Treasury Policy

(Incorporating Council's Investment and Liability Management Policies)

August 2014

Contents

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Responsibility	**Corporate Services**

INVESTMENT POLICY

1.0 Summary

1.1 The following is developed pursuant to Section 102 (4) LGA 2002. It seeks to outline the suggested content for an Investment Policy in compliance with Section 105 of the LGA 2002. It discloses Council's principles of prudent financial management and risk mitigation strategies as they relate to investments.

2.0 Policy Objectives

2.1 The objectives of this policy are:

- To comply with sections 102 and 105 of the Local Government Act 2002.
- To promote long term prudent financial management.
- To outline how investment risk associated with investment activities is assessed and managed.
- To outline how investments (strategic, equity, and treasury) are managed and reported on.
- To safeguard WDC's financial market investments by establishing and regularly reviewing investment parameters and ensuring that all investment activities are carried out within these parameters
- Ensure the integrity of WDC's financial market investments by only investing in appropriately rated organisations and in appropriate financial instruments, as detailed in this policy
- Produce accurate and timely information that can be relied on by senior management and Council for control and exposure monitoring purposes in relation to the investment activities of WDC.

3.0 Statutory Requirements

3.1 Section 105 of the LGA 2002 outlines the content of an investment policy:

105 Investment Policy

A policy adopted under section 102(1) must state the local authority's policies in respect of investments, including—

(a) [Repealed]

(b) the mix of investments; and

(c) the acquisition of new investments; and

(d) an outline of the procedures by which investments are managed and reported on to the local authority; and

(e) an outline of how risks associated with investments are assessed and managed.

4.0 Relationship to other Council Policies

4.1 It is important when reading this policy that it is read in conjunction with other related Council policies. Council policies often reference and inform each other so that any issue before Council can be dealt with in an integrated and comprehensive fashion. Policies that have a clear relationship with this Investment Policy are:

- The **Liability Management Policy** (for borrowing by the Council and guarantees by the Council which are ultimately a liability);

- Council's **Significance and Engagement Policy** (which if triggered by a proposal to make an investment will mean that the proposal will be subject to further decision-making and consultation requirements).

5.0 Mix of Investments

5.1 Council is a risk adverse entity and therefore takes a prudent approach to managing its investments. Council seeks to maintain diversity in its investment portfolio to spread and minimise risk. Council generally has three types of investments:

- **Strategic Investments** - investments made or held in alignment to Council's strategic direction and typically retained on a long term basis. These include property investments - i.e. land and buildings (including subdivisions) – quarries, forestry and property vested in the Council.

- **Equity Investments** - equity (ownership) participation in a private (unlisted) company (including Council Controlled Organisations) or a start-up (a company being created or newly created). Such investments may not necessarily provide a financial return to Council, and may be held for wider social, tactical and/or economic reasons. Notwithstanding, Council will continue to actively seek opportunities for a financial return from all such investments.

- **Treasury Investments** – short to medium term financial investments that maximise financial return but ensure an appropriate level of liquidity for forecast expenditure.

5.2 WDC shall manage its short term money market and longer term fixed interest investments in accordance with the parameters contained in Appendix 1 of this policy.

6.0 New Investments

6.1 Prior to making new strategic or equity investments Council will consider (where relevant):

- The expected financial return.
- How the investment will contribute in furthering the Waitomo District's Community Outcomes as documented in the Long Term Plan.
- The existing investment portfolio and how the proposed investment 'fits' in terms of Council's preference to spread and minimise risk.

- Any other consideration Council deems appropriate.

6.2 Despite anything earlier in this Policy on Investment, the Council may invest in shares and other financial instruments of the New Zealand Local Government Funding Agency Limited (LGFA), and may borrow to fund that investment.

6.3 The Council's objective in making any such investment will be to:

- Obtain a return on the investment; and
- Ensure that the LGFA has sufficient capital to become and remain viable, meaning that it continues as a source of debt funding for the Council.

6.4 Because of this dual objective, the Council may invest in LGFA shares in circumstances in which the return on that investment is potentially higher than the return it could achieve with alternative investments.

6.5 If required in connection with the investment, the Council may also subscribe for uncalled capital in the LGFA.'

7.0 Management and Reporting

7.1 Investments will generally be monitored and reported through Council's established reporting procedures (Quarterly and Annual Report).

7.2 For equity investments:

- Transparency and reporting mechanisms will be key elements in any governance arrangements. The frequency and nature of reporting will depend on the nature and size of each investment.
- In general terms reporting will comply with generally accepted accounting practice and International Financial Reporting Standards.
- Performance of investments will be reported in accordance with any governance arrangements, but no less than on a six monthly and annual basis.

8.0 Risk Management

8.1 Council is a risk adverse entity and therefore takes a prudent approach to managing its investments. Council seeks to maintain diversity in its investment portfolio to spread and minimise risk.

8.2 Where material risk to Council is apparent (e.g. equity investments) Council will commission an independent risk assessment and management report prior to entering into the investment.

8.3 To ensure the protection of Treasury investments Council will only invest with credit worthy counter parties. Low risk counter parties are defined as those having a Standard and Poors rating of AA- or better.

APPENDIX 1

Authorised Investment Criteria for Short Term Funds and Long Term Funds

Authorised Asset Classes	Overall Portfolio Limit as a Percentage of the Total Portfolio	Approved Financial Market Investment Instruments (must be denominated in NZ dollars)	Credit Rating Criteria – Standard and Poor's (or Moody's or Fitch equivalents)	Limit for each issuer subject to overall portfolio limit for issuer class
New Zealand Government	100%	• Government Stock • Treasury Bills	Not Applicable	Unlimited
Local Authorities where rates are used as security	70%	• Commercial Paper • Bonds/MTN's/FRN's	Not Applicable	$2.0 million $2.0 million
New Zealand Registered Banks	100%	• Call/Deposits/Bank Bills/Commercial Paper • Bonds/MTN's/FRN's	Short term S&P rating of A1 or better Long term S&P rating of A+ or better	$7.5 million $2.5 million
State Owned Enterprises	60%	• Commercial Paper • Bonds/MTN's/FRN's	Short term S&P rating of A1 or better Long term S&P rating of BBB+ or better Long term S&P rating of A+ or better	$2.0 million $1.0 million $2.0 million
Corporates	60%	• Commercial Paper • Bonds/MTN's/FRN's	Short term S&P rating of A1 or better Long term S&P rating of A- or better Long term S&P rating of AA or better	$2.0 million $1.0 million $2.0 million

Investments that no longer comply with minimum rating criteria due to a rating downgrade must be sold within one month of the downgrade being notified unless Council formally approves the continued holding of the investment.

LIABILITY MANAGEMENT POLICY

1.0 Background

1.1 The Local Government Act 2002 (LGA 2002) empowers a local authority to undertake any activity or business on behalf of its communities. Unlike its predecessor, LGA 2002 provides a form of general empowerment to councils to enable them to enter contracts and undertake transactions, etc, similar to the way in which a private individual or company would. The introduction of an empowering framework provided for in the legislation removes the need for complex prescriptive legislation that by definition prevents council flexibility and responsiveness.

1.2 The legislation however requires that Councils' must conduct their business in an open and transparent manner and be accountable for the decisions made by them. They have to undertake any commercial transactions in accordance with sound business practices. Councils have to abide by significant procedural requirements especially with regard to financial management. These are aimed to ensure that decisions are made in light of community views; decisions are subject to public scrutiny; and ultimately electoral accountability.

1.3 The requirement to have a Liability Management Policy is an example of these procedural requirements. This requirement is designed to ensure that local government is transparent and accountable when exercising its stewardship role.

2.0 Statutory Requirements

2.1 Section 104 of the LGA 2002 outlines the content of a liability management policy:

104 Liability Management Policy

A policy adopted under section 102(1) must state the local authority's policies in respect of both borrowing and other liabilities, including—

(a) interest rate exposure; and
(b) liquidity; and
(c) credit exposure; and
(d) debt repayment.

3.0 Liability Management Policy for the Waitomo District Council

3.1 The following policy is developed pursuant to Section 102(1). It seeks to outline the suggested content for a Liability Management Policy in compliance with Section 104 of the LGA 2002. It discloses Council's principles of prudent financial management and risk mitigation strategies as they relate to liability management.

4.0 Policy Objectives

4.1 The objectives of this Policy are:

- To comply with Sections 102 (1) and 104 of the LGA 2002.

- To promote long term prudent financial management.

- To outline how liability risk associated with borrowing activities is assessed and managed.

- To outline how liabilities (current and non current) are managed and reported on.

- Ensure that WDC has an ongoing ability to meet its debts in an orderly manner as and when they fall due in both the short and long-term, through appropriate liquidity and funding risk management

- Arrange appropriate funding facilities for WDC, ensuring they are at market related margins utilising bank debt facilities and/or capital markets as appropriate.

- Maintain lender relationships and WDC's general borrowing profile in the local debt and, if applicable, capital markets, so that WDC is able to fund itself appropriately at all times.

- To provide appropriate levels of funding for investments (in accordance with Sections 3.0, 5.0, 6.0 and 8.0 of the Council's Investment Policy) and as may be authorised from time to time by way of Council resolution.

- Control WDC's cost of borrowing through the effective management of its interest rate risk, within the rate risk management limits established by the liability management policy.

- Ensure compliance with any finance/borrowing covenants and ratios.

- Maintain adequate internal controls to mitigate operational risks.

- Produce accurate and timely information that can be relied on by senior management and Council for control and exposure monitoring purposes in relation to both the debt raising and financial market investment activities of WDC.

5.0 Relationship to other Council Policies

5.1 It is important when reading this Policy that it is read in conjunction with other related Council policies. Council policies often reference and inform each other so that any issue before Council can be dealt with in an integrated and comprehensive fashion. Policies that have a clear relationship with this Liability Management Policy are:

- The Policy on Investments (outlines principles of prudent financial management and risk mitigation strategies as they relate to investments).

- Council's Significance and Engagement Policy (which if triggered by a proposal will mean that the proposal will be subject to further decision-making and consultation requirements).

- The Revenue and Financing Policy (which outlines that proceeds from assets sales will be applied to debt repayment).

6.0 Organisational Structure

6.1 Council has established a Treasury Management Committee (TMC) whose duties are listed below. The TMC shall comprise –

- Group Manager – Corporate Services
- Finance Manager
- Senior Accountant
- WDC's Independent Treasury Advisor

6.2 Duties shall comprise of:

Full Council

- Approve Treasury Policy (TP), including any amendments proposed by the TMC
- Approve any hedging outside the parameters of the TP
- Approve the use of any risk management products not authorised by the TP
- Monitor treasury performance through receipt of appropriate reporting
- Approve overall borrowing limits on an annual basis through the Annual Plan process
- Determination of any Local Government Funding Agency transactions as per Section 11 of this Policy.

Treasury Management Committee

- Plan and discuss all funding and interest rate risk management activities of WDC prior to implementation/execution.

- Plan and discuss all financial market investment activities of WDC prior to execution.
- Monitor and review the ongoing treasury performance of WDC and compliance with TP parameters through the receipt of regular reporting.
- Conduct a review of the TP every three years or on an ‘as required’ basis and submit any recommended changes to Council for approval once the necessary statutory processes have been followed.

Chief Executive Officer

- In the absence of the Group Manager – Corporate Services, oversee the funding, interest rate risk management and financial market investment activities of WDC.
- In the absence of the Group Manager - Corporate Services undertake all his/her duties as detailed in the Liability Management Policy and the Policy on Investments or delegate the duties as appropriate.
- In the absence of the Group Manager – Corporate Services sign documents relating to the financial market activities of WDC.

Group Manager – Corporate Services

- Make decisions in respect to treasury management within the parameters of the TP.
- Report to Council on overall treasury activity on a regular basis.
- Manage the bank lender and capital markets relationships, providing financial information to lenders and negotiate new/amended borrowing facilities or methods for approval by the full Council.
- Sign documents relating to the financial market activities of WDC.
- Execute treasury transactions in the absence of the Senior Accountant.
- Check external confirmations against internal records.

Finance Manager

- In the absence of the Group Manager – Corporate Services undertake all his/her duties under a delegated authority, other than those duties delegated to the Chief Executive Officer.
- In the absence of the Senior Accountant undertake all his/her the duties under a delegated authority.
- Check external confirmations against internal records.

Senior Accountant

- Execute treasury transactions.
- Assist the Group Manager – Corporate Services in the preparation of reports to Council.
- Check external confirmations against internal records.

7.0 Interest Rate Exposure

7.1 Interest rate risk is the risk of significant unplanned changes to interest costs as a result of financial market movements.

7.2 The objective of managing interest rate risk is to have a framework in place under which Council can actively manage its borrowings within overall guidelines to spread and reduce risk and stabilise interest costs.

7.3 Borrowings can only be made in New Zealand dollars (Section 113 of the LGA 2002).

7.4 The interest rate exposures of WDC shall be managed according to the parameters detailed in the following table and shall apply to the projected core debt of WDC. Core debt is defined as that contained in the Annual Plan or as otherwise determined by the Group Manager – Corporate Services.

Fixed Rate Hedging Percentages		
	Minimum Fixed Rate Amount	**Maximum Fixed Rate Amount**
0 – 2 years	50%	100%
2 – 5 years	30%	80%
5 – 10 years	0%	50%

7.5 To manage the interest rate risk associated with its debt WDC may use the following interest rate risk management instruments.

- Interest rate swaps.
- Swaptions.
- Interest rate options, including collar type structures but only in a ratio of 1:1.
- Forward rate agreements.
- Fixed Rate Term Loans.
- (Refer to Appendix 1 for definitions and objectives of each of the interest rate risk management instruments)

7.6 Council may retain the services of an Independent Treasury Advisor to assist in managing the funding and interest rate risks of WDC.

8.0 Liquidity

8.1 The objective of managing liquidity is to ensure that Council has adequate financial resources available to meet all its obligations as they fall due.

8.2 To avoid a concentration of debt maturity dates Council will, where practicable, aim to have no more than 50% of debt subject to refinancing in any 12 month period.

8.3 Council's main revenue sources are cyclical in nature and therefore committed bank facilities are required to ensure sufficient funds can be called upon when required.

8.4 WDC shall aim to maintain committed funding lines of not less than **105%** of projected core debt. (Core debt is defined as that contained in the Annual Plan or as otherwise determined by the Group Manager-Corporate Services).

9.0 Credit Exposure

9.1 Credit risk is the risk that a party to a transaction will default on its contractual obligation. A credit risk may exist when the credit rating of an entity with which Council has borrowings with deteriorates.

9.2 Council will only enter into borrowing agreements with creditworthy counterparties. Creditworthy counterparties are selected on the basis of their Standards and Poors rating which must be AA- or better.

10.0 Funding Methods

10.1 WDC may obtain funding utilising the following methods:

- Bank debt
- Capital markets issuance comprising Fixed Rate Bonds, Medium Term Notes and Floating Rate Notes

11.0 Local Government Funding Agency

11.1 Despite anything earlier in this Liability Management Policy, the Council may borrow from the New Zealand Local Government Funding Agency Limited (LGFA) and, in connection with that borrowing, may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA;
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required;
- Subscribe for shares and uncalled capital in the LGFA; and
- Secure its borrowing from the LGFA, and the performance of other obligations to the LGFA or its creditors with a charge over the Council's rates and rates revenue.

12.0 Debt Repayment

12.1 The objective of managing debt repayment is to ensure that Council is able to repay debt on maturity with minimum impact on Council operations.

12.2 Borrowings will be repaid as they fall due in accordance with the applicable loan agreement. Subject to borrowing limits, a loan may be rolled over or re-negotiated as and when appropriate.

12.3 All borrowings are deemed to be corporate borrowings. Debt repayments will be made from general funds, by funds raised specifically to repay debt and by proceeds from asset sales. Funds derived from any asset sales are applied first to offset borrowing in the relevant activity from which the asset is sold.

12.4 The cost of capital is spread over significant activities using internal loans. Internal loans are raised to cover the economic life of capital projects to a maximum of 30 years for infrastructural assets and 15 years for other assets.

13.0 Specific Borrowing Limits

13.1 Council will borrow to fund its total funding needs in accordance with the annual plan. Borrowing includes funding of short term working capital and long term capital investment. In general terms, Council approves borrowing through the Annual Planning process with public disclosure by way of resolution.

13.2 Ratios based on revenue and debt servicing and debt to equity are used for measuring a prudent borrowing level. Council borrowing limits are based on the following ratios:

- Total interest expense will not exceed **15%** of total revenue.
- Total borrowings will not exceed **25%** of total equity. Total borrowings must not exceed **20%** of total assets.
- Net debt will not exceed **170%** of total [cash] revenue.
- Net interest will not exceed **20%** of annual rates.

APPENDIX 1

Forward Rate Agreement

An agreement between WDC and a counterparty (usually a bank) protecting WDC against a future adverse interest rate movement. WDC and the counterparty agree to a notional future principal amount, the future interest rate, the date and the benchmark rate (BKBM).

Objective

To provide WDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. A Forward Rate Agreement (FRA) typically applies to a 3 month period, starting at some point within the next 12 months.

Interest Rate Swap

An interest rate swap is an agreement between WDC and a counterparty (usually a bank) protecting WDC against a future adverse interest rate movement. WDC pays a fixed interest rate and receives a floating interest rate. The parties agree to a notional principal amount, the future interest rate, the settlement dates and the benchmark floating rate (BKBM).

Objective

To provide WDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. Floating rate sets are typically every 1 or 3 months over the life of the swap.

Forward Start Interest Rate Swap

A Forward Start Interest Rate Swap is a financial instrument that fixes the interest rate for a set amount of debt at some date in the future (generally up to 2 years). These transactions are negotiated with Banks.

Objective

To provide WDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period, commencing at a future point in time. All other conditions are as with an interest rate swap.

Options on a Swap – *Swaption*

A 'Swaption' is an option to enter into an interest rate swap. In exchange for an option premium, the buyer gains the right but not the obligation to enter into a specified swap agreement with the issuer on a specified future date.

Objective

To provide WDC with the right but not the obligation to enter into a fixed rate swap at a future point in time on an agreed principal amount for an agreed period. A *swaption* is an option on a swap and typically requires a premium to be paid.

Interest Rate Options

The purchase of an interest rate option gives the holder (in return for the payment of a premium) the right but not the obligation to borrow (described as a cap) or invest (described as a floor) at a future date. WDC and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark floating rate (BKBM).

Objective

To provide WDC with worst case cover on its interest rate cost on an agreed principal amount for an agreed period. As for an interest rate swap, rate sets are typically at each 1 or 3 month date for the life of the option. A premium is payable for entering into an interest rate option.

Interest Rate Collar

The combined purchase (or sale) of a cap or a floor with the sale (or purchase) of another floor or cap.

Objective

To provide WDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period, but at the same time avoid the need to pay an up front premium.

Fixed Rate Term Loans

A Fixed Rate Term Loan is an agreement between WDC and a counterparty (usually a bank) protecting WDC against a future adverse interest rate movement. WDC pays a fixed interest rate as set by the counterparty on an agreed principal amount for the term of the loan.

Objective

To provide WDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period.