

7 Finances

7.1. Financial results 2010

Although the Dutch economy in general continued its modest recovery in 2010, the same cannot be said of the property sector. As predicted, there was no easing of the crisis on the residential and office property markets. This is having a marked impact on the housing associations and more particularly on their investment activities. Sales of newbuild housing are extremely low and existing properties are selling very slowly. Funding of investment activities is also being seriously hindered by the uncertainty surrounding tighter regulation (including the debates on state support, Basel III and the new Housing Act).

In response to the lower level of disposals and the difficult funding conditions, Stadgenoot was obliged to reduce its investment volume again in 2010. Stadgenoot's policy is to invest only if the investment is covered by higher equity and if the projected cash flow permits. In recent years, when the economy was strong, sales of existing properties held up at an adequate level, enabling us to greatly expand our project portfolio and take several strategic land positions (for the long term).

In times of economic crisis, however, the investment policy has to be monitored more closely and must be continuously adjusted to suit the rapidly changing market conditions.

As we noted in our 2008 and 2009 annual reports, we started monitoring our investment programme more closely at an early stage and have pursued an active policy on provisions and writedowns on a prudent basis. Because we made an early start, further writedowns were not needed in 2010. The primary objective of our management activities in 2010 was to improve the cash flow from operations.

Our policy with regard to management activities is to ensure that the management units (Residential Property business unit, Commercial/Civic Property business unit and Property division) generate sufficient cash flow from operations to enable them at all times to maintain their present size and quality.

The cash flows from operations generated by the management units are monitored via the interest-coverage ratio (ICR).

Improving the cash flows from operations is the object of the 'norm operation' project, which measures the available funds for each class of property on the basis of external benchmarking.

The number of employees was also reduced sharply in 2010, from around 460 FTEs at the beginning of the year to 415 FTEs at the end (including the Property division), which translated into a further reduction in organisation-related management charges.

This combination of measures enabled us to achieve a net result in 2010 of €21.0 million positive compared with €14.1 million negative in 2009.

This positive result in 2010 also translated into a higher solvency ratio, which increased from 27.4 per cent at the end of 2009 to 27.7 per cent at the end of 2010, which is within the target solvency ratio bandwidth of 32.5–27.5 per cent (green zone).

It was widely expected at the end of 2010 that the recession in the property sector would persist for some time, which meant that Stadgenoot had to continue to work hard to preserve financial continuity in 2011 and 2012. In practical terms, this means that investments must not exceed disposals and the ICR must exceed 1.1, assuming that all housing improvement costs are charged to operations. The determining factor here is and will remain the sale of existing properties.

7.2. Result for the year

The full-year result for 2010 was a profit of €21.0 million, which represents a significant improvement after the losses of the past two years. Compared with 2009, when we sustained a loss of €14.1 million, the improvement was €35.1 million. The Nieuwe Koers project and changes to the organisation played a major part in the achievement of this positive result.

The main items of the profit and loss account are reviewed below:

- Rental income was €3.4 million higher compared with 2009, rising 2 per cent from €167.8 million to €171.2 million. The increase in rental income partly reflects the reduced loss of income due to vacancy, which had a positive effect of €1.7 million compared with 2009.
- As in past years, the number of existing homes sold was again lower, falling from 296 to 253, but the proceeds of sale, instead of falling, increased slightly from €22.2 million to €22.9 million. This reflects the lower average value in use and lower selling costs per unit compared with 2009.
- Sales of new homes were significantly lower compared with 2009. The total proceeds of sales fell from €84.6 million in 2009 to €12.2 million in 2010, which relates directly to the lower number of projects in the wake of the review of the investment programme. The result on newbuild was zero, mainly due to adjustment of the ratio of owner-occupied to rented properties compared with 2009, which incurred additional expenses of €1.4 million.
- The other movements in the value of tangible fixed assets (referred to as ‘unprofitable assets’) were lower compared with 2009, falling from €39.1 million to €35.9 million. A review of the investment projects resulted in the inclusion of additional unprofitable assets of €8.9 million in 2010. Despite this review, costs were lower compared with 2009.
- Maintenance costs were €12.5 million lower than in 2009, falling to €37.2 million in 2010. Over €10 million of this decrease had been included in the 2010 budget. The actual costs ultimately turned out lower than budgeted, most notably with regard to planned maintenance. This was due mainly to delayed decision-making by the owners’ associations (VvEs), which resulted in less maintenance being carried out. The changes to the VAT rules had a positive effect of €0.6 million.
- Other operating expenses were €13.5 million lower compared with 2009. The effect of the Nieuwe Koers project is clearly visible here, with a reduction €6.1 million in temporary staff costs and professional fees. There were also substantial reductions totalling some €1.5 million in miscellaneous operating expenses. Another prominent item here is project acquisition and preparation costs, which were down €3.0 million compared with 2009, reflecting the cuts in the project portfolio.
- The share in the results of participating interests was €26.2 million negative, mainly due to the provision formed for the winding-up of the Far West association, totalling €15.3 million. Forum Bos en Lommer’s result was €6.5 million negative, mainly due to the provision for the GAK building (see paragraph on unprofitable assets) and an increase in our share in this joint venture (from 25 per cent to 50 per cent).
- The net movement in the value of tangible fixed assets was positive in 2010, at €27.9 million. Compared with 2009, this represents an improvement of €12.7 million. The improvement is the net effect of two factors: the adjustment of the earning power value and the change in value of assets. The earning power value was €99.3 negative (2009: €43.8 positive), due to the 0.75 percentage point reduction in the discount rate. Conversely, the change in value of assets was €127.2 million positive (2009: €16.6 million negative). The reasons for this increase are discussed in detail in paragraph 7.4.
- Total finance income and expense was €2.8 million higher compared with 2009. This improvement reflects the €3.5 million increase in interest income. Part of this increase relates to Far West’s interest income, which was accounted for in 2009 as a correction to the operating expenses and the interest charged on to subsidiaries and participating interests. The recent restructuring exercises will have an impact on interest expense in the years 2010–2012. Our interest commitments have increased by only €0.7 million, despite €77 million of growth in the loan portfolio compared with 2009.

The result for the year increased our equity in 2010 from €678.4 million to €699.4 million.

7.3. Solvency ratio

The solvency ratio is a key indicator of Stadgenoot’s financial continuity. As always, it is crucial to maintain our financial health.

In light of the current economic situation, we took steps in 2010 to significantly reduce the scale of our investment programme for the coming years. We also have to maintain a solvency ratio that is high enough to accommodate the possible winding-up of the Far West association in the coming year.

As explained in our 2008 and 2009 annual reports, Stadgenoot's solvency ratio declined from over 30 per cent at the end of 2007 to 29.1 per cent at the end of 2008.

The 2008 annual report gave the following prediction for 2009 and 2010: 'Given the severity of the economic crisis, we expect a modest further deterioration in our solvency ratio in 2009. We expect the solvency ratio to continue to fall to the lower limit of the bandwidth, to around 27.5 per cent. We do not envisage any improvement in the solvency ratio until 2010 at the earliest'.

The solvency ratio was 27.4 per cent at the end of 2009 and 27.7 per cent at the end of 2010, very close to the forecast we gave at the end of 2008. Our internal solvency ratio target is 30 per cent with a bandwidth of plus or minus 2.5 per cent punt. The solvency ratio at the end of 2009 and 2010 was therefore almost at the lower limit of the bandwidth, but was still well above the agreed absolute lower limit (set at 25 per cent).

The 0.3 percentage point increase in the solvency ratio in 2010 was the net effect of the positive result for the year of €21.0 million (0.8 percentage points positive) and the €46.8 million increase in the balance sheet total (0.5 percentage points negative).

Social investments and quality-of-life projects

Our social investments (expenses), which totalled €40.7 million, related to unprofitable assets and quality-of-life projects:

- unprofitable assets: investments in property purchases, newbuild rental projects and renovation projects on which losses are sustained by virtue of our social objective (rented social housing). We invested a total of €35.4 million in such assets in 2010. These investments are discussed in the paragraph on unprofitable assets;
- external costs of quality-of-life projects in the context of the management business, which may or may not be in the form of joint ventures (management of public spaces through warden services and the like). We invested a total of €5.3 million in these activities in 2010. External expenditure on quality-of-life activities in 2010 related to:
 - management of public spaces: €1.3 million
 - on-site local management: €3.1 million
 - safety: €0.1 million
 - cleaning: €0.5 million
 - social, cultural, neighbourhood and welfare amenities: €0.3 million

7.4. Valuation policies

Stadgenoot's assets are measured at current value. We believe that this gives the best view and provides a good basis for policy discussions, risk analyses, assessment of investment plans and decisions on the future scope of rental, maintenance and investment policy. The valuation policies have not changed materially since 2008, when Stadgenoot's new accounting policies were adopted.

Property valuation

Stadgenoot's real estate (property) is a key element in its valuation. These assets appear on the balance sheet in various items. Depending on the stage of development, they can be classed as:

- property in operation, carried at value in use;
- property in development, carried at the lower of cost incurred and value in use;
- work in progress and development positions, carried at the lower of cost incurred or purchase price and realisable value (usually in the form of the direct net selling price).

Value in use (property in operation)

The value in use is an important tool for managing the value of the property portfolio at complex level. The value in use of a complex is in principle a measure of its future earning capacity. Property in operation is measured at the value in use. Since this property accounts for about 82.0 per cent of Stadgenoot's balance sheet total, its value in use largely determines the association's value.

Both the 2010 opening balance sheet and the 2010 closing balance sheet were based on the new accounting policies and were identical to those used for the 2008 opening balance sheet. No material changes were made during the year under review apart from the lowering of the discount rate. At the instigation of WSW, the discount rate was reduced from 6.00 per cent to 5.25 per cent with effect from the 2010 financial statements. The inflation factor included in the discount rate was reduced from 2.25 per cent to 2.00 per cent.

To summarise, the current value of the property in operation in 2009 and 2010 was as follows:

Tangible fixed assets in operation x € million	2010 financial statements	2009 financial statements	Change 2010–2009
Stadgenoot at company level	1,939.2	1,883.9	55.3
N.V. Stadsgoed	120.3	111.7	8.6
Amsterdamse Compagnie	21.7	21.5	0.2
Stadgenoot consolidated	2,081.2	2,017.1	64.1

Value in use variance analysis

As the above summary shows, the value in use of the property in operation increased in 2010 by €64.1 million from €2,017.1 million to €2,081.2 million. Apart from the investments of €63.9 million and disposals of €27.6 million in 2010, Stadgenoot's consolidated profit and loss account also shows an increase of €27.9 million in the current value of the tangible fixed assets. This movement in value includes a downward adjustment of €99.3 million to the earning power value of our loan portfolio, mainly due to the effect of the lower discount rate. Without this adjustment, the increase in value would have been €127.2 million.

The most significant factor affecting this positive value movement was the change to the discount rate. Other important factors were:

- lower proceeds from the sale of existing assets, which had a negative effect;
- lower maintenance costs, which had a positive effect.

Detailed information on movements in the value in use can be found in the financial statements.

Property in development , work in progress and development positions

Property in development and development positions are in principle carried at incurred cost. All incurred costs were reviewed and the total project portfolio was critically assessed at the end of 2010 to determine how realistically the projects were valued. This resulted in further rationalisation of the work in progress and adjustment of the provisions.

Unprofitable assets

Unprofitable assets totalled €35.4 million in 2010. In the financial statements, these amounts are included in 'Depreciation and amortisation' and 'Exceptional changes in value of current assets'. These unprofitable assets are social expenses on which we willingly accept a loss (because we support these activities in accordance with our object under our articles of association). These social expenses relate both to rented social housing units completed in 2010 and investments in social housing projects for completion in the coming years. In the interests of prudence, we apply the following system. All expenditure we undertake on potential projects (i.e. in the acquisition phase) is recognised as an expense and when the project is given the go-ahead, all expenditure is recognised as unprofitable investment (and charged to the provision of the same name), to the extent that this expenditure forms part of the unprofitable asset as previously costed. When the investment decision is taken on a project, we immediately charge the remainder of the previously costed unprofitable asset to the provision of the same name.

The 'unprofitable assets' item is made up of the following components:

- | | |
|--|----------------|
| 1. released from provision for land positions | – €0.5 million |
| 2. provisions formed for newbuild | €23.8 million |
| 3. unprofitable assets due to housing improvements | €11.8 million |

4. unprofitable assets due to acquisitions €0.3 million

Re 1:

The development locations are carried at current market value (appraisal value). The development locations were reappraised at the end of 2010 by an external broker, who determined that the value of the stock position was the same as at the end of 2009.

If the temporary operation of the stock positions does not cover the costs, the shortfall is added each year to the provision for unprofitable assets. Interest charges are an important factor here. Because the operating result is not reflected in the appraisal value, a provision for unprofitable assets has to be formed. This applies to almost all stock positions. The total addition to the provision was €1.8 million.

There has been a change in the provision for the GAK building. A provision of €2.3 million had already been formed but, because the GAK building is in the name of a separate entity (BLP 1 Properties), the writedown on the building is recognised in the 'results of participating interests' item, instead of the 'provision for unprofitable assets' item. The net effect was the release of €0.5 million.

Re 2:

There were numerous changes in the value of the newbuild projects. The total figure of €23.8 million comprises:

- unprofitable assets relating to investment decisions (€29.5 million negative)

Investment decisions were taken in 2010 on three projects: Polderweg 12A and 12B (€2.1 million and €0.6 million, respectively, added to the provision) and the Campus 1873 building (€14.3 million added to the provision). The investment decisions on the RIVA and Argentina projects were revised in 2010, as part of which the rental and sale assumptions in particular were adjusted downwards. These changes resulted in additional unprofitable investments of €5.8 million in RIVA and €6.8 million in Argentina.

- movement in provision due to financial settlement (€11.7 million positive)

Three projects were delivered and financial settlement was completed for those projects in 2010. Of the provisions formed in prior financial years €11.7 million was released from the provision for unprofitable assets because these projects had been completed. The first phase of the Campus project was handed over in 2010, so that €6.5 million of the €14.3 million referred to in the previous paragraph could be released.

- movement in the provision due to the change in the discount rate (€2.6 million positive)

The discount rate used to determine the value in use was revised downwards by 0.54 percentage points. A new value in use calculation was performed for the projects on which an investment decision had been taken in the past but which had not yet been handed over at the end of 2010. This relates to WG Oost blok C and Solids 1/2 IJburg.

- provision for expenditure incurred in advance of the investment decision (€8.6 million negative)

This sum was spent in 2010 on a large number of different projects, on which no investment decision had yet been taken but for which the provision for the unprofitable investment exceeded the expenditure to date. The largest sums were spent on Eendrachtsparkbuurt (demolition costs), Can phase 3 (soil removal) and Oostenburg (decontamination costs)

Re 3:

The large number of housing improvement projects (renovation without relocation) undertaken by Stadgenoot constitute an unprofitable asset in excess of €11.8 million.

Re 4:

A modest unprofitable asset of €0.3 million relates to a number of purchases.

7.5. Selected items in detail

Operating income

Stadgenoot's income according to our 2010 consolidated financial statements was €234.7 million, compared with €279.9 million in 2009. The decrease can be attributed entirely to lower sales. The various income items are briefly discussed below.

The income figure presented in the financial statements gives only a limited view of the financial magnitude of Stadgenoot's activities. Project development activities (investments) in the context of rented housing, which are not recognised as income, amounted to €113.8 million. On the sale of an existing asset, only the result is recognised as income, not the actual revenue, which makes a difference of €31.2 million. Including these items, Stadgenoot's adjusted 'income' for 2010 was €379.7 million.

Income from and result on sales

Income from sales in 2010 amounted to over €69.8 million, allocated as follows:

- sales of newbuild	€12.2 million (€84.6 million in 2009)
- sales of existing assets	€57.6 million (€81.5 million in 2009)

Newbuild

Newbuild homes forming part of the Dudokhaken, Wenslauerstraat and Het Schouw projects were sold in 2010. A large part of the income came from VOF Kolenkit, a joint venture with Far West in which Stadgenoot has a 43.1 per cent stake. The result on these newbuild sales was €1.0 million (€6.2 million in 2009), consisting of a distribution of remaining profit (€1.0 million) on the Meer en Oever project developed in conjunction with Properstok. The net result on the sale of the other newbuild homes was nil.

Existing assets

The result on sales of existing assets, amounting to €26.4 million, can be divided into the result on sales of formerly rented housing and the result on other sales.

Sales of existing assets: €22.9 million (€22.2 million in 2009)

The tight property market prevented us meeting our sales target in 2010. We sold 253 homes in 2010 (2009: 296), which fell short of our target of 340 (net result: €25.0 million). It became apparent in mid-2010 that this target was unrealistic, given the current state of the market, and it was revised downwards to 250. The net result on sales of existing assets was €22.9 million (€89,700 per unit), compared with €22.2 million in 2009. Although we were unable to achieve the target of 340 in 2010, the financial result showed little change compared with 2009 due to higher average sales proceeds and a lower value in use of the homes that were sold. To stimulate sales, we ran a no-cost transfer campaign, bearing the purchaser's expenses such as property transfer tax and notary fees. This represented a reduction of around 7 per cent in the total cost to the purchaser, which made financing the purchase easier. The number of sales was higher during the period that the no-cost transfer campaign was running in 2010, compared with the first part of the year before the campaign was launched.

Other sales: €3.5 million (€0.7 million negative in 2009)

Several other sales were completed in 2010. A complex on Nieuwendijk was sold to Stadsgoed Monumenten BV and the GWL site was sold to Rochdale. The result on these sales amounted to €3.5 million.

Income from rents

Total rental income (including rental income generated by subsidiaries) in 2010 amounted to €177.7 million, which was 1 per cent higher than in 2009 (€175.7 million).

The increase was due to a combination of factors, including rent harmonisation, the annual rent increase and the taking of a number of projects into operation.

Social rents were adjusted with effect from 1 July 2010 to take account of inflation in 2009. From that date, it was permitted to increase social rents by a maximum of 1.2 per cent.

Harmonisation has a positive effect on rental income. When a tenant moves out, the rent on the property he leaves is recalculated under the WWS (home valuing scheme).

Taking new projects into operation also has a positive effect on rental income. Dudokhaken in Nieuw-West is a good example of this.

Homes were also taken out of operation in 2010, which had a negative effect on rental income, but the negative effect was only modest because tenants had been leaving in the years before the property was

actually taken out of operation and the homes had been let temporarily or given on loan, which generated less rental income. One project taken out of operation in 2010 was Eendrachtspark in Nieuw-West.

Loss of rental income due to vacancy

At the consolidated level, the loss of rental income due to vacancy of residential and business property in 2010 amounted to €6.5 million (€8.2 million in 2009). The loss relative to total rental income in 2010 was 3.66 per cent (4.66 per cent in 2009).

Loss of rental income, which was €1.7 million lower than in 2009, was due to the deferment of several large demolition, newbuild and renovation projects. This resulted in delays in relocating the tenants occupying the properties, which translated into lower vacancy. In response to disappointing sales, some homes which were vacant awaiting sale were relet.

Loss of rental income at NV Stadsgoed and Stadsgoed Monumenten BV increased from 2.2 per cent to 4.3 per cent. Amsterdamse Compagnie lost rental income of 8.4 per cent in 2010 (€196,000). Compared with 2009, however, Amsterdamse Compagnie's loss of rent was 14.3 per cent lower.

Rent arrears

At the consolidated level, total rent arrears in 2010 amounted to €6.1 million, divided between:

- current tenants €3.9 million (€4.9 million in 2009)
- departed tenants €2.2 million (€1.9 million in 2009)

The arrears in 2010 can be analysed as follows:

	Current tenants	Departed tenants
Residential	1.6 million	1.0 million
Business premises	1.1 million	0.3 million
Subsidiaries	0.4 million	0.4 million
Third-party management	0.8 million	0.5 million
Total	3.9 million	2.2 million

We formed a provision of €2.8 million in 2010 against the risks relating to these receivables, leaving a receivable in respect of rent arrears of €3.3 million (€4.6 million in 2009).

Operating expenses

Operating expenses continued to fall from €239.6 million in 2009 to €166.9 million in 2010, mainly due to:

- a reduction of €10.7 million in exceptional changes in the value of stocks;
- a reduction of €3.2 million in other movements in the value of tangible fixed assets;
- a reduction of €12.5 million in maintenance charges;
- a reduction of €13.5 million in the other operating expenses;
- a reduction of €33.9 million in the subcontracted work relating to newbuild.

Management costs

The management costs include general operating expenses, premises, IT, other staff costs, temporary staff costs and professional fees. The management costs fell from €36.2 million to €23.1 million, largely due to a reduction of €5.5 million in the cost of temporary staff and a €2.3 million reduction in other operating expenses. The acquisition provision for project development was also reduced by €2.9 million.

Staff costs

Stadgenoot's staff costs showed little change in 2010. Partly as a result of the Nieuwe Koers project, the number of FTEs at the end of 2010 was lower than at year-end 2009. Because most of the decrease occurred in the last quarter of 2010, this is not yet reflected in the staff costs. In connection with the Nieuwe Koers project, we spent more on contract termination payments.

Brasa

Stichting Brasa (in which the partners are Stadgenoot, Rochdale, De Key and Ontwikkelingsbedrijf Amsterdam) has been helping its affiliated foundation Sekrepatu to build a local association in Surinam since 2000. The association has now grown into an organisation that owns over 200 homes. The support takes the form of both an exchange of skills and expertise and guaranteeing of loans via DIGH. To cover the operating shortfalls in the start-up phase, the associations set up the Brasa Fund with the approval of the Ministry of Housing, Spatial Planning and the Environment (VROM) as it then was. Agreement was reached in 2010 on winding down the financial support so that Sekrepatu would be able to stand on its own feet as from 2012. Stadgenoot contributed €125,000 to the Brasa Fund and €51,000 to the cost of the operation in 2010.

7.6. Development of the loan portfolio and financing results

General

2010 saw the flight of investors out of loans issued by countries that were giving cause for concern and into countries that offered relative security, which drove interest rates in the two blocs far apart. Because the Netherlands was on the right side of the line, we benefited from unprecedentedly low interest rates. The 50-year interest swap rate fell to 2.41 per cent briefly on 20 August 2010. Considering that the interest rate for that term was 3.74 per cent on 1 January 2010 and ended the year at 3.24 per cent, it is fair to say that the interest rate swings in 2010 were massive in both percentage and absolute terms.

The lower interest rates reduced our average interest costs, although the effect was limited because almost 40 per cent of the loans drawn down have been used for current derivatives contracts for which the interest rate was set in prior years. As in 2009, we combined the majority of the transactions with derivatives to counter the adverse effect of the credit crunch on the interest margins. The availability of long-term funding has improved significantly for businesses that can attract investors to buy their bonds. Because associations obtain private loans mainly from two banks, BNG and NWB, the pricing is less favourable, which means that in some cases our sector has to borrow dear, even compared with businesses that have a lower credit rating.

We are working towards solutions that will ultimately enable us to borrow on the public capital market, in accordance with our creditworthiness, both with and without the WSW guarantee.

Funding policy, related transactions in loans and derivatives and evaluation of the related risks are always on the agenda of Treasury meetings and periodically on the agenda of the Audit Committee. Copies of their reports are submitted to the Supervisory Board.

Transactions

We obtained long-term loans totalling €132 million under WSW guarantee in 2010. A loan contracted without guarantee in 2009 was also drawn down in early 2010. The total loan portfolio increased by €77 million.

We entered into four derivatives contracts in 2010 totalling €103 million. We used these swaps mainly to hedge floating-rate loans; a small part was used to restructure our derivatives portfolio. After the major optimisation effort in 2008, we needed to make only incremental changes to maintain a low average rate, in both absolute terms and relative to the sector average. Maturity of a number of derivatives reduced the nominal amount outstanding by €44 million.

	Derivatives	Long-term loans	Interest rate	Duration
2009	€767.8 million	€1,456 million	4.28%	11.48
2010	€723.7 million	€1,533 million	4.06%	12.41

The duration of our loan portfolio, together with the interest-rate hedge provided by derivatives, increased to 12.41, due partly to the raising of long-term loans and partly to the lower market interest rates.

The average interest coupon for our loan portfolio, together with the derivatives, declined to 4.06 per cent.

Investments in homes over €200,000

Stadgenoot completed nine homes for owner occupation in 2010 which cost more to build than the €200,000 limit. These were one-family houses and apartments in the Wenslauerstraat and Het Schouw projects. Stadgenoot also completed 53 rental units that cost more than €200,000 to build. These are non-subsidised rented housing units in the Dudokhaken and Het Schouw projects. These completions are consistent with Stadgenoot's policy of differentiated building and occupation: we seek to achieve a mixture of owner-occupied, unsubsidised rented and social rented housing in our complexes, which we believe benefits the quality of life and amenity at neighbourhood level.

Supervisors

Each year, Stadgenoot's performance is assessed by the Ministry of Housing, Spatial Planning and the Environment (VROM), CFV (Central Housing Fund) and WSW in their capacity as external supervisors.

In its annual assessment of the financial position of associations, CFV fulfils an advisory role (pursuant to the Decree on the Management of the Rented Social Housing Sector, in the context of central government supervision). Its advice is based on an assessment of solvency ratio using information provided in the financial statements and related digital accounting data. CFV also performs an annual continuity analysis to assess the financial viability of the medium-term investment plans. As agreed, we submitted the digital forecasting information based on the medium-term financial plan 2011–2020.

Neither the continuity analysis nor the solvency ratio assessment for the 2010 financial year is yet available. According to CFV's timetable, they should be available later this year. In its letter dated 25 November 2010, CFV commented with regard to the 2009 solvency ratio assessment 'that, on the basis of the Far West continuity principles, your association's housing capital as at year-end 2009 exceeds the risk calculated for your association and the capital requirement. The assessment would have been that the solvency ratio is adequate if there were no question of winding up the Far West association' and added that 'The fund concludes that implementation of the Far West termination might create uncertainties and risks of material importance for all parties concerned. As regards the solvency ratio assessment, the foregoing means that the fund prefers to withhold judgement'. On the basis of discussions with CFV, the expectation at present is that the continuity assessment for 2011–2020 will be within the required limits and will pose no obstacle to the demerger and integration of Far West.

WSW assesses the financial position and verifies (pursuant to article 8 of the regulations for participation in WSW) that the association complies with the creditworthiness requirements and the guarantee conditions. WSW had not completed its creditworthiness assessment by the end of 2010. The 2009 finding was that there had been no change in Stadgenoot's creditworthiness.

Section 33 of the Social Housing Management Decree (BBSH) requires the Minister of Housing, Spatial Planning and the Environment (VROM), before 1 December of each year, to pronounce a judgement on the activities of the individual associations in the previous reporting year. Pursuant to Section 43a of the BBSH, the Lower House of the Dutch Parliament must be informed of proposed activities in the current year. That section also requires submission of a comprehensive report on the association's activities, including a judgement on its compliance with the primary and secondary legislation, its financial position and its internal organisation and governance.

The Minister's judgement on the 2010 reporting year is not yet available. As regards the financial position, the 2009 judgement took a similar line to the CFV assessment referred to above. Our performance in housing provision has been assessed by the Ministry of Housing, Neighbourhoods and Integration (WWI), which expressed its appreciation of our performance and our neighbourhood-based approach.

7.7. Risk management

Stadgenoot defined its risk policy in a risk-management memorandum in 2010. Because conduct is a key element in the implementation of this policy, we are planning to organise workshops in 2011 for the Supervisory Board, the Managing Board and senior executives and managers to address this aspect. Specific risks will then be identified and process owners appointed for each area of operation. Stadgenoot aims at all costs to prevent risk control degenerating into a box-ticking process.

Organisation risks

Optimum risk management requires an effective system of administrative organisation and internal control, based on maximum possible functional segregation. We speak of 'optimum' risk management and not 'maximum' risk management because it is never possible to guarantee 100% that no instances of material loss, fraud or infraction of primary or secondary legislation will occur at Stadgenoot. It is also necessary at all times to weigh the cost of avoiding risks against the potential (financial) loss.

With the implementation of organisational changes in the context of the Nieuwe Koers project, we have created a balanced organisational structure and formulated the related job descriptions. The business processes are defined in over 50 process descriptions. A start was made in late 2010 on updating these process descriptions to bring them into line with the requirements of the Nieuwe Koers project.

A separate organisational unit, the Auditing and Improvement Management department, has been formed to make risk management more effective. The department is broadly responsible for conducting internal audits, advising on the design, improvement and management of business processes and developing and deploying risk and quality management tools. The Auditing and Improvement Management department is part of the Finance business unit. The department is accountable to the Managing Board for the formulation of audit plans and submits the final audit report to the Managing Board.

The Auditing and Improvement Management department is authorised to make an independent judgement on the basis of its findings. If warranted by its findings, the department may submit an interim report to the Managing Board. If the Managing Board is unreceptive to the department's findings, the department has the right and is obliged to contact the chairman of the Audit Committee directly.

Audits

The Auditing and Improvement Management department performed a documentary analysis of all procedures and internal rules relating to tendering, procurement and purchasing in order to assess their integrity, transparency and efficiency. It concluded that, while documentation was generally well organised, there was room for improvement in terms of uniformity of structure and content.

The department also performed the following audits.

- Treasury fraud risks
- Property purchases
- Project development tendering procedures
- Associated entities and participating interests
- Supervision structure for VvE Beheer Amsterdam BV.

The general conclusion was that internal control of these processes was adequate, but the following improvements could be made:

- Clearer records should be kept (especially for the first three audits).
- The effective exchange of information relating to associated entities among all staff members concerned across the organisation should be promoted, with separate reporting of the findings of the annual evaluation of the associated entities.
- Managing Board bylaws should be drawn up, with clear-cut remits relating to associated entity VvE Beheer Amsterdam BV, in consultation with fellow shareholder De Key.

This will make it possible to demonstrate to third parties, if required to do so in the future, that we have acted ethically and in accordance with the remit. The audit reports have been adopted by the Managing Board and discussed with the members of the Audit Committee. The auditor is provided with copies of the audit reports for information.

The recommendations were implemented by the senior executives and managers concerned and the 2011 audit plan includes a reaudit of the processes referred to above. Eight primary business processes, including the procedure for taking properties into operation and the selling process, will also be audited.

Improvement projects

The Auditing and Improvement Management department participated in the Vacancy and Service Improvement project group in 2010, helping to identify problems with the current processes and reconfiguring the processes in the interests of more efficient operation, effective risk management and improved quality.

Insurance

The Auditing and Improvement Management department oversees professional operation and management of the insurance portfolio as part of the risk control function. The following improvements were made in 2010:

- In the interests of maximum efficiency in the processing of fire and buildings insurance claims greater than the policy excess (deductible), a procedure has been agreed with the assessment bureau and the broker which enables these claims to be processed more quickly and with the investment of less of our staff's time.
- Properties have been grouped by type of insurance into standard properties, special properties and owners' associations (VvEs), with a view to reducing the risks of under-insurance.
- A number of glass, fire and buildings insurance policies have been combined and a fee structure instead of a commission-based structure has been agreed with the broker, to ensure that insurance is purchased on the best possible terms.
- A tendering procedure for fire and buildings insurance was initiated in January 2011 in consultation with all parties concerned within Stadgenoot, because the group fire and buildings insurance taken out together with other Amsterdam associations expired at the end of 2010.

To facilitate the efficient processing of claims and imputations of liability by the relevant departments within Stadgenoot and to support the prevention policy designed to reduce the burden of claims, an insurance team consisting of staff from the Property division, the Residential Property business unit and the Commercial/Civic Property business unit is to be set up in 2011 under functional control.

In view of the specialist expertise required, AVM has chosen to deploy an external expert instead of a permanent member of staff. The expert's expenses are included in professional fees.

Financial continuity risks

How do we safeguard our financial continuity? First and foremost, we do this through the planning and control (P&C) cycle. In practical terms, our task is to manage and to render account. For the products we offer, the P&C cycle at Stadgenoot is concerned primarily with managing and only partly with rendering account. Consequently, the management reports focus mainly on projections in relation to the targets (budgets). Actual performance is used only to analyse in greater depth and finalise the projections.

Responsibility for the P&C cycle is vested in the Finance and Strategy & Policy business units. Substantive consideration of all the output from the planning and control process takes place via the Managing Board and senior management.

The solvency ratio is a good indicator of financial continuity. What action did Stadgenoot take in 2010 to control the deterioration in the solvency ratio? Taking into account the nature of the organisation, the capital structure and the external financing requirements, we set the structural solvency ratio target at 30 per cent, with a bandwidth of plus and minus 2.5 per cent and a lower limit of 25 per cent.

Another important indicator of financial health is the interest coverage ratio (ICR). This ratio indicates the extent to which operational cash flows are sufficient to meet the interest charges now and in the future. Consistent with normal practice in the property and housing association markets, Stadgenoot has set a minimum ICR target of 1.1.

A Medium-Term Financial Plan (MJP) for the period 2010–2019 was formulated at the end of 2009. In response to the economic crisis, we revised the MJP in 2010 to bring it into line with the current economic reality and substantially reduce the investment volume. The MJP serves as input to CFV's assessment of financial continuity and WSW's assessment of creditworthiness. The duly adopted MJP meets both the solvency ratio target and the ICR target and, on that basis, we have been awarded a positive creditworthiness certificate.

Despite all our control measures, Stadgenoot is not able to exert significant direct influence over the most important risks to its financial continuity. It is largely exogenous factors, such as inflation, the economy, rental

legislation, politics and European regulations on state support, that have a substantial direct effect on financial position and future cash flow.

A combination of highly prudent financial policy and good management is the only effective response.

Project risks

Despite the significant reduction in investment volume for the next five years, Stadgenoot still had a substantial project development portfolio at the end of 2010. Project investments are expected to average €120 million per year for the next five years. Such a high level of project development activity, including both newbuild and restructuring, presents significant financial risks, so an effective risk control system is essential. In its project development operations in 2009, Stadgenoot continued to develop the risk-control measures deployed in 2008:

- implementing the integrated project administration system;
- allocating project responsibility to project development when the decision to start the project is taken;
- explicitly vesting control of project development in the officially recognised housing association;
- completing the process architecture which has already been implemented;
- clearly defining remits;
- simplifying alliances within project development.

Treasury risks

Our organisation needs a large amount of borrowed capital, in both relative and absolute terms, so it is essential to optimise the access to and cost of this finance. Stadgenoot regularly enters into large loan and derivatives contracts in order to control these cash flows and to assist with the effective timing of (re)financing transactions to coincide with repayments of existing loans and financing of new investments. The related processes of scheduling, execution and administration are defined in our treasury and investment regulations.

The main aspects covered are:

- organisation design;
- functional segregation;
- definition of remits and signatory powers;
- procedures and instructions.

The Auditing & Improvement Management department conducted a fraud risk audit at the Treasury department in 2010. The general conclusion was that the control measures in place provided adequate protection against the fraud risks identified in the treasury process. The issues raised and recommendations made in the report have led to improvements to working processes and better definition of responsibilities, resulting in new recording procedures and changes to the treasury and investment regulations.