Waitomo
District Council

Treasury Policy

(Incorporating Council's Investment and Liability Management Policies)

2018

Contents

Last Review	**August 2014**
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Responsibility	**Corporate Services**

Introduction

1. Waitomo District Council undertakes borrowing and investment activities. Together these make up the Treasury Management activity. Council's borrowing and investment activities are carried out within the requirements of the Local Government Act 2002 (LGA) and its various amendments, which define the operating environment for local authorities in relation to borrowing, investment and treasury risk management.

2. The Treasury Policy includes the Investment Policy and the Liability Management Policy as required by Part 6, sections 104 and 105 of the LGA. The policy provides the framework for all of Council's treasury activities and the operating parameters within which the treasury activity is to be carried out.

INVESTMENT POLICY

Purpose and scope

1. The purpose and scope of this policy is:

   a) To prudently manage the Council's financial investments by seeking to maximise investment income within acceptable investment risk parameters.

   b) To promote long term prudent financial management.

   c) To manage the operational cash position and ensure that any surplus cash is invested in approved liquid instruments, or used to minimise debt.

   d) To safeguard Council's investments by establishing and regularly reviewing investment parameters and ensuring that all investment activities are carried out within these parameters

   e) Ensure the integrity of Council's investments by only investing in appropriately rated organisations and in appropriate financial instruments, as detailed in this policy

   f) Produce accurate and timely reporting on investment performance

Relationship to other Council Policies

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.

2. Policies that have a clear relationship with this Investment Policy are:

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

   b) The **Revenue and Financing Policy** (for sources and level of funding);

   c) 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).

Policy statement

1. Mix of Investments

1.1. **Council's** investments are maintained to meet specific strategic and economic objectives outlined in the Long Term Plan (LTP). Council generally has the following types of investments.

1.2. **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, and quarries.

1.3. **Equity Investments** - equity (ownership) participation in a private (unlisted) company (including Council Controlled Organisations). 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.

1.4. Council currently maintains equity investments in Inframax Construction Ltd (ICL), Waikato Local Authority Shared Services Ltd (WLASS), and Civic Financial Services Ltd.

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

1.6. **Loan Advances** – Council has an existing outstanding community loan advance that it will manage until repayment is complete.

1.7. **Local Government Funding Agency (LGFA) Borrower Notes** – Must be subscribed for when borrowing from the LGFA at 1.6% of the amount borrowed. The notes are repaid when the related debt is repaid, they are subordinated and may convert to LGFA shares in some circumstances rather than being repaid.

2. New Investments

Strategic Considerations

2.1. Prior to making new investments Council will consider

a) The expected financial return.

b) Initial risk assessment of the proposed investment

c) How the investment will be funded

d) How the investment will contribute in furthering the Waitomo District's Community Outcomes as documented in the Long Term Plan.

e) The existing investment portfolio and how the proposed investment 'fits' in terms of Council's preference to spread and minimise risk.

f) Any other consideration Council deems appropriate.

2.2. Generally it is not Council's intention to undertake new equity investments other than to achieve strategic objectives.

2.3. Despite anything earlier in this Policy on Investment, the Council may invest in shares and other financial instruments of the Local Government Funding Agency Limited (LGFA), and may borrow to fund that investment, after taking into account the strategic considerations set out in 2.1 above.

2.4. The purchase or disposal of investment property will be given effect to by the Chief Executive and is subject to an adopted Long Term Plan or the Exceptions Annual Plan.

2.5. Council will consider any requests for loan advances on a case by case basis and will take into account the needs of the community and Council's stated outcomes for the District in its considerations.

3. Management and Reporting

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

3.2. 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.

3.3. Reporting will comply with generally accepted accounting practice and applicable accounting standards for financial reporting purposes.

3.4. Performance of investments will be reported in accordance with any governance arrangements, but no less than on a six monthly and annual basis.

4. Risk Management

4.1. 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.

4.2. 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.

4.3. To ensure the protection of Treasury investments (short term money market or medium term fixed interest investments), Council will only invest with credit worthy counter parties and in accordance with Appendix 1.

4.4. Council may periodically review investments with a view to exiting at a time when market conditions are favourable and if the overall strategic objectives are not compromised.

Investment Policy - APPENDIX 1

Authorised Investment Criteria for Treasury Investments

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 A-1 or better Long term S&P rating of A or better	$7.5 million $2.5 million
Local Government Funding Agency (LGFA)	100%	• Borrower Notes • Commercial Paper • Bonds/MTN's/FRN's	Not Applicable	Unlimited

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

Purpose and scope

1. The scope and purpose of this policy is:

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

    b) To promote long term prudent financial management.

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

    d) To outline how liabilities are managed and reported on.

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

    f) Arrange appropriate funding facilities for WDC at competitive pricing.

    g) Maintain relationships with banks, investors, the Local Government Funding Agency and other creditors.

    h) To provide appropriate levels of funding for investments and as may be authorised from time to time by way of Council resolution.

    i) 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.

    j) Ensure compliance with all financial covenants and ratios within this policy and any others agreed to with other significant creditors.

    k) Maintain adequate internal controls to mitigate operational risks.

    l) Produce accurate and timely information for control and monitoring purposes in relation to both the debt raising and financial market investment activities of WDC.

Relationship to other Council Policies

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.

2. Policies that have a clear relationship with this Liability Management Policy are:

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

b) 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).

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

d) Council's accounting policies for financial reporting.

Policy Statement

1. Liability Management Policy for the Waitomo District Council

1.1. 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.

2. Organisational Structure

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

2.1.1. Group Manager – Corporate Services

2.1.2. Finance Manager

2.1.3. Senior Accountant

2.1.4. WDC's Independent Treasury Advisor

2.2. Full Council duties

2.2.1. Approve Treasury Policy (TP), including any amendments proposed by the TMC

2.2.2. Approve any hedging outside the parameters of the TP

2.2.3. Approve the use of any risk management products not authorised by the TP

2.2.4. Monitor treasury performance through receipt of appropriate reporting

2.2.5. Approve overall borrowing levels on an annual basis through the Annual Plan and first year of the Long Term Plan process.

2.2.6. Determination of any Local Government Funding Agency transactions as per Section 11 of this Policy.

2.3. Treasury Management Committee duties

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

2.3.2. Monitor and review the ongoing treasury performance of WDC and compliance with TP parameters through the receipt of regular reporting.

2.3.3. 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.

2.4. Chief Executive Officer duties

2.4.1. To approve recommendations made by the Treasury Management Committee in respect to treasury management within the parameters of the TP.

2.4.2. Execute and sign various legal documents with respect to extending security under the Debenture Trust Deed.

2.4.3. To approve the opening or closing of bank accounts.

2.5. Group Manager – Corporate Services duties

2.5.1. To approve recommendations made by the Treasury Management Committee in respect to treasury management within the parameters of the TP.

2.5.2. Report to Council on overall treasury activity on a quarterly basis as part of the Quarterly Financial and Non-financial Reporting process.

2.5.3. 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.

2.5.4. Sign documents relating to the financial market activities of WDC.

2.5.5. Check external confirmations against internal records.

2.6. Finance Manager duties

2.6.1. Check external confirmations against internal records.

2.6.2. Check cash payments of treasury transactions.

2.7. Senior Accountant duties

2.7.1. Execute treasury transactions.

2.7.2. Assist the Group Manager – Corporate Services in the preparation of reports to Council.

2.7.3. Review the Treasury Management Report that forms part of the Financial and Non-financial Quarterly Report.

3. Interest Rate Exposure

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

3.2. 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.

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

3.4. 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	40%	100%
2 – 5 years	30%	80%
5 – 15 years	0%	50%

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

3.5.1. Interest rate swaps.

3.5.2. Forward start interest rate swaps.

3.5.3. Swaptions.

3.5.4. Interest rate options.

3.5.5. Interest rate collars (only in a ratio of 1 to 1).

3.5.6. Fixed rate bonds.

3.5.7. Fixed Rate Term Loans.

(Refer to Appendix 1 for definitions and objectives of each of the interest rate risk management instruments)

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

4. Liquidity

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

4.2. To avoid a concentration of debt maturity dates Council will, where practicable, aim to have no more than **33%** of debt subject to refinancing in any 12 month period.

4.3. 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.

4.4. Subject to clause 8.5 committed funding lines shall be maintained of not less than **110%** 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).

4.5. At balance date in accordance with the Local Government Funding Authority Multi-Issuer Deed the Available Financial Accommodation will be more than **110%** of External Indebtedness.

5. Credit Exposure

5.1. 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.

5.2. 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 A or better.

6. Funding Methods

6.1. WDC may obtain funding utilising the following methods:

6.1.1. Bank debt; Money market loans (Term and Call Advances), Term Loans and Overdrafts.

6.1.2. Issuances of Fixed Rate Bonds, Medium Term Notes and Floating Rate Notes to the LGFA on either a bespoke basis or participation in the LGFA tender process.

6.1.3. Capital markets issuances through either Fixed Rate Bonds, Medium Term Notes and Floating Rate Notes

7. Local Government Funding Agency

7.1. 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:

7.1.1. Contribute a portion of its borrowing back to the LGFA in the form of Borrower Notes;

7.1.2. Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;

7.1.3. Commit to contributing additional equity or approve the conversion of Borrower Notes to equity of the LGFA if required;

7.1.4. Subscribe for shares and uncalled capital in the LGFA; and

7.1.5. 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.

8. Debt Repayment

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

8.2. 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.

8.3. All borrowings are deemed to be corporate borrowings except for borrowings that fund Council's shareholding investment in its subsidiary company; Inframax Construction Limited.

8.4. Debt repayments will be made from general funds, by any funds raised specifically to repay debt and by proceeds from asset sales, except for any sale of Council's investment in Inframax Construction Limited, where these proceeds will be applied to borrowings relating to that shareholding, in the first instance.

8.5. 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.

9. Specific Borrowing Limits

9.1. Council will borrow to fund its total funding needs in accordance with the Exceptions Annual Plan or first year of the Long Term Plan. Borrowing includes the funding of short term working capital requirements and long term capital investments. In general terms, Council approves borrowing through the annual planning process with public disclosure by way of resolution.

9.2. Council will adhere the following financial covenants in the management of its liabilities:

- Total borrowing costs will not exceed 10% of total revenue
- The ratio of net interest to total revenue will not exceed 20% Total borrowings must not exceed 20% of total assets.
- The ratio of net debt to total cash revenue will not exceed 170%
- Net interest will not exceed 20% of annual rates

10. Accounting treatment of financial instruments

10.1. Derivative financial instruments are used primarily for the management of interest rate risk.

10.2. Public benefit accounting standards require that any changes in fair value of derivative financial instruments go through the Income Statement unless a hedge relationship has been designated and is effective.

10.3. Where an effective hedge is determined any change in value will show as "Other Comprehensive Revenue and Expense" and rather than being included in the Net Operating Cost/(Surplus) result and is transferred directly to a reserve within equity.

10.4. Valuations of derivative financial instruments are to be carried annually for balance date by an independent third party for financial reporting purposes. Indicative valuations are to be provided by the counter party to the financial instrument and reported to Council as part of the Quarterly Financial and Non-financial Reporting process.

10.5. Management of derivatives will continue with the dual purpose of managing interest rate risk and remain within the hedge accounting framework. Where at all possible hedge accounting be carried out.

10.6. The purpose of this policy to is remove market related volatility due to valuation changes in derivative financial instruments from the Statement of Comprehensive Revenue and Expenditure statement.

Liability Management Policy - APPENDIX 1

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.

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.

Fixed Rate Bond

A Fixed Rate Bond is a debt instrument where the amount of interest is constant throughout the term of the bond.

Objective

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