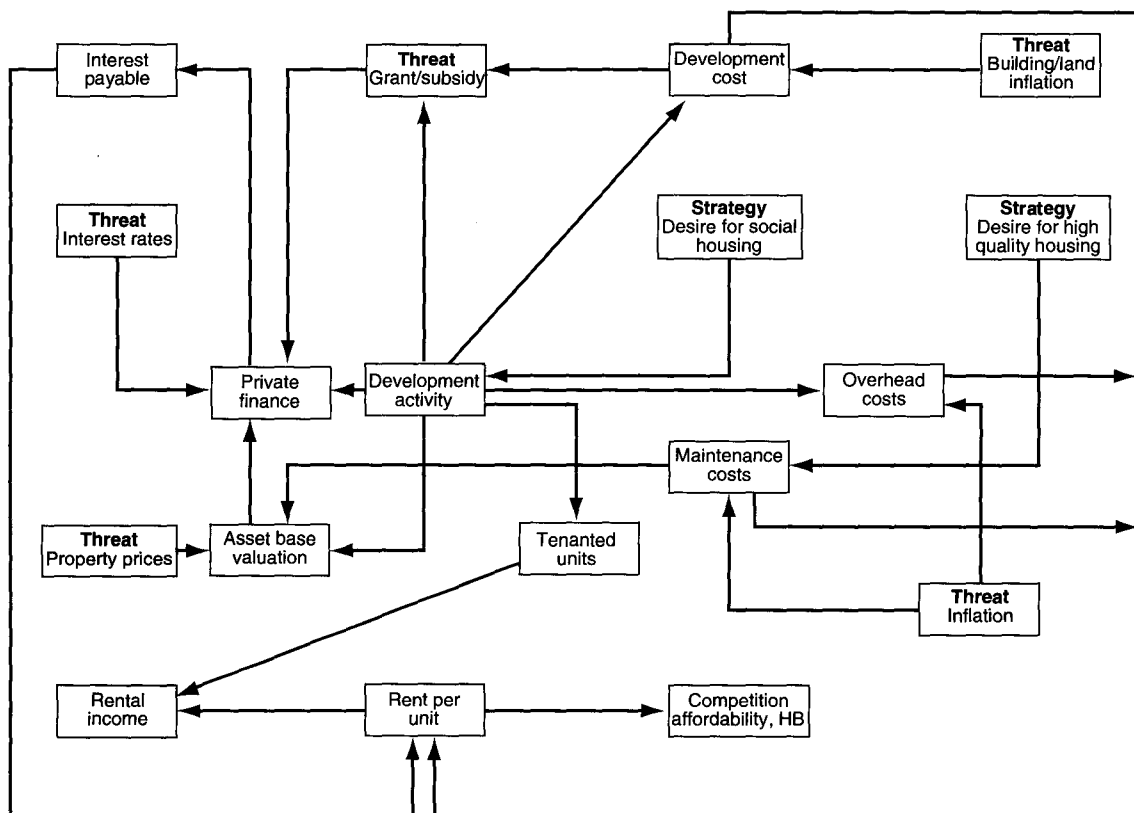


Figure 2 Causal loop diagram: housing for rent strategy

of fulfilling social housing leads to the need to develop housing. There is obviously a cost of such a process in terms of acquiring land and building costs which are affected by the environmental threats of land and building cost inflation. The development of housing is financed by a certain combination of housing association grant/other public subsidy with the residue being financed by private-sector finance. The private-sector finance has an interest-related cost which can be affected by the environmental threat of interest rate changes (dependent on the association's interest rate hedging strategy). An association's ability to raise future private-sector financing will be affected by its asset base valuation, which is typically used by lenders for security purposes. Housing associations typically have a high asset base valuation due to the nature of their activities, i.e. developing social housing. The asset base valuation is a function of what has been developed in terms of housing and property price levels.

The development activity will have some effect on the association's overhead costs. Overhead costs are also a function of the external threat of inflation levels.

The strategic objective of the need for high-quality housing requires maintenance to be undertaken for existing housing.

The variables of interest payable, loan repayments, overhead costs, maintenance costs can all put pressure on the average rental levels where the association has the environmental threat or constraint of maintaining tenants' affordability, housing benefit levels and relative competitiveness with other associations.

There may be the need for an association to make substantial investment in its existing properties by bringing properties identified as having outdated facilities up to present-day quality standards. This process is seen to be similar to that outlined in Figure 2 and thus would represent a not too different challenge.

Step four is to involve the organisation's key decision makers to test the validity of the causal loop

diagram. This is extremely important as this will provide an outline of how the model is constructed and facilitates the planning of the model. This process will help key decision-makers think about the problem and is more likely to lead to management acceptance of the model.

Step five is to produce and maintain the business planning model. It is recommended that the model is written in a quality spreadsheet package. The model should be designed with the objective of user friendliness and maximum functional flexibility. The model should be menu-driven in respect of its input assumptions, Scenario and goal planning facilities and model outputs. Functional flexibility relates to the need to enable the decision maker to enter assumptions that the model is capable of handling and will automatically calculate the result. These aspects are very important as the model should have the capability of a decision support tool.

The business planning model should represent more than just a set of forecast financial statements (i.e. income statement, balance sheet and cashflow statement). The business planning model should consider the main drivers of the business. The model inputs should be set up in detail using the causal loop diagram as a framework. For example, the future development programme should be driven by the number of units started during the planning year, the percentage of completions per annum, the development cost per unit at current year prices, land inflation and building inflation levels.

However, it is not the purpose of this article to discuss this aspect in much more detail as this is considered an almost non-exhaustive topic.

Step six, once the model is written it is extremely important that it is fully documented. This ensures that the organisation has full support in the event of the model builder being absent through illness or leaving the organisation. The documentation will also help the model's auditors to undertake the audit. The manual should be user-friendly and well indexed.

Step seven is to ensure the accuracy of the model's calculations. It is extremely important that a model of such complexity is audited either by a firm of external consultants or perhaps by another employee.

Step eight is to train the model's users. This would involve both presentations and workshop sessions.

Step nine is to engage the management in the appreciation of risk. This involves the use of sensitivity analysis and scenario planning. This process would involve the measurement of particular sensitivities or scenarios against key financial ratios and performance indicator targets over the planning horizon. Obviously, such performance measurement targets should include the measurement of general financial viability from the association's viewpoint (liquidity etc), together with the measurement of lenders' financial covenants, i.e. gearing, interest cover and security levels. Tenants' forecast rental levels should be measured against affordability, housing benefit levels and other housing association levels.

Step ten involves the ongoing appraisal of further threats and opportunities on the long-range financial viability of the association. The key threats have been outlined earlier in this article. There are obviously new business opportunities that a housing association may face which would also need to be included in the business planning process. An example of this is the area of urban regeneration projects. Again, it is not proposed to discuss this topic in detail but only to make the reader aware of possible diversification opportunities in this sector

and the advantage of business planning in this sector.

The implementation of business planning in this sector allows management to review the long-term financial viability of the strategic planning process. More specifically the association would be able to make decisions regarding its maximum development capacity. For example, if building prices and interest rates are low at present the association could investigate the maximum level of housing development that is financially viable.

The business planning model could be used in order to make decisions on the association's borrowing strategy. The model could be used to manage and plan the debt maturity mix and interest rate exposure. It is extremely important that the business planning model uses a planning horizon which is in line with the association's debt maturity profile. The business planning model could be used in order to review the viability of the association's planned rental levels, finding the balance against the key performance indicators and financial ratios outlined earlier.

There are potentially many other uses for a business planning model in this sector. However, for the purposes of brevity this has been restricted to its key uses.

Conclusion

This represents a framework for implementing business planning in the housing association sector. It can be concluded that the implementation of such a process has clear advantages for the sector, which has recently become a higher-risk one.