GROUP TREASURY MANAGEMENT POLICY

POLICY IMPLEMENTATION CHECKLIST	
Policy Guardian:	Director of Finance & Governance
Author:	Director of Finance & Governance
Version number:	2.0
Approved by Chief Executive on:	August 2019
Approved by Governing Bodies:	August 2019
Effective from:	August 2019
Due for review on:	August 2022
Diversity compliant:	Yes
Equality Impact Assessment required:	No
Data Protection compliant:	Yes
Health & Safety compliant:	N/A
Procedure implemented:	
QL system changes made:	
KPIs / reporting arrangements implemented:	
Training Completed:	
Posted on intranet:	Yes
Posted on website:	Yes
Publicity material issued:	

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Group Treasury Management Policy

1 Policy Statement

1.1 Caledonia Housing Group (referred to as the 'Group' in this document) comprises Caledonia Housing Association and Cordale Housing Association and their subsidiaries.

1.2 The Group defines its treasury management activities as:

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

1.3 The Group 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 for the organisation, and any financial instruments entered into to manage these risks.

1.4 The Group acknowledges that effective treasury management will provide support towards the achievement of our business and service objectives. We are therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance techniques, within the context of effective risk management.

2 Scope of Policy

2.1 This policy statement sets out the Group's policy concerning all of its funding or borrowing from external sources and the lending or investment of surplus cash balances. In addition, the policy covers cash and cash flow management and details the Association's delegation of responsibility for treasury activity and its reporting requirements. Notwithstanding the schedule of delegated authorities contained in appendix one the Director of Finance & Governance will liaise with and seek guidance from the Association's Treasury Management Consultants in all matters relating to raising loan finance and/or the investment of surplus funds.

3 Risk Management

3.1 All treasury management activities involve risk and potential reward.

3.2 The policy of the Group in the investing of cash is to achieve a satisfactory return while minimising risk. The overriding principle is to avoid risk rather than to maximise return.

3.3 The policy of the Group in borrowing funds is to ensure the stability of the Association's long-term financial position by borrowing on the most economically advantageous terms.

3.4 <u>Liquidity Risk Management</u>

3.4.1 Each Association in the Group will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all time to have the level of funds that are necessary for the achievement of its objectives. The Group will only borrow in advance of need where there is a clear business case for doing so to fund the current capital programme or to finance future debt maturities

3.5 Interest and Inflation Rate Risk Management

3.5.1 The Group will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements. The effects of varying levels of inflation, insofar as they can be identified as impacting on treasury management activities, will be controlled by the Group as an integral part of its strategy for managing its overall exposure to inflation.

3.5.2 It will achieve these objectives by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues. A degree of flexibility will be maintained so as to take advantage of unexpected, potentially advantageous changes in interest and/or inflation rates. The above are at all times subject to budgetary and/or Governing Body approval.

3.6 Investment Risk Management

3.6.1 Each Association in the Group regards a prime objective of this policy to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited. Investment activities will be limited to methods and techniques set out below.

3.6.2 The Director of Finance & Governance will monitor the credit quality of all counterparties. If the credit rating of a counterparty is downgraded below the minimum requirement or there is a rating review with a view to such a downgrading then this will be reported to the Governing Body on an exception basis with appropriate recommendations, which might include proposals to unwind borrowings and associated derivatives transactions and the early redemption of investments, even where this results in a loss of interest to the Group. The security and protection of assets, including cash and deposits, is the principal objective of our Investment Strategy

3.6.3 The Group recognises that, whilst credit ratings remain a key source of information, they do have limitations and will be regarded only as a starting point when considering credit risk. The Group will give consideration to other sources of generally available market information, including the financial press, market data including credit default swap (CDS) and information on government support for banks, in assessing counterparty risk.

3.6.4 The Group regards a prime objective of its treasury management activities and this Policy to be the security of the principal sums it invests, and considers this to rank above seeking to secure the highest possible revenue return (yield) on its investments. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited. As a general rule, the Group will pursue a diversification policy (i.e. spread the investments and investment risk amongst a number of qualifying counterparties) with high credit quality counterparties.

3.6.5 The Associations recognise the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations to which it may place deposits and investments The investment (deposit) Counterparty Requirements are set out below:

Counterparty	Min credit rating S&P/Moody's/Fitch	Maximum term	Maximum Exposure Amount per Counterparty	Other
Short term deposits	Short term A2/P2/F2 Long term A-/A3/A	Up to 6 months	£5m or 33% of total funds invested	Deposits with Association's main clearing bank may represents up to 50% of total deposits
Medium term deposits	Long term A / F1 / P1	Up to 24 months	£5m or 33% of total funds invested	Deposits with Association's main clearing bank may represents up to 50% of total deposits
Sterling denominated money market funds (MMFs)	Long term AAA		£5m or 25% whichever is the lower.	The investment in any MMF must not be more than 10% of the MMF's total Assets Under Management

3.6.6 In addition to the exception noted above for the Group's main clearing bank, this investment and cash management strategy also allows the following two additional criteria for the investment of surplus cash. This means those counterparties who do not meet the credit limit criteria may still be considered for deposits if they meet one of the two exceptional criteria below:

- Substantial UK Government support for the institution
- Strength of the institution in regard to self-funding and capital position. There are some financial institutions that are close to 100% self-funded via their deposit base (enforced by their own rules) and so are generally deemed less risky (e.g. certain building societies). Although their scale means that they cannot absorb very large deposits (probably up to £10m maximum per depositor)

3.6.7 The Group will maintain a list of Approved Counterparties reflecting the above criteria. Both the list and the criteria itself will be reviewed on an annual basis as part of the annual treasury strategy but more frequently as market conditions require. As with other exceptions to this Policy, counterparties that no longer meet these criteria will be reported to the Governing Body along with a risk assessment of the potential impact on the Group's risk management policy in relation to financial counterparties.

3.7 Refinancing Risk Management

3.7.1 The Group will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, with a view to obtaining offer terms for renewal or refinancing, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time. It will actively manage its relationships with other parties in these transactions in such a manner as to secure this objective, and will avoid over reliance on any one source of funding.

3.7 Legal and Regulatory Risk Management

3.7.1 Each Association in the Group will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. The Group recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on each Association.

3.8 Fraud, Error and Corruption, and Contingency Management

3.8.1 Each Association in the Group will ensure that it has taken all reasonable precautions to limit its exposure to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures to these ends.

3.9 General

3.9.1 The risks and subsequent mitigation associated with treasury management will be assessed and controlled with reference to the undernoted policies and procedures:

- Group Risk Management Policy
- Group Anti-Fraud Policy
- Group Financial Regulations
- Group Insurance Crime Policy

4 Formulation of Treasury Management Strategy

4.1 In accordance with the CIPFA Code, the Director of Finance & Governance will prepare for the approval of the Governing Body an annual report on the strategy and plan to be pursued in the coming financial year.

4.2 In preparing such a report, the Director of Finance & Governance will have due regard for:

- The aggregate of all funds, borrowings and accounts operated by the Group
- The maintenance of the Group's financial stability and its ability to meet its short and long term financial obligations
- The Group's desire to meet its business plan objectives and service requirements
- The prevailing economic circumstances and forecasts.

5 Approved Methods of Raising Loan Finance

5.1 The Director of Finance & Governance, in conjunction with the Chief Executive, undertakes on its behalf the borrowing activities of the Group; however all borrowing is subject to the approval of the Governing Bodies.

5.2 Loan finance will be raised on a programme basis rather than a project by project basis with a recommended minimum application amount of £10m. The amount of finance required will, under normal circumstances, depend on future capital expenditure requirements and anticipated levels of grant from the Scottish Government, Local Authorities or other bodies or the requirement to re-finance current debt.

5.3 The Director of Finance & Governance will prepare a report for the Governing Body for each proposed capital borrowing. The report will include:

- Proposed lender
- Interest rate structure
- Lender's margin
- Arrangement fees
- Securities required
- Arrangements for draw down and impact on cash flows
- Comparison with alternatives
- Compliance with annual treasury management strategy
- Any other matters which might assist the Governing Body in reaching a decision.

5.4 In all cases, the loan finance will be subject to the following parameters:

- Security given to any lender should be granted by way of allocation of units from the Security Trust or identifiable assets secured directly to the lender.
- The Association's gearing ratio (i.e. outstanding loans as a proportion of the original cost of housing assets) should not exceed existing or proposed lending covenants
- Variable interest rates will be based on a margin over three month LIBOR rates
- The maximum loan repayment period will be 30 years.

5.5 Interest rate options (including fixed rate options, caps and collars) can be agreed in accordance with the Association's Rules and specifically approved by the Governing Body.

6 Derivatives

6.1 Derivatives can be used by the Group provided they have adopted the appropriate rules and are restricted to Caps, Collars and Interest Rate Swaps. These may be used to reduce or manage treasury risk but not for speculative purposes.

6.2 Any Association in the Group will only enter into interest rate or inflation linked derivatives denominated in sterling.

7 Use of Derivatives

7.1 <u>Embedded Derivatives</u>

7.1.1 When an embedded option is available within a loan agreement, the Association may enter into Caps, Collars, index linked and Interest Rate Swaps provided all the following conditions are met:

- Speculative trading is not allowed. Derivatives must only be used to manage treasury risk. There must be an exposure that the derivative can be matched against.

- The Association will not enter into a derivative when the nominal amount is in excess of their total outstanding and committed debt. For example, if our variable rate debt is £20 million and an additional £10 million of committed facilities, the maximum permitted nominal value of a variable to fixed rate swap would be £30 million.

- In the case of Forward Rate Agreements, loans do not have to be drawn down prior to a derivative being entered into, but there must be a loan commitment in place and an expectation backed up by a business plan projecting that debt will be drawn down to match the derivative that is to be entered into.

- The counterparty providing the derivative must have a long term credit rating of at least single A. (An explanation of credit ratings is contained within Appendix 2).

7.2 Free-standing Derivatives

7.2.1 Free standing derivatives, also known as stand-alone derivatives, can be transacted with many recognised financial institutions whether the Association borrows from them or not. The derivatives that may be entered into are free-standing legal contracts and not embedded into any loan documentation. The transactions are normally subject to a standardised International Swaps and Derivatives Association (ISDA) master agreement between the parties. (An explanation of ISDA master agreements are set out at section 7).

7.2.2 The advantage of this approach is that the Association may possibly achieve finer pricing by being able to use the wider financial market rather than be restricted to a specific lender.

7.2.3 The Association will only enter into free-standing derivatives if we can satisfy all the conditions noted in section 7.1 above which apply to embedded derivatives and in addition the following:

- A rule change will be necessary to allow the Association to enter into free-standing derivatives.
- Systems of reporting and control need to be in place so that the Association can demonstrate that it is not exposing itself to unnecessary risks by entering into derivative transactions.
- Legal advice is required before entering into an ISDA master agreement with counterparty.

8 Approved Sources of Finance

8.1 In order to eliminate exchange rate risk, all borrowing should only be in sterling. In securing loan finance, each Association will normally borrow from the following institutions:

- High Street Clearing Banks
- Building Societies
- European Investment Bank
- The Housing Finance Corporation
- UK based Insurance Companies
- Capital Market Management Organisations

8.2 The Director of Finance & Governance is responsible for closely monitoring the terms and conditions offered by counterparties. Where he/she has reason to believe that counterparty's standing is or may become impaired, he/she should advise the Governing Body at its next meeting.

8.3 The overriding borrowing limit for each Association in the Group, will be in accordance with its Rules.

9 Interest Rate Exposure

9.1 The Group should adopt a relatively risk averse policy on interest rate management and should favour fixing interest rates if the financial and economic conditions are suitable.

9.2 However the proportions of fixed and variable rate loans will depend on the projected cash flows of the assets being funded and the general liquidity of the Association. In addition, factors such as current interest rates compared to historical trend, estimates for future interest rate movements and the impact of interest rate movements on the revenue account will also be considered. These factors will be reviewed annually and will determine any change in policy regarding interest rate exposure.

9.3 The broad parameters regarding fixed and variable rate loans are as follows:

Maximum Variable Rate Loans	50%
Maximum Fixed Rate Loans	80%

10 Future Funding and Liquidity

10.1 Each Association in the Group will maintain a minimum liquidity level of sufficient cash and committed loan facilities capable of immediate drawdown to cover the next eighteen months forecast cash requirement based day to day on working capital plus committed development expenditure. This will be reviewed regularly (minimum every quarter) to ensure that the Association has sufficient liquidity to meet its obligations. For this purpose liquid resources are defined as a combination of:

- Cash deposits/ investments at hand
- Bank overdraft facilities with our relationship bank
- Committed loan/bond facilities, where these facilities are fully charged and available for drawing on request

10.2 Liquidity will be managed by:

- Daily monitoring of cleared bank balances
- Effective cash flow forecasting and monitoring systems to identify potential shortfalls against available facilities
- Diversifying risk by spreading available facilities through different counterparties
- Minimising borrowings by only drawing down funds when required and repaying when cash is available and it is beneficial to do so (for example through the use of revolving facilities)
- Monitoring the spread of maturities on available facilities

11 Legal Matters

11.1 Prior to entering any borrowing or investment transactions, it is the responsibility of the Director of Finance & Governance to ensure, by reference to the Group's legal advisors if necessary, that the proposed transaction does not breach any statute, external regulation or the Group's Financial Regulations.

11.2 The Director of Finance & Governance is the officer responsible for monitoring compliance with the Money Laundering Regulations. Employees are required to report any suspicions of money laundering where the money is generated through criminal activity. Any such suspicions should be reported to the Director of Finance & Governance in the first instance or, if necessary, directly to the Chair of the Audit & Risk Management Committee.

12 Use of External Service Providers

12.1 The Group recognises the potential value of employing external providers of treasury management services in order to acquire access to specialist skills and resources. When it employs such service providers it will ensure it does so for reasons that will have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. It will also ensure, where feasible and necessary, that a spread of service providers is used, to avoid over reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Director of Finance & Governance.

13 Staff Training & Qualifications

13.1 The Group recognises the importance of ensuring that all staff involved in the treasury management function is fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

14 Delegation

14.1 Each Association in the Group recognises the importance of appropriate levels of clarity and segregation of responsibilities for treasury activities. Accordingly, the scheme of delegation for the operation of the Treasury Management Policy is set out in Appendix 1.

15 Reporting Arrangements

15.1 The Director of Finance & Governance will prepare an annual Treasury Management Strategy report to the Governing Bodies which will contain information on the following matters:

- Treasury Management activity since the previous report
- Compliance with the Treasury Management Policy
- Compliance with external regulation and with loan covenants
- Compliance with the nine areas of risk contained within the CIPFA Code as follows:
- Liquidity
- Interest rates
- Exchange rates
- Inflation
- Credit & counterparty
- Re-financing
- Legal & Regulatory
- Fraud, error and contingency management
- Market Conditions

15.2 Each Association's Annual Budget will include current and projected cash balances and a quarterly cash position will be incorporated in the quarterly accounts submitted to the Governing Bodies during the course of the financial year.

16 Corporate Governance

16.1 The Group is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Director of Finance & Governance will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

<u>Appendix 1</u>

Group Treasury Management Policy

Scheme of Delegation for Treasury Policy

Delegated Power	Exercised by
Approval and amendment of Treasury Management Policy	Governing Body
Amendments to lists of counterparties	Audit & Risk Management Committee
Approval of Annual Treasury Management Strategy	Governing Body
Approval of new borrowing	Governing Body
Application of additional surplus funds for investment purposes	Governing Body
Application of approved strategy	Director of Finance & Governance
Treasury dealing with counterparties	Director of Finance & Governance
Investing surplus cash and agreeing term of notice on deposits	Director of Finance & Governance/Chief Executive
Opening new bank accounts or building society accounts	Director of Finance & Governance/Chief Executive
Borrowing and lending documentation	Director of Finance & Governance under authority of the Governing Body
Reporting on treasury activity to Governing Body	Director of Finance & Governance