ADVANCED SUBSIDIARY GCE

APPLIED BUSINESS

F246/SM

Unit 7: Financial Providers and Products

STIMULUS MATERIAL
SERIES 5

It is intended that this stimulus material is used for the January 2010 and June 2010 examination sessions.

OCR Supplied Materials:
None

Other Materials Required:
- Calculator

INSTRUCTIONS TO TEACHERS

- The stimulus material provides a vocational context for the internally assessed unit – Unit F246 – Financial Providers and Products.
- Each year **one** scenario will be released on OCR's web-site which will provide an authentic vocational context for candidates' subsequent investigations.
- Although it is intended that this stimulus material is used for the January 2010 and June 2010 examination sessions, there is no shelf life for this OCR generated stimulus material.
- If you wish to generate your own stimulus material for this portfolio unit, please ensure it is fit for purpose and adheres closely to the guidelines laid down in the unit specification.
- There are no separate marking criteria with this stimulus material.
- Once the candidate has produced their financial package, they must then consider its effectiveness, given a change in the future circumstances of their customer. At this point you must provide additional guidance on what these future changes could be, referring to the unit specification as a source of further information.

INFORMATION FOR CANDIDATES

- This stimulus material has been created to provide you with a vocational context for the internally assessed unit – Unit F246 – Financial Providers and Products.
- If you have any questions regarding the stimulus material, you must consult both your teacher and the unit specification.
- Once your financial package has been generated you must then consider its effectiveness, given a change in future circumstances to your customer. At this point, you will be provided with additional guidance from your teacher to allow you to carry out this evaluative task.
- This document consists of **8** pages. Any blank pages are indicated.

A calculator may be used for this stimulus material

Wilson Builders

Introduction

George and Barry Wilson are brothers and partners in *Wilson Builders*.

George Wilson is 55 years old. He gained a qualification in civil engineering at university and had, until about ten years ago, worked abroad on a number of major construction projects. In his last five years in that profession he had acted as project manager with responsibility for over 300 employees and budgets in excess of £20 million. He returned to the UK in November 2000 with his wife, Mchumba, who he had met whilst working in Africa. He wanted to obtain work in the UK and have a family after many years of being single. Now, in 2010, George and Mchumba have two children, aged eight and nine years.

Barry, who is 58 years old, has always worked in the building trade after leaving school at 16 and completing his apprenticeship. He had his own business in the 1980s but went bankrupt during the recession of the early 1990s. He was soon, because of his abilities and willingness to work, able to obtain work with a local building firm. Within two years he had progressed to foreman and Barry had managed the business for the owner when he could no longer work due to ill health. In December 2000 the owner, who had no family, died and left the business to Barry.

Although Barry felt able to manage the day to day business of the building firm, the need to deal with the financial aspects of the business worried him. At the same time, George was having difficulty finding suitable employment. So, the brothers decided it would be a good idea to form a partnership so they could share skills and expertise. Also, as they had had little contact over the years, they liked the idea of working together. *Wilson Builders* was formed in April 2001.

From 2001 to early 2008 the business grew steadily and the main work was acting as sub-contractors for large house-building companies which were building housing estates locally. This contract work was largely obtained by George who found that some of his previous civil engineering contacts were consultants for these large organisations. In addition, Barry ensured that the business continued to deal with his predecessor's customers' repair and refurbishment work, thus maintaining good long-term business relationships.

During late 2008 and 2009 the effects of the 'credit crunch' and beginnings of a recession meant that the contracts with the major house-building companies ended and were not replaced. The local repair and refurbishment work also reduced. During this period, the partners reluctantly reduced the size of their workforce from 15 to six in view of the reduced work available. Furthermore, they both felt that they needed to plan for several years ahead and obtain additional work to generate an income or *Wilson Builders* could eventually fail.

The brothers each had a different view of risk. Barry's previous experience as a result of being bankrupt meant that he was very cautious when taking on new work and when spending money. George was always keen to expand and develop the business. However, he respected Barry's wishes which meant that the business had not expanded as much as it could have done. *Wilson Builders* has only rarely experienced small amounts of unpaid debts and has always been able to pay its bills as they became due. At the present time, *Wilson Builders* has current and savings bank accounts with a net balance of just over £200 000 and the bank regards the partners as excellent customers.

George Wilson has an idea for using these funds to provide work for the partnership until the economy improves.

George's Idea

George has suggested that *Wilson Builders* buys old properties in need of refurbishment. He has investigated the local auctions and noticed that increasing numbers of such properties are becoming available, and prices are falling. He has focused on those properties which he reasons will not be attractive to people who simply want to move or buy their first home. Because of the work needed, such properties are selling at under £90 000 each and he expects the price to continue to drop, on average, to £70 000 over the next couple of years.

George's plan is to buy one of two such properties at a time and for the partners and their employees to make them suitable for rented accommodation. He and Barry can then re-sell some of the properties they buy each year as investment properties to commercial landlords. The remaining properties they can let out themselves as landlords.

In the case of the properties that they let out, they will be able to sell these in the future when the housing market recovers. Alternatively they could keep them and use the rental income to provide them both with an income in retirement. Neither George nor Barry have made any pension arrangements.

Because *Wilson Builders* still undertakes some repair and refurbishment work for local and longstanding customers, the partners will need to concentrate on maintaining quality and competitive pricing for these customers. George estimates that the business should be able to buy 12 properties at auction each year. Five or six of these properties would be refurbished and then let out to their own tenants by George and Barry. The other six or seven properties would be resold, at a profit, to commercial landlords.

When Barry first heard the idea he was reluctant to see the cash funds depleted. However, he agreed that something had to be done. He asked George to make some calculations and said that they should talk it over with a mutual friend, Raymond, who had some financial expertise, to obtain an independent view about the potential viability of the plan. George was happy to do this because he appreciated that he might have been over-enthusiastic.

George, therefore, devised the following forecast **(see Fig. 1)** on the basis that *Wilson Builders* continued to only provide a repair and refurbishment business for its existing clientele.

Fig. 1 – Forecast repair and refurbishment income and expenditure for *Wilson Brothers* (2010 – 2012)

	2010 (£)	**2011 (£)**	**2012 (£)**
Forecast Income	350 000	360 000	385 000
Forecast Expenditure			
Materials	130 000	140 000	150 000
Wages and salaries	140 000	145 000	150 000
Administration and other costs	70 000	75 000	80 000
Remuneration for partners	60 000	60 000	60 000
Total costs	400 000	420 000	440 000
Surplus/(Deficit)	(50 000)	(60 000)	(55 000)

George based his figures on a similar level of business as *Wilson Builders* had obtained from January to June 2009, but projected to full annual figures for each of the years 2010 to 2012 and assuming small increases in costs and pricing.

George based his figures for an expansion into housing rental **(see Fig. 2)** on the partnership being able to renovate one property every two months for rental and to let it out at £625 per month. Typical current rental income for similar local properties is about £600 per month.

House rental (assuming about half of all properties renovated are managed and let out by *Wilson Builders*)

Fig. 2 – Forecast rental income and expenditure –
***Wilson Brothers* (2010 – 2012)**

	2010 (£)	2011 (£)	2012 (£)
Forecast Income	45 000	90 000	135 000
Forecast Expenditure			
Refurbishment costs	48 000	50 000	52 000
Annual running costs	5 000	10 000	15 000
Total Costs	53 000	60 000	67 000
Surplus/(Deficit)	(8 000)	30 000	68 000

Having prepared the forecast figures, George realised that he and Barry would not be able to finance the purchase of properties from the business resources. They would need to borrow to finance the purchase of the properties, after buying the first one or two using the money in the bank. *Wilson Builders* was also likely to need overdraft facilities to meet short-term needs, particularly in 2010 and 2011.

The cost of buying properties should be offset by the properties sold. For example, if 12 properties are bought at £75 000 each (total cost £900 000), George expects to be able to sell seven of the properties at £130 000 each to commercial landlords, so recovering the £900 000.

George and Barry would welcome advice from Raymond on the viability of the idea, the best financing arrangements and an assessment of the likely amount of finance needed. George and Barry have only considered financing from the business' existing reserves and/or borrowing from the bank but if there are suitable alternatives available they would like to consider their cost, advantages and disadvantages. George is aware that sometimes grants are available in certain circumstances and wonders if anything is appropriate in this instance. This is an important business decision and it is an important time in their lives.

After discussing the idea with Raymond, George and Barry are now aware that George's forecasts are incorrect because, for example, it will take at least two months before any rental income will be received from the first renovated property.

Barry's Personal Situation

Barry lives alone in a small rented flat close to *Wilson Builders'* yard. The pressure of his bankruptcy led to the failure of his marriage and he divorced in 1994. After a number of years alone he met an ex-girlfriend, Brenda, in 2007. She had been widowed a year previously. Barry and Brenda have now decided to marry. Barry's flat is too small for them both and Brenda wants to sell her old marital home so she can start afresh with Barry.

They have found a house and Brenda has a prospective buyer for her property. With the sale proceeds and savings provided by Barry they will still need a mortgage of £40 000. Brenda wants to completely refurbish (furnishings and fittings) their new home and she expects that this will cost about £10 000, and she is thinking about hire purchase to finance the cost. Brenda currently works for the local council and earns about £17 000 per year.

Barry and Brenda are content with a fairly inexpensive wedding but neither has travelled much outside the UK and would like a dream honeymoon. They have decided on three weeks in Hawaii but think they will need to borrow £6 000 to meet the cost. They have considered different methods of financing their honeymoon.

Barry and Brenda have devised the following predicted joint monthly income and expenditure in their new property, excluding mortgage payments, personal insurances and pension needs and the financing of the furnishing of the new property **(see Fig. 3)**.

Fig. 3 – Predicted joint monthly income for Barry and Brenda in their new property

	£	£
Income		2750
Less Expenses		
Council tax	250	
Food	400	
Electricity	100	
Gas	125	
Buildings and contents insurance	40	
Motor expenses	300	
Entertainment and leisure	300	
Savings	200	
New furnishings and fittings	?	
Personal insurance and pension	?	
Mortgage	?	
Total Expenses		?
Surplus (Deficit)		?

Barry and Brenda now need advice on:

- type and term of mortgage;
- financing the new furnishings;
- financing their honeymoon;
- obtaining a good return on their planned monthly savings;
- personal insurances and pension provision.

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