



REGISTERED SOCIAL LANDLORDS PANEL BULLETIN

TREASURY MANAGEMENT IN RSLs

Issue Number 19

April 2007

AT THE HEART OF
PUBLIC SERVICES



Contents

1. INTRODUCTION	2
2. TREASURY MANAGEMENT – WHAT IS IT?	3
3. GOVERNANCE – ARE YOU IN CONTROL?	4
4. TREASURY MANAGEMENT RISKS	6
5. TREASURY MANAGEMENT POLICIES	8
6. HEDGING INSTRUMENTS AND WIDER RULE CHANGE	12
7. BEST VALUE AND PERFORMANCE MANAGEMENT	15
8. CONCLUSION	17
CHECKLIST OF QUESTIONS FOR THE GOVERNING BODY	19
COMMON DEFINITIONS.....	22

1. INTRODUCTION

- 1.1. The Registered Social Landlord (RSL) sector continues to grow and consists of 1,840 active housing associations registered with the Housing Corporation. Over 65% of these RSLs manage fewer than 250 units each, the remaining stock is managed by around 630 larger associations who between them manage over 2 million properties. In 2004-05 the overall debt of the sector increased by 9.5% (£2.3 billion), to £26.9 billion (source: Housing Corporation - 2005 Global Accounts of Housing Associations).

Wales includes a further 32 developing housing associations, registered with Community Housing Cymru and managing over 73,000 properties. Long term debt increased by £27 million in 2004/05 to a total of £694million (source: CHC – 2005 Global Accounts).

Scotland includes a further 116 developing housing associations, registered with Communities Scotland and managing over 257,000 properties. Long term debt increased by £317 million in 2004/05 to a total of £1369 million (source: Communities Scotland – The Digest 2004/05 and Affordable Housing Investment Programme – Statistical Report 2004/05).

- 1.2. RSLs are increasingly becoming involved in diverse activities (beyond the normal definition of social housing). These activities may require expert knowledge and customised funding structures to meet project specific needs and more sophisticated risk management techniques.
- 1.3. The RSL sector has benefited from a stable economy and a low interest rate environment for many years. Recent movements in the base rate and global pressures do seem to provide for a more uncertain outlook for interest rates. The stock transfer programme in England for 2006-08 will require (subject to gaining tenant backing) new loan facilities exceeding £4.5 billion, and this is in addition to the amount required by developing RSLs to fund on-going development programmes. In Wales, there is only one stock transfer organisation with the tenants of two other local authorities recently returning a yes vote to transfer and more ballots in the pipeline. This situation means that a significant increase in new loan facilities will be seen in Wales over the coming years.

- 1.4. Treasury Management is and will remain an important part of an RSL's business. The prudent management of an RSL's loan portfolio; the associated risks and active management of the relationship with perhaps a range of funding institutions must form part of an effective Treasury Management Policy.
- 1.5. This bulletin provides a brief overview of treasury management and is aimed specifically for Board Members or those Members who have responsibility for overseeing and establishing an appropriate risk framework for the treasury activity. This bulletin is not a practitioner's guide but it may be helpful to those new to the sector and Treasury Management. Attached at the end of this bulletin is a Checklist for Members, which summarises the key risks which the governing body will need to ensure are adequately addressed as part of their overall approach to treasury management.

2. TREASURY MANAGEMENT – WHAT IS IT?

- 2.1 Defining treasury management varies depending upon each organisation's activities and the range of funding options available and may include for example:

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

'Treasury management refers to the set of policies, strategies and transactions that an organisation adopts and implements to raise finance at acceptable cost and risk, to manage its cash resources, and to reduce interest rate, (foreign exchange and commodity price risks where appropriate) as well as in the conduct of its relationships with its financial stakeholders'.

Regardless of the precise definition the Housing Corporation expects each RSL to adopt comprehensive written policies which are appropriate to the nature and extent of the treasury activity undertaken (source: Housing Corporation – Treasury Management Regulatory Policy 99/04).

The Welsh Assembly Government requires Welsh Associations to have "a treasury management strategy covering borrowing and investment which minimises exposure to risk" (source: Regulatory Code 2006 – Welsh Assembly Government)

2.2 These documents clearly place responsibility upon the RSL's governing body to ensure that there is adequate awareness and understanding of these risks at both governing board level and officer level. The governing body is responsible for ensuring the formulation and implementation of treasury management policy and procedures and appropriate controls and to this end the following documents provide further guidance.

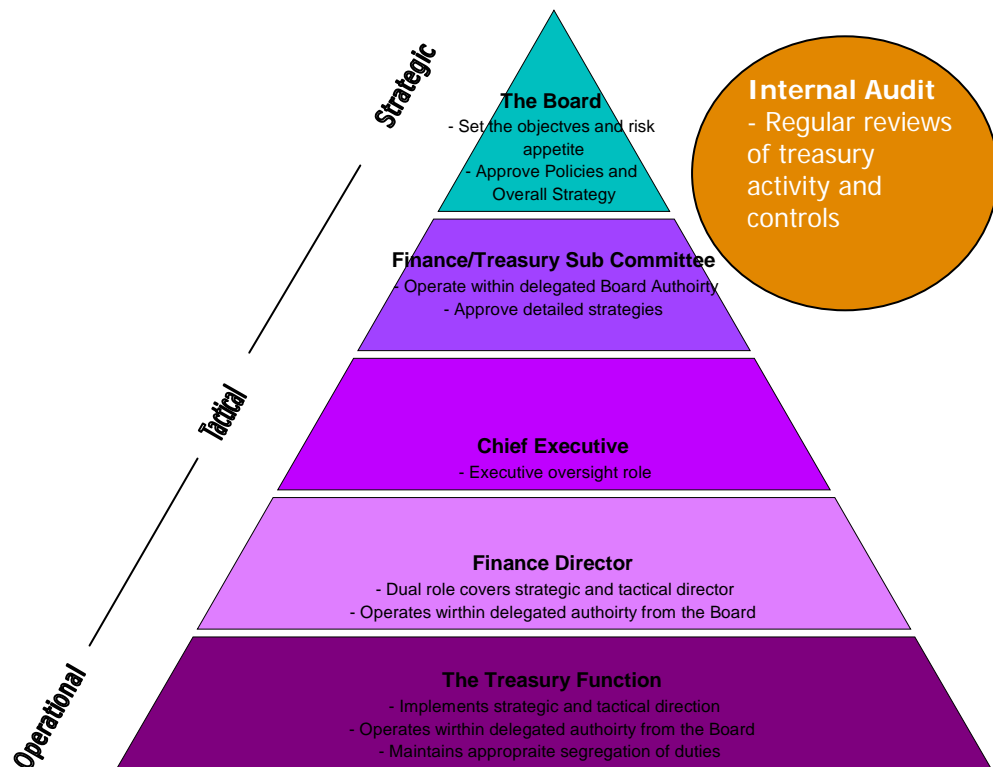
Title	Date
Treasury Management – Regulatory Policy (The Housing Corporation)	Issued: Jul 99 Rev: Sept 02
Financial Risk Management – Focus on Treasury (The National Housing Federation)	Issued: Mar 99
Treasury Management in the Public Service - Code of Practice and Cross-sectional Guidance Notes (CIPFA)	Issued: 01
Treasury Management for Housing Associations – Good Practice Guide (The Housing Corporation)	Issued: Mar 06
Treasury Management by housing associations – Consultation Paper (The Housing Corporation)	Issued: Jul 06
Treasury Management by housing associations – Post Consultation Note** (The Housing Corporation)	Issued: Dec 2006

** The Housing Corporation are expecting to issue a revised Treasury Management Policy in 2007.

2.3 Identifying an appropriate treasury management strategy which has been developed by taking account of the environment within which the RSL operates; the framework established by the Regulators; good practice which ensures risks are systematically evaluated and appropriate controls developed; and is tailored to the RSL's specific needs and business plan requirements is critical to ensure treasury management is managed appropriately. Different organisations will have different 'risk appetites' which may change over time. Therefore a one-size fits all treasury strategy is not appropriate and the governing body needs to ensure that their RSL's particular circumstances and interests are adequately covered.

3. GOVERNANCE – ARE YOU IN CONTROL?

3.1 There is a clear expectation that the governing body will ensure that treasury risks are identified and their potential impact assessed and that the organisation possesses appropriate knowledge and skills. The diagram below illustrates how responsibility for treasury management may typically be structured.



3.2 By adopting a structured approach to treasury management it enables the governing body to establish parameters within which the treasury is to operate and the principles to be applied in controlling this activity. The framework established by the governing body needs to reflect the scale of treasury activity and the risks, and may include policies, procedures, financial regulations and individual authority limits and reporting mechanisms.

3.3 The Housing Corporation’s Circular 99/04 (Treasury Management – Regulatory Policy) establishes four key principles, outlined below, which should be central to any treasury policy statement. These principles clearly reflect a risk minimisation attitude towards the treasury activity and the governing body need to ensure their own policies reflect this approach. Indeed in England the governing body are required to confirm annually to the Housing Corporation, through the Self Assessment Compliance Statement, whether they comply with all aspects of Section 1 of the Regulatory Code (Finance and Viability)

1. Compliance – with statute, regulation and best practice
2. Security – of financial assets

3. Liquidity – ensuring adequate resources to meet obligations
 4. Effectiveness and Efficiency – in the use of financial resources and achieving value for money
- 3.4 The governing body should review and approve annually the RSL's Treasury Management Policy Statement and Treasury Management Practices. Together these two documents substantially provide the framework for the treasury activity. The questions listed at the end of this bulletin highlight some of the key questions which the governing board need to be assured are adequately addressed as part of their organisation's treasury activity.

4. TREASURY MANAGEMENT RISKS

- 4.1 Due to its very nature and the size of transactions being undertaken the management of the treasury function creates additional risk for the organisation. The governing body needs to ensure that the risks have been properly identified and evaluated; appropriate management strategies and financial risk management techniques have been deployed to manage those risks; and that the governing body can gain assurance that through continued monitoring such controls remain effective. Detailed below are some of the key risks faced by an RSL's treasury operations.

4.2 Interest Rate Risk

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. As most RSLs are net borrowers their single largest interest rate risk will be the servicing of debt. For those RSLs with too much variable rate debt, increasing interest rates mean higher interest payments and repayment costs. On the other hand, for those RSLs with too much fixed debt a fall in interest rates would result in opportunity losses because the RSL cannot benefit from improving interest rates.

If an RSL has cash invested, it can be exposed to the risk that interest rates will decrease and impact on the size of the yield from its investments. Another source of interest rate risk therefore lies in the RSL's holdings of interest-sensitive investments. Thus interest rate exposure is the risk of reduced cash flow, either in the form of diminished cash inflows or increased cash outflows. The main danger resulting from interest rate risk is that an RSL could face liquidity problems. In the worst case scenario, loan covenants such as minimum interest cover ratios (net operating income/net interest payments) could be breached by rising interest rates

4.3 **Inflation Risk**

The effects of varying levels of inflation impact on an RSL's treasury management activities through their link with interest rate management. This is because the cost of fixed rate finance is wholly dependent on the rate of inflation. An RSL's rental income and operating surpluses (the amounts available to pay interest) depend on the rate of inflation so if these increase by less than forecast while fixed rate loan costs remain as forecast, there is a real cost to the RSL of low inflation.

4.4 **Liquidity Risk**

This is the risk that an RSL will have insufficient cash to meet its liabilities as they fall due. RSLs need to ensure that they are always in a position to meet their cash outflows as and when they occur. This usually means having sufficient liquid funds available, typically in the form of cash balances held on deposit, overdraft facilities and committed loan facilities and other liquid assets.

Cash flow forecasting is integral to effective and efficient treasury management and there is a risk that cash flow forecasts do not predict accurately how much excess cash is available to invest or when borrowings are required.

4.5 **Funding Risk**

This is the risk that loans falling due, which the RSL does not have the cash resources to repay, cannot be replaced at an acceptable cost. Bunching in an RSL's loan maturity profile increases refinancing risks. Whilst overdependence on one lender who leaves the market is also a risk.

4.6 **Counterparty or Credit Risk**

This is the risk that a loss will be incurred by an RSL if a counterparty/ debtor defaults on an obligation. There are two main aspects to this risk. Firstly, there is the risk that the RSL has deposited surplus funds with an organisation which does not repay the monies. This aspect of the risk should be controlled by the approval of formal lending criteria based on the nature of the counterparty (either regulatory status or credit rating), maximum amounts to be lent (in monetary value and proportion of total lending), and period of deposit.

Secondly there is the risk that an organisation that is due to make a payment to the RSL under a contractual agreement (e.g. loan facility or derivative agreement) may default on its obligation, or in the case of a long term loan agreement, may be less than cooperative if the RSL needs to renegotiate the loan.

It is important to recognise that counterparty risk is not just limited to the non-payment of monies owed. It also encompasses late payments and partial (rather than full) payments, both of which can have as detrimental an effect on an RSL's cash flow as non-payment.

4.7 Failure of Internal Controls/Systems

This risk of inadequate systems of control, reporting and performance measurement is not specific to treasury management. However the value of the sums involved and the specialist nature of much of treasury management means that this risk is significantly greater in this area than in other areas of an RSL's operations. In a systems context, there is the risk of misappropriation of funds through fraud or error. There is the risk that funds will be directed fraudulently from the RSL's accounts to an unauthorised recipient using the payments system. Whilst the high value of transactions that a treasury processes means that even a straightforward error, such as delayed or incorrect processing of transactions by the banking system, may lead to significant losses.

4.8 Political, Regulatory and Legal Risk

These risks refer to the possibility that the RSL or its counterparties may be prevented from fulfilling their obligations or intentions due to political, legal or regulatory changes and restrictions.

4.9 Currency Risk

Currency risk is due to fluctuations in exchange rates. The risk that a company's operations or an investment's value could be affected by changes in one currency's value relative to another that could lead to a loss in value of assets denominated in foreign currencies.

5 TREASURY MANAGEMENT POLICIES

5.1 Even associations with very small loans portfolios have a need to review their cash and loan policies and practices on a regular basis. As mentioned in part 3, all governing bodies should annually consider and agree a Treasury Management Policy Statement, an example of which is set out

below. CIPFA Members should adopt its Treasury Management in the Public Service Code of Practice.

TREASURY MANAGEMENT POLICY STATEMENT

The Association defines its treasury management activities as:

The management of the Association's 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.

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 for the Association.

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

- 5.2 The policy statement should be supported by a Treasury Management Practices document setting out how the policy will be delivered. Whilst there are a number of standard items required, there are several which will be entirely dependent on the type and scale of the loan portfolio involved.

5.3 Treasury Management Practices

The following checklist outlines the key features which Members should look for:

1. **Treasury risk and risk management**
 - *Please refer to Section 4*

2. **Best value and performance measurement**
 - a. a statement about the performance methodology which will be used to ensure best value
 - b. how will potential improvements in alternative methods of financing be considered?

3. **Decision-making and analysis**
 - a. roles and responsibilities of Members and officers
 - b. level of delegation for treasury matters
 - c. how loan decisions will be made and recorded

4. **Approved instruments, methods and techniques**
 - a. what different types of borrowing will be considered e.g. bonds, term loans, repayments etc
 - b. limits on amounts borrowed from individual funders
 - c. any limits on numbers of funders
 - d. any limits or parameters relating to repayment limits e.g. at least 50% of loans for over 25 years
 - e. approved investment instruments
 - f. use of derivatives
 - which types will be considered
 - maximum exposure limits
 - whether these should be embedded or stand-alone

(note: only those associations who have obtained the wider rule change from the Housing Corporation will have access to all of these)

5. **Organisation, clarity and segregation of responsibilities, and dealing arrangements**
 - a. how officers will delegate and distribute treasury work
 - b. statement re: segregation of duties
 - c. how procedures will be documented and updated

6. **Reporting requirements and management information arrangements**
 - a. annual treasury strategy report setting out annual objectives
 - b. what information is required by Members quarterly to measure performance against targets and in what format e.g. graphical or written
 - c. benchmarking and trend analysis of key indicators
 - d. sensitivity to interest changes etc.

7. **Budgeting, accounting and audit arrangements**
 - a. identification of key budget holders and monitoring arrangements
 - b. scale and frequency of audits

8. **Cash and cash flow management**
 - a. a high level overview of banking arrangements including overdraft facilities
 - b. any minimum cash balances required
 - c. how and with whom balances will be invested e.g. AA rated only
 - d. maximum exposure limits with individual banks

9. **Money laundering**
 - a. A clear statement on systems in place to detect irregularities

10. **Staff training and qualifications**
 - a. Identification of the key staff (and Members) involved in treasury activities and their relevant qualifications
 - b. *How will these staff and members be trained and kept updated?*

11. **Use of external service providers**
 - a. How and when external/independent service providers or advisers will be used
 - b. Any parameters re legal advisers, valuers or security trustees

12. **Corporate governance**
 - a. Statement re: openness and transparency, honesty, integrity and accountability
 - b. Confirmation of any external Codes which have been adopted

6 HEDGING INSTRUMENTS AND WIDER RULE CHANGE

Housing Associations based in Wales and Scotland will need to check what instruments they are able to enter into with legal advisor and Regulator.

- 6.1 At the time of writing of this bulletin, the Housing Corporation has not issued their revised Treasury Management Policy. CIPFA understand that the Housing Corporation are expected to make a number changes and therefore any subsequent policy release will need to be taken into account.
- 6.2 Derivatives are financial contracts designed to create price exposure to an underlying commodity, asset, rate, index or event. In general they do not involve the exchange or transfer of principal or title. Rather their purpose is to capture, in the form of price changes, some underlying price change or event. The term *derivative* refers to how the price of these contracts is *derived* from the price of some underlying security or commodity or from some index, interest rate or exchange rate.
- 6.3 Whilst the appropriate use of derivatives can play an important part in an RSL's management of interest rate risk, it can equally if misunderstood significantly increase the risk and fall foul of the Regulatory Code. Derivatives must only be used to reduce or manage interest rate risk. It is critical that the governing body ensures that policies, procedures, controls and monitoring exist to ensure derivative transactions are appropriate and in accordance with its approved interest rate management strategy.
- 6.4 Most RSL loan arrangements/agreements will incorporate interest rate options, enabling the RSL at specified times to convert variable interest rate debt to fixed rate debt for specific durations. This type of embedded arrangement does not require the RSL to adopt any rule change, however the governing body should fully understand the implications of entering into an embedded interest rate transaction and that it is in the best interest of the RSL and understand the associated risks.
- 6.5 RSLs that require more sophisticated hedging tools to manage their interest rate exposure may also utilise stand-alone derivative transactions. However their use is limited to those RSLs that have successfully achieved the wider rule change and have an express enabling power within their constitution to ensure its legal validity. The governing body will need to seek independent legal advice and go through a number of approval processes to action the necessary change. The governing body should

seek its own advice to establish whether it has the necessary approvals before entering into any stand-alone derivative transaction.

6.6 The governing body will need to be satisfied that policies, procedures and internal controls are sufficiently robust to ensure that the use of derivative instruments can be properly managed without increasing the risk to the RSL. The Regulator will make an independent assessment of the RSL's ability to use derivatives through completion of an Application Questionnaire which the RSL must submit as part of the approval process. Once an RSL has achieved the wider rule change and approval from the Regulator, the governing body must ensure derivative instruments continue to be managed within the approved framework and their knowledge is sufficient to discharge their duties.

6.7 RSLs which have adopted the wider rule change and have appropriate systems in place to manage derivative transactions will be permitted to undertake the following:

- **Interest Rate Swaps**

A swap contract is an agreement between two parties to exchange a series of cash flows generated by underlying assets. No physical commodity is actually transferred between the buyer and seller. Because swaps do not involve the actual transfer of any assets or principal amounts, a base must be established in order to determine the amounts that will periodically be swapped. This principal base is known as the "notional amount" of the contract.

A Swap is not a lending facility. It is an interest rate management tool that can be used in conjunction with any variable rate lending facility, including a facility with another lender. An RSL's underlying lending facility will continue to be governed by the terms and conditions set out in your facility agreement. It is also important to remember that a Swap only affects the base interest rate applicable to your underlying lending facility. It has no effect on any acceptance or other fees and margins payable under that facility. An RSL will remain obligated to pay those fees and margins no matter what happens with the Swap.

- **Forward Rate Agreement (FRA)**

An FRA is a legally binding agreement between two parties to determine the rate of interest to be applied to a notional loan. The agreement will specify the future date (the settlement date) when this notional loan is deemed to start, and how long it is to last. A forward rate enables an RSL to borrow in the future at a guaranteed rate of interest, hence it provides certainty and allows an RSL to plan its

cashflow. When an FRA is taken out, it will come into force even if an RSL does not take out the originally anticipated loan. An RSL needs to have worked out its cashflow/loan for the future correctly.

FRA's are generally used to manage short term interest rate exposure for periods up to two years. The parties will make periodic payments, one to the other, calculated by reference to the changes in variable rates in comparison with the agreed fixed rate, usually at the beginning of the period and then discounted.

▪ **Interest Rate Futures Contract**

A futures contract is an agreement to enter into a notional loan based on a fixed rate of interest starting on the delivery date of the interest rate futures contract. The interest rate futures contract is similar to an FRA, except that it is exchange traded rather than a standard over the counter instrument. On expiry of the contract cash settlement is the difference between the initial futures price/rate and the underlying interest rate on the settlement date. (source: Housing Corporation – Financial Derivative Instruments – Regulatory Policy -99/05)

▪ **Interest Rate Options**

An interest rate option would enable an RSL to hedge its position against the increase or the decrease of interest rates and offers flexibility but at a price. The discharge of payments is not connected with one period, but with several repetitive periods. An interest rate option is a one-sided deal, payments from the RSL's side are limited to the premium payment.

An interest rate option does not commit the RSL in the way a swap or FRA does, however it gives the RSL a right but not an obligation to hedge at an agreed rate (the strike rate). If the strike rate is advantageous to the RSL in comparison to the prevailing market rate on a preset date(s), the option will be exercised and a compensating payment made by the seller to the RSL. If market rates are not advantageous to the RSL, the option will be allowed to expire and the market rate will be paid. The most common maturity ranges for an option are 1 year to 5 years. There are variations of interest rate options which allow:

- a *cap* to be set as an upper limit on interest costs over a period of time,
- A *floor* is an agreement where the seller agrees to compensate the buyer if the interest rate falls below the agreed floor rate,

- A *collar* is constructed by buying a cap and simultaneously selling a floor at lower strike price to the cap. The net impact is to constrain the floating rate of interest between the upper (cap) and lower limits (floor). The benefit of a collar is that whilst it limits the exposure it is not as expensive as buying a cap.

- **Cancellable Option**

A cancellable option is where the issuer has the right at periodic intervals to terminate the fixed rate within the loan and substitute a variable one. This right, once exercised, is irreversible. These represent embedded derivatives where the economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host contract. As such, they are not separated from the host contract and are treated as one. They are accounted for at amortised cost using the effective interest method.

6.8 RSLs intending to enter into swap and derivative instruments will most likely utilise the ISDA (International Swaps and Derivatives Association) Agreement. ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association. The ISDA Master Agreement provides the legal basis for transactions between financial institutions in many of the world's commodity and financial markets. The ISDA Master Agreement is a bilateral framework agreement. This means it contains general terms but does not, by itself, include details of any specific derivatives transactions the parties may enter into. The ISDA Master Agreement is a pre-printed form which will not be amended itself (save for writing in the names of the parties on the front and signature pages). However, it also has a manually produced schedule in which the parties are required to select certain options and may modify sections of the Master Agreement if desired.

6.9 The Regulator will impose limits on the power of RSLs to enter into derivative transactions by imposing an aggregate maximum notional principal amount, similar to the borrowing limit found in an RSL's rules. Prior to entering into a hedging instrument whether embedded or stand-alone the governing body needs to ensure that it is in the best interest of the RSL and have taken proper advice.

7 BEST VALUE AND PERFORMANCE MANAGEMENT

7.1 The RSL should be committed to the pursuit of best value in its treasury management activities, and to the use of performance methodology in support of that aim. The governing body needs to ensure that the treasury

function is subject to on-going analysis of the value it adds in support of the organisation's objectives. It should be subjected to regular examination to ensure the organisation's treasury activity.

7.2 CIPFA's Treasury Management in Public Services – code of practice gives the treasury management practices which should be developed. This includes reporting requirements and management information requirements which are key to monitoring performance.

7.3 An association's Treasury management service should be included within an association's overall best value plans and with regard to probity and should be subject to review on a regular basis. As a minimum associations should regularly report on:

- Details of investments made
- Details of new loans drawn down
- Details of refinancing exercises undertaken
- An independent review of the Association's loan portfolio, at least every five years (may be appropriate when an RSL has a substantial loan portfolio)

7.4 To ensure value for money, associations should include:

- Details of comparative investments available at the time the investment was made
- Accuracy of cashflow information and historical information collated to measure if the association could develop increased accuracy in its cashflow forecasting

7.5 Some methods to consider for performance management arrangements in RSLs on treasury management include:

- Interest Receivable (whenever there are funds to invest)
- Amount received compared to target (base rate + X)
- Interest Paid Fixed (monthly)
- Interest paid on fixed compared to 5 yr target rate
- Interest Paid on Variable (monthly)
- Interest paid on variable compared to target 1 yr rate
- Continue 3 Month projection (monthly) treasury management to result in favourable outcome by balancing overdraft facility / drawdown
- Percentage of fixed to variable (with a maximum level of exposure ref variable say 30 to 40 %)
- Exposure profile expressed as a graph: showing level of fixed, variable, proposed draw downs, repayments

8 CONCLUSION

- 8.1 This bulletin provides a brief overview of treasury management for Board Members or those Members who have particular responsibility for overseeing and establishing an appropriate risk framework for the treasury activity.
- 8.2 The RSL sector continues to grow and diversify and our appetite for funding will inevitably increase. As funding arrangements become more sophisticated to meet the specific needs of an RSL structure and project requirements, the Governing Body needs to ensure that appropriate and effective treasury management strategies, policies and procedures are in place.
- 8.3 The potential impact of not complying with funding conditions or an inappropriate interest rate management strategy can be catastrophic and therefore treasury management remains an important part of an RSL's ability to demonstrate good financial standing and its ability to meet its future obligations.
- 8.4 The Governing Body needs to establish clear controls and appropriate delegated authority to ensure an effective treasury management operation. The Governing Body needs to ensure that it understands the risks and obligations of entering into a treasury transaction and that it is consistent with the approved policy. Due to the nature of treasury transactions, the Governing Body and senior staff may feel it appropriate to seek independent external advice to validate the specific proposals requiring approval.
- 8.5 As funding and project structures become more sophisticated some RSLs may consider using stand-alone derivatives transactions. These types of instruments are only available to those RSLs who have successfully achieved the wider rule change and approval from the Regulator. The Governing Body needs to be satisfied that policies, procedures and controls are sufficiently robust to ensure that the use of derivative instruments can be properly managed without increasing the risk to the RSL.
- 8.6 Performance management should equally apply to the treasury activity. The Governing Body needs to ensure that the treasury function is subjected to on-going analysis and review and ensure that the RSL's loan portfolio continues to offer value for money.

8.7 Treasury management is a vital and growing part of an RSL's finances and it is critical that the Governing Body adopts appropriate policies and practices to ensure effective management and control.

CIPFA'S RSLs Panel

The RSLs Panel reports to the Institute's Public Finance and Management Board. Its areas of interest and activity are:

- consideration of finance and policy issues relating to registered social landlords
- the production and dissemination of relevant advice and material on best practice for members and employers on social housing issues
- responding to government, professional bodies' and other bodies' consultation and discussion papers.

The Panel meets four times a year. Its meetings consider technical issues in the field of social housing finance, responses to government and others' consultation papers, and Panel projects.

Panel Members

The Panel membership includes practitioners and consultancy firms working in and for RSLs, along with representatives from the National Housing Federation and national regulators. Its current membership consists of:

Anne Turner (Chair)	<i>Orbit Housing Group</i>
Charles Brotherton	<i>Rooftop Housing Group</i>
Arthur Cockburn	<i>Prospect Community Housing Association</i>
Tony Deakin	<i>The Wrekin Housing Trust Ltd</i>
Bob Hartness	<i>Scottish Federation of Housing Associations</i>
Lakhbir Jaspal	<i>Accord Housing Group</i>
Mei Lee	<i>Community Housing Cymru</i>
Redmond Lee	<i>Kensington & Chelsea TMO</i>
Harry Lloyd	<i>Welsh National Assembly</i>
Brian Logan	<i>Bield Housing Association</i>
Nigel Martin	<i>Guinness Trust Group</i>
Patrick McCarthy	<i>Wirral Partnership Homes</i>
Arthur Merchant	<i>RSM Robson Rhodes</i>
Pascale Mezac	<i>Westlea Housing</i>
Katrina Michael	<i>Mid Wales Housing Association</i>
Michael Rafferty	<i>N. Ireland Federation of Housing Associations</i>
Deb Reynolds	<i>Adullam Homes Housing Association</i>
Julie Robinson	<i>Orbit Housing Group</i>
David Taylor	<i>Consultant / Teachers Housing Association</i>
Norman Thomas	<i>Places for People Group</i>
Bob Wilson	<i>National Housing Federation</i>
Philip Winter	<i>The Housing Corporation</i>
Roy Yates	<i>Communities Scotland</i>

Further Details

Details about the RSLs Panel and its activities can be found on the Panel website www.cipfa.org.uk/panels/RSL

Comments

If you have any comments or suggestions regarding this bulletin please contact Julian Smith, Policy Support Officer, CIPFA, 3 Robert Street, London WC2N 6RL (tel 020 7543 5795 or email julian.smith@cipfa.org).

CHECKLIST OF QUESTIONS FOR THE GOVERNING BODY

The questions set out below aim to identify the key risks which the governing body need to ensure are adequately addressed as part of their overall approach to treasury management. RSLs should ensure they are aware of regulatory requirements. The questions are set out in 9 areas.

Cash Management/Liquidity

Q1. How does the RSL ensure that it always has sufficient cash to meet its obligations?
Q2. How does the RSL determine its minimum cash holding balance?
Q3. What funds are available to be accessed and what notice is required?
Q4. What is the size of the RSL's overdraft facility; how can it be accessed and is it cost effective?
Q5. What is the extent of the RSL's undrawn loan facilities and when will they be utilised?
Q6. When will the RSL need new loan facilities and how much?
Q7. How does the RSL ensure that non utilisation fees are avoided wherever possible?
Q8. Does the RSL produce regular cash flow variance reports and how are these used?

Relationship with Funders/Bankers

Q1.How are the RSL's funders engaged with the RSL's work and business plans?
Q2.Have funders raised any issues and how are these monitored by the governing body?
Q3.How regularly does the RSL meet its funders?
Q4.How does the RSL assess funders' performance and what added value do they bring?
Q5.Does the RSL have too many or too few funders?
Q6.Does the RSL regularly monitor and report against covenants included in loan documents?
Q7.Is this information used to review requirements with funders?

Covenants and Compliance

Q1.How many different covenants does the RSL have?
Q2.How does the RSL monitor its covenants position on an on-going basis?
Q3.If there are a range of different variations of similar covenants, is that necessary, can they not be rationalised?
Q4.How does the governing body gain assurance that there are no covenant breaches during the year and what early warning indicators exist?
Q5.If covenants are tight what action is being taken to re-negotiate?
Q6.Does the RSL comply with all requirements of its loan agreement(s)?
Q7.What would happen if the RSL breached its loan covenants?
Q8.Is the RSL required to verify covenant compliance at the end of the financial year?

Staff and Board Experience

Q1.Do the staff who manage the treasury function have appropriate skills and knowledge?
Q2.Does the RSL engage independent advisors to assist with treasury decisions?
Q3.Does the governing body have the appropriate skills to ensure they understand their roles in respect of treasury management and understand the policies/strategy and their implementation and impact?
Q4.Is there appropriate division of duties and responsibilities (for the size of organisation) between staff working on treasury management?
Q5.Does the RSL retain independent advisors to keep abreast of market conditions and funding opportunities?
Q6.Are there adequate arrangements in place to ensure loan obligations can

continue to be met, in the event of key personnel being unavailable?

Q7.If the RSL does not consider it has appropriate numbers of staff working on treasury management (for example in a small organisation), has it considered additional controls and whether risks are regularly monitored?

Delegation

Q1.Does the governing body know what delegated authority has been given to officers?

Q2.Is the delegated authority for treasury transactions appropriate to ensure segregation of duties?

Q3.What arrangements exist when key treasury staff are unavailable?

Q4.How frequently do delegated authority levels get reviewed?

Q5.Are the delegated authority levels adequately set out in the RSL's Standing Financial Regulations?

Q6.Do the delegated authority levels adequately split the responsibility between different levels of staff and Board Members?

Audit and Control Assurance

Q1.Are there formal Treasury Management Policy and Procedures?

Q2.Are the controls established by the governing body effective?

Q3.Does the annual audit plan adequately address the key risks associated with the treasury activity at the strategic and operational levels?

Q4.How often is the treasury function subjected to an internal audit review?

Q5.Have the recommendations (if any) from the previous internal audit report on treasury management been actioned?

Q6.Have the external auditors reviewed treasury management as part of their year end work, if so were there any issues?

Q7.Has the Internal Auditor independently reviewed the RSL's compliance against loan covenants?

Risk Management

Q1.What is the RSL's exposure to fixed and variable rate debt?

Q2.What is the impact of a 0.5%, 1%, 1.5% and 2% increase in interest rates?

Q3.By how much would interest rates need to move to create a covenant breach?

Q4.Do we have sufficient security to borrow funds as and when required to meet our obligations?

Q5.Does our business plan demonstrate the RSL's ability to meet funding

conditions and repay interest and principal when due?
Q6. Is there an appropriate risk culture embedded within the RSL and are the controls relating to treasury management effective?
Q7. Do we continue to enjoy a good relationship with our funders and are we able to increase loan facilities if required?
Q8. Does the RSL review its treasury management policy on an annual basis and does the Board receive reports on a regular basis?
Q9. Are we using derivatives as a proper hedging tool and what is our exposure to such instruments?

Portfolio Management

Q1. How often is the RSL's loan portfolio reviewed?
Q2. How does our loan portfolio compare to other RSLs with similar characteristics?
Q3. How have we determined our interest rate management strategy and the proportion of fixed and variable debt?
Q4. How often does the RSL review its interest rate management strategy and how is it tested in conjunction with its business plan?
Q5. What are the risks associated with our current debt portfolio?
Q6. What alternative debt portfolios should be considered?
Q7. If the RSL is considering re-financing what cost benefit analysis has been undertaken?
Q8. How does the RSL's debt portfolio link to its Investment Strategy?
Q9. Do we have a wider rule change in place? If yes, what are its implications?

COMMON DEFINITIONS

(Source: The Housing Corporation: Treasury Management for Housing Associations)

This glossary includes a number of terms which are referred to within the good practice guide, but also includes other terms which may be of use to those involved in treasury management.

BACS

Bankers Automated Clearing Services (BACS) is the UK's low-value clearing system.

Basis price

The price agreed in an option contract is the 'basis' or 'striking' price. The buyer of the option pays a premium over and above the basis price in return for receiving the option and this is the amount of the buyer's risk.

Bond

A certificate evidencing indebtedness - a legal contract sold by an issuer promising to pay the holder its face value plus amounts of interest at future dates.

CHAPS

The Clearing House Automated Payment System (CHAPS) is the UK interbank RTGS (real time gross settlement) system providing same day settlement for (typically) low-volume, high-value transactions. As a result of its migration to a new platform, it is also called New CHAPS.

Convertible

A bond which gives to its owner the privilege of exchanging it for other securities of the issuing corporation on a preferred basis at some future date or under certain conditions.

Call (option)

The exercise of the right of an issuer of bonds or other obligation to repay the obligation before its stated maturity at a given price on a given date.

Capped rate funding

Funding whereby the underlying interest rate increases in line with underlying interest rate movements, any movement capped at a predetermined interest rate level.

Cash pooling

Cash management technique aimed at improving liquidity management by pooling an organisation's account balances either under the form of a cash concentration or a notional pooling arrangement.

Clearing house

An association of banks in a city or country created to facilitate the clearing of cheques, drafts, notes, and other items among its members. It also formulates policies and rules for the mutual welfare of all members, and in times of financial stress, may aid those members who might require help in the process of clearing cheques, etc. The settlement of debtor or creditor balances usually must be made daily.

Collateral

Stock, bonds, evidences of deposit, and other marketable properties which a borrower pledges as security for a loan.

Cost of capital

The opportunity cost of an investment, i.e. the rate of return that a company would otherwise be able to earn at the same risk level as the investment that has been selected.

Coupon

The attachments to a bond (usually non-registered) that constitute evidence of interest payable on the bonded indebtedness. These attachments usually consist of a series of small sections, each dated serially for future payment dates. These small sections when cut or "clipped" from the bond on the date specified, are called coupons, and are negotiable "bearer" instruments. The coupon recites the terms of the payment and the legal entity which issues the bond, the date and place of payment, and the number of the bond from which the coupon was clipped.

Covenant

Agreement by a borrower incorporated in the documents of a new issue and legally binding upon the issuer over the life of the issue, unless otherwise stated, to perform certain acts or to refrain from certain acts.

Counterparty risk

Counterparty risk is the risk that a counterparty may fail, resulting in financial loss to the transacting party.

Credit risk

The degree of risk assumed for possible non-payment of credit extended.

Dealing limit

The maximum amount of all unmatured trading contracts that can be outstanding for a given counterparty.

Debenture

A bond for which there is no specific security set aside or allocated for its repayment.

Demand deposit

Deposits that are payable on demand at any time the depositor elects. They are drawn against by cheques, and require no notice of withdrawal.

Deposit limit

The maximum amount and the maximum term of all deposits that can be outstanding with a given counterparty.

Derivative

A financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or reference rate.

Drawdown

Payment to the borrower of all or part of a bank's loan commitment.

Drawee

The person to whom a bill is addressed (usually the buyer).

Drawer

The person who fills out (draws) the bill (usually the seller).

Duration

A measure of the sensitivity of a security's market value that is defined by the average time until receipt of the cash flows weighted by the present value of those cash flows.

Effective yield

The actual return earned by an investor consisting of all cash received from the investment, including coupon return, interest earned on re-invested interest or principal payments and any capital gain or loss from disposing of the investment in comparison to the initial acquisition price.

Electronic funds transfer (EFT)

The exchange of money via telecommunications, without physical currency actually changing hands. EFT refers to any financial transaction that transfers a sum of money from one account to another electronically.

Embedded derivative

An embedded derivative is a derivative that is embedded in another contract i.e. the host contract.

Fixed rate loan

A loan in which the interest rate does not change during the entire term of the loan.

Floating rate

Indebtedness for which the interest payable is periodically adjusted.

Floating rate notes

Bonds without a fixed rate of interest, the coupon rate periodically determined according to a predetermined formula typically tied to a short-term interest rate in an appropriate market.

Forward position

An enterprise's future net holding as constituted by all transactions already entered into, excluding the spot position.

Futures contract

A forward contract that is standardised and exchange traded.

Gearing

The ratio of a company's long-term funds with fixed interest to its total capital.

Hedging

Engaging in transactions to reduce or eliminate exposure to changes in market conditions (e.g., interest rate changes) under forward commitments.

Interest cover

A company's pretax operating income (or occasionally, cash flow) divided by its interest obligations, for a given period.

Interest margin/spread

A measure of investment profitability often calculated as the difference between interest income on loans or investments and the applicable cost of funds (e.g., LIBOR) expressed as a percent of the principal.

Interest rate contract

An off-balance sheet transaction which involves a future commitment to pay or right to receive certain cash flows calculated on the basis of interest rates on an underlying notional principal amount. Examples include, interest rate swaps, forward rate agreements and interest rate options (including caps, floors, collars and swaptions or other derivatives).

Interest rate risk

The risk of increased interest expense (or reduced interest income) as a result of change in market interest rates.

LIBOR

London Inter Bank Offer Rate. The interest rate which banks in London charge on interbank deposits for set periods of time (e.g., 3-month LIBOR).

Line or line of credit

An arrangement whereby a bank will lend or trade for funds up to an internally approved maximum amount.

Liquidity

Available cash or the capacity to obtain it on demand.

Loan

A business transaction between two legal entities whereby one party, known as the lender, agrees to give the use of funds to the second party, known as the borrower, with or without a fee. Such a fee, if charged, is called interest or discount. Banks are the principal lenders of funds for commercial purposes.

Margin

For secured loans the difference between the market value of collateral pledged to secure a loan and the face value of the loan itself. Margin requirements, set by each bank, specify the ratio of collateral to loan value that must be maintained by the borrower to keep adequate security pledged to the bank for the life of the loan. See also Interest margin/spread.

Mark-to-market

The adjustment of a position to reflect accrued profits and losses. (The adjustment of a position to its market value).

Matching

Entering into an equal and opposite transaction which may differ from the original transaction only as to price (for example, the interest rate). The effect of matching, which is also referred to as covering, is to determine the profit or loss attributable to the two deals.

Maturity

The date on which a note, time draft, bill of exchange, or other negotiable instrument becomes due and payable.

Notional

The value of the principal amount advanced.

Option

A contract giving the holder the right to either buy from or sell to the issuer of the contract a fixed quantity (of, e.g., securities) at a fixed price within a specified time period.

Option premium

The total price paid by the buyer or received by the seller for the option.

Overdraft

The debit balance in a demand deposit or current/checking account resulting when a cheque drawn against the account exceeds the amount available and is paid.

Principal

The face value or par value of an instrument which becomes the obligation of the maker or drawee to pay to a holder in due course. Interest may be charged on this principal. In some instances, however, the obligation is for the principal only. This is termed "non-interest bearing" principal.

Retail Price Index (RPI)

A monthly indication of the average price changes to a particular 'basket' of consumer goods. Used as a general indicator of price inflation.

Revolving letter of credit

A credit that enables a number of letters of credit to be issued under one facility.

Rollover

The period, usually 3 or 6 months, for which the interest rate on an adjustable-rate loan is set. At rollover date the funds are notionally repaid and relent (or rolled over) and the new interest rate established.

Securities

A variety of financial instruments evidencing and promising the fulfilment of certain obligations.

Settlement

The actual delivery and receipt of the media of exchange under a contract.

Spot position

The position at the present time encompassing present assets, liabilities, and commitments due within two working days.

Subordinated

Debt obligations not in the first (senior) tier of obligations. In the event of default, subordinated debt holders are paid after all senior obligations have been discharged.

Swap

An exchange of streams of payments over time according to specified terms. The most common type is an interest rate swap, in which one party agrees to pay a fixed interest rate in return for receiving an adjustable rate from another party.

Swaption

An option giving the holder the right, but not the obligation, to enter into or cancel a swap agreement at a future date.

SWIFT

An acronym for the Society for World-wide Interbank Financial Telecommunications, a system which provides electronic payment of funds between banks in different countries (principally in Europe, Canada, the U.S. and Australia).

Syndicate

A group of bankers and/or bond houses which act together in underwriting and distributing a new securities issue.

Syndicated loan

A loan granted to a borrower by an organised group (syndicate) of banks.

Volatility

The degree of price fluctuation for a given asset, rate or index. Usually expressed as variance or standard deviation.

Working capital

Working capital measures the liquidity of a company's assets and equates to current assets less current liabilities.

Yield

The return received from one's investment in a specific security or a specific piece of property over and above the repayment of the funds invested. Yield is most commonly expressed in terms which designate an annual rate of return on the investment.

Zero balancing

Transference of all account balances into a nominated master account.