Faifley Housing Association
Treasury Management Policy

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1. Introduction

1.1 This treasury management policy is based upon the recommendations of the Code of Practice on Treasury Management (2017 edition) issued by the Chartered Institute of Public Finance and Accountancy.

1.2 The Code identifies three key principles-

- The Association should put in place formal and comprehensive objectives, policies and practices, strategies 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 a 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 that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives, and that, within the context of effective risk management, the treasury management policies and practices should reflect this.

1.3 The Association's financial regulations include the CIPFA Code recommended clauses in relation to treasury management.

1.4 When taking account of the large cash sums moving in and out of the Association it is important that appropriate treasury management practices and procedures are in place. Treasury management is concerned with making appropriate use of surplus funds whilst meeting the overriding need to protect the capital sum and, in the case of borrowing, keeping costs to a minimum whilst ensuring the stability of the longer term financial position.

1.5 Overall control of the Association's treasury management rests with the Management Committee. The Association's staff must not operate outside of the guidelines set out in this policy and are accountable at all times to the Management Committee for their actions and decisions.

1.6 It is essential that committee members are aware of and understand the decisions being made by the Association, and what the financial implications of these decisions could be. The Management Committee is responsible for reviewing and monitoring the financial requirements of the Association in compliance with the Scottish Housing Regulator's (SHR) Regulatory Standards of Governance and Financial Management, the Association's own financial regulations and procedures, and CIPFA's Code of Practice on Treasury Management. Committee members will be briefed and receive appropriate training as requested or required.

2. Treasury management policy statement

2.1 The Association defines its treasury management activities as:

The management of the Association's borrowings, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.

2.2 The Association regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications.

2.3 The Association acknowledges that effective treasury management will provide support towards the achievement of its business objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 Taking account of the large cash sums moving in and out of the Association 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 the capital sum and, in the case of borrowing, keeping costs to a minimum whilst ensuring the stability of the longer-term financial position.

2.5 The overriding aim of the policy is to ensure that the Association will not be exposed to undue risk. In balancing risk against return, the Association is more concerned to avoid risks than to maximise returns.

2.6 The Association's finances comprise a number of different operations or cost centres. Treasury management allows the organisation to deal with the combined position of each cost centre within the Association in the most advantageous way. All of the Association's funds should be aggregated for treasury management purposes.

2.7 The Association's treasury management policy will be reviewed every three years, and its system for ensuring effective compliance will be subject to regular review and at least on an annual basis.

2.8 The Association will review its treasury strategy at least on an annual basis.

3. Regulatory Standards of Governance and Financial Management

3.1 The SHR's Regulatory Standards which govern treasury management activities have been taken into account:

- RS3.1: 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 interests 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.

3.2 SHR guidance (August 2015) contains the regulatory expectation that an RSL will comply with the CIPFA Code.

4. Risk management

4.1 In considering risk management the Association will; design, implement and monitor all arrangements for the identification, management and control of treasury management risk, report at least annually on the adequacy/suitability of this policy and will report as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Association's objectives as set out in this policy.

4.2 The CIPFA Code of Practice details some of the key risks faced by a housing association's treasury operations and those considered relevant to Faifley's operations are set out in this section.

4.3 The Association has considered the potential risks facing it should the treasury management procedures fail to be adhered to. Material additional interest costs or other charges and costs (potentially via loan covenant or condition breaches) could arise from the failure to follow these procedures properly. Should it be deemed that the Association is not complying with the conditions contained within this document, SHR may comment adversely on such matters. This could have an adverse effect on confidence in the Association by lenders, other partners and members.

4.4 In order to minimise the risk, the Association ensures the treasury management procedures are reviewed regularly and that all personnel are aware of their contribution to compliance and to the efficient and effective running of the Association. Furthermore, methods of validation and ensuring probity include an annual external audit, regular internal audit, reports to members and to SHR.

4.5 The main areas of borrowing risk are:-

a) <u>Interest rate risks</u>

Interest rate risk exposure arises when a change in interest rates has the potential to affect the value of an RSL's assets and liabilities. Too much variable rate debt could mean increasing interest rates result 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 on interest cover ratios.

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 forecasted while fixed rate loan costs remain stable there is a real cost to the Association in terms of low inflation.

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

b) 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.

The use of monthly cash flow projections, together with appropriate monitoring, will assist in reducing this risk.

c) Funding and refinancing risk

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

The use of cash flow projections, a mix of funders, appropriate records on loan maturities and advance discussion with funders shall assist in minimising this risk.

d) Failure of internal control systems

The risk of inadequate systems of 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 would include the risk of exposure to fraud, error and corruption. Accordingly, the Association will employ suitable systems and procedures and will maintain effective contingency management arrangements.

Regular reviews and documentation of financial practices and internal audits will contribute towards reducing the potential for such risks.

e) Soft covenants

It must be borne in mind that a loan agreement can be broken not just by a breach of covenants, but also by failing to meet deadlines, comply with particular 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, 5-year stock condition survey, annual valuation and quarterly returns.

The introduction of a check list for compliance with loan conditions together with comprehensive records of contractual responsibilities and liabilities should avoid such risks materialising.

4.6 The main areas of investment risk are:-

a) Risk of default by an institution

This can occur where funds are deposited in a financial institution and are subsequently defaulted upon. This risk would previously have been regarded as low given the regulation of this area by the Prudential Regulation Authority (PRA, replacing FSA) and Bank of England, but an increased awareness is required given all issues attached to the current economic climate.

The Association regards a key objective of its treasury management activities to be the security of the principal sum it invests, and the regular review of market data and commentaries and credit rating information will assist in negating such risks.

b) Funds are invested for too long a term and liabilities fall due

This is where funds are invested in, say, a six-month no access account and liabilities fall due by the Association which requires these funds to settle.

The inclusion of accurate detailed cash-flow projections within the annual budget document, quarterly cash flow updates with the management accounts, appropriate budget monitoring and the regular updating of the long-term projections should assist in limiting this risk.

4.7 General treasury risk considerations:-

a) Legal and regulatory risk

The risk that the Association itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the Association suffers losses accordingly.

Legal advice, where appropriate, and regular monitoring of regulatory advice and guidance will both assist in reducing this risk.

The Association recognises that future legislative changes may impact on its treasury management activities and, as far as it is reasonably able to do so, will seek to minimise the risks of these impacting adversely on the organisation.

5. Treasury management approach

5.1 Responsibilities

a) Responsibility for implementing and monitoring rests with the Management Committee.

b) Only the Management Committee has the authority to commit the Association to borrowing facilities or to vary any existing loan documentation.

c) The Director, in consultation with the Finance Agent, will be responsible for making recommendations to management committee on borrowing, investment and financing decisions.

d) Operational responsibilities relating to existing day-to-day loan arrangements and deposits are delegated to the Director in conjunction with the Finance Agent. This includes ensuring compliance with loan covenants and information requirements as well as the placing of deposits for up to twelve months in accordance with policy.

e) It is recognised that the Director may have to execute a decision quickly in relation to fixed interest opportunities, with no time available to refer the matter for committee consideration. In all such instances the Director will consult with all available office bearers and a written report must be presented at the next available Management Committee meeting.

f) The Management Committee will oversee the overall risk approach by the Association to ensure it remains up to date and relevant. The Management Committee will also take all reasonable steps to ensure that day-to-day controls are carried out by staff.

5.2 Approved activities

a) Raising capital finance for capital projects
b) Raising capital finance for stock acquisitions
c) Investment of surplus funds
d) Arrangement of short term overdraft facility
e) Banking facilities

5.3 Approved methods of raising capital finance

a) Borrowing for term loans will normally be on a standard capital and interest basis
b) Appropriate use may be made of capital repayment holidays
c) Borrowing for development or bridging funding may be by overdraft
d) Borrowing may not exceed £100 million in accordance with the Association's rules (Rule 18.1).

5.4 Approved sources of finance

a) The following organisations are approved currently as sources of funding:

- Clydesdale Bank
- RBS
- Bank of Scotland
- Santander UK
- CAF Bank
- Nationwide Building Society

The above list may be amended, with approval from the Management Committee, if other lenders enter into the market offering loan finance to RSLs on attractive terms.

In addition to traditional loan finance from the above institutions, the Association will consider participating in aggregated bond finance alongside other Scottish RSLs. Again, this will only be following a Management Committee decision.

b) Before any new lender is added to the approved sources of funding, the Association must satisfy itself, acting reasonably, that the organisation is financially stable. This will be the responsibility of the Director in conjunction with the Finance Agent, and, where appropriate, a suitably qualified external Financial Investment Adviser. A written report will be submitted to the Management Committee advising of any request for a new institution to be added to the above list.

c) The Association will not enter into any derivative transactions and will not borrow funds denominated in a foreign currency.

d) The Association will not enter into any loan transactions that are index linked.

e) The Association will not enter into hedging arrangements that are regarded as being of a sophisticated nature.

5.5 Interest rate exposure

a) It is recommended good practice that RSLs ensure an appropriate mix of fixed and variable rate finance is in place. The actual mix between fixed and variable rate finance will be determined by the treasury management strategy to be approved each year by the management committee.

b) If fixed rate loans are to be considered in the future, any fixed rate arrangements will also consider the maturity of fixed interest loans over periods ranging from 5 to 25 years subject to no major variations in rates being achieved over the different interest periods.

c) The potential for material breakage costs on any fixed rate arrangements, which would arise if the Association decides to ‘break’ the agreed fix, will be considered as a part of the decision making process.

d) The annual treasury management report should contain information on current interest rate trends for the short, medium and longer term.

5.6 Approved organisations for investment

a) The following organisations are currently approved for investment purposes:

- Bank of Scotland
- Santander UK
- The Nationwide Building Society
- Allied Irish Bank

The list of approved financial institutions has been shortlisted from the institutions with a UK banking licence.

b) Deposits should only be placed with institutions which have ratings which satisfy certain criteria from at least two of the three recognised credit rating agencies (Moody’s, Fitch and Standard and Poor’s):

- Moody’s - ‘P-1’ - Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations.

- Fitch - ‘F1’ - Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments.

- Standard & Poor’s – ‘A-1’ - An obligor rated 'A-1' has strong capacity to meet its financial commitments. It is rated in the highest category by Standard & Poor's.

The credit worthiness of approved counterparties will be monitored by the Finance Agent. Any impairment to the credit worthiness of the approved counterparties will be advised to the Management Committee.

c) Sensible judgement should prevail in deciding whether to immediately remove the Association’s funds from fixed-term or notice deposit accounts (if it is possible to do so prematurely) of an approved deposit-taker should its credit ratings fall below the minimum criteria set out above. Funds should be removed, at the very latest, at the end of the fixed-term (should it continue to fail to satisfy the minimum criteria at that time), or immediate notice should be given.

d) Credit ratings will be a key source of information but it is important to recognise that they have their limitations. The Association should also make use of generally available market information including quality financial press, market data and information on government support for banks.

e) If information becomes available which causes concern as to the deposit-taker's ability to meet its financial commitments, regardless of its credit ratings, the Association should take all possible steps to repatriate its funds and place them with an institution it considers to be safer.

f) Before any investment is made with a new organisation, the Association must satisfy itself, acting reasonably, that the organisation is financially stable. This will be the responsibility of the Director in conjunction with the Finance Agent and, where appropriate, a suitably qualified external Financial Investment Adviser. A written report will be submitted to the Management Committee requesting that this new organisation be added to the above list.

g) Given current sums available for investment, there is a £1.5 million maximum sum that can be invested with any one institution. This amount excludes any day to day working capital.

h) The Association will not deposit funds denominated in foreign currency.

i) The Association will monitor the detail of the Financial Services Compensation Scheme or such similar schemes which may offer a degree of protection of funds.

5.7 Reporting

a) A report will be presented to the Management Committee at least once a year on treasury management operations.

b) The annual report on treasury management operations must provide information on the following:

- Details of current lenders
- Loan balances outstanding per lender

- Loan terms
- Expected settlement dates
- Mix of fixed rate and variable rate finance
- Security cover provided, details of ‘excess’ security per lender and basis of valuation
- Valuation update requirements in the year ahead
- Covenant compliance
- Unencumbered stock and indicative valuation
- Future proposed borrowing or refinancing for the financial year ahead
- Interest earnings from investment of surplus funds
- Forecast cash flows and confirmation of liquidity and covenant compliance
- Market view of future interest rates over the next 12-36 months
- A review of the approved sources of finance with reasons behind any recommendation(s)
- A review of the approved organisations for investment with reasons behind any recommendation(s)
- Any value for money considerations and benefits attaching to the treasury management function
- Compliance with policy

b) All recommendations to members on borrowing decisions must be provided in a written form and consider the following:

- Borrowing requirements
- Sources
- Basis of interest rates
- Loan margin
- Borrowing period
- Repayment options and costs
- Assessment of documentation (including margin review and early repayment clauses and default clauses)
- Security (including release of security provision)
- Arrangement fees
- Non-utilisation fees
- Draw down arrangements
- Hedging requirements from lender
- The implications of fixed rate arrangements (including breakage costs)
- Changes in existing loan terms

- Fixed/capped rates
- Capital repayment details
- Compliance with policy

The report must contain a recommendation from the Director (and, where appropriate, a suitably qualified Financial Investment Adviser) in consultation with the Finance Agent and provide costs and terms from all lenders approached.

c) The Association may periodically consider the early repayment of loan debt. Any requests to do so must be supported by a written report to the Management Committee whose approval would be required.

d) Cash flow projections are considered a sound framework for effective cash management and will be discussed with the management committee as appropriate to allow the monitoring of income, deposits and other treasury management issues.

e) All budgets and management accounts must include relevant information in respect of covenant compliance and liquidity.

f) Quarterly management accounts will contain information regarding all cash funds and deposits.

g) The Finance Agent will prepare loan portfolio returns in accordance with SHR requirements. These returns must be approved by the Management Committee prior to submission to SHR.

6. Operation of Treasury Management Procedures

6.1 The Director will carry out the task of investing surplus funds, taking appropriate advice from the Finance Agent.

6.2 Bank balances must be checked frequently by the Finance Agent.

6.3 The Association, subject to working capital requirements, will endeavour to maximise the use of bid deposits. In this regard, consideration will be given periodically to rates on offer from approved investment institutions.

6.4 The Director will undertake a regular check on the investment of surplus funds in liaison with the Finance Agent.

6.5 Requests for deposit rates and funding terms will normally be issued to three approved institutions and information received will be recorded by the Director.

6.6 Responsibility for negotiating development project finance lies with the Director who will make appropriate recommendations to the Management Committee.

6.7 The period of borrowing must not normally exceed 30 years. .

6.8 In selecting an appropriate lender the Association must give consideration to its current loan portfolio in order to ensure an appropriate mix of lenders. It is acceptable that the Association can opt to go with one lender if this represent the correct business decision.

6.9 The Association will obtain legal advice before agreeing loan documentation and no loan or other funding agreements can be entered into without the formal consent of the Management Committee.

6.10 Whilst the Association will seek to minimise the number of units on which security is granted at the outset, the terms of the overall funding package will take precedence.

6.11 The Association must ensure that it has the permission (where required) of existing lenders to borrow additional funds and that any additional borrowing will not breach any existing covenants with existing lenders or increase the Association's risk exposure to a default situation where the lender will recall or re-price existing loan finance.

6.12 The Association reserves the right, if it is considered appropriate, to fund from its own reserves the balance of any scheme costs after deduction of grants, or to make a partial contribution to the overall project.

6.13 The Association will not enter into any derivative transactions or enter into hedging arrangements that are regarded as being of a sophisticated nature.

6.14 The Association will not enter into any loan transactions that are index linked.

6.15 The Association will not borrow funds denominated in a foreign currency.

6.16 The Association will at no time grant any lender a floating charge over its properties.

6.17 The Association will maintain records of stock valuations and will arrange revaluations of stock where required for funding purposes or to comply with loan documentation.

6.18 The Association‘s banking facilities are currently with the Royal Bank of Scotland. Service levels and charges shall be reviewed on a regular basis by the Director.

6.19 The Finance Agent will maintain regular contact with all funders and will ensure provision of up to date and accurate information on the financial status of the Association in a timeous manner.

6.20 The Finance Agent shall ensure he/she has access to financial market commentaries and reviews on the likely courses of interest and inflation rates to enable the Association assess future treasury risks and scenarios and to permit the effective management and control and development of suitable risk management strategies.

6.21 The Association is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff receive proper awareness training in this respect.

6.22 The Association must at all times, in carrying out the treasury management function, give consideration to the Rules of the Association, all applicable legislation, its financial regulations and standing orders, all existing loan agreements and guidelines issued by SHR, OSCR, FCA and the Scottish Government as appropriate.

6.23 The Association is committed to the pursuit of proper corporate governance throughout its business and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and the treasury management activities will be undertaken with openness and transparency, honesty, integrity and accountability. The Association has adopted and implemented the key principles of the CIPFA Code of Practice. This, together with the other arrangements detailed in this policy, is considered vital to the achievement of proper corporate governance in treasury management.

7. Policy review

7.1 This policy will be reviewed every three years, or more frequently in line with changes to legal, regulatory and best practice requirements. The next review will take place no later than October 2021.