TREASURY POLICY

Incorporating Investment and Liability Management Policies in accordance with Sections 104 and 105 of the Local Government Act 2002.

Philosophy

Council has treasury risks arising from debt raising, investments and associated interest rate management activity.

Council carries out its liability management and investment activity (in total referred to in this document as treasury activity) within its finance function. Council's broad objectives in relation to treasury activity are as follows:

- Comply with the Local Government Act 2002, particularly Sections 102(4)(b), 102(4)(c), 104, 105, and other relevant local authority legislation.
- Develop and maintain professional relationships with the financial markets.
- Manage all of Council's investments within its strategic objectives; invest surplus cash in liquid and creditworthy investments.
- Raise appropriate finance, in terms of both maturity and interest rate.
- Manage the overall cash position of Council's operations.

In meeting the above objectives Council is a risk averse entity and does not wish to seek risk from its treasury activities. Interest rate risk, liquidity risk and credit risk are risks Council seeks to manage, not capitalise on. Accordingly activity which may be construed as speculative in nature is expressly forbidden.

Liability Management Policy

General Borrowing Policy

Council borrows as it considers appropriate. Council exercises its flexible and diversified borrowing powers within the Local Government Act 2002. Council approves borrowing by resolution arising from the Annual Planning process. Projected debt levels are ascertained from cashflow forecasts prepared during the Strategic and Annual planning process.

Council raises borrowing for the following primary purposes:

- General debt to fund Council's Balance Sheet, including borrowing to fund Council controlled organisations, trading enterprises etc.
- Specific debt associated with "special one-off" projects and capital expenditure.
- To fund assets with intergenerational qualities.

Council is able to borrow through a variety of market mechanisms including the issue of stock and debentures and direct bank borrowing or through accessing the capital markets directly.

In evaluating new borrowings (in relation to source, term, size and pricing) the Chief Executive will take into account the following:

- The size and the economic life of the project.
- The impact of the new debt on the borrowing limits.
- Relevant margins under each borrowing source.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates relative to term for both stock issuance and bank borrowing and management's view of future interest rate movements.
- Available term from bank and stock issuance.
- Ensuring that the implied finance terms within the specific debt (e.g. project finance) are at least as favourable as Council could achieve in its own right.
- Legal documentation and financial covenants.

Borrowing Limits

In managing borrowing, Council will adhere to the following limits:

- **The gross interest expense of all borrowings will not exceed 15% of total annual rates revenue.**
- **Net cashflows from operating activities to exceed gross annual interest expense by two times.[1]**

Liquidity and Credit Risk Management

Council's ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet as well as its ability to rate,

[1] Net cashflows from operating activities = net cashflows from operating activities adding back non-cash items e.g. decpreciation; plus interest expenses and taxation.

manage its image in the market and its relationships with bankers. Council seeks a diversified pool of borrowing and ensures that bank borrowings are only sought from registered banks.

To ensure funds are available on repayment of debt, maturities of treasury investments and debt are matched through rolling cashflow forecasts, and treasury investments are maintained in liquid assets.[2]

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high for reasons within or beyond Council's control, Council ensures debt maturity is spread widely over a band of maturities. Council manages this specifically by ensuring that:

- **No more than $30.0 million of existing borrowing is subject to refinancing in any financial year.**

Interest Rate Risk Management

Council's borrowing gives rise to direct exposure to interest rate movements. Generally, given the long term nature of Council's assets, projects and intergenerational factors, and Council's preference to avoid an adverse impact on rates, there is a general tendency to have a high percentage of long term fixed rate or hedged borrowing. This preferred interest rate position is reflected in Table 1 which outlines the maximum unhedged or floating rate exposure requirements allocated into various time bands. The table logo also outlines the individual discretions to meet these hedge requirements:

Table 1: Percentage of Floating Rate Borrowing[3]

Term of Exposure	Maximum Floating Rate Exposure
	Executive Committee
0 - 1 year	20%
1 - 3 years	10%
3 - 5 years	N/A
5 - 7 years	N/A
7 years and over	N/A

In addition, Council is exposed to interest rate repricing risk on the maturing of existing fixed rate debt that is refinanced, as well as issue yield risk on planned new debt. Council manages these exposures using the following operational parameter:

- The Executive Committee can approve hedging up to 100% repricing risk on existing fixed rate debt and issue yield risk on forecast new debt within the next one-year period

The Executive Committee sets interest rate risk management strategy by monitoring the interest rate markets on a regular basis, evaluating the outlook for short term rates in comparison to the rates payable on its fixed rate borrowing.

The Manager Treasury implements interest rate risk management strategy through the use of the following:

- Adjusting the average maturity of its borrowings, thereby managing interest rate risk within the confines of liquidity management.
- Maintaining cashflow forecasts which consider the impact of interest rates on its treasury assets and utilises natural borrowing offsets minimising mismatches.
- Interest rate risk management products (refer note below) to convert fixed rate borrowing into floating rate, floating rate borrowing into fixed or hedged borrowing, and to manage maturity mismatches between its borrowings and investments.

The following interest rate risk management instruments may be used for interest rate risk management activity, after seeking formal prior approval of the Executive Committee:

- Forward rate agreements.
- Interest rate swaps.
- Purchase of interest rate options products including caps, bond options and swaptions.
- Interest rate collar type option strategies.

Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.

Security

In general the Council will secure its borrowings against its rate revenue.
In unusual circumstances with prior Council approval, a charge over one or more of the Council's assets may be offered.

Repayment

The Council repays borrowings from the specific sinking fund allocated to that borrowing or from general funds

Trade Creditors and Purchase Contracts

The purchase of goods and services is managed by formal delegated staff authorities within Council approved budgets. Significant purchases and contracts also require the additional approval of the appropriate

[2] A liquidity ratio of not less than 1:1 is maintained at month end.
[3] Includes total existing and forecast debt but not debt refinancing in the current year.

Council Committee Chairman ($300,000+) or full Council ($1,000,000+). Contracts are executed under Council Seal and any contracts over $25,000 (including all subsequent extensions) are reported in detail to the next Council meeting .

Contingent Liabilities

Council from time to time provides financial guarantees to recreation and service organisations. The Manager Accounting Services ensures that the business plan of the guaranteed party furthers the strategic objectives of Council and that financial statements are received on a regular basis. Should the guarantee be called up, Council will take immediate steps to recover the money.

The total of financial guarantees outstanding is limited in value to 4% of the current year rates revenue.

Investment Policy

Council maintains investments in the following financial assets:

- Equity investments including shareholdings and loan advances to trading and service enterprises, charitable trusts and incorporated societies e.g. sporting and community organisations, and for residential and rural housing purposes, which are consistent with Council's normal course of business.
- Investments in land and buildings (property) and from time to time commercial mortgages and deferred payment licenses.
- Treasury instruments incorporating longer term and liquidity investments.

Equity Investments and Loan Advances

Investments include shareholdings in and advances to Council controlled organisations, charitable trusts, incorporated societies, residential and rural housing and other long term investments which are consistent with Council's strategic plan.

The Executive Committee, reviews performance of these investments on a regular basis to ensure strategic and economic objectives (see Section 6 for performance measurements) are being achieved. The Manager Accounting Services ensures that interest and principal repayments are being made in accordance with the loan agreement.

Advances and loans are only provided to organisations where the Council has significant interest and in default the assets of the organisation would revert to the Council. Residential and rural property owners have a charge placed over the land pursuant to s 188 of the Local Government Act 2002.

Any disposal of these investments requires Council approval. The use of sale proceeds is determined by Council resolution.

All dividend income from Council's equity investments is included in the consolidated revenue account.

Property Investments

Council's overall objective is to only own property that is necessary to achieve its strategic objectives. As a general rule, Council will not maintain a property investment where it is not essential to the delivery of relevant services, and property is only retained where it relates to a primary output of Council. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements which could deliver the same results. This assessment is based on the most financially viable method of achieving the delivery of Council services. Council generally follows a similar assessment criteria in relation to new property investments.

The Executive Committee reviews the performance of its property investments on a regular basis (see Section 6 for performance measurements).

All income, including rentals and ground rent from property investments is included in the consolidated revenue account.

The use of proceeds on disposition is determined by Council resolution.

Treasury Investments

Council maintains treasury investments for the following primary reasons:

- To provide ready cash in the event of a natural disaster. This cash is intended to bridge the gap between the disaster and the reinstatement of normal income streams.
- To invest amounts allocated to special funds, sinking funds and reserves.
- To invest proceeds from the sale of assets.
- To invest surplus cash, and working capital funds (also see Section 5 Cash Management).

Risks associated with investment activity that need to be managed are:

- Default or credit risk which refers to the risk that the issuer of the security will be unable to deliver maturity proceeds to the investor. In a general sense Government investments are assumed to have zero default risk followed by local authorities with very low risk, followed by banks and corporates of various credit standing.
  It is now common practice to monitor credit standing of various institutions by referring to credit ratings

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regularly provided by independent rating agencies such as Standard and Poors.

- Interest rate risk which relates to the extent to which an entity's income/expense is affected by movements in market interest rates.
- Liquidity risk which relates to the ready availability of willing buyers and sellers for a particular instrument. This is particularly important when investments need to be sold prior to maturity where abnormal losses can be incurred where ready buyers are not available.

Investment Objectives:

The Executive Committee sets overall investment strategy, by reviewing, on a regular basis, cashflow forecasts incorporating plans for approved expenditure and strategic initiatives, evaluating the outlook for interest rates and the shape of the yield curve and, where applicable, seeking appropriate financial advice.

Council's primary objective when investing is the protection of its investment. Accordingly, only creditworthy counterparties are acceptable. Creditworthy counterparties are selected on the basis of their current Standard and Poors (S&P) rating which must be strong or better.
Credit ratings are monitored on a monthly basis by the Manager Treasury.

Within the above credit constraints, Council also seeks to:

- Maximise investment return.
- Ensure investments are liquid.
- Manage potential capital losses due to interest rate movements if investments need to be liquidated before maturity.

The above objectives are captured in the investment framework in Table 2, which provides operating parameters for investment activity including approved counterparties, instruments and limits. The following principles form the key assumptions of the operating parameters contained in the investment framework:

- **Credit risk is minimised by placing maximum limits for each broad class of non- Government issuer, and by limiting investments to registered banks, strongly rated State Owned Enterprises (SOEs), within prescribed limits.**

- **Liquidity risk is minimised by ensuring that all investments must be capable of being liquidated in a readily available secondary market. Furthermore, Council maintains $5 million of its reserves with a maturity of less than one year.**

Table 2: Approved Issuers, Instruments, and Limits

Issuers	Instruments	Limits (Percentage of Total Investment Portfolio)
Risk-Free		
Government guaranteed	Treasury bills Government stock	100%
Near Risk-Free		
Local authorities and other institutions with the ability to levy rates or taxes	Local authority stock Local authority Debentures	Up to 100% subject to not more than $2.5million with one issuer
Low Risk		
Major banks registered with the Reserve Bank, and other issuers as long as they have a short term credit rating of at least A-1 or better and a long term credit rating of at least A or better as determined by Standard and Poors.	Money market call deposits Money market term deposits Registered certificates of deposit Promissory notes National Provident Fund deposits Corporate bonds **	Up to 100% but not more than $5.0 million with one registered bank or not more than $1.0 million with any single issuer with appropriate credit ratings. The exception is Council's banker * which may from time to time exceed this requirement for up to five working days.
Medium/High Risk	Commercial and residential mortgages	Typically regarded as unsuitable for investment by the Council. Council will specifically authorise each investment.

Note:
* Limit for Council's principal banker excludes balances in current accounts used for cash management purposes.
** Issuers must have a long term rating of A or better as determined by Standard and Poors.

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Interest Rate Risk Management

Council's investments give rise to a direct exposure to a change in interest rates, impacting the return and capital value of its fixed rate investments.

The Executive Committee sets interest rate risk management strategy by monitoring the interest rate markets on a regular basis, evaluating the outlook and determines the interest rate profile to adopt for investments.

Manager Treasury, implements interest rate risk management strategy by reviewing rolling cashflow forecasts and:

- Changing interest rate profiles by adjusting the average maturity of its investments to match the borrowing maturity profile. Investments held to maintain liquidity and for specific purposes are excluded and/or;
- Using risk management instruments to protect investment returns and/or to change interest rate and maturity profile.

The following interest rate risk management instruments may be used for interest rate risk management activity, after formal prior approval of Executive Committee.

- Forward rate agreements.
- Interest rate swaps.
- Purchase of interest rate options products including caps & floors, bond options and swaptions.
- Interest rate collar type strategies.

Selling interest rate options for the purpose of generating premium income is not permitted.

Sinking Funds

Under the Local Government Act 2002, the Council is not required to use specific borrowing mechanisms and therefore Council uses its discretion in determining whether a sinking fund mechanism is appropriate. The Council operates sinking funds and nominated commissioners to administer the outstanding loans. The sinking fund commissioners are Mayor, Deputy Mayor, Chief Executive and Director, Corporate Services.

Sinking funds are managed as part of the Council's overall investment portfolio.

A statement of sinking funds is prepared annually by the sinking fund commissioners and reported to Council.

Existing loans prior to 1 July 1998 will be repaid as they progressively mature from the annual all purposes loan together with the associated sinking funds available.

New loans after 1 July 1998 will not require associated sinking funds to be established and generally will be repaid by the annual all purposes loan on maturity.

The level of long-term net debt will be determined by the long-term financial strategy.

Foreign Exchange Policy

Council may have foreign exchange exposure through the occasional purchase of foreign exchange denominated plant and equipment.

Generally, all significant commitments for foreign exchange will be hedged using foreign exchange contracts, once expenditure is approved. Both spot and forward foreign exchange contracts can be used by Council.

However borrowing in foreign currencies is expressly forbidden by Section 113 of the Local Government Act 2002. Borrowing can only be in New Zealand dollars.

Cash Management

From time to time, Council has daily cashflow surpluses and borrowing requirements due to the mismatch of daily receipts and payments. All cash inflows and expenses pass through bank accounts controlled by the finance function.

Council maintains rolling daily, monthly and yearly cashflows. These cashflows determine Council's borrowing requirements and surpluses for investment. Generally any cash to be invested for longer than three months is covered by Section 3 of this policy.

Cash management activities must be undertaken within the following parameters:

- Cash management instruments are limited to:
  - Call deposits with registered banks.
  - Negotiable instruments with a maturity less than three months.
  - Term deposits with registered banks (less than three months).
- If practical, a targeted minimum of $1 million is invested at call.
- Overdraft facilities are utilised as little as practical.
- Interest rate risk management on cash management balances is not permitted.

Cash may only be invested with approved counterparties as detailed in Table 2.

Performance Measurement

Measuring the effectiveness of Council's treasury activities is achieved through a mixture of subjective and objective measures. The predominant subjective measure is the overall quality of treasury management information. The Executive Committee has prime responsibility for determining this overall quality. Objective measures are as follows:

1. Borrowing:

- Adherence to policy.
- Unplanned overdraft costs.
- Number and cost of processing errors.
- Comparison of actual monthly and year to date interest costs vs budget borrowing rate.
- Comparison of year end average interest rate vs large commercial borrower.

2. Equity Investments:

- Adherence to policy
- Comparison of financial ratios to budgeted benchmark levels. Accepted ratios include:
  - Return on Shareholders Funds.
  - Debt/Total Assets Ratio.
  - Current and Liquidity Ratios.
  - Gross Profit Margin.
  - Interest Coverage.
  - Earnings per Share.
  - Dividend per Share.

3. Property Investments:

- Adherence to policy.
- Comparison of actual rental yield to budgeted yield.

4. Treasury Investments:

- Adherence to policy.
- Number and cost of processing errors.
- Comparison of actual monthly and year to date accrued returns vs investing the entire treasury portfolio at the weekly average three month bank bill rate for short term investments. For investments of longer maturity compare year to date accrued returns to a weekly average three year Government stock rate or recognised fixed interest benchmark index e.g. First NZ Capital Index.

Reporting

Reports

The following reports are produced:

Report Name	Frequency	Prepared by	Recipient
Daily Cashflow Report Investment Register	Daily	Treasury Accountant	Manager Treasury
Monthly Treasury Report (see Appendix II), including, Investment Liquidity Profile	Monthly	Manager Treasury	Chief Executive Director, Corporate Services
Limits Report (included within the Treasury Report)	Once a month, reported daily on an exceptions basis	Manager Treasury	Chief Executive Director, Corporate Services
Debt Maturity Profile (included within the Treasury Report)	Monthly	Manager Treasury	Chief ExecutiveDirector, Corporate Services
Statement of Public Debt	Annually	Manager Treasury	Chief Executive Director, Corporate Services
Statement of Sinking Funds	Six Monthly	Manager Treasury	Sinking Fund Commissioners

Meetings

A six monthly meeting of the Executive Committee, Director Corporate Services and Manager Treasury is held to discuss the activity for the previous months together with likely activity for the coming six months. Borrowing, investment and risk management strategies are also discussed and reviewed at this meeting as required. Impromptu meetings are held from time to time if changes to the agreed strategies are necessary.

Delegated Authorities and Key Internal Controls

Delegated Authorities

Activity	Responsibility
Alter policy document	Council
Authorise bank facilities Open/close bank accounts	Council
Cheque signatories	As approved by Council
Approve new loans	Council
Arrange new loans	Manager Treasury
Manage investments	Manager Treasury
Transfers of stock/register new debt issues	Seal register signatories

Key Internal Controls

Sound treasury procedures with appropriate controls are required to minimise risks the Council may experience through unauthorised treasury activity or unintentional error. Control procedures are in place for:

Investment Activity

Cheque / Electronic Banking Signatories
Authorised Personnel
Recording of Deals
Confirmations
Reconciliations
Holding of Certificates

Borrowing Activity

Issue of Securities
Procedures for bank borrowing