

Investa Funds Management Limited
Funds Management
Financial Risk Management

Policies and Procedures



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1 Financial Risk Management Policy

1.1 Purpose

This policy framework establishes prudential limits and operational guidelines under which risk management strategies are developed and implemented for the funds (Funds) managed by Investa Funds Management Limited (IFML).

The policies reflect the risk tolerance and management philosophy of the Board of IFML, and should be read in conjunction with other financial risk management policies and directives issued by the Board from time to time.

The policy should be reviewed by the Board annually, with Management to recommend to the Board any changes to this policy for its approval.

1.2 Risk management objectives

IFML's preference is to protect its' funds from large and rapid movements in financial markets, i.e. to achieve a less volatile exposure to movements in interest rates and currencies through prudent risk management techniques. IFML's attitude toward financial market risk is risk averse.

The primary objective of interest rate and currency risk management is to manage the potential for financial loss measured in terms of impact on earnings arising from unfavourable movements in interest rates and currencies. To achieve this objective, IFML Funds may need to undertake a high level of hedging. Accordingly IFML Funds may experience interim profit and loss volatility due to unrealised gains and losses from marking to market the hedge instruments. IFML is prepared to accept this interim profit and loss volatility.

1.3 Measurement methodology

The Funds managed by IFML are exposed to two key risks being interest rate risks and liquidity risks. The risk measurement methodology, in general terms, for these risks are specified below.

The impact on earnings of changes in interest rates is measured for a probable change in interest rates based on historic interest rate movements. The probability of a negative impact on earnings is determined with a 95% confidence level i.e. there is a less than 5% chance that an adverse change in interest rates will exceed a fixed percentage of forecast earnings. This potential adverse change in earnings, known as 'Earnings at Risk', is calculated in percentage terms by dividing the adverse change in earnings by the forecast earnings.

Appendix 1 provides an outline of the EaR method employed by IFML to measure market risk. The EaR benchmark is the level of EaR that is acceptable to the Board. Benchmark EaR and maximum EaR are a function of the Board's risk tolerance and objectives for managing interest rate within the Funds.

Investa undertakes cashflow forecasting in order to manage the short and long term liquidity of its Funds.

1.4 Management approach: General

The approach to managing interest rate and currency risk involves five stages:

- identification of exposures;
- measurement of the exposure;
- development of risk management strategies;
- implementation of risk management strategies; and
- reporting of risk exposures and hedge positions to the Audit & Compliance Committee and to the Board.

Policy statement

Foreign currency, interest rate and liquidity exposures shall be managed at all times within the risk policy framework approved by the IFML Board comprising the objectives, delegations, limit structures and risk parameters for identifying, measuring, managing, and reporting exposures.

1.4.1 Strategy design and approval

Risk management strategies are designed with regard to each Fund's earnings sensitivity to financial market rates and risk management objectives. Key inputs to the strategy design process are:

- the consensus/market view of future interest rate and currency behaviour;
- Investa's view of future interest rate and currency behaviour;
- existing and projected total asset and debt levels;
- projected foreign currency earnings and expenditure;
- the cost (in premium or increased cost of funds) of a proposed hedge strategy; and
- impact of the proposed strategy on each Fund's sensitivity to market rates.

Papers detailing strategies are to be forwarded to the Risk Management Committee for ratification. The Risk Management Committee is comprised of:

- (a) any two of the Chief Executive Officer, the Chief Financial Officer, the Group Executive – Funds Management, or the Group Company Secretary; and
- (b) the Group Financial Controller (with the Treasury Analyst acting as alternate).

These papers will contain:

- an economic summary outlining expected interest rate/currency behaviour;
- scenario analysis for any exotic options;
- the costs and benefits of the strategy; and
- the impact of the strategy on the relevant Fund's cost of funds and/or earnings sensitivity.

On Committee approval the Group Financial Controller or the Treasury Analyst will then implement the strategy.

1.5 Authorised instruments

Policy statement

Investa's Funds can only transact in those financial instruments that are approved by the IFML Board.

Policy statement- Interest Rate Risk

In order to be classified as fixed rate risk, written interest rate options must be used to offset the cost of purchasing option cover or have a known worst case interest rate. Any interest rate options without a known worst case rate must be regarded as floating rate instruments.

The approved hedging instruments denominated in Australian dollars are:

- Interest rate swaps and forward starting interest rate swaps
- Forward rate agreements
- Interest rate swaptions
- Interest rate options, specifically caps, floors and collars
- Tiered or other exotic interest rate options with a known worst case interest rate (contracts without a known worst case are permitted but are to be treated as floating rate instruments)

1.6 Responsibilities and authorities

The Risk Management Committee has been delegated responsibility for the Fund's risk management activities in relation to debt and must approve all hedging strategies prior to execution by the Group Financial Controller or Treasury Analyst. (i.e. no hedging activity can be undertaken unless it is sanctioned as part of a hedging strategy)

All hedge limits are to be reviewed on an ongoing basis by the Group Financial Controller with any recommendations to change limits submitted to the Committee and the Board.

Responsibility Structure

The following components of organisational structure have varying degrees of responsibility and input into financial risk management:

- The IFML Board
- Audit & Compliance Committee (Board Committee)
- Risk Management Committee (Executive Committee)
- Chief Financial Officer
- Group Financial Controller

The IFML Board

The responsibilities of the Board include:

- (i) Approval of the Policy and to consider enhancements from time to time;
- (ii) Authorisation of new financial instruments;
- (iii) Approval of all new loan facilities or capital market raisings (debt or equity);
- (iv) Delegation of the authority to borrow, invest and hedge within the constraints of the policy and existing loan facilities to the Managing Director and CFO;
- (v) Review of exposures to ensure that exposure limits and hedging limits are being observed;
- (vi) Review of performance in financial risk management; and
- (vii) Ratification of actions to address breaches of this Policy.

Audit & Compliance Committee (ACC)

The responsibilities of the ACC include:

- (i) Review the Policy as appropriate and at least annually;
- (ii) Recommend any enhancements to the Policy to the Board;
- (iii) Review in detail any issues that are considered relevant to prudent financial risk management activities
- (iv) Review actions to address breaches of this policy; and
- (v) Review the semi-annual Risk Management Compliance Report.

Risk Management Committee (RMC)

The responsibilities of the RMC include:

- (i) Approval of treasury strategies, proposed for each Fund by management;
- (ii) Review of Policy changes and recommendations for approval by the ACC prior to review by the IFML Board;
- (iii) Review of reports provided by management on the risk position and risk management performance of each Fund; and
- (iv) Review of Policy breaches and direction on actions which should be taken to address breaches of this policy.

The Chief Financial Officer (Finance Director)

In this Policy references to the Chief Financial Officer or CFO include the Finance Director at any time in which Investa Property Group Holding Pty Limited's (IPGH) most senior financial officer is a member of the IPGH Board.

The CFO has the responsibility to:

- (i) Recommend to the Board (or through the Audit & Compliance Committee for approval by the Board) the establishment of, and amendments to, the Policy;
- (ii) Where appropriate, delegate authority to enter into borrowing, investment, and hedging transactions;
- (iii) Together with the RMC, review and, where appropriate, endorse risk management strategies put forward by the Group Financial Controller;
- (iv) Ensure that the treasury function has not exceeded Board approved delegation and exposure limits or RMC approved hedging strategies and report any such breaches to the CEO immediately and the ACC at its next meeting; and
- (v) Act as a member of the RMC.

Group Financial Controller

The Group Financial Controller is responsible for supervising the management of borrowing, investment and hedging activities. Specific responsibilities include:

- (i) Undertake or authorise borrowing and investment transactions as delegated by the CFO;
- (ii) Undertake hedging transactions as delegated by the CFO and approved by the RMC;
- (iii) Develop strategies to achieve financial management objectives that are within the limits of this Policy for consideration by the CFO; and
- (iv) Make recommendations to the CFO on amendments to the Policy; and
- (v) Act as a member of the RMC.

1.7 Reporting and performance measurement

Reporting

A semi-annual report is to be prepared and presented to the IFML Board detailing:

- Position with respect to risk limits for each Fund;
- Mark to market value of each Fund's hedge portfolio;
- Summary of hedge strategy for each Fund;
- Details of any large, unusual or very complex derivative transactions including the potential impact of the exercise of any granted options;
- Certification of compliance with risk limits from the Chief Financial Officer;
- Appropriateness of inputs used in the EaR calculations (which will be supported by independent advice);
- Sensitivity analysis regarding forecast covenant compliance consistent with EaR scenarios; and
- Any investment of surplus cash with or derivatives entered into with a bank counterparty which is not of the major four Australian banks, where a Fund is financed by a debt capital market issue.

Any breaches of risk limits should be reported to the Chief Financial Officer (CFO) immediately following the discovery of the breach and then reported to the Risk Management Committee, Audit & Compliance Committee and the IFML Board at the next available meeting, or earlier if deemed appropriate by the Chief Executive Officer or CFO. The regular report of the CFO to the Board will confirm compliance with risk limits.

1.8 Operational controls

To ensure adequate control and to minimise **operational risk** the tasks of approval, implementation, confirmation and settlement of financial payments are segregated to ensure appropriate authority is in place for each step in the transaction process.

A separate paper detailing Treasury operational procedures has been approved by Investa senior management.

The operational controls in place from time to time should ensure:

- (i) A level of segregation of duties sufficient to ensure that transactional staff are adequately separated from payment and deal authorisation;
- (ii) Appropriate checks and balances to ensure that the Treasury System at all times contains a complete and accurate record of all debt and hedging instruments; and
- (iii) The settlement function for derivatives and capital markets debt has been outsourced to an external party who is contracted to undertake payments and the confirmation of all transactions to third parties and to Investa back office staff.

1.9 Foreign Exchange Risk Management

Presently IFML Funds presently do not have any investments, borrowings or material sources of income or expense denominated in foreign currency. In the event that a Fund anticipates having these exposures (in excess of AUD 100,000 equivalent) – then IFML will develop a strategy to manage an anticipated currency exposure (prior to the Fund incurring the exposure). This strategy will be submitted to the RMC and IFML Board for its approval. At the same time approval will be sought for the permit to use of relevant foreign currency hedging instruments

2 Interest Rate Risk Management Policy

2.1 Interest rate risks

Funds managed by IFML can be exposed to interest rate risk in a number of ways. Funds can be geared through debt which will expose Funds to rising interest rates.

The types of interest rate risks arising from the financing activities of our Funds are:

- (a) **Outright risk** - the impact upon interest expense of a movement in interest rates.
- (b) **Basis risk** –
 - the risk that the price or value of a hedge does not move in line with the underlying exposure and/or
 - the risk of incurring a higher interest rate expense due to the hedge instrument and underlying exposure re-pricing at different times
 -
- (c) **Concentration risk** associated with:
 - unhedged interest rate positions re-pricing on the same day; and
 - hedging instruments maturing at the same date

2.2 Management approach

In managing the interest rate exposure of each Fund, management will need to take into consideration events which may materially change the nature and duration of a Fund's cashflows. A planned divestment may substantially reduce the quantum and duration of required hedges for a Fund. An acquisition will have the opposite effect.

The impact of interest rate exposure upon the profitability of each Fund is measured over a 10 year forecast year period.

Policy statement

Interest rate hedging shall be undertaken, taking into account current debt levels, pre-existing hedges, Board approved capital returns, Board approved acquisitions and divestments of assets and the committed capital expenditure of each Fund.

Policy measurement statement

Interest rate risk shall be measured in terms of the impact of interest rate changes on annual profit of the Fund.

2.2.1 Risk parameters & limits

The limit structures and risk parameters include:

- an Earnings at Risk (EaR) ratio limit;
- a debt portfolio maturity (duration) target range; and
- hedge ratio limits

For the purposes of calculating Hedge Ratios, options or other derivatives with no known worst case (that is, those that involve sold options or derivatives with net sold optionality) should be treated as floating rate instruments and not included in the Hedge Ratios.

EaR parameter

The EaR (defined in section 1.3) percentage has been set according to the maximum acceptable risk threshold of each Fund for a given level of gearing.

The EaR limit will permit Fund net income to fluctuate by a greater percentage in the latter stages of the 5 year period reflecting the fact that debt may be hedged on a descending percentage as well as the greater volatility of forecast income in latter years. A hedge profile weighted to the immediate period allows greater predictability of income in the next period, and provides greater flexibility for future periods.

Policy statement

The permissible Earnings at Risk (EaR) (ie. variability of earnings) for each Fund (for the next five years) resulting from interest rate movements to be no more than the percentage indicated in the table below of projected operating income over a rolling five year period for each Fund, subject to a 95% confidence level.

Fund Gearing ¹ levels	Year 1	Year 2	Year 3	Year 4	Year 5
Gearing > 40%	4%	5%	6%	8%	10%
Gearing < 40%	5%	6%	7%	10%	12%

Duration limits

Duration measures the weighted average term of the cash flows of the debt portfolio. The duration target range is the range of hedge duration that best fits with each Fund's risk objectives. These decision drivers are:

- the term of assets/lease income being funded;
- the term and certainty of the funding;
- the level of EaR;
- the prevailing interest rate view
- the review/maturity date of the Fund; and
- the risk tolerance and objectives of the IFML Board.

The Duration limits have been set with regard to the nature of the assets and income streams of each Fund, which comprises a mixture of long term assets generating annuity style income and development assets generating profits on sale of manufactured lots, the Gearing policy of each Fund and the volatility of income generated by each Fund. The Duration limits also are designed to encourage Funds to extend hedging beyond five years – as the EaR limits only cover the next five years.

Policy statement

The duration of the debt portfolio for each Fund will be between 2.5 and 6 years, except where the Fund has a review date within 6 years, in which case the duration period of the debt portfolio for that Fund will be between zero and the Fund review date.

Hedges that mature beyond the final maturity date of the Fund will require specific Board approval.

¹ Gearing is defined to be total interest bearing liabilities divided by total tangible assets (excluding for the avoidance of doubt any intangible assets and mark to market of derivatives) as calculated using the most recent management or financial accounts of the Fund.

Hedge Ratio Limits

An aggregate maximum and minimum hedge ratio has been set for each debt portfolio based on:

- the certainty of the amount of debt expected to be in place over a five year period (maximum ratio); and
- the maximum level of exposure that the IFML board is prepared to accept as expressed in terms of the impact upon earnings (minimum ratio).

The maximum hedge ratio is set at 100% to ensure that hedges are not speculative and are applied to reduce risk on debt that we know we have or will incur. The minimum hedge ratio (for the first five years) in any one year is set at 50%, which can be viewed to be a neutral position. i.e. if our debt is half fixed and half floating, then assuming that interest rates have an equal chance of rising or falling, then we are indifferent between the two outcomes as losses on the fixed rate portfolio will be offset by gains on the floating rate portfolio and vice versa.

A five year forecast horizon has been adopted as it is the time period over which most stakeholders value the Funds. It also represents a period of time over which it is possible to be reasonably confident that forecasts are useful.

Policy statement

The maximum hedge ratio limit is set for each Fund at 100% of total projected debt (current debt plus committed capex, Board approved capital returns, and Board approved acquisitions, less Board approved divestments) for the next five years.

Fund Gearing levels	Hedge ratio limit range	
	0 to 5 yrs	5 + years
Gearing > 40%	60% - 100%	0 – 75%
Gearing < 40%	50% - 100%	0 – 75%

Beyond a Fund review date, the hedge ratio limit will be between 0 and 75% of the total projected Fund debt.

The impact of any exercise of granted options should not cause the hedge ratios to be breached.

3 Credit Risk

3.1 Types of Credit Risk

There are two main areas of treasury activities that give rise to risks associated with counterparty credit exposures:

1. **Investment of Surplus Cash** – Credit risk arises from the investment of surplus cash either as a deposit or through the purchase of securities. There is the risk that a change in the creditworthiness of an issuer/borrower will result in a change in the market value of the security or deposit. In the extreme case, it is the risk that default, or the inability of the issuer to meet its payment obligations which will result in substantial erosion or total loss in value of the security or deposit. Changes in credit quality that do not result in default will generally not have a realised monetary consequence unless the security is sold prior to maturity.
2. **Credit Risk related to derivative exposures** – Derivative instruments represent contingent obligations, so they also entail credit risk. Credit risk arises from derivative transactions because if a counterparty were to default, the derivative would need to be replaced at the prevailing market interest rate, which will be either higher or lower than the rate on the swap on which the default has occurred. If swap rates are higher at the time of the default, we would make an opportunity loss as our cost of funds will be higher than would be the case if the bank had remained solvent and the swap stayed in place until maturity.

3.2 Measurement methodology

Credit risk needs to be measured for both the investment of surplus cash as well as derivative transactions (including options).

Credit utilisation from the investment of surplus cash will be calculated to include all cash deposits, and the principal amount of any securities such as commercial paper, bonds, bank bills or certificates of deposit.

Credit limit utilisation for derivatives will be calculated by reference to the below table:

Transaction Type	Credit Limit Utilisation
Investments	100% of principal invested
Interest Rate Swaps and granted swaptions	Notional principal x 1.5% x years to earlier of swap maturity or mutual termination clause (“MTC”) date

3.3 Limit and reporting framework

Policy Statement :

Where Funds are financed by secured bank loans, all investments and derivatives are to be transacted with the banks that provide the debt funding.

Where Funds are financed through debt capital market securities (eg. Commercial Mortgage Backed Securities), the Funds credit exposures are not to exceed the limits below:

Bank	Rating	Limit
Major four Australian bank	AA	AUD 250million
Other domestic bank	A+/A/A-	AUD 50 million

4 Liquidity Risk

Liquidity risk is financial risk due to uncertain liquidity. An institution might lose liquidity if its credit rating falls, it experiences sudden unexpected cash outflows, or some other event causes counterparties to avoid trading with or lending to the institution. A firm is also exposed to liquidity risk if markets on which it depends are subject to loss of liquidity.

Therefore liquidity risk management is associated with ensuring that there are sufficient funds available to meet each Fund's financial commitments in a timely manner. It is also associated with planning for unforeseen events which may curtail cash flows and cause pressure on liquidity. The possible causes of a liquidity crisis include:

- an unplanned reduction in revenue;
- business disruption; and
- unplanned capital expenditure.

Liquidity (or funding risk) is also created by allowing debt maturities to be concentrated within a short time, having debt maturities significantly shorter than the assets that they are funding and waiting till the imminent maturity of debt facilities prior to renegotiating maturing facilities.

4.1 Measurement methodology

Investa undertakes cashflow forecasting in order to manage the short and long term liquidity of its Funds. Cash forecasting is undertaken at two key levels:

- (i) Monthly cash forecasts are updated monthly by each Trust Accountant or Fund Analyst. This forecast is used to plan capital raisings or debt retirement in the medium term; and
- (ii) Annual five year forecasts are prepared to forecast Fund Cashflow, Balance Sheet, Income and Distribution Statements.

Projected net debt levels (which are a combination of the opening net debt plus projected cash flows) can be compared to the level of committed facilities and liquid assets (which provides an indicator of immediate and reliable liquidity).

In addition Fund debt facilities' maturities will be monitored in terms of their maturity in order to manage 'funding' risk.

4.2 Limit and reporting framework

4.2.1 Funding Risk

Any new debt facilities or equity raisings must be approved by the IFML Board or its delegates under the Delegated Authority policy in place from time to time. A Fund's debt maturity profile will be considered by the IFML Board at each refinancing or approval of new debt.

4.2.2 Reporting

Quarterly reporting on the forecast liquidity positions of the Funds will be provided to the Executive Committee as part of the distribution approval process. These reports will provide information on projected net debt for each Fund.

5 Accounting for Financial Risk Management

5.1 Accounting for derivatives under international accounting standards

Under AASB 139, we are required to classify our financial assets and liabilities into one of five categories that will determine the accounting treatment of each transaction. These five categories are:

- (a) Loans and receivables – measured at amortised cost;
- (b) Held to maturity – measured at amortised cost
- (c) Held for trading – fair value measurements with any changes taken to profit and loss account;
- (d) Available for sale – fair value measurement with any changes take to equity and interest recorded in the profit and loss; and
- (e) Non-trading liabilities – measured at amortised cost (this method of accounting is used by IFML for Fund liabilities).

Derivatives are required to be measured at fair value and be brought onto the balance sheet at the time the transaction is entered into. After initial recognition of the derivative, we are required to subsequently mark to market these instruments at each reporting date. Any gain or loss arising on revaluation of these transactions is required to be recognised through the profit and loss. Where a derivative meets certain tests and achieves classification for hedge accounting, movements may be taken to equity instead of the profit and loss.

5.2 Management approach

The purpose of using derivatives is to reduce volatility in the net cashflows of the Funds. Primarily, derivatives are focussed on reducing volatility in interest expense. It is acknowledged that derivatives may cause volatility in a Funds unit pricing due to the unrealised mark to market of derivatives.

Policy statement

Interest rate hedges should be constructed with a view to minimising interest expense and volatility in realised earnings. The potential volatility in Fund unit pricing and accounting treatment should be a secondary concern.

Appendix One

Ear/VaR methodology

Value at Risk (VaR) and Earnings at Risk (Ear) can be defined as an estimate of the level of loss on a portfolio which is expected to be equalled or exceeded with a given, small probability.

There are three generally accepted methods for calculating VaR/EaR : parametric, historical simulation, and Monte Carlo. Parametric VaR is most closely tied to modern portfolio theory, as the VaR is expressed as a multiple of the standard deviation of the portfolio's return.

Historical simulation expresses the distribution of portfolio returns as a bar chart or histogram of hypothetical returns. Each hypothetical return is calculated as that which would be earned on today's portfolio if a day in the history of market rates and prices were to repeat itself. The VaR then is read from this histogram.

Monte Carlo also expresses returns as a histogram of hypothetical returns. In this case the hypothetical returns are obtained by choosing at random from a given distribution of price and rate changes estimated with historical data.

Each of these approaches has strengths and weaknesses. The parametric approach has as its principal virtue speed in computation. The quality of the VaR estimate degrades with portfolios of nonlinear instruments. Departures from normality in the portfolio return distribution also represent a problem for the parametric approach. Historical simulation is free from distributional assumptions, but requires the portfolio be revalued once for every day in the historical sample period. Because the histogram from which the VaR is estimated is calculated using actual historical market price changes, the range of portfolio value changes possible is limited.

Monte Carlo VaR is not limited by price changes observed in the sample period, because revaluations are based on sampling from an estimated distribution of price changes. Monte Carlo usually involves many more repricings of the portfolio than historical simulation.