Croydon Churches Housing Association Limited

Treasury Management Strategy 2021/22 – Appendix 1

March 2021

Classification: Confidential

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1. Introduction

1.1 The Treasury Management Policy of Croydon Churches Housing Association ("ccha") requires the Board to consider and approve an annual treasury management strategy based on the latest business plan.

1.2 The budget and the new business plan have not yet been approved by the Board. This treasury management strategy is based on the latest version of the business plan which includes the updated forecast development programme. The business plan will continue to be refined with a view to presenting a final version of the plan and the FFR for approval by the Board by the end of June.

2. Current position

2.1 Last year, two new £10 million revolving credit facilities were arranged with NatWest and Santander. Ccha also raised new long-term fixed rate debt through a participation in a THFC bond issue.

2.2 Ccha has loan facilities and drawings from the following lenders:

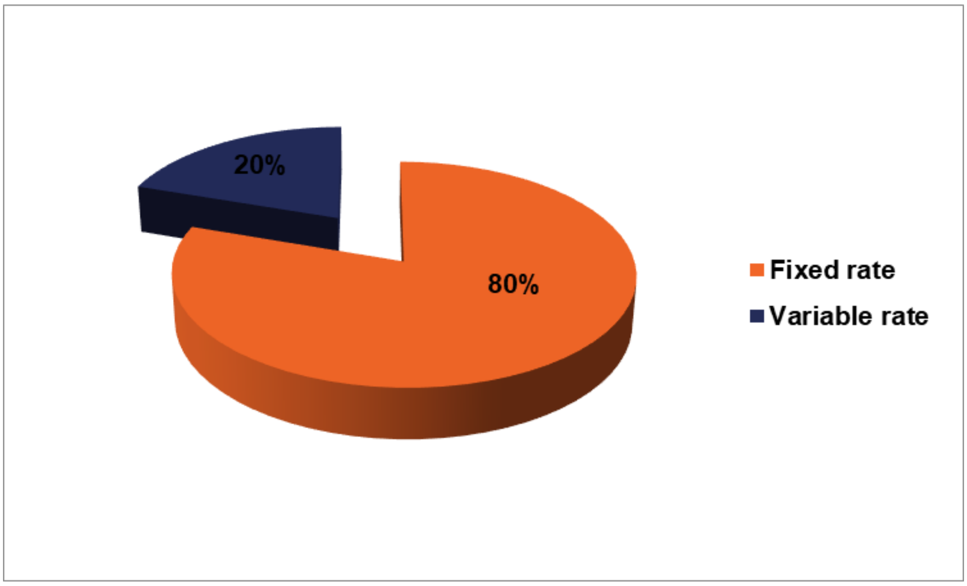
Lender	Facility Amount (000's)	Drawn (000's)	Facility Available (000's)	Margin/ Rate	Repayment date
Orchardbrook	£1,752	£1,752	£0	10.72%	Mar-45
Nationwide	£3,870	£3,870	£0	1.50%	Feb-28
NatWest Tranche A	£7,500	£7,500	£0	1.20%	Aug-26
NatWest Tranche B	£10,000	£10,000	£0	1.75%	Sep-26
NatWest Tranche C	£10,000	£0	£10,000	1.55%	Sep-30
NatWest sub-total	**£27,500**	**£17,500**	**£10,000**		
Santander A	£10,000	£0	£10,000	1.75%	Mar-25
Santander B	£22,500	£22,500	£0	1.20%	Apr-24
Santander C	£10,000	£0	£10,000	1.65%	Apr-29
Santander sub-total	**£42,500**	**£22,500**	**£20,000**		
AHF	£13,000	£15,082	£0	3.07%	Mar-49
THFC	£7,500	£11,883	£0	2.05%	Oct-43
AHF &THFC sub-total	**£20,500**	**£26,965**	**£0**		
Total	**£96,122**	**£72,587**	**£30,000**		
Cash		**£ 14,797**			
Net Debt		**£57,790**			

2.3 As can be seen from the table above, there is little refinancing risk in the loan portfolio. The earliest refinancing is the £12.5 million Santander facility due for repayment in over 36 months in Apr 2024.

2.3 Ccha has put in place the following fixed rates to manage its exposure to interest rate risk.

Lender	Amount	Fixed rate	Expiry date	Years to maturity
AHF	£15,082	3.07%	Mar-49	28
THFC	£11,883	2.01%	Oct-43	23
Orchardbrook	£1,752	10.72%	Mar-45	24
Nationwide	£2,072	4.48%	Mar-28	7
Santander	£12,500	3.58%	May-25	4
NatWest	£3,000	3.15%	Mar-29	8
Total	**£46,289**			

2.4 The Chart below shows the current split of fixed and variable rate borrowing based on net debt.



2.5 The weighted average life of the fixed rates is 18 years. The weighted average fixed rate on these loans is 3.31%.

2.6 Ccha therefore has good protection from interest rate risk at a relatively low cost and for a long duration.

2.7 The Board of ccha has agreed a treasury policy which requires that between 70% and 90% of the loan portfolio be on fixed rates of interest. The hedged position is therefore currently compliant with policy.

2.8 Undrawn bank facilities of £30 million will, once security charging is complete, provide ccha with liquidity of £30 million to support new development or refinancing.

2.9 Following completion of security charging to THFC, ccha also has cash on deposit of £15 million. The total liquidity available to meet future commitments therefore amounts to just under £45 million.

2.10 The expectation of the regulator is that Registered Providers have sufficient liquidity to cover up to 18 months of capital commitments. The strong liquidity position of ccha provides significantly longer cover with facilities expected to cover all capital commitments until 2026.

2.11 Although this is a very strong liquidity position, there is a cost to holding liquidity in the form of committed bank facilities or in cash. Banks typically charge a commitment fee of 50% of the margin on undrawn loan facilities.

2.12 Our estimate of the commitment fee cost of the undrawn facilities is set out in the table below.

Lender	Undrawn facility (000's	Margin	Commit ment fee	Annual cost (000's)	Repayment date
Santander A	£10,000	1.75%	0.875%	£88	Mar-25
Santander C	£10,000	1.65%	0.825%	£83	Apr-29
NatWest Tranche C	£10,000	1.75%	0.875%	£88	Sept-26
Total	**£30,000**			**£258**	

2.13 In the current interest rate environment income from investing surplus cash is negligible. The weighted average interest rate on cash currently invested is 0.19%. The interest cost on loans will be at least equal to lending margins which are currently around 1.50%. The net cost of holding cash for every £1 million pounds of loans is therefore around £13,000 per annum.

2.14 Ccha has also drawn £10 million under the Tranche B NatWest facility. The interest rate on £3 million of this facility has been fixed until 2029, with the balance drawn on a variable rate. The margin on this loan is 1.75%. Ccha could generate annual interest rate savings of £14K pa by drawing £7 million from the new NatWest facility at the lower margin of 1.55%.

3. Forecast borrowing requirements

3.1 Ccha has an ongoing development programme of affordable rent, shared ownership and market sale housing.

3.2 Cash proceeds of £11 million are held on instant access deposit and are immediately available. This cash covers over 18 month's liquidity requirements from the committed development programme.

3.3 Ccha also has committed facilities of £30 million. When security is charged these facilities will enable Ccha to commit to new schemes over the next 12 months and continue to satisfy the 18-month liquidity rule.

3.4 Ccha therefore has no pressing need for new facilities. However, there is a cost to holding excess security and potential for savings by repaying or cancelling loans that are no longer required.

3.5 Ccha has a Variable rate amortising loan from Nationwide. This variable rate loan of £1.8m could be repaid without penalty to generate annual interest savings of around £27,000.

3.6 Ccha also has a £10 million facility from Santander which is currently undrawn. Cancelling this facility (due for repayment in March 2025) would generate commitment fee savings of £88k per annum.

3.7 After repaying the Nationwide variable rate loan and cancelling the Santander £10 million facility ccha would still have committed facilities of around £20 million and cash liquidity of over £10 million to support further development commitments.

3.8 As identified in our analysis of the funding market in appendix 2, the cheapest source of long-term finance over the next few years is likely to be the new government guaranteed scheme being delivered by ARA Venn.

3.9 The new scheme is expected to open for applications shortly will provide long term (30 year) fixed rate loans at an estimated cost of 0.35% over the long-term gilt yield plus administration costs 0.10% pa. Based on current gilt yields this will deliver all in fixed rates of under 2.0% pa. This is significantly cheaper than any other current source of fixed rate debt.

3.10 Registered providers will be able to apply for loans from the new scheme based on the net cost of affordable housing schemes approved by the Board not yet on site.

3.11 We understand that ccha has a development pipeline of affordable housing (including uncommitted schemes) with a total net cost of just over £50 million. This is the amount that might be available to ccha subject to due diligence on the development programme and credit underwriting.

3.12 The total amount available under the government guarantee scheme is £3 billion and will be disbursed over a period of three years.

3.13 We recommend that ccha submit a loan application for up to £36 million from ARA Venn. Given the level of liquidity held by ccha there is no urgency in submitting this application. If it is successful ccha can at that point consider refinancing other more expensive loans.

4. Conclusions and recommendations

4.1 Ccha is currently well funded with sufficient liquidity in the form of cash to cover the committed development program for at least 18 months. It also has undrawn facilities of £30 million to cover the future programme and other capital commitments. It has no need to arrange new facilities at this point in time.

4.2 However, the new government guaranteed scheme from ARA Venn will deliver very low-cost long-term loans. We recommend that ccha begin the process of applying for a loan of up to £36 million from ARA Venn.

4.3 Excess cash and surplus liquidity have a cost. Given the liquidity cover available to ccha we recommend the following repayments/restructuring of the loan portfolio.

- ➢ The variable rate loan of £1,800,000 from Nationwide should be repaid early. This can be done at no cost and will generate interest savings of around £27,000 per annum.
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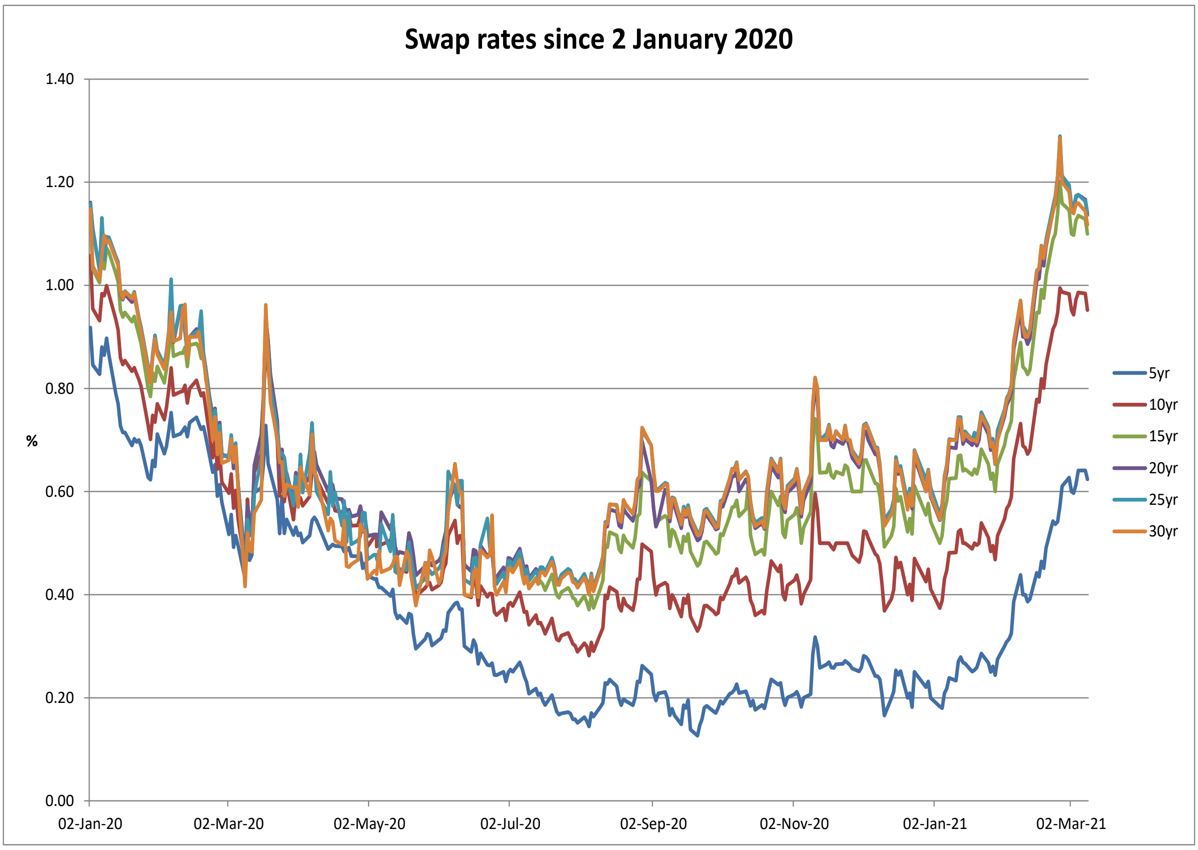
- ➢ The £10,000,000 high margin (1.75%) undrawn facility from Santander should be cancelled to generate commitment fee savings of £88,000 per annum.

4.4 The existing fixed rate loans and new THFC loan provide good protection against interest rate risk. No new hedging is required.

5. Appendix I – Economic environment

1. Fixed rates have moved lower over the last 12 months with markets dominated by the economic consequences of Covid-19 and measures taken to slow its progress. The following shows the movements in interest rate swap rates since the beginning of 2020.



Source: Thomson Reuters

2. As can be clearly seen, there has been a very sharp increase in rates since the start of the year. This is a result of renewed optimism about the UK economy following the roll-out of the vaccination programme, as well as the influence of US rates, which have risen in response to the large fiscal package announced by the new Biden administration and the effects that this might have on the US and world economies (including increased levels of inflation). In the last week or so, rates have fallen back a little.

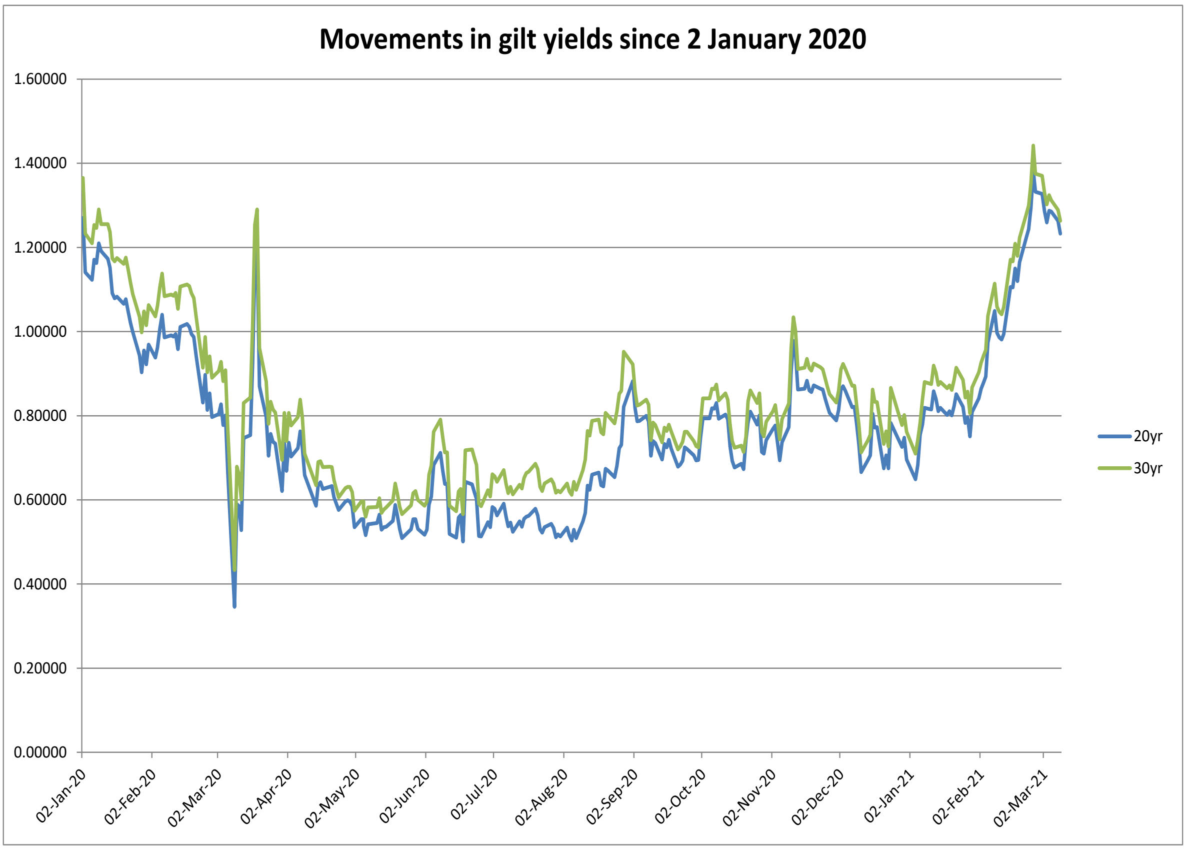
3. In historic terms, rates are still very low reflecting the impact of the coronavirus on the economy and the very loose monetary policy that is being pursued by the Bank of England. In particular, Bank Rate is at its lowest ever level and the Bank has increased its own gilt purchasing programme, which has a direct effect on yields. On 5 November 2020, the MPC announced and increase to its bond buying programme (QE) of £150 billion.

4. The following table shows today's interest rates for periods of one month through to 30 years. These form the underlying rates for bank borrowings, with lending margins and credit and capital costs payable on top.

Period	%
1 month	0.047
3 months	2.000
6 months	0.094
12 months	0.152
2 years	0.261
3 years	0.394
5 years	0.624
7 years	0.783
10 years	0.952
15 years	1.100
20 years	1.139
25 years	1.136
30 years	1.118
	09/03/2021

Source: Thomson Reuters

5. Long-term funding is now most commonly done by borrowing money from financial institutions through public bond issues, private placements or borrowing from a bond aggregator (such as MORhomes or bLEND). The interest rate payable on these loans is fixed by reference to the rate on government bonds (gilts). The following chart shows the movements in the 20 year and 30 gilt yields over the last 12 months.



6. The 20 and 30-year gilt yields are current at 1.26% and 1.27% respectively. As can be seen, there was a sharp movement down in March followed by an equally sharp upwards movement. This occurred as concerns over the coronavirus gripped the market, forcing yields down, but this quickly followed by worries about there being sufficient liquidity in the financial markets. This was eased by the Bank of England taking decisive action and yields have stabilized since then. As with the swap rates, recent improvements in sentiment have now pushed gilt yields back to pre-pandemic levels with some reversal in recent days.

7. These underlying rates suggest that it is a very good time to raise money through long-term fixed rate borrowing. However, the next few months could see increased volatility in the markets, as the effects of Covid-19 continue to weigh on sentiment. However, some uncertainty has been removed with the negotiation of a trade deal between the UK and EU, and the start of the Covid vaccination programme.

6. Appendix II – Forecasts

1. The following table shows our latest forecasts, together with those from Capital Economics, an independent economics consultancy that we retain.

Capital Economics (12/02/21)								
	Q/E1 2021	Q/E2 2021	Q/E3 2021	Q/E4 2021	Q/E1 2022	Q/E2 2022	Q/E3 2022	Q/E4 2022
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
CPI	0.80%	2.00%	2.30%	2.60%	2.30%	1.40%	1.20%	1.00%
RPIX	1.90%	3.00%	3.00%	3.10%	2.60%	1.80%	1.80%	1.70%
RPI	1.80%	3.00%	3.10%	3.20%	2.70%	1.90%	1.90%	1.80%
CPIH	1.70%	0.80%	0.80%	0.70%	0.40%	1.30%	1.40%	1.70%
5yr gilt yield	0.15%	0.25%	0.30%	0.40%	0.45%	0.55%	0.60%	0.65%
10yr gilt yield	0.50%	0.60%	0.65%	0.75%	0.80%	0.90%	0.95%	1.00%
30yr gilt yield	1.10%	1.15%	1.25%	1.30%	1.40%	1.55%	1.65%	1.75%
3m LIBOR	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
6m LIBOR	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.12%
12m LIBOR	0.90%	1.00%	1.05%	11.15%	1.20%	1.30%	1.35%	1.40%
Link Group (8/2/21)								
	Q/E1 2021	Q/E2 2021	Q/E3 2021	Q/E4 2021	Q/E1 2022	Q/E2 2022	Q/E3 2022	Q/E4 2022
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr gilt yield	0.10%	0.10%	0.10%	0.10%	0.20%	0.20%	0.30%	0.30%
10yr gilt yield	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.70%
25yr gilt yield	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.30%	1.30%

2. We do not think that the MPC will increase Bank Rate during the current and next two financial years, as we expect the economy to take a prolonged period to recover momentum after the Covid crisis.

3. Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

4. We expect bond yield volatility to continue, as investors switch back and forth between “risky” equities and “safe haven” of government bonds. The overall longer run trend is for gilt yields to rise, albeit gently, with periods of sharp volatility from time to time.

5. Our forecasts are also predicated on an assumption that there is no break-up of the eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming, and that there are no major disruptions in

international relations, especially between the US and China, North Korea and Iran, which have a major impact on international trade and world GDP growth.

6. As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields is unchanged. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Author:	Howard Webb	Checked:	David Rider	Date:	12/03/2021