ARK
CONSULTANCY

SOUTHSIDE HOUSING ASSOCIATION

Treasury Management Policy Review Report

26 October 2017

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1 INTRODUCTION

1.1 Ark Consultancy has been asked to provide a draft Treasury Management Policy Statement for discussion and in due course endorsement and adoption by the Management Committee.

1.2 Good treasury management policy, having been established, is unlikely to change radically unless the nature and ethos of the RSL's business or the legal or regulatory regimes change significantly. Hence, the Treasury Management Policy statement itself is likely to evolve slowly through minor revisions. However, the implementation of treasury operations within policy parameters will naturally respond to external influences such as conditions in the money market and the strategic objectives of the business as it develops.

1.3 As a consequence, the treasury documentation that controls day to day operations; procedures, delegations of authority and so on are likely to change to a greater extent and more frequently than the Treasury Management Policy statement itself. As a corporate control document any changes to the Policy Statement must be endorsed by the Management Committee but it is not necessary for Members to be involved in the day to day arrangements set out in Procedures and empowered by Delegations of Authority.

1.4 At section 2 we provide a resume of the changes to the regulatory regime that have taken effect in recent years and must be reflected in SHA's Treasury Management Policy. This is intended to provide context within which to set our recommended Treasury Management Policy Statement.

1.6 At section 3 we provide explanatory notes that are intended to describe and illustrate the principles and rationale that underlie the draft Treasury Management Policy Statement. The proposed Policy Statement takes account of and refers to the most recent regulatory framework and accepted best practice and is based on a template that has been adopted by many RSLs and is familiar to and accepted by the regulator and funders to our sector.

1.7 **At Appendix A to this report we provide a draft Treasury Management Policy Statement that we commend to the Management Committee for endorsement and adoption.**

1.8 Some of the terminology used in connection with treasury management is commonly misused interchangeably and this can lead to confusion. We feel that it is worthwhile defining our use of terminology.

Policy; determines the highest level of corporate parameters, that is, **what SHA may do.** It is the case that because the Treasury Management Policy is a corporate control statement the Management Committee will be held "jointly and severally accountable and responsible" for it irrespective of any internal delegations. As a consequence, we believe that "ownership" of the policy properly resides with the Management Committee that should receive a policy review report at least annually even though that may well be a "No Action Required" report.

Strategy; determines how policy will be implemented in the near-term future, say 2 to 3 years on a rolling basis, that is, **what SHA will do.** We suggest that treasury strategy should be reviewed by the Management Committee at least half yearly, in conjunction with the budget for the coming year and at approximately mid-year and revised as necessary for the delivery of corporate objectives. In our view responsibility for implementing treasury strategy can be held at Management Committee level or can be delegated to an appropriately authorised Sub-Committee or Finance Panel. **Strategy does not form part of the corporate control structure** but is in effect an action plan for the delivery of the objectives of the business within the confines of Policy.

Procedures; determine how strategic decisions will be put into effect, that is, **how SHA will do it**. Procedures determine the responsibilities and accountabilities of the Management Committee and its Sub-Committees and of members of the Executive team and finance staff. These responsibilities should include reporting duties that escalate up through the organisation at reducing levels of detail that allow the recipients to take fully informed decisions at their level of responsibility without being burdened by unnecessary detail.

Delegation of Authority; determines which level of management or staff is able to take decisions and implement them, that is, **who within SHA will do it.** Delegation of Authority should empower each level or individual within the organisation to carry out those tasks and duties for which they are responsible and accountable under Procedures, but no more.

1.9 We believe very strongly that Accountability, Responsibility and Authority must hang together as a cohesive structure and that whoever is Accountable for any element of treasury management should also have Responsibility for that decision or task and the Authority to undertake it.

1.10 When reviewing and developing treasury policy and strategy it must always be borne in mind that treasury management in not a precise discipline in the way that, for example, financial accounting is. Good treasury management strategy is essentially achieved by the application of judgement to produce a balanced combination of conflicting influences that vary over time, hence, it is very rarely the case that there is only one correct treasury solution in any given set of circumstances with all other solutions being inferior. As a consequence, treasury control documentation must accommodate adequate flexibility to allow the organisation to respond to unforeseen opportunities or changing circumstances without undue delay.

2 THE REGULATORY REGIME

2.1 In drafting the suggested Treasury Management Policy Statement we have been mindful of the prevailing regulatory and guidance regime.

2.2 On 31 August 2015 the Scottish Housing Regulator issued "Treasury Management – Revised Regulatory Guidance". The Regulatory Expectation is that the RSL will comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) "Treasury Management in the Public Services Code of Practice and Cross Sectorial Guidance Notes" (2011 Edition) (the Code).

2.2 Section 5 of the Regulatory Framework sets out the Regulatory Standards of Governance and Financial Management of which Standard 3 states that "The RSL manages its resources to ensure its financial well-being and economic effectiveness". Regulatory Standard 3 is expanded through seven Guidance Notes and a supplementary section, 3.13 "Financial Derivatives", that will apply where an RSL seeks to use such instruments to mitigate interest rate exposures.

2.3 The Guidance Notes to Regulatory Standard 3 are quite brief and we reproduce them here for ease of reference by Members.

3.1. The RSL has effective financial and treasury management controls and procedures, to achieve the right balance between costs and outcomes. The RSL ensures security of assets, the proper use of public and private funds, and access to sufficient liquidity at all times.

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. Where the RSL makes use of financial derivatives it applies the guidance at 3.13.

3.3. The RSL has a robust business planning and control framework and effective systems to monitor and accurately report delivery of its plans. Risks to the delivery of financial plans are identified and managed effectively. The RSL considers sufficiently the financial implications of risks to the delivery of plans.

3.4. The RSL bases its financial forecasts on appropriate and reasonable assumptions and information.

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.

3.6. The governing body sets the employee remuneration levels at a level to be sufficient to ensure the appropriate quality of staff to run the organisation successfully but avoid paying more than is necessary for this purpose.

3.7. The RSL provides accurate and timely statutory and regulatory financial returns to the Scottish Housing Regulator.

2.4 We have not reproduced section 3.13 of the Regulatory Standard which gives specific guidance on the use of Financial Derivatives since we understand that it is highly unlikely that SHA would wish to use such instruments. If, in the future, SHA did wish to consider the management of interest rate exposure through the use of Financial Derivatives we strongly suggest that both

Members and the Executive Team should receive appropriately focused training and should be confident that they have adequate understanding of the potential risks inherent in such instruments before entering into any derivatives trade.

3. The Treasury Management Policy Statement – Explanatory Notes

3.1 Rather than set out a line by line explanation of the recommended Policy Statement, much of which is self-explanatory, we explain in the following notes the principles and rationale that underpin the document, cross referencing to the statement where appropriate.

3.3 General Comments

3.3.1 The Treasury Management Policy Statement must in all instances require the Association to acknowledge and comply with the legal and regulatory parameters by which it is constrained.

Throughout the Policy Statement we have;

3.3.1.1 Introduced references to the relevant Regulatory Standards and Guidance Notes as set out in the Regulatory Framework and Treasury Management – Revised Regulatory Guidance issued on 31 August 2015 against which the Association's treasury management activities and performance will be measured.

3.3.1.2 Made reference to the CIPFA Code of Practice for Treasury Management in the Public Services and Cross Sectorial Guidance Notes published in 2011 in accordance with the Regulatory Expectation.

3.4 Specific Comments

3.4.1 In the following notes we describe and illustrate the principles that underlie the various sections of the revised Treasury Management Policy Statement and expand on some of the more technical aspects of the Policy.

3.4.2 Treasury Management

3.4.2.1 "Treasury Management" determines the fundamental parameters and ethos of the treasury management operations of SHA. It acknowledges and where appropriate formally adopts the external standards and codes within which SHA is constrained to operate or within which the Association chooses to operate in order to demonstrate best practice in its treasury management activities.

3.4.2.2 This section also sets out the "Mission Statement" for treasury activities, clearly identifying treasury management as a means by which SHA will seek to achieve its primary purpose of "the acquisition, development, provision and management of affordable housing". For an RSL the treasury function is a means to that end, not an end in itself. The treasury function should not be regarded as a profit centre as it might be in a profit motivated commercial company, but as a cost reduction and risk management function. In all of its financial activities, but especially in treasury management that is essentially dealing with cash flows into and out of the Association, SHA should seek to minimise its exposure to risks and to identify, quantify and manage those residual risks that cannot be mitigated.

3.4.2.3 The latter paragraphs of the section set out the responsibilities of the Management Committee in determining the corporate control structure and of the Executive team in the day to day implementation of strategies designed to achieve the policy objectives. These paragraphs also set out the hierarchy through which the implementation and effectiveness of policy and strategy is reported on a regular and timely basis to each successively more senior level of management, in a way that supports effective decision making.

3.4.2.4 Responsibility for formulating, reviewing and monitoring Financial Standing Orders, Financial Regulations, Treasury Management Policies and the Scheme of Delegation for Treasury Management is assigned to the Management Committee. In order for the Management Committee to discharge its responsibilities it must receive adequate and timely information in the form of reports from the Executive team and paragraph 1.8 describes specific high level reports and the frequency with which they must be delivered.

3.4.2.5 The Policy recognises that the nature of SHA's assets and the revenues that it derives from them are the limiting factor when assessing and determining what financial liabilities the Association will take on and how it will manage them. In making its assessment of what financial liabilities it can assume SHA will undertake sensitivity analysis and stress testing of its business plan and financial plan to demonstrate that the business and its financial assets can sustain them under the most unfavourable combination of circumstances that could reasonably be forecast. The guiding principle is that SHA will not take on financial liabilities or accept financial exposures unless they are demonstrably sustainable.

3.4.3 Cash Management

3.4.3.1 The section on Cash Management is largely self-explanatory but it is worth expanding on the principles that underlie the 6 headline statements.

3.4.3.2 The flows of cash into and out of SHA are the lifeblood of the business. The Association must ensure that it has adequate liquid financial resources available at all times to support its activities and meet its obligations. In order to do so it has a business plan and cash-flow forecasts that are regularly revised to incorporate all current information. These management information tools are used to identify; the need for additional external borrowing, the Association's ability to service and repay its external debt, temporary cash surpluses that can be deposited in interest-bearing accounts and the on-going solvency of the business.

3.4.3.3 In the normal course of business the ideal position for SHA is to have just enough liquid cash available at all times to meet its own payment liabilities but not to hold any significant cash surplus for any longer than is necessary or unavoidable. For any organisation that has a significant borrowing portfolio and regular forecastable cash flows holding large cash surpluses is highly inefficient. Liquid cash in excess of necessary working capital balances that is derived from long term private finance facilities can be thought of as over-borrowed. For any given time period the cost of borrowing from a first class bank or building society will be higher than the earnings from lending to a bank or building society of equivalent credit quality. This differential is termed the "cost of carry" and is exacerbated if cash surpluses that earn short term variable interest are derived from capital borrowing at much higher long term fixed interest rates. Cost of carry should be minimised as far as is reasonable without introducing the risk of temporary insolvency that would require short term borrowing in order to meet cash liabilities.

3.4.3.4 SHA's cash surpluses are not genuine long term investment surpluses but are temporary excess working capital that will be expended on the acquisition, development or improvement of housing assets. The timing of that expenditure is uncertain so the cash cannot be locked away in long term investments. Neither should it be held as investments that have market reactive pricing in order to be sure of avoiding a capital loss on realisation. For this reason, we recommend that temporary cash surpluses should be held in the form of interest bearing deposits that provide a pre-determined return at a specific future date. We suggest that these interest-bearing deposits should normally be for terms of no more than 3 months to minimise the risk that an unforeseen requirement for cash cannot be met without unacceptable penalty cost for breaking longer term deposits. However, there may be exceptional circumstances in which it is appropriate to place deposits for longer periods but that should only be in response to a conscious strategic decision endorsed at Member level.

3.4.3.5 When placing its surplus funds on deposit SHA, as a risk averse RSL, will wish to identify counterparties of the highest credit quality and lowest risk. The selection criteria set out are stringent and limit the number of banks and building societies with which deposits can be placed to less than 10. The institutions that satisfy the selection criteria are, in our view, those that are least likely to be unable to meet their obligations to SHA. The selection criteria are quite straightforward. Deposit counterparties must fall under the supervisory regime of the Financial Conduct Authority Ltd. (FCA) which by definition means that they are incorporated in the U.K., hold a licence to carry on banking business in the U.K. issued by the Bank of England and make regular statutory returns to the FCA.

3.4.3.6 However, more than 400 financial institutions hold such a licence and in order to identify those of the highest credit quality/lowest risk we apply a second filter. Fitch Rating is a market leading independent credit rating agency that provides a Short Term Credit Rating in respect of financial institutions. The Policy requires counterparties to hold a Short Term Credit Rating of Rating of F1 or F2 which means that any lender to the bank or building society, here SHA, has the greatest level of assurance that the borrower (bank) has the greatest capacity to meet its near term cash obligations.

3.4.3.7 The financial institutions that satisfy the selection criteria described are, at present;

Barclays Bank

Clydesdale Bank

HSBC/Midland Banking Group

Lloyds Banking Group (Lloyds Bank and Halifax Bank of Scotland)

Nationwide Building Society

Royal Bank of Scotland Group (Royal Bank of Scotland and NatWest Bank)

Santander U.K. Corporate Bank (previously Abbey and incorporating Alliance & Leicester)

The credit rating of these institutions is easily monitored since any change would be widely reported in the media and is clearly shown on each institution's own web site. It should be recognised that subsidiaries of these organisations do not necessarily share the credit rating or market standing of the parent and are unlikely to satisfy the recommended selection criteria.

3.4.4 Borrowing

3.4.4.1 In order to carry on its business SHA needs to borrow significant amounts of private finance to supplement its allocations of public housing subsidy. It is essential that SHA has sufficient identified funding, either internally generated or externally borrowed, in place to allow it to meet its contractual commitments. The Policy precludes the Association from entering into contractual commitments for capital works unless it can demonstrate that it has adequate committed funding available to meet its obligations.

3.4.4.2 However, it is equally important for SHA to seek and demonstrate best value in its borrowings and to avoid unacceptable risks in its obligations to its lenders. The Policy determines the types of borrowing arrangements that it may enter into, the methodology to be employed to ensure that it achieves the best terms available in the market and certain unusual categories of risk that it will not accept. The effect of these provisions taken together is that SHA will arrange its borrowing facilities in sterling and through structures and instruments that are widely used and available and for which there are liquid markets that allow it to place potential lenders in competition. Extending the principle of competition in order to achieve best value, the Policy also states that SHA will exploit any opportunities that present themselves to develop and maintain good working relationships with a range of lenders, thus seeking to avoid overdependence on any counterparty in the longer term.

3.4.4.3 All borrowing arrangements carry costs for SHA and arranging private finance facilities in excess of demonstrable need will incur avoidable costs that may be material. The Policy statement requires SHA to determine its borrowing needs by reference to its financial plan and as far as is possible to match its borrowing arrangements to its projected requirements both in amount and timing. This approach reflects the regulatory requirement for SHA to seek best value in its financial operations. However, it is normally necessary to arrange private finance facilities well in advance of expenditure that will itself be uncertain and a measure of contingency is required that may result in a temporary mismatch. SHA's Policy is to seek to build in as much flexibility as possible to its funding arrangements to allow it to reduce or otherwise manage its borrowing facilities to adequately meet, but not exceed, its requirements.

3.4.5 Security Management

3.4.5.1 When SHA enters into private finance borrowing arrangements it will do so by agreeing and signing a Loan Agreement with its lender. The Loan Agreement is a legally binding contract that incorporates all of the entitlements and obligations of both parties. By signing the Loan Agreement SHA undertakes to meet certain financial covenants on a continuous basis. The financial covenants are principally concerned with the value of physical assets charged or pledged to the lender as security for its loan (Asset Cover) and with measures of financial viability that provide the lender with ongoing assurance that SHA will be able to service and repay its debt obligations as they fall due (Interest Cover) and demonstrate the extent to which the business is dependent on external borrowing (Gearing - expressed as a percentage of Net Worth or Value of Housing Property Assets). A breach, or potential breach, of any covenant must be reported to the lender, in which circumstances the lender will have a range of remedies open to it including, in extremis, calling an Event of Default in relation to the loan. The consequences for SHA of such a chain of events would be extremely serious and could certainly threaten its continuing existence as an independent entity.

3.4.5.2 SHA will almost invariably borrow on a secured basis, that is, it will grant a legal charge over some or all of its assets of sufficient value to provide the lender with security for its loan. The security requirements are set out in the Loan Agreement and the value of the assets to be charged must be established by an independent professional valuer.

3.4.5.3 This legal charge can be a first fixed legal charge over specific and identified assets limiting the lender's security accordingly or can be a floating charge that gives the lender a claim against all of the Association's assets. Such a floating charge is not in SHA's best interests and if the Association was forced to grant such a charge to one lender it would need to grant similar charges to all lenders, or obtain waivers, under the legal dictum of "pari passu" (or "all equally") that is incorporated into all Loan Agreements. If a floating charge is unavoidable or considered to be temporarily beneficial it must be replaced with a first fixed charge as soon as possible.

3.4.5.4 The Policy requires SHA to maintain a register of its Assets and Liabilities in accordance with established best practice. This register should include a summary of its obligations under its financial covenants against which to monitor its performance on an on-going basis. The Head of Finance is required to report regularly to the Management Committee on all matters of covenant compliance and bring to the Management Committee's notice any potential for a possible breach of covenant in the future with recommendations for action to obviate that risk. The Management Committee must address any covenant issues and if necessary adopt any appropriate changes to the Association's governing documents.

3.4.5.5 It is noteworthy that most, though not all, Loan Agreements that require a first fixed legal charge also include what is known as a "featherweight floating charge". This type of floating charge has no effect other than in a winding up of the borrower in which case it gives the lender equal ranking with all other creditors.

3.4.5.6 Over time the value of charged security will increase and the borrowing that it secures will diminish resulting in over-securitisation. Security charged to one lender is not available to charge to another as security for further loan facilities, hence over-securitisation of existing facilities potentially reduces SHA's future debt capacity and consequently development capacity. It may on occasions be possible to arrange additional borrowing against the excess security already charged to a lender but that would tie SHA to that lender and remove competition from the process of raising private finance. To make the best use of the security value represented by its chargeable assets SHA needs to be able to have excess security released from charge and will seek to ensure that its Loan Agreements make provision for such release, when requested. Members should note that loan documentation may include a restriction on the release of excess security to the effect that the security that remains in charge after any release must be adequate to secure both the capital debt and all Fixed Rate Break Costs that would be incurred in the premature repayment of the facility.

3.4.6 Debt Management

3.4.6.1 All debt introduces risk to the business of SHA and the Association recognises this through its Treasury Management Policy. Floating rate debt introduces interest rate risk that can be managed by agreeing a fixed interest rate, but doing so introduces inflation risk. Interest rate and inflation risks are reciprocal and as one is mitigated the other is exacerbated. SHA's policy is to construct a debt portfolio in which the different exposures are broadly balanced but to recognise the external circumstances that bear on the portfolio and adjust the balance accordingly. Decisions on the mix and duration of floating and fixed rate obligations will be reviewed and modified at least annually in conjunction with consideration of the treasury management strategy that supports the business plan and the requirements of lenders. The strategy will include a target portfolio structure for the Association to work towards recognising that its ability to do so will be in part determined by past decisions and the prevailing position.

3.4.6.2 Subject to the adoption of appropriate enabling constitutional powers SHA is able to make direct use of financial derivative instruments to mitigate and manage residual treasury risks inherent in its private finance facilities and loans. However, before doing so the Management Committee must be satisfied that the Members and staff taking the decisions to use derivatives have received adequate training and information to fully understand and appreciate the implications for SHA of such transactions. Financial derivatives are not inherently riskier than any other type of financial transaction but they are more technical and less transparent and are more easily misused if those risks are not properly appreciated.

3.4.6.3 The use of financial derivatives or other categories of "non-basic financial instrument" as determined under the provisions of Financial Reporting Standard 102 can give rise to specific and potentially onerous accounting and reporting obligations. The Policy requires that the Management Committee and Executive should receive appropriate advice on the FRS 102 implications before entering into a transaction using a non-basic instrument. We suggest that the Association's external auditor, as the ultimate arbiter of correct accounting by the Association, is the best person from whom to take such advice. However, the Management Committee may take such advice from any person whom they reasonable believe to be qualified to provide it.

APPENDIX A

SOUTHSIDE HOUSING ASSOCIATION

DRAFT TREASURY MANAGEMENT POLICY STATEMENT

OCTOBER 2017

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1. TREASURY MANAGEMENT

1.1 SHA acknowledges the requirements of the revised Regulatory Framework issued by the Scottish Housing Regulator on 31 August 2015 and will comply with Regulatory Standard 3, "The RSL manages its resources to ensure its financial well-being and economic effectiveness".

1.2 SHA acknowledges the Regulatory Expectation to comply with the CIPFA "Treasury Management in the Public Services Code of Practice and Cross Sectorial Guidance Notes, 2011" and will do so in so far as is appropriate to its operations and activities.

1.3 SHA's purpose is the acquisition, development, provision and management of affordable housing. The prime objectives of its Treasury Management Strategy will be the provision of the financial resources necessary to achieve its purposes and the management of the associated risks, organisational and financial, which might threaten its ability to do so.

1.4 In all Treasury Management matters SHA is risk-averse. Its Treasury Management policy, strategies and procedures shall be structured so as to minimise exposure to risks that could jeopardise the security or value of its assets or otherwise impede the delivery of its prime objectives.

1.5 The Management Committee is responsible for formulating, reviewing and monitoring Financial Standing Orders, Financial Regulations, Treasury Management Policies and the Scheme of Delegation for Treasury Management.

1.6 Responsibility for formulating Treasury Management Strategy rests with the Management Committee. Responsibility for the day to day implementation of Treasury Management Strategy rests with the Head of Finance in consultation with the Director. The Head of Finance and her/his staff shall be required to act in accordance with the relevant Regulatory Standards and Guidance Notes as issued from time to time by the Scottish Housing Regulator or any successor regulatory authority. In the conduct of treasury management activities, the Head of Finance and her/his staff shall seek to follow the operational guidance set out in the CIPFA Code of Practice (2011) in so far as that does not conflict with Regulatory Standards and Guidance Notes issued from time to time by the Scottish Housing Regulator or any successor regulatory authority.

1.7 In order that the Management Committee is able to undertake its responsibility for reviewing and monitoring Standing Orders, Financial Regulations, Treasury Management Policies and the Scheme of Delegation of Authorities for Treasury Management the Committee will receive reports at least annually and within six months of the end of each financial year addressing -

a. the implementation of the Treasury Management Strategy, and

b. a review of the Treasury Management Strategy and Treasury Management performance, and

c. a review of

- skills, knowledge and experience at both Management Committee and officer levels,

- treasury management systems and controls
- access to independent advice
- the identification and management of the treasury risks to which the Association is exposed, and

d. setting out the results of and conclusions to be drawn from annual multi-variance stress testing of the Business Plan that demonstrates the combination of adverse circumstances which could lead to failure of the business and detail the planned controls and mitigations intended to provide resilience against such failure.

1.8 In order that the Management Committee is able to undertake its responsibility for overseeing Treasury Management it will receive a report at least twice in each financial year on the implementation of the treasury management strategy, the risks to the Association related to treasury management and the effectiveness of the policy.

1.10 Central to SHA's management of financial risks is its Business Plan. Through risk and sensitivity analysis using the Plan (that recognises the nature of the Association's assets) it will form its view of the nature of liabilities that it is prepared to assume and in what proportions.

2. CASH MANAGEMENT

2.1 SHA's policy is to borrow sufficient monies to meet its known and reasonable contingent requirements for liquidity. The long-term level of cash balances required will be approved by the Management Committee as one of the long term financial planning assumptions. The short-term requirements will be approved by the Management Committee as part of the annual Treasury Management Strategy. SHA will not borrow material amounts of money substantially in advance of these requirements, unless there is a clearly demonstrable benefit from doing so.

2.2 SHA will hold its surplus funds as cash or cash equivalents and will not invest in gilts, equities or other non-money assets that have market reactive pricing and may suffer diminution of value if liquidated in response to cash requirements rather than market conditions.

2.3 SHA's policy is to lend its surplus funds only to (or deposit them only with) UK incorporated institutions falling under the supervisory regime of the Financial Conduct Authority Ltd. and having a Fitch Ratings Short Term Credit Rating of F1 or F2. See Appendix A to this Policy Statement for a list of institutions that currently meet these selection criteria.

2.4 SHA will maintain a cash-flow forecast which identifies its future need for liquidity required to meet its obligations and the amount and timing of temporary cash surpluses. The Association will not normally lend or deposit its surplus funds externally for periods of longer than three months. Entering into contracts to lend or deposit funds for periods of longer than three months must be specifically approved by the Management Committee.

2.5 In the circumstances described in 2.1 to 2.4 above, SHA's policy is to manage its cash 'in-house' and not to employ external cash managers.

2.6 SHA will ensure that it can re-borrow or, through its financial plan, that it is generating sufficient cash to make the repayment of its debt. The Association may set aside funds in its accounts for the repayment of loans when that is necessary or prudent.

3. BORROWING

3.1 SHA will arrange sufficient committed private finance facilities to deliver its committed capital programme. The Association will not enter into contracts for works unless it is satisfied that it will have sufficient internally generated funds or committed borrowing facilities in place to deliver the projects concerned.

3.2 SHA may borrow by overdraft, loan agreement, bonds or loan stock, recoverables sold or discounted, lease, hire purchase or conditional sale agreement and by no other instrument.

3.3 SHA will only take on new borrowing liabilities if it is satisfied that it understands and can manage the likely impact on current and future business performance and regulatory compliance.

3.4 SHA will achieve and demonstrate economic effectiveness in its private finance facilities, as required by Regulatory Standard 3, by arranging its funding either through competitive tenders or by benchmarking directly negotiated funding offers against the market.

3.5 SHA will not borrow funds for which its repayments of principal and/or payments of interest are denominated in currencies other than that in which its income is received, thereby avoiding foreign exchange risk.

3.6 SHA will not borrow funds that involve unusual risks related to taxation, including tax risks associated with borrowing from organisations that are not UK-resident.

3.7 SHA recognises the need to be able to prematurely repay its borrowings in appropriate circumstances and will seek to ensure that its borrowing arrangements include provisions that allow it to do so wherever possible.

3.8 When arranging private finance facilities SHA will be mindful of the potential risk of reliance on a single type of institution or funding product and will give full and proper consideration to the pros and cons of diversifying its borrowing facilities across a range of providers and products. The Association will seek to develop and maintain good relationships with a number of private sector lenders as and when the opportunity to do so arises and when it is considered to be beneficial.

3.9 SHA will refer to its Financial Plan in determining the periods for which it needs credit. It recognises that this can be different from, and in particular shorter than, the periods that it assumes in its appraisals. Unless specifically authorised by the Management Committee SHA will not borrow for periods longer than it assumes in its financial appraisal of investment decisions and other projects.

4. SECURITY/ PROMISE MANAGEMENT

4.1 SHA will maintain a register of its assets and liabilities including a summary of the security requirements and other financial covenants imposed by its borrowing agreements. The Head of Finance will report at least each half year to the Management Committee on actual performance against financial covenants. At least annually and whenever the budget for the forthcoming year is considered by the Management Committee reports will include a review of whether and under what circumstances breaches of financial covenants could potentially occur and make recommendations on possible action to prevent such breaches.

4.2 SHA recognises that it needs to provide security to its funder(s). The Association will grant floating legal charges over its assets only if it is unavoidable or there is a measurable and material benefit from doing so and will replace such floating charge with a first fixed charge as soon as possible and beneficial. It will at all times seek to retain as high a value of uncharged assets as is possible and is consistent with the Business Plan and projected loan drawings.

4.3 SHA will seek to ensure that its private finance facilities provide for the release of excess security where debt has become over secured. In those circumstances the Association may seek to have excess security released by the lender if that is appropriate and beneficial or alternatively may seek to negotiate additional borrowing facilities against the excess charged security providing that the terms offered are market competitive.

5. DEBT MANAGEMENT

5.1 SHA recognises that there is an interest rate risk inherent in floating-rate debt and an inflation risk inherent in fixed-rate debt. It will manage these risks by maintaining a balance between them, to be determined annually and included in the Treasury Management Strategy.

5.2 In determining the periods for which interest is fixed SHA will have regard to inflation risk, to covenant and security management issues and to the need to diversify fixed interest periods.

5.3 SHA may insure against residual interest rate risks by the direct use of the derivatives markets subject to the adoption of appropriate constitutional powers. Before endorsing a Treasury Management Strategy that suggests the use of financial derivative instruments the Management Committee must be satisfied that adequate training has been provided to ensure that the use of financial derivative instruments is fully understood and that appropriate internal controls have been established to ensure that the use of such instruments cannot inadvertently introduce unidentified or unacceptable financial risks.

5.4 The Management Committee will determine the required target portfolio structure and a strategy intended to achieve that structure annually.

ARK Consultancy Limited
31 March 2017

APPENDIX A

Deposit Counterparties that currently meet the adopted selection criteria

	Fitch Short Term Credit Rating
Barclays Bank	F1
Clydesdale Bank	F1
Halifax Bank of Scotland (part of Lloyds Banking Group)	F1
HSBC/Midland Banking Group	F1+
Lloyds Bank (part of Lloyds Banking Group)	F1
Nationwide Building Society	F1
NatWest Bank (part of Royal Bank of Scotland)	F2
Royal Bank of Scotland	F2
Santander Bank U.K.	F1

NB. The Royal Bank of Scotland Group has been downgraded from F1 to F2 in recognition of the 71% public shareholding in the Bank and the downgrade of the UK Sovereign debt rating from AAA to AA+ and is not a reflection of the weakening of the basic financial metrics of the Bank.