

## Treasury Management Policy Statement

The policies and objectives of the treasury management activities of Hexagon Housing Association (Hexagon) are as follows: -

1. Hexagon defines its treasury management activities as:

“The management of the organisation’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”.

2. Hexagon 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 Hexagon.
3. Hexagon 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.

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### Treasury Management Practices and Schedules

Hexagon operates the following Treasury Management Practices, and the systems and routines employed and the records maintained are set out in the schedules to these practices.

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## **Treasury Management Practices**

### **1. Treasury risk management**

#### **General statement**

1. The Board has considered its arrangements for the identification, management and control of treasury management risk, and will review these at least annually to ensure the adequacy/suitability thereof.
2. The Finance & IT Director, as the responsible officer, will be responsible for implementing and monitoring the arrangements established by the Board and will prepare a report to assist the Board in their annual review.
3. The Finance & IT Director will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 (Reporting requirements and management information arrangements).
4. The treasury management risks currently identified by the Board and the practices the organisation has adopted towards them are set out in subsections TMP1.1 to TMP1.8.

#### **1.1 Liquidity risk management**

- 1.1.1 Hexagon will ensure it has available and can access adequate, but not excessive cash resources, borrowing arrangements, overdraft and/or standby facilities to enable it at all times to have the level of funds available which are necessary for the achievement of its business/service objectives.
- 1.1.2 The detailed parameters within which the organisation will seek to operate are set out in Schedule S1.1.

#### **1.2 Interest rate and inflation risk management**

- 1.2.1 Hexagon will manage its exposure to fluctuations in interest rates with a view to containing its net interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements, and so as to ensure that it is able to comply with the financial covenants applying to its borrowings.
- 1.2.2 The organisation will ensure that it is aware of the potential impact of inflation on its ability to operate within its budgetary arrangements and the financial covenants on its loans, and that this is taken fully into account in establishing its interest rate strategy.
- 1.2.3 It will achieve these objectives by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates, or inflation.
- 1.2.4 The use of such instruments will be exercised in accordance with the adopted interest rate strategy as set out in Schedule S1.2 and as amended annually as required under

TMP6 (Reporting requirements and management information arrangements). Such instruments will only be used to hedge an existing or anticipated underlying liability.

1.2.5 The above are subject at all times to the consideration and, if required, approval of any policy or budgetary implications.

1.2.6 For the avoidance of doubt the Board may authorise transactions that result in a breach of the policies or limits set out in this document provided that it has considered and approved a report setting out the business case for such transactions.

### **1.3 Exchange rate risk management.**

1.3.1 Hexagon will not expose itself to any exchange rate risk.

### **1.4 Credit and counterparty risk management**

1.4.1 This organisation regards a prime objective of its treasury management activities to be the security of the principal sums it invests, and considers this to rank above seeking to secure the highest possible revenue return on its investments. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited.

1.4.2 The investment parameters adopted by the organisation, and criteria for approved bodies for the deposit of funds and placing of investments is set out in Schedule S1.3.

1.4.3 The organisation will limit its investment activities to the instruments, methods and techniques referred to in TMP4 (Approved instruments, methods and techniques).

1.4.4 The organisation also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements. This is set out in Schedule S1.4.

### **1.5 Refinancing risk management**

1.5.1 Hexagon will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

1.5.2 It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure these objectives, and will avoid over-reliance on any one source of funding if this might jeopardise achievement of the above.

1.5.3 The organisation will continually monitor its ability to comply with any and all financial covenants applying to its borrowings, so as to ensure that it is not subject to any unplanned refinancing risk.

1.5.4 The organisation's current position on refinancing risk is set out in Schedule S1.5.

### 1.6 Legal and regulatory risk management

- 1.6.1 This organisation will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities.
- 1.6.2 In framing its credit and counterparty policy under TMP1.4 (Credit and counterparty risk management), it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.
- 1.6.3 This organisation recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.
- 1.6.4 Schedule S1.6 identifies the key legislative and regulatory framework within which the organisation currently operates.

### 1.7 Fraud, error and corruption, and contingency management

- 1.7.1 Hexagon will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

### 1.8 Market risk management

- 1.8.1 Hexagon will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.
- 1.8.2 The organisation's current exposure to market risk, and its strategy for dealing with this are set out in Schedule S1.8.

## 2. Best value and performance measurement

- 2.1 Hexagon is committed to the pursuit of best value in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its Treasury Management Policy Statement.
- 2.2 Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements.
- 2.3 The procedures used to ensure best value and the performance measures used are set out in Schedule S2 to this document.

## **Treasury Management Practices**

### **3. Decision making and analysis**

- 3.1 Hexagon will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in Schedule S3.

### **4. Approved instruments, methods and techniques**

- 4.1 Hexagon will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in Schedule S4 to this document, and within the limits and parameters defined in TMP1 (Risk management).

### **5. Organisation, clarity and segregation of responsibilities, and dealing arrangements**

- 5.1 Hexagon considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, and for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.
- 5.2 The principles on which this will be based are: a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling them (particularly with regard to the execution and transmission of funds); the recording and administering of treasury management decisions; and the audit and review of the treasury management function.
- 5.3 If and when this organisation intends, as a result of lack of resources or other circumstances, to depart from these principles, the responsible officer will ensure that the reasons are properly reported in accordance with TMP6 (Reporting requirements and management information arrangements), and the implications properly considered and evaluated.
- 5.4 The Finance & IT Director will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangement for absence cover. The present arrangements are detailed in Schedule S5 to this document.
- 5.5 The delegation to the responsible officer in respect of treasury management is set out in Hexagon's Standing Orders and Delegated Authorities. The responsible officer will fulfil all such responsibilities in accordance with the organisation's policy statement and TMPs and, if a CIPFA member, the Standard of Professional Practice on Treasury Management.

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### **6. Reporting requirements and management information arrangements**

- 6.1 Hexagon will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and the transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.
- 6.2 As a minimum, the Board will receive:
- an annual report on the strategy and plan to be pursued in the coming year
  - an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's Treasury Management Policy Statement and TMPs.
  - Exception reports on a timely basis of any breach or potential breach of the organisation's financial covenants with lenders, that is likely to have a material adverse effect upon the organisation's finances and continued operation
- 6.3 The present arrangements and the form of these reports are detailed in Schedule S6 to this document.

### **7. Budgeting, accounting and audit arrangements**

- 7.1 The Finance & IT Director will prepare, and the Board will approve and, if necessary, from time to time amend, an annual budget, which will include all of the costs involved in running the treasury management function, together with associated income. The matter to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 (Risk management), TMP2 (Best value and performance measurement), and TMP4 (Approved instruments, methods and techniques). The responsible officer will exercise effective controls over the treasury management budget, and will report upon and recommend any changes required in accordance with TMP6 (Reporting requirements and management information arrangements).
- 7.2 Hexagon will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being. These are set out in Schedule S7 to this document.
- 7.3 Hexagon will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal

## **Treasury Management Practices**

policies and approved practices. The information made available under present arrangements is detailed in Schedule S7 to this document.

### **8. Cash and cash flow management**

- 8.1 Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this organisation will be under the control of the responsible officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1.1 (Liquidity risk management). The present arrangements for preparing cash flow projections, and their form, are set out in Schedule S8 to this document.

### **9. Money laundering**

- 9.1 Hexagon is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in Schedule S9.

### **10. Staff training and qualifications**

- 10.1 Hexagon recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements. The present arrangements are detailed in Schedule S10.

### **11. Use of external service providers**

- 11.1 Hexagon recognises the potential value of employing external providers of treasury management services, in order to acquire access to specialist skills and resources.
- 11.2 When it employs such service providers, it will ensure it does so for reasons which will have been submitted to full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.
- 11.3 It will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over-reliance on one company. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Finance & IT Director, and details of the current arrangements are set out in Schedule S11 to this document.

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### **12. Corporate governance**

- 12.1 Hexagon is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.
- 12.2 The organisation has adopted and has implemented the key recommendations of the Code. This, together with the other arrangements detailed in Schedule S12 to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Finance & IT Director will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

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### S1.1 Liquidity risk management parameters

#### Short term investments and cash balances

1. Cash balances (including short-term investments of less than 15 days to maturity) will be maintained at between £0.5m and £1.0m.
2. Cash balances plus undrawn loan facilities that are secured and available to draw will be maintained at no less than £2m.
3. Inter-group loans should be on terms approved by the Board and fully documented in writing.
4. Where cash in excess of the minimum amounts is received Hexagon will in the first instance use such funds to repay revolving loan facilities.
5. In circumstances where it is not possible to repay revolving loan facilities Hexagon will place such funds in call accounts or term deposits of no more than 3 months (except in the circumstances described in S1.3 below where cash may be invested for up to 12 months).
6. Hexagon currently does not have a overdraft arrangement with its clearing bank.

#### Loan facilities

7. Hexagon produces three year forward cash flow forecasts on a monthly basis to identify future capital requirements. Hexagon will ensure that it has loan facilities in place to meet its known committed capital programme for 18 months ahead, and will not enter into contracts for development schemes unless it is satisfied that there will be sufficient borrowing facilities in place for the projects concerned.

#### Security

8. The Association recognises that the efficient use of security is an important part of its treasury management function. It has adopted procedures to ensure that security is used efficiently, and can be pledged to lenders when it is required, so as to enable facilities to be drawn as required to meet the association's cash flow requirements, or to be pledged to satisfy any unanticipated calls for collateral.
9. Property security will be charged ahead of need, to ensure that there is sufficient security in place to fund projected loan drawdowns at least 6 months ahead. This will be monitored against a cash flow forecast by month for the three years ahead, compared to undrawn loan facilities with security already charged.
10. All new security will be charged to Prudential, acting as security trustee, wherever possible. This will enable more efficient allocation of property security between loans and ISDA agreements in the event that security can be released as valuations and loan repayments warrant.

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11. When a valuation is required, either for initial charging or to update the valuation in accordance with loan agreements, Hexagon will request a valuation of each property on three bases – open market vacant possession (OMV), tenanted market value (TMV) and existing use value (EUV). The Association will avoid wherever possible entering into agreements with third parties which diminish the investment value of its properties. As an example, the wording on S106 planning agreements should ensure that properties do not have to be held as social housing in perpetuity and mortgagee in possession clauses do not place onerous obligations on lenders.
12. Hexagon will endeavour to maintain flexible provisions within loan agreements for the use of security. An assessment of which properties can be released and re-charged will be made following every updated valuation.
13. The Association will endeavour to avoid the use of cash as security but accepts that this may be necessary if
  - a) Mark to market values on ISDA lines exceed the total of the unsecured threshold plus any property security already in place
  - b) It is necessary to draw existing loan facilities before the end of the availability period, and charging property security has been delayed
14. Initial charging of security is to be treated as a project, with the Finance & IT Director as the sponsor and the Senior Accountant as the Project Manager. The Project Brief and Project Plan will indicate how and when other Hexagon departments, solicitors and valuers will be involved. The properties to be charged, and answers to the standard legal questions thereon, will be identified before solicitors and valuers are appointed.
15. The Association will not enter into any new floating charges unless:
  - a) they offer a material benefit which outweighs the disadvantages
  - b) they are required as a short term measure until fixed charges over property assets are put in place.

## S1.2 Interest rate management strategy

### Interest rate management strategy

1. Hexagon 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 and by the use of derivatives markets to insure against interest rate risks. In addition a mix of maturity dates within the fixed rate debt is considered prudent.
2. ***The current interest rate strategy is that Hexagon will put in place fixes which allow the business plan to withstand both a 1% increase in real interest rates and a 1% drop in inflation without the key ratio of EBITDA MRI falling below 110%. Hexagon will not undertake further fixes if these are not necessary for it to meet this test.***

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3. The rules of Hexagon permit the use of interest rate hedging instruments with third parties on a standalone basis. Such transactions will be considered in conjunction with, or as an alternative to, the use of any embedded hedging options that are available under the terms of existing loan agreements.
4. Whether standalone derivatives will be used will be decided after consideration of:
  - Price
  - Security requirements
  - Relative Complexity
  - Implications for the future refinancing of the loans
  - Counter party risk criteria
  - Potential impact on reported accounting results
5. Index-linking may be used as a hedge against low inflation. Hexagon will consider the use of Index-linking funding as part of its overall strategy, but will not enter into any new stand-alone index-linked derivatives as these cannot be including in hedge accounting under International Financial Reporting Standards.

### Annual treasury strategy

6. The annual report on the strategy and plan to be pursued in the coming year will include a consideration of any new interest management transactions to be taken. This strategy will be presented to the Board for approval.

## S1.3 Counterparty policy (investments) and approved deposit takers

1. Hexagon will invest cash surpluses with
  - Banks which are authorized by the Bank of England (or the appropriate supervisory authority in the European Economic Area in which they are incorporated or formed).R
  - UK Building Societies
  - AAA rated Money Market Funds (MMFs)

In the case of banks and building society investments will only be placed with institutions included on the latest Counterparty Credit List provided by Capita. The Counterparty Credit List includes the ratings of Fitch, Moody's and Standard & Poors and is updated for all notices issued by these agencies as and when published. The credit rating list also incorporates information on credit default swap prices which provide information on current market perceptions of the listed institutions.

2. The term of Money market deposits shall be limited to a maximum of three months subject to the exception described in paragraph 3 below.
3. Where funds are held as collateral for other exposures and therefore are not available to pay down debt, investment for up to 12 months will be permitted

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4. No more than £5 million or 33% of total available funds (at the point of investment) will be invested in any one institution, except for investments for up to 7 days with the Association's clearing bank where there will be no limit.
5. No more than £15 million may be invested in any AAA rated Money Market Fund. The higher limit for MMFs reflects the higher credit rating and the instant access to funds provided by this structure.
6. If any future offers of funding are conditional on the deposit of drawn funds or interest payments in advance with an organisation not meeting the criteria in the paragraph above, independent advice will be sought on the credit worthiness of the counter party. Any greater counter party credit risk will be weighed against any benefits in the offer as part of any decision to accept such an offer.
7. No approved counterparty list will be maintained, as all proposed counterparties will be checked against the most recent weekly counterparty credit list provided by Capita before investment or rollover of investment.
8. With the exception of overnight investments and investments of up to 7 days with the Association's Clearing Bank, all investments and roll-over of investments will be approved by two Directors, one of which will be either the Chief Executive or the Director of Finance & IT. The decision to invest will be supported by relevant cashflow forecasts and advice from Capita on counterparty ratings.
9. Overnight investments and investments of up to 7 days with the Association's clearing bank will be made by one of the Finance and IT Director, the Finance Manager or the Senior Accountant in accordance with the procedures set out in the Finance Manual.

### S1.4 Counterparty policy (lenders) and approved list of lenders

#### Borrowing

1. This organisation may borrow from:

- Banks
- Building Societies
- Financial Institutions (pension Funds, insurance Companies etc.)
- The Bond Markets (either via an intermediary or in the organisation's own name)
- Not for profit specialist intermediaries such as the Housing Finance Corporation

Loan facilities will be arranged only with organisations that are judged to have sufficient financial strength to ensure that the funds committed under the facilities will be available as and when they are required by the organisation in accordance with the terms of the loan agreement.

2. The organisation's current lenders are:

Santander (previously Abbey National Treasury Services)  
Lloyds (previously Lloyds TSB and Bank of Scotland)  
Newcastle Building Society  
The Housing Finance Corporation (THFC)  
Affordable Housing Finance plc (a subsidiary of THFC)  
Housing Securities Ltd  
Orchardbrook Ltd

### Derivative products

3. Hexagon will transact derivatives only with institutions included on the list provided by Capita for investment durations of up to six months or more. The Board recognise that the credit ratings of financial institutions can and do change. Given the duration of the interest rate hedging transacted it is possible that the credit rating of one or more approved counterparties may fall below the minimum thresholds approved by the Board.

4. ISDA lines are currently in place with:

- Santander (previously Abbey National Treasury Services)
- Barclays
- Lloyds

5. Like most ISDA agreements, the above agreements give hedging counterparties the right to call for cash or property collateral to secure the negative mark to market exposures. Hexagon recognises that market rates can change very quickly and that failure to meet such a call would have serious consequences. The Director of Finance & IT is responsible for ensuring that the potential credit exposure to ISDA counterparties (Mark to Market (MTM) exposure) is calculated and reported to the Board on a quarterly basis.

6. Hexagon recognises that the exposure to mark to market collateral calls may be mitigated in the following ways;

- maximising the level of unsecured thresholds agreed with potential counterparties
- limiting the duration of stand-alone hedging instrument used
- increasing the number of hedging counterparties
- frequent monitoring of mark to market exposures
- charging property collateral as security against ISDA margin accounts

7. The Director of Finance & IT continuously assesses the risk of collateral calls by monitoring weekly exposure reports received from Barclays Bank. Potential collateral calls under these agreements form part of Hexagon's liquidity management arrangements.

Hexagon's total exposure to any one counterparty will be calculated as follows:

$$X * 4\% * Y$$

Where;

X is the nominal amount of each swap with that counterparty and  
Y is the remaining term of that swap.

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- Hexagon will, over time, seek to increase the number of ISDA lines by making arrangements with counterparties with support ratings as above and who are willing to accept property security as collateral.
- The maximum exposure to any one counterparty will be considered and approved by the Board as and when any new counterparty is approved. The current counterparty limits are £20m for each counterparty (see schedule 4.1).

### S1.5 Exposure to refinancing risk

- Hexagon will have loan facilities in place to meet its known capital programme and any loan repayments for 18 months ahead, and will not enter into contracts for development schemes unless it is satisfied that there will be sufficient borrowing facilities in place for the projects concerned. This will be monitored against a cash flow forecast by month for the three years ahead.
- Where the need for additional funding is identified the Finance & IT Director will tender firstly for a funding advisor, and through them, the funding requirement. The Finance & IT Director will be responsible for drafting loan terms with advice from the funding advisor. The Board will approve the terms of the loan and the execution of any related notices, letters or documentation.
- The Association will aim to have no more than 55% of its loan facilities provided by any one lender. Although Hexagon will aim to work with a small number of key lenders, there shall be no restrictions on the institutions from whom the Association may borrow money, aside from any statutory requirements.
- The Association will not seek to raise funds on the capital market in its own name, as this is unlikely to be cost effective. Access to capital markets will therefore be by consortium bond or stock issues, or private placement.
- Financial covenants applying to the Hexagon's existing bank loans are set out below. There are no financial covenants relating to non-bank loans (THFC, HSL, AHF and Orchardbrook) other than those comparing the net rental income from the security to the interest and capital payments due on the loans.

Lender	Minimum interest cover	Maximum gearing
Santander	100% averaged over three consecutive years	75%
Lloyds	110% averaged over three consecutive years	70%
Lloyds (ex Bank of Scotland)	110% averaged over three consecutive years	60%
Newcastle	110% each year	70%

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6. Compliance with the financial covenants is modelled in the Association's 30 year business plan. Interest cover for the forthcoming year is forecast as part of the annual budget, and the gearing ratio forecast as part of the three year forward cash flow. The Association will not enter into contracts for development schemes unless it is satisfied that there will be headroom of at least 5% on the gearing ratio. The Board monitors the actual interest cover and gearing ratio as part of the quarterly management accounts.
7. Currently, the most serious threat to covenant compliance is the volatility of results to be introduced by new accounting rules on swaps from 2015/16 onwards. This threat is being managed by not entering into any new swaps unless they can be accounted using hedge accounting, and by the use of frozen GAAP for covenants for the time being.

## S1.6 Legislative and regulatory framework

### Legal framework and regulations

1. Hexagon is registered as an Industrial & Provident Society at the FCA. Its registration number is 19128R.
2. The treasury management activities undertaken by the organisation will be only those permitted by its Rules. The relevant extracts of the rules of the Association are included as Appendix S1.6.
3. The organisation is also registered with the Homes and Communities Agency (HCA) as a registered social landlord, and as such it is required to comply with regulations issued from time to time by that body.
4. Hexagon has adopted the wider rule 19, and is therefore permitted to enter into interest rate caps, floors, collars, swaps, forward rate agreements and option on any of these outside of the loan agreement.
5. Derivative instruments will be used solely to hedge against existing or anticipated underlying liabilities.
6. Hexagon will only enter into derivative instruments that are intended to support the interest rate management strategy of the board, that hedge specific interest rate exposures within its borrowing arrangements, and which can be demonstrated to be effective hedges of those interest rate exposures.
7. Hexagon adopts the key recommendations of CIPFA's "Treasury Management in the Public Services: Code of Practice 2001), and will throughout its treasury management operations seek to work to any guidance on best practice issued by its regulatory and/or the professional accountancy bodies.

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### Proof of Hexagon's powers

8. Details of the legislative and regulatory framework within which Hexagon operates, and copies of its constitutive documents will be provided to potential and /or existing counterparties, where these may be reasonably requested for the purposes of entering into treasury management arrangements with Hexagon.

### Proof of powers [counterparties]

9. Prior to entering into any treasury management agreement with a counterparty, all reasonable steps will be taken to verify the powers of that counterparty to enter into such agreements, and such evidence as may be required to do this will be sought from the counterparty.

### State and political risks

10. A number of elements of Hexagon's finances are impacted directly and indirectly by the policies and decisions of central government. These include rental income (directly through rent guidance, and indirectly through housing benefit/universal credit), Social Housing Grant and the Decent Homes Standard.
11. Such risks will be taken into account, as far as this is possible, in determining treasury management policy and risk management strategy.

## S1.7 Current systems and procedures to protect against fraud, error and corruption

1. Hexagon has in place a wide range of procedures and practices to protect against fraud, error and corruption:

Standing Orders and Delegated Authorities (SODA)	Available on intranet
Audit & Risk Committee	Terms of reference included in the SODA
Risk Management Policy	Available on intranet
Finance Risk Map	Stored on Managers section of the Hexagon documents folder
Finance Procedures	Summary available on intranet
Code of Conduct	Available on intranet
Fraud Policy	Available on intranet
E-mail usage policy	Available on intranet
IT Security Policy	Available on intranet

2. Hexagon has arranged insurance for money and cheques. Hexagon is also insured for up to £2million against theft, fraud and dishonesty by employees or third parties. Both policies are arranged via Arthur J Gallagher brokers. Potential claims should be notified to the Finance & IT Director
3. Hexagon has a business resumption plan. Scenario testing is undertaken once a year, as are the IT back up arrangements.

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### S1.8 Market risk management

Hexagon has no exposure to market risk on its investments or borrowings.

## S2 Best value and performance measurement procedures

### Loan facilities

1. A record will be maintained of the interest rate secured by the organisation on the new loans that it takes from time to time in comparison with the general level of interest rates prevailing at the time that such loans are taken. These records will be summarised and reported to the Board as part of the annual treasury report.
2. The Finance & IT Director will periodically review the organisation's loan facilities with a view to assessing whether or not they continue to provide best value, or whether advantage might be taken from alternative sources or methods of finance. This will include the following performance measures:
  - Comparison of the margins and other borrowing costs applying to the organisation's existing loans compared to those on new facilities currently being provided to similar organisations
  - The level of interest rates on the organisation's loans as compared to current market rates, taking into account the cost of unwinding existing positions
  - The financial covenants applying to the organisation's existing facilities as compared to those applying to new loans being made in the market to similar organisations
  - The requirements for loan security applying to the organisation's loans as compared to those attaching to new facilities being offered to similar organisations
  - The costs of establishing new or revised loan facilities

A report on the findings of this review will be made to the Board.

### Interest rate management

3. The Finance & IT Director will seek to benchmark the weighted average interest rate payable on borrowings against the rates achieved by other members of the L9 benchmarking group.

### Investments

4. The current policy of Hexagon is to keep investment balances to a minimum by repaying loans drawn down from its revolving credit facilities. As a result the amounts available for investment are small and are invested for very short periods.
5. The potential benefit of carrying out detailed analysis of investment returns would be minimal and does not justify the cost of carrying out this analysis.
6. Unless and until this situation changes Hexagon will therefore not provide any analysis of investment returns to the Board and will not review alternative investment options.

**External Services**

7. Best value in treasury management services will be ensured by tendering for these services on a periodic basis. General treasury advice will be tendered at least once every seven years. The current advisors are Capita, on the basis of a tender undertaken in December 2010. In assessing the value added by the providers of external services, account will be taken of all relevant factors, including the cost, quality, reliability and scope of service to be provided.

**S3 Decision making processes****Key borrowing decisions**

1. The Finance and IT Director undertakes the borrowing activities of the Association. He/she cannot commit the Association to any new borrowing facility without obtaining the specific authority of the Board. The interaction of new loans on current loans will continue to be monitored closely.
2. The Finance and IT Director will prepare for the Board a report for each proposed new borrowing facility which will include the following details:-
  - \* Proposed lender
  - \* Interest rate structure - fixed, variable, variable with options to fix, index-linked, deferred interest, interest caps etc
  - \* Interest rate - base plus lenders margin
  - \* Arrangement fees
  - \* Security arrangements
  - \* Purpose
  - \* Comparison with alternatives
  - \* Compliance with borrowing strategy
  - \* Arrangements for drawdown
  - \* In multi-association vehicles - cross-collateralization and issues regarding other associations' liability and exposure.
  - \* Any other matters which might assist the Governing Board in considering the proposal.
3. The decision to draw down on existing facilities as required is delegated to the Finance & IT Director, with the Chief Executive acting in the absence of the Finance & IT Director.

**Key interest rate management decisions**

4. The decision to fix the rate of interest payable in respect of any loan facility or any part or parts thereof is delegated to the Finance & IT Director. The Board has authorised the Finance & IT Director to use existing ISDA lines to deal in swaps within the Association's rules, provided that advice is obtained from the Hexagon's treasury advisors and the transaction is reported at the next meeting. Any such decision will be in accordance with the approved Annual Treasury Strategy for the year or, in the event that the proposed transaction falls outside the policies or limits set in this document, following specific consideration and approval by the Board.

5. In all cases a stand alone interest rate swap deal must be documented showing:
- a) amount
  - b) period
  - c) counterparty
  - d) interest rate
  - e) deal structure
  - f) dealing date
  - g) start date
  - h) maturity date
  - i) payment dates
  - j) commission (if any)
  - k) transmission arrangements
  - l) a note of the basis on which the particular deal was entered into with reference to the relevant board approved treasury strategy;
  - m) the loan that the transaction is intended to hedge
  - n) calculations to demonstrate that the transaction will deliver an effective hedge
  - o) a unique deal number
  - p) name of broker where applicable
  - q) name and signature of dealer
  - r) the price/yield/coupon and issue details as appropriate
  - s) the time of dealing
  - t) at least one alternative, competitive quote.

Deal tickets should be signed as being authorised and should always be accompanied by Hexagon's and the counterparty's confirmation letters and the brokers note (if applicable).

### **Key investment decisions**

6. Procedures for investment decisions are set out in Section S1.3 above

**S4 Approved instruments, methods and techniques****Borrowings**

1. Hexagon currently has debt outstanding and borrows additional funds under loan agreements with the lenders listed in Schedule S1.4. The agreements set out in detail the terms and conditions under which funds may be borrowed from the lenders, and under which they are to be repaid, or otherwise may be required to be repaid by the lenders.
2. The loan agreements have been drawn up in accordance with the law of England, and are fully within the powers of the organisation. The agreements have been approved by the Board, having taken appropriate legal and other specialist advice. The agreements have received all necessary consents from the Housing Corporation (the regulator at the time), and comply with all appropriate regulatory requirements. At the time of entering into the agreements, it is considered that the terms and conditions of the agreements accorded with those generally available to Registered Social Landlords at the time.
3. A schedule of the agreements into which the organisation has entered and the terms and conditions applying to them is filed in the loans section of the finance folder on the P drive. Paper copies of the agreements are kept by the Finance & IT Director and by Devonshires solicitors.
4. In entering into any new loans, Hexagon will ensure that these are similarly implemented under clear and binding legal documentation that:
  - Accurately reflects the terms and conditions agreed with lenders
  - Complies with applicable legislative and regulatory requirements
  - Reflects or improves on current market practice
5. All new loan documentation will be approved by the Board with the benefit of appropriate advice from officers of the organisation, the organisation's solicitors or other legal advisers, and other such specialist advice as the Board may require.

**Interest Rate Management**

6. Hexagon will undertake interest rate management through the medium of its loan documents, and may utilise any style of interest that is provided for within those documents. These will include:
  - Floating rates of interest
  - Fixed rates of interest
  - Index linked rates of interest
  - Capped rates of interest
  - Collared rates of interest
7. Hexagon is also authorised under Rule 19 to utilise a wider range of derivative instruments, and may make use of these as it sees appropriate within the context of its agreed interest rate strategy.

## Schedules

8. Any such derivatives will be entered into only with organisations on the list provided by Capita with a suggested investment duration of 6 months or more.
9. Use of these styles of interest will at all times be in accordance with the interest rate strategy as agreed from time to time under TMP 1.2, and prior to their use full consideration will be given to the potential impact on the organisation.
10. Before entering into any derivative The Finance and IT Director will ensure that the transaction meets the hedge accounting tests. At present, this means that no new index linked transactions or transactions with a cancellable element will be undertaken.
11. The nominal values of swaps with any one counterparty will not exceed £30m. Hexagon will aim to ensure that the notional exposure (calculated as 4% of nominal x remaining maturity in years) will not exceed £20m with any one counterparty, and will seek to reduce the current levels of notional exposure where this exceeds £20m.
12. Settlement dates will be aligned with those of the matching loan as far as possible, generally either 16<sup>th</sup> or 31<sup>st</sup> of the month for all new swaps.

### Investments

13. Hexagon only invests in the following Instruments:
  - Bank and Building Society call or term deposits
  - AAA rated Money Market Funds
14. In respect of Banks and Building Societies investments will only be made with licensed satisfying the criteria set out in section S1.3

## S5 Responsibility for treasury management

### Segregation of duties

1. The Finance & IT Director is responsible for the provision of an adequate system of internal controls and for ensuring as far as possible that a division of duties exist such that dealing staff are separate from staff operating the cash book. Also, as far as is possible, segregation of duties will be maintained so that separate staff are involved in the deal checking and deal confirmation activities.
2. The Board approves the treasury management policy and the annual treasury strategy. The Finance & IT Director takes interest management decisions in accordance with the approved annual treasury strategy. Other responsibilities are as set out below.

### **Investing and depositing of surplus funds**

3 Responsibilities are as set out in Schedule 1.3.

### **Derivatives trading**

- 4 Where, as is normally the case, dealing is undertaken directly with a counterparty, evidence must be obtained and recorded that the transaction is being undertaken at best market rates. The Finance & IT Director is also responsible for checking the proposed transaction satisfies Hexagon's counterparty credit policy. In addition, advice from the Association's treasury advisors must be taken before execution by Finance & IT Director.
- 5 Deals are recorded on email, which the Finance & IT Director checks to the paper confirmation received from the counter-party. The Finance & IT Director signs the counter-party confirmation and passes this to the Finance Team Leader for returning to the counter-party by fax, with a copy to the Senior Accountant. At this stage the Finance Team Leader enters the transaction on the interest accrual spreadsheet, and notes the next settlement date.
- 6 The Finance & IT Director adds details of the new swap to the spreadsheet summary of all current loans and swaps, and prepares a summary of the transaction for reporting to the Board at its next meeting. This summary is reconciled to the general ledger once a quarter by the Finance Manager before being reported to the Board.

### **Loan drawdowns**

7. The Senior Accountant is responsible for recommending loan drawdown amounts having considered:
- Whether internally generated funds are available to met cash requirements for the forthcoming week
  - The likely timing of anticipated capital receipts (generally grant and first tranche sales)
  - The next available rollover date on any revolving facility to allow repayment of loans as an alternative to investing surplus funds
8. New rollover dates will be set at either 16th or 31st of the month, to align with swaps settlement dates.
9. Loan drawdowns must be approved as required by the relevant loan agreement. For the Santander facility, this requires the signature of one of the following:
- Finance & IT Director
  - Operations Director
  - Chief Executive
  - Any board member

### Loan rollover decisions

10. The Senior Accountant (or, in their absence, the Finance Manager) is responsible for decisions as to whether loans should be rolled over for 1 month or 3 months, depending on the interest rates offered any whether there are any plans to repay an element of revolving facilities within the period. Each decision is to be recorded on a dealing ticket which states the amount, period, LIBOR rate offered, MLA and the standard margin for that facility and calculates the anticipated settlement amount. The ticket is printed and filed.

### Settlement

11. The Senior Accountant (or, in their absence the Finance Manager) checks interest invoices received from counter-parties (which may be by email) against the filed dealing ticket, querying any discrepancies. The Senior Accountant signs the deal ticket and passes both the invoice and deal ticket to the Finance Team Leader to arrange for payment processing.

12. The Senior Accountant (or, in their absence the Finance Manager) checks swaps invoices received from counter-parties (which may be by email) against the filed counter party confirmation, querying any discrepancies. The Senior Accountant produces and signs a deal ticket and passes both the invoice and deal ticket to the Finance Team Leader to arrange for payment processing.

13. The Senior Accountant (or, in their absence the Finance Manager) checks repayment invoices received from counter-parties (which may be by email) against the electronic summary of the loan agreement, querying any discrepancies. The Senior Accountant authorises the invoice and it to the Finance Team Leader to arrange for payment processing.

14. The Finance Team Leader is responsible for making all interest and loan payments in time, after approval of each payment by the Finance Manager (amounts below £60,000), the Finance & IT Director (or, in their absence, the Chief Executive). The Finance Manager may not approve any payment where they have previously agreed the rollover or checked the deal ticket.

### Horniman

15. Hexagon has a small subsidiary, Horniman Housing Association. Horniman has an inter-company loan from Hexagon. The Assistant Accountant is responsible for ensuring that all interest and loan payments are made when due, after approval of each payment by the Finance Manager.

**S6 Treasury management reports to the Board****Matters to be included in the quarterly treasury reports**

- Three year cash flow forecast
- Summary of current loans and swaps
- Summary of latest security valuations and uncharged security
- Loan covenant compliance
- Any funds on deposit

**Matters to be included in the Annual Treasury Performance Review**

Summary of activities and outcomes in terms of:

- Liquidity and cash management, including security management and funds placed on deposit
- Funding and refinancing
- Interest rate management (including review of derivatives outstanding and transacted)
- Counterparty risks
- Prevention of fraud and error
- Value for money

**Matters to be included in the Annual Treasury Strategy**

1. Proposals for amendments to the Treasury Policy.
2. Cash flow forecast covering the three year period including the current financial year.
3. Details of principal borrowing maturities over the next three financial years.
4. Maturity ladder of existing borrowings and interest rate fixings.
5. Strategy for refinancing maturing borrowings (if any) and for financing new borrowing requirements over the next three years:-
  - proposed sources of finance
  - proposed maturities and maturity structure
  - whether fixed or floating rate (etc) and if floating rate, proposed rollover periods
  - suggested mechanisms for controlling interest rate exposure including potential use of stand alone derivatives
  - estimated rates of interest
  - effect of proposed borrowings on Hexagon's overall security position
  - proposed new maturity ladder
  - estimated effect on revenue budget of financing strategy
  - expected maximum total outstanding and short-term borrowing
  - expected maximum proportion of interest payable on variable rate borrowing

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6. Analysis of present levels of short and long-term interest rates together with:

- comparison with historical trends
- estimated trend movements in interest rates over the next financial year
- any proposals for changes to current strategy

7. In respect of surplus funds:-

- the extent to which surplus funds are earmarked for short-term requirements or to repay maturing borrowings
- the extent to which surplus funds should be held available to meet contingencies
- the proposed strategy for surplus funds.

## S7 Budgeting, accounting and audit arrangements

Hexagon is subject to annual external audit, and also internal audit. The following information is made available for these purposes:

- Rules of the Association
- Standing orders and delegated authorities (SODA)
- Policies and Procedures
- Minutes of meetings of senior management, The Board, and other committees.
- Management accounts
- Homes and Communities Agency returns and reports.

Accounting practices and standards as set out in the financial accounts are in compliance with the Statements of Recommended Practice. Statutory external audits are carried out annually in accordance with Auditing Standards.

Responsibilities of the Audit and Risk Committee are set out the SODA.

Budgets are prepared annually and approved by the Board.

Hexagon will ensure that it will be able to meet the requirements of the International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) for hedge accounting as and when these are introduced.

For all new interest rate swap transactions entered into Hexagon will follow the following procedure

- at date of execution, all swaps and loans will be documented in accordance with pre approved templates (approved by the Group's auditors) and will be updated at each event (rollover, re fixing date etc).
- All initial documentation will be prepared by the Director of Finance and signed by the Chief Executive .

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### S8 Cash flow management

1. The Senior Accountant is responsible for producing a three-year forward cash flow forecast by month. The forecast is updated monthly and shows:
  - Revenue income and expenditure
  - Capital expenditure on existing homes, and office/IT capital
  - Anticipated sales of existing homes
  - Development cash flows (payments, grant income, shared ownership first tranche sales income) by schemes in contract, schemes approved, schemes not yet approved
  - Loan interest and repayments
  - Cash balances
  - Balances on undrawn loan facilities, and whether secured
  - Gearing ratio
2. The cash flow forecast is reviewed by the Finance & IT director every month, and a summary is reported to the Board every quarter.
3. The Senior Accountant is responsible for producing a 2-week forward cash flow forecast. This is updated daily and is reviewed by the Finance & IT Director every Monday.

### S9 Money laundering

It is a requirement of the Financial Conduct Authority ("FCA") that a Money Laundering Record be maintained.

The procedures in relation to money laundering have been approved by the Audit & Risk Committee and are available on the intranet.

No loan shall be taken from, nor any deposit made with any organisation or individual who has not previously lent funds or taken deposits from Hexagon, without the prior consent of the Director of Finance & IT, Directors Group or Board (whether or not that organisation or individual complies with the Hexagon's established investment or lending criteria).

Details of any proposal in relation to a loan from or deposit with such an individual or organisation will be reported as soon as possible to the Director of Finance & IT. In granting consent to a loan to, or deposit from a new organisation or individual, the Director of Finance & IT will ensure that the identity and credentials of such individual or organisation have been appropriately ascertained and verified. The Director of Finance & IT will maintain a written record of such verification and the details provided by the organisation or individual. The Director of Finance & IT will ensure that these requirements are communicated to and understood by all members of staff likely to be involved in the taking of loans or making deposits.

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The Director of Finance & IT will be similarly responsible for taking reasonable steps to ensure that members of staff dealing with any element of the Hexagon's cashflow are appropriately alert to the possibility of attempts being made to use the Hexagon for money laundering purposes. Such staff will also be made aware of the requirement to report suspicions of money laundering to the Director of Finance & IT.

Where the Director of Finance & IT is satisfied that a suspicion of money laundering does exist, he/she will up load a report in the form provided on the National Crime Agency ("NACA") website ( <http://www.nationalcrimeagency.gov.uk> )  
Written confirmation of all reports submitted will be requested.

**For the avoidance of doubt all staff loans are excluded form any of the above procedures**

### S10 Staff training and qualifications

The Finance & IT Director will ensure that all personnel involved in the treasury management function receive appropriate training. In addition advice and training for staff and board members will be sought from Hexagon's treasury advisors where necessary.

### S11.1 Use of external service providers

The following service providers are currently used:

- Bankers (National Westminster Bank)
- treasury management consultants (Capita )
- funding advisers (appointed after competitive tender as required)
- 

### S12 Corporate governance

Hexagon publishes the following documents on the external website:

- Annual Financial Statements
- Annual Report
- Annual Report to Residents
- Corporate Plan
- Homes News (newsletter for residents)
- Names of Board members and Executive Directors

**Appendix S1.6 Extract from rules of Hexagon Housing Association****Borrowing**

- F13 The total borrowings of the association at any time shall not exceed £5,000,000,000 (five billion) pounds sterling or such a larger sum as the association determines from time to time in general meeting. For the purpose of this rule F13, any amount of the association's borrowings in any currency other than pounds sterling (as may be permitted or not prohibited by the regulator from time to time) shall be converted to sterling at the exchange rate or rates applicable under the related derivative transaction or transactions by which the association has hedged its exposure to currency exchange rate movements in relation to the principal amount of such borrowings.
- F14 The rate of interest payable at the time terms of borrowing are agreed on any money borrowed shall not exceed the rate of interest which, in the opinion of the board, is reasonable having regard to the terms of the loan. The board may delegate the determination of the said interest rate within specified limits to an officer, board member or a committee.
- F15
- F15.1 In respect of any proposed borrowing, for the purposes of rule F13 and in relation to the amount remaining undischarged of any deferred interest or index-linked monies or amounts on any deep discounted security previously borrowed by the association, the amount of such pre-existing borrowing shall be deemed to be the amount required to repay such pre-existing borrowing in full if such pre-existing borrowing became repayable in full at the time of the proposed borrowing.
- F15.2 For the purposes of rule F14 in respect of any proposed borrowing intended to be on deferred interest or index-linked terms or on any deep discounted security the amount of borrowing shall be deemed to be the proceeds of such proposed borrowing receivable by the association at the time of the proposed borrowing.
- F15.3 No person dealing in good faith with the association shall be concerned to know whether rule F13 or F14 or this rule F15 have been complied with.
- F16
- F16.1 The association shall have the power to enter into and perform a derivative transaction, or series of derivative transactions, where the board (or a duly authorised officer, employee or committee established under the rules) considers entry by the association into such transaction(s) to be in the best interests of the association.
- F16.2 A person entering into a derivative transaction with the association who has received a written certificate signed by the secretary confirming the association's compliance with this rule F16 shall not be concerned to enquire further whether or not the association has complied with the provisions of this rule F16 and such transaction shall be valid at the date that it is entered into and throughout its term in favour of such person (or any assignee or successor in title) whether or not the provisions of this rule F16 have been complied with.

**Investment**

- F17 The funds of, or monies borrowed by, the association may be invested by the board in such manner as it determines.