

## Treasury management savings

Case Studies

<b>Organisation:</b>	Wandle Housing Association
<b>No. Properties:</b>	3998
<b>Type:</b>	Housing Association
<b>Region:</b>	London
Country of	England
Relevance:	
Date:	2004



### Summary

Wandle HA's first Annual Efficiency Statement in July 2005 reported substantial efficiency gains from treasury management (the management of the organisation's investments and borrowings).

A review of borrowing terms and negotiation with existing funders achieved overall improvements in each of the following areas:

- Loan margins (i.e. how much interest is paid above base rate)
- Utilisation of security (i.e. how much money could be borrowed against its assets)
- Financial covenants (i.e. the strictness of the financial restrictions that have to be observed to avoid being in breach of the terms of the loan).

At the same time, refinancing of a bond issue allowed interest payment savings.

As a result of these initiatives Wandle was able to generate on-going savings of around £265,000 per year, on borrowings of around £180m. There were no initial costs off-setting these savings.

But Wandle is not complacent about these gains. The markets do not stand still and it is actively reviewing terms and looking to improve them even further.

### Background

Wandle had loans of around £100m from eight different funders, including a £15m bond issue, on which the interest payable was around 8.75% (compared to the then current base rates of under 5%).

The association needed to increase its borrowings to around £180m within around two years. To do this it needed to obtain additional loan facilities (the amount available to borrow on loan). A particular issue was the need to make better use of the security available – that is, to be able to get higher loans for the properties 'mortgaged'.

### Approach

One option in these circumstances would be to completely refinance. That is, go out to tender for completely new facilities and terminate existing loan facilities. The disadvantage of this approach is that new facilities incur very significant one-off arrangement fees (typically of the order of 1% of the loan value).

Wandle decided to negotiate improved terms and increase the size of its facilities with its existing lenders. This avoided new arrangement fees. Although this approach did not involve competitive tendering, there was an element of competition between the existing lenders and ultimately Wandle could have gone out to competitive tender if it had been unable to negotiate satisfactorily improved terms.

Retained treasury advisors Murja were able to give additional assurance that a good deal was being obtained.

### Efficiency gains

Efficiency gains were made in the following areas:

- **Improvement in margins**

The interest paid on a loan is made up of:

- the 'base rate' which, broadly speaking, is the current rate at which banks lend to each other; plus
- the margin, which is the additional interest rate payable, from which the lender makes its profit .

*NB This description simplifies the arrangements somewhat and uses the term 'base rate' somewhat loosely to help explain the concept*

As a result of the renegotiation Wandle improved its overall margins from about 0.5% to 0.4%. On expected future borrowings of £140m, this gave on-going annual saving of around £140,000.

- **Better security utilisation**

Previously the loan agreements had value Wandle's properties using the 'Existing Use Value – Social Housing' (EUV-SH) method (in other words, what the property would sell for on the open market assuming a continuation in housing use and that properties are let at affordable rents)..

As a result of the renegotiation the basis of the valuation was changed to the 'Open Market Value Tenanted' (OMVT) basis, which gave valuations two or three times higher. The asset cover requirement was increased slightly (from around 110% to 125%), but this still enabled Wandle to borrow about twice as much using its existing assets as security for the loan.

This was a significant benefit in itself. It also saved costs of around £85,000 for fees that might have been incurred in 'charging ' additional assets under the previous arrangements.

- **Less restrictive financial covenants**

When lenders lend money they build financial covenants or requirements into the loan agreement. The most important of these normally set minimums for asset cover and interest cover ratios. The interest cover ratio is intended to measure the association's ability to meet the costs of servicing its debt from available surpluses after tax. If the borrower breaks the covenants the lender can recall the loan, which could lead to financial collapse. The tighter the covenants the more restricted the borrower is in how it manages its finances without having to seek the permission of the lender.

As a result of the renegotiation Wandle was able to relax the interest cover ratios from around 110% to 105%, with added flexibility to allow for peaks and troughs in building costs.

- **Bond refinancing**

When a company issues a bond, it agrees to pay the bond holders a fixed rate of interest up until the date of redemption of the bond. The finance raised by the bond is an alternative to traditional loans.

Wandle had issued £15m of bond finance (via The Housing Finance Corporation) when interest rates were much higher, at fixed rates averaging about 8.75%.

Fixed rates cannot be changed without incurring a penalty. However, Wandle chose to take the penalty and refinance the bond at an interest rate of about 5.25%. The old bond had a redemption date of 2021 - the new bond ran until 2035. The interest rate on the new bond was similar to the rate that could have been obtained for other forms of long term finance at that time - December 2004. The covenants and security pledged were improved with the new bond.

The costs of the penalties and re-financing were all rolled up into the new bond, increasing the debt to around £20m. After taking everything into account Wandle estimates that the refinancing has delivered an on-going saving of about £125,000 per year.

The total on-going savings from Wandle's refinancing initiatives was around £265,000 a year, as well as the improvements in security utilisation and covenants.

### Costs and savings

Wandle estimates that the costs of the renegotiation (mainly legal) were around £20,000. However, these costs would have been incurred anyway to enable the association to increase its loan facilities. In fact, the arrangement fees for any new loans would have greatly exceeded these costs. In addition, charging fewer properties saved on costs of charging.

The costs of refinancing the bond were rolled up into the new bond debt.

Thus there were no one-off costs to set against the on-going efficiency savings. In fact there were notional savings against what it might have costs if a different approach had been taken.

### Glossary

The **facility** is the amount available to borrow on a loan, as opposed to the actual amount 'drawn down' (or borrowed).

The **asset cover** is the ratio of the valuation of the assets to the amount that can be borrowed using the assets as security. Thus if assets are worth £110m and the asset cover is 110%, then £100m can be borrowed.

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*Produced by Patrick Symington with the assistance of Wandle Housing Association and published by HouseMark on 17/11/2005*

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