

# Treasury Management & Borrowing

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## TREASURY POLICY STATEMENT

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## **1.0 Scope of Policy**

- 1.1 Throughout this policy the term “Association” will relate to both Oak Tree Housing Association (OTHA) and Cloch Housing Association, (CHA) and the term governing body refers to OTHA’s Management Committee and CHA’s Board.
- 1.2 For the sake of the policy “Treasury Management” can be defined as:  
*“The management of all money and capital market transactions in connection with cash and funding resources of the Association and the control of the associated risks”.*
- 1.3 The Treasury Management Policy is based on the recommendations of the Code of Practice on Treasury Management issued by the Chartered Institute of Public Finance and Accountancy, (2011 edition).
- 1.4 The code identifies three key principles:
- The Association should put in place formal and comprehensive strategies, objectives, policies, practices and reporting arrangements for the effective management and control of its treasury management activities.
  - The policies and practices should make clear that the effective management and control of risk are prime objectives of the Association’s treasury management activities and that responsibility for these lies clearly within the organisation. The appetite for risk should form part of the annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
  - The Association should acknowledge the pursuit of value for money in treasury management. The organisation should ensure suitable performance measures are valid and an important tool to employ in support of the business service objectives. For effective risk management the treasury management policies and practices should also reflect this.
- 1.5 Overall control of the Association’s Treasury Management rests with the governing body. The Association’s staff must not operate outside of the guidelines set out in this policy and are accountable at all times to the governing body for their actions.
- 1.6 The monitoring of the policy has been delegated to the Finance, Staffing & General Purposes Sub-Committee (OTHA) and the Finance & Corporate Services Sub-Committee (CHA). These committees will review and monitor the financial requirements of the Association, in compliance with the Scottish Housing Regulator’s, (SHR), Regulatory Standards of Governance & Financial Management and the Association’s Financial Regulations and procedures.
- 1.7 All executive decisions on investment, refinancing or financing shall be delegated to the Finance Director in conjunction with the Association’s Chief Executive, (OTHA) and Director, (CHA). Decisions on borrowing will be approved by CHA’s Board and delegated by OTHA’s Board to OTHA’s Finance, Staffing and General

Purposes Sub-Committee. The Finance Director and his or her staff are required to act in accordance with CIPFA's code of practice. They must also have regard for all matters relating to statutory requirements, the Association's own rules and standing orders and regulatory requirements and/or expectations.

1.8 The Scottish Housing Regulator's regulatory standards, (*April 2015*), which governs Treasury Management activities have also been taken into account within the policy:

- RS 3.1: The RSL has effective financial and treasury management controls and procedures, to achieve the right balance between costs and outcomes. The RSL ensures security of assets, the proper use of public and private funds and access to sufficient liquidity at all times.
- RS 3.2: The governing body fully understands the implications of the treasury management strategy it adopts, ensures this is in the best interest of the RSL and that it understands the associated risks.
- RS 3.5 The RSL monitors, reports on and complies with any covenants it has agreed with funders. The governing body assesses the risks of these not being complied with and takes appropriate action to mitigate and manage them.

1.9 It is essential that governing body members are aware of and understand the decisions being made by the Association and their financial implications and risks.

## **2.0 Risk Management**

2.1 The CIPFA Code of Practice details some of the key treasury management risks faced by registered social landlords and those considered relevant to the Association's operations are set out in this section.

2.2 The main areas of borrowing risk are:

2.2.1 Interest rate risk:

Interest rate risk exposure arises when a change in interest rate has the potential to affect the value of an RSL's assets and liabilities. Too much variable rate debt could mean increasing interest rates resulting in higher interest payments and repayment costs; conversely, too much fixed debt could result in opportunity losses because the Association cannot benefit from improving rates.

The main danger of interest rate risk is that the Association could face liquidity problems servicing debt as well as breaching lenders' covenants and interest cover percentages.

Inflation risk can impact on the Association's treasury management activities through the link with interest rate management. If the rate of inflation increases less than forecast, while in contrast fixed rate loan costs remain stable, there can

be a real cost to the Association in terms of low inflation impacting rental income streams versus high fixed interest cost.

An appropriate hedging strategy will assist in minimising any adverse effects caused by increases to interest rates.

#### 2.2.2 Liquidity risk:

This risk is where the Association has insufficient cash to meet its liabilities as they fall due. In this respect, the Association will ensure that it has adequate, though not excessive, cash resources and borrowing arrangements at all times as are necessary for the achievement of its business objectives.

#### 2.2.3 Funding and refinancing risk:

This is the risk that loans fall due which the Association does not have the cash resources to repay and cannot be replaced at acceptable costs. In addition, funding risk can cover overdependence on one lender in the market.

#### 2.2.4 Failure of internal control systems:

The risk of inadequate systems of internal control, reporting and performance measurement is not specific to treasury management. The Association is required to ensure that measures are in place to manage its overall exposure to risk in this area. This includes the risk of exposure to fraud, error and corruption. Regular reviews of financial procedures and internal audits will contribute towards reducing the potential risks in this area.

#### 2.2.5 Soft covenants:

Loan agreements can be broken not just by a breach in covenant but also by failing to meet deadlines, clauses or by failing to provide documentary evidence as required. It is now usual for companies to set up a calendar with all loan requirements and trigger dates for compliance such as insurance schedules, business plans, quarterly returns, etc.

### 2.3 The main areas of investment risk are:

#### 2.3.1 Risk of default by an institute:

This can occur where funds are deposited in a financial institution who subsequently defaults. This risk would previously have been regarded as low given regulation by the Prudential Regulation Authority and Bank of England, but an increased awareness is required given all issues attached to the current economic climate. The Association regularly reviews market data/commentaries and credit rating information to assist with negating such risks.

#### 2.3.2 Funds are invested for too long a term and liabilities fall due:

This is where funds are invested in, for example, a one year, no access account and liabilities fall due by the Association which requires these funds to settle. The Association manages this risk via accurate and detailed cashflow projections within the annual budget, mid-year budget review and quarterly cashflow updates within the management accounts.

### 2.4 General treasury risk considerations:

#### 2.4.1 Legal and regulatory risk:

The risk that the Association itself, or an organisation with which assists with treasury management activities, fails to act in accordance with the law or regulatory requirements and as a consequence the Association suffers losses. Legal advice, where appropriate, and regular monitoring of regulatory advice and guidance will help assist with reducing this risk.

2.5 In considering risk management the Association will design, implement and monitor all arrangements and will report at least annually on the adequacy and suitability of this policy.

2.6 In order to minimise risk, the Association will ensure the treasury management procedures are reviewed regularly and that all staff are aware of their contribution to compliance and to the efficient and effective deliver of the policy. In addition, methods of validation of compliance will be undertaken using a variety of sources, e.g. the external annual audit and planned internal audits.

### **3.0 Treasury Management Activities / Policy Statement**

3.1 The Association treasury management activities cover the following:

- (a) Borrowing for day-to-day expenditure needs;
- (b) Borrowing for housing capital projects;
- (c) Borrowing for any other one-off purposes;
- (d) Investment of surplus cash balances;
- (e) Arrangement of short term overdraft facilities;
- (f) Banking facilities.

3.2 The Association regards risk management in terms of identification, monitoring and control of risk to be the prime criteria by which effective treasury management activities are measured.

3.3 Taking account of the large cash sums the Association is dealing with, it is important that appropriate treasury management procedures and practices are in place. Treasury management is concerned with making appropriate use of surplus funds whilst meeting the overriding need to protect capital sums. In the case of borrowing, the aim is to keep costs to a minimum whilst ensuring the stability of the longer-term financial position.

3.4 The Association's finances take account of a number of different operations, e.g. rental activities, development, factoring services, etc. Treasury management allows the organisation to deal with the combined position of each operation in the most advantageous way. Therefore all of the Association's funds should be aggregated for treasury management purposes.

3.5 The Association's treasury management policy will be reviewed every 3 years or sooner, if deemed appropriate. The policy will also be reviewed on an annual basis to ensure it remains fit for purpose.

3.6 The Association's treasury strategy will be reviewed at least annually.

## 4.0 Treasury Management Objectives and Strategies

### 4.1 Borrowing Objective

**When borrowing the objective is to keep costs to a minimum, however this has to be balanced against the need to ensure long-term financial stability for the Association.**

### 4.2 Borrowing Strategy

4.2.1 In balancing longer-term financial stability against costs, the Association is more concerned with avoiding risk than minimising cost

4.2.2 In seeking new finance the Association should compare market rates to ascertain the most competitive and suitable offer. Tenders should be sought from at least three financial institutions. Consideration should also be given to fixed and variable rates or a combination of the two.

4.2.3 In order to minimise risk the Association should hedge against interest rate exposure, ensure that the minimum amount of security is given to the lender, only borrow from specified financial institutions and ensure that any financial covenants are not overly restrictive.

4.2.4 It is good practice to ensure an appropriate mix of fixed and variable rate finance is in place across the loan portfolio, (referred to as hedging). There are no hard and fast rules about what constitutes an appropriate mix as this will depend on an Association's individual circumstances and the rates available when funding is being sought, against the backdrop of future rate predictions. Any changes to the loan funding structure will be subject to a paper with recommendations to help the governing body identify the right options for the Association at the time.

4.2.5 As at November 2017, the following organisations are currently approved as sources of funding, *(based on the 2016 tender exercise)*:

- RBS
- Bank of Scotland
- Nationwide Building Society
- Clydesdale Bank
- Triodos Bank

The above list may be amended, with approval from the governing body, if other lenders enter into the market offering loan finance to RSLs on attractive terms. Before a new lender is added to the approved sources of funding, the Association must satisfy itself that the organisation is financially stable. This will be the responsibility of the Chief Executive / Director in conjunction with the Finance Director.

4.2.6 Any amount borrowed must be within the Association's borrowing limit as authorised by the Governing Body and Association rules, stated as £50,000,000.

- 4.2.7 An assessment of the most suitable period of the loan should be made whilst ensuring that properties held as security are for no longer than is necessary.
- 4.2.8 Borrowing for term loans will normally be on a standard capital and interest basis, however appropriate use may be made of capital repayment holidays.
- 4.2.9 The Association will not enter any loan transactions which are index linked or complex in nature, e.g. foreign currency lending. In addition, hedging arrangements should not be regarded as sophisticated or complex in nature.

#### 4.3 Investment Objective

**In investing surplus cash balances the objective is to optimise returns to the Association while meeting the overriding need to protect the capital sum.**

#### 4.4 Investment Strategy

- 4.4.1 In balancing risk against return, the Association is more concerned with avoiding risk rather than maximising return.
- 4.4.2 Association funds will be invested in property, with adequate security, or alternatively, in deposits at variable and fixed rates of interest held in banks, buildings societies, national savings accounts and government securities.
- 4.4.3 Investment in property will include providing finance for development programmes equivalent to the amount of private finance on a scheme, thus removing the need to borrow more money. This will reduce interest and set-up costs of a new loan and ensure the Association has un-encumbered stock should it be required at a later date, however, this should only be done in line with cashflow analysis.
- 4.4.4 The Association cannot invest in shares or other equity investments. Such investments, however, can be made by subsidiary companies.

### **5.0 Approved Methods of Raising Capital Finance**

- 5.1 In the main, borrowing for day-to-day expenditure needs will be by way of bank overdraft at an agreed rate of interest. The Finance Director should closely monitor the cashflow position of the Association to identify in advance when such borrowing will be necessary.
- 5.2 Borrowing for office equipment/office vehicles, in the main, may be raised via lease arrangements or short term lending/credit facilities.
- 5.3 Borrowing for housing capital projects will be by way of "Development Period" overdraft and term loan facilities at market rates of interest.
- 5.4 For each new housing project the maximum amount to be borrowed will be the shortfall (after HAG) on the funding required to provide houses to the Association's standard specification. It will not be the policy to borrow further



sums to increase the standard of accommodation as this would result in rent levels beyond those considered affordable to the Association's potential tenants.

5.5 Where it is found to be economically and financially favourable a facility may be arranged to fund a number of schemes where draw down can take place at intervals agreed by the Association and the lender.

5.6 In return for these facilities the Association will provide security over property to the value agreed with the lender. The Association will endeavour to avoid offering an "excessive" amount of property equity as security as this will restrict future borrowing ability.

5.7 Borrowing for any other one-of purposes will be the subject of a specific report to the governing body.

## **6.0 Inter-Group Borrowing**

6.1 Where possible, and to reduce transaction costs, inter-group borrowing/lending should be considered by the Association before an approach is made to external lenders.

6.2 In considering inter-group borrowing, the Finance Director must provide a report to the governing body detailing;

- Borrowing project details
- Borrowing requirements
- Project timetable
- Sources of finance
- Basis of interest rates
- Loan margins
- Loan period
- Repayment options and costs
- Assessment of documentation (including margin review and early repayment clauses)
- Security (including release of security provision and basis of valuation)
- Changes in existing loan terms
- Loan covenants
- Compliance with policy

6.3 All existing loan covenants must be reviewed before any borrowing/lending is agreed.

## **7.0 Approved Sources of Financing**

7.1 Where inter-group lending is not appropriate, the Association's borrowings will be restricted to the approved providers of funding, (see section 4.2.5). Funding from other sources will be considered, e.g. European funding, bond funding, however this should be subject to a specific report to the governing body. Members must be satisfied that such funders would bring no more risk than usual funding sources.

7.2 The negotiation of borrowing should take the form of a formal interview and must include at least three institutions.

7.3 In considering the most suitable lender, senior staff should consider the following:

- Borrowing project details
- Borrowing requirements
- Project timetable
- Sources of finance
- Basis of interest rates
- Loan margins
- Loan period
- Repayment options and costs
- Assessment of documentation (including margin review and early repayment clauses)
- Security (including release of security provision and basis of valuation)
- Arrangement fees
- Non utilisation fees
- Draw down arrangements
- Fixed/capped rates
- Review clauses
- Changes in existing loan terms
- Loan covenants
- Compliance with policy

7.4 The maximum borrowing period will take account of the life of the Asset, as illustrated below:

Housing capital projects	30 years
Purchase of office equipment/office vehicles	3-6 years
Bank overdraft	1 year
Borrowing for any other one-off purpose	30 years - subject to report to the governing body

## **8.0 Approved Organisations for Investment**

8.1 The Association shall generally confine investments to national high street banks, building societies, national savings accounts and government securities. Where non-national institutions are used, a maximum of £85k in line with the Financial Services Compensation Scheme limit may be invested after a report has been submitted to the governing body for approval.

8.2 If required, inter-group investments can be made.

8.3 Credit checks will be carried out on institutions prior to investing or borrowing.

- 8.4 Temporary cash balances resulting from development schemes will be aggregated with other cash funds. The finance development scheme records should clearly identify “funds received not utilised” and the Finance Director should use detailed cash flow forecasts to plan for any necessary overdraft/loan facilities required.
- 8.5 There will be no limit on investment term where there is instant access without penalty. Where there is no instant access or a penalty for access the term of investment should be restricted to a maximum of 12 months.
- 8.6 In an effort to reduce risk the funds should be spread / invested according to the financial business plan needs, in terms of the requirement to have access to funds for annual operating activities versus funds required for future years’ investments. This will be determined annually as part of the budget and financial business plan process and monitored on a quarterly basis via cashflow projections.
- 8.7 No more than 75% of all Association funds should be held in a single financial institution.

8.8 At no time should the Association’s funds be less than £1,200,000 unless short-term finance has been arranged. This value is based on providing a reasonable short term liquidity provision. As a financial plan target, the cash held at the year-end will also be measured against the target of holding the equivalent of 3 months rental income in cash terms and this will be reported to the governing board annually within the 30 year cashflow review.

## **9.0 Interest Rate Exposure**

- 9.1 The Association will borrow by way of conventional finance unless this would cause financial difficulties.
- 9.2 Where appropriate, the Association will maintain a portfolio of fixed and variable interest borrowing that reflects current market conditions.

## **10.0 External Cash Managers**

- 10.1 Due to the anticipated level of cash reserves, the Association would not normally consider the use of an external broker.
- 10.2 Should the level of reserves increase to the extent that such an approach may be worth investigating, approval must be sought from the governing body prior to the appointment.

## **11.0 Responsibilities & Delegation**

- 11.1 Responsibility for implementing the policy on a day to day basis rests with the staff team and the governing body will monitor compliance via reports and other documents presented to them.

- 11.2 Overdraft facilities for working capital purposes will be arranged by the Finance Director who should report to the governing body at the first available opportunity on the reasons why this borrowing was necessary.
- 11.3 Negotiations on the terms and conditions to be applied to loans for housing projects should be carried out by the Development & Technical Services Manager / Development Agent and the Association's Finance Director. Only the Association's governing body has authority to enter into loan agreements. The Finance, Staffing & General Purposes Sub Committee for OTHA and the Board for CHA should be advised by the Finance Director of the details of each agreement prior to these being entered into.
- 11.4 Borrowing for any other purpose will be the subject of a specific report to the Finance, Staffing & General Purposes Sub Committee (OTHA) / Finance & Corporate Services Sub Committee (CHA) by the Finance Director. This will include any lease or credit arrangement entered into where the value is over £10k per annum.
- 11.5 Day to day decisions on the amount and timing of investments are the responsibility of the Finance Director.

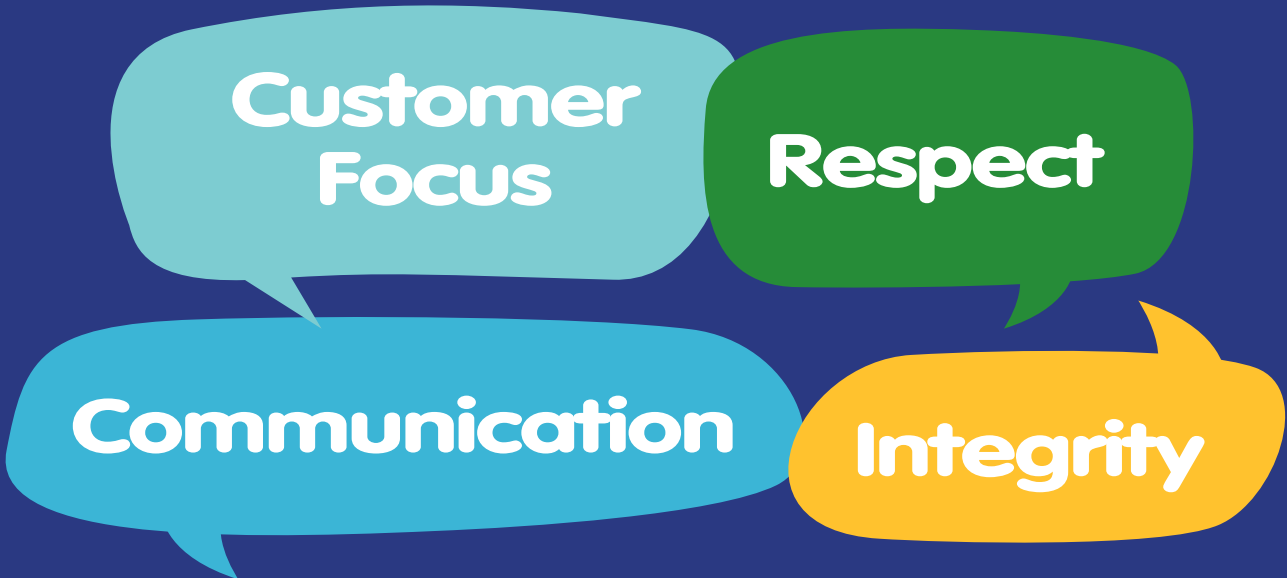
## **12.0 Contract Approval**

- 12.1 Where it is determined that a project should be funded using internal resources, the Finance Director must produce a detailed cashflow confirming the availability of funds prior to the member of staff entering into any formal agreement or contract in excess of £50,000.
- 12.2 Where it is determined that external borrowing is required to fund a project, the Development Agent / Development & Technical Services Manager or any other member of staff may not enter into a contract without the Association receiving written confirmation from the external funder that the Association has access to the required funds.

## **13.0 Review and Reporting Arrangements**

- 13.1 This policy document statement will be reviewed every three years. However, an annual assessment will be undertaken to ensure the document remains fit for purpose.
- 13.2 Any departure from the agreed policy during the year will constitute a breach of the Associations' Financial Regulations and as such should be the subject of a report to the governing body by the Finance Director.
- 13.3 The Finance Director will report to the Finance, Staffing and General Purposes Sub-Committee (OTHA) and the Finance & Corporate Services Sub Committee (CHA) as follows:

<b>Report</b>	<b>Details</b>
Quarterly Treasury Management Report / or in the Management Accounts	Details of Lenders Loan Terms Loan Balances Outstanding Loan Period Outstanding Compliance Covenants Mix of Fixed & Variable Debt Finance Confirmation of submission of reports to Lenders
6 Monthly Treasury Management Report: Lending	At least every 6 months a report giving details on a loan-by-loan basis, covering the first 6 months of the financial year and covering the whole financial year. The report should cover: <ul style="list-style-type: none"> <li>• Details of current lenders</li> <li>• Loan terms</li> <li>• Loan balances outstanding</li> <li>• Loan period outstanding</li> <li>• Undrawn facilities and purpose of loan</li> <li>• Any changes in the intended use of loan funds</li> <li>• Security cover provided and basis of valuation</li> <li>• Covenant compliance</li> <li>• Mix of fixed and variable debt finance</li> <li>• Business case for mix of fixed/variable rate finance</li> <li>• Future proposed borrowing for the financial year ahead</li> <li>• Interest earnings from investment of surplus funds</li> <li>• Current market view on interest rates over short, medium and long term</li> </ul>
6 Monthly Treasury Management Report: Investment	As a minimum, a 6-monthly report giving details of current bank balances, interest rate earned, name of financial institution and credit rating.



CLOCH HOUSING ASSOCIATION LTD	
<b>Policy Name</b>	Treasury Management & Borrowing
<b>Policy Category</b>	FS
<b>Policy Number</b>	017
<b>Date Adopted</b>	01/10/2012
<b>This Review</b>	01/11/2017
<b>Next Review</b>	November 2020
<b>Equalities Impact Assessment Required</b>	
<b>Link to other policies</b>	
<b>Consultation</b>	
<b>Need for Procedure</b>	