

# Treasury Management Policy

## INTRODUCTION

### Purpose of Policy

The purpose of the Treasury Management Policy is to outline approved policies and procedures in respect of all treasury activities to be undertaken by Buller District Council (BDC). The formalisation of such policies and procedures will enable treasury risks within BDC to be prudently managed. As circumstances change, the policies and procedures outlined in this policy will be modified to ensure that treasury risks within BDC continue to be well managed.

### Changes to Treasury Management Policy

Inclusion in this policy is the ability to borrow from or invest in the Local Government Financing Agency.

## 1. Policy Objective

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

Council's broad objectives in relation to its Treasury activity are:

- Prudence - to ensure long term financial stability
- Manage the overall cash position of Council's operations
- Invest surplus cash in liquid and creditworthy investments
- Raise appropriate finance, in terms of both maturity and interest rate
- Minimise any risks

## 2. General Approach

Council is a risk-averse entity and does not wish to increase risk from its Treasury activities.

Activity which may be construed as speculative in nature is not permitted.

Loans are repaid to the Treasury activity, six monthly, based on standard loan lives, depending on the useful life of the asset. The maximum term of any loan shall be 30 years.

## 3. Delegation of Authority and Authority Limits

Council has the following authorities in place for the Treasury functions.

| Activity   | Delegated Authority                                    | Limit   |
|--|--|---|
| Approving & changing policy  | Council  | Unlimited   |
| Borrowing limits   | Council  | Borrowings limits are approved in the Long Term Plan by Council           |
| Approving and setting up borrowing arrangements                            | Manager: Corporate Services                            | Subject to the limits approved in the draft Long Term Plan or Annual Plan |
| Drawing down debts & Re-financing existing debt                            | Chief Executive Officer<br>Corporate Services Manager  | Subject to Council set limits   |
| Approving transactions outside policy                                      | Council  | Unlimited (Subject to Council resolution)                                 |
| Approving credit counterparty limits                                       | Chief Executive Officer                                | Subject to Council set limits   |
| Adjust interest rate risk profile on borrowing                             | Chief Executive Officer                                | Fixed/floating ratio between 55% and 95%                                  |
|  |  | Fixed rate maturity profile limit as per risk control limits              |
| Managing funding maturities in accordance with Council approved facilities | Chief Executive Officer and Corporate Services Manager | Per risk control limits   |
| Authorising lists of signatories   | Chief Executive Officer                                | Unlimited and reviewed as and when required                               |
|  |  | Annual letter to lender   |
| Opening/closing bank accounts  | Chief Executive Officer                                | Unlimited   |
| Approval of policy   | Finance & Audit Committee                              | Ongoing   |
| Ensuring compliance with policy  | Corporate Services Manager                             | Ongoing   |
| Review key performance measures  | Finance and Audit committee                            | Quarterly Reports   |

## 4. Liability Management Policy

Section 102(4) (c) of the Local Government Act 2002 states that a local authority must adopt a liability management policy. The liability management policy must state the local authorities policies in respects of both borrowings and other liabilities.

### 4.1 Council raises borrowing for the following purposes:

Council raises borrowing for the following purposes:

- To fund assets with inter-generational qualities
- General debt to fund Council's Balance Sheet
- Specific debt associated with "special one-off projects and capital expenditure

### 4.2 Council approves borrowings by resolution during the annual planning process:

A resolution of Council is not required for hire purchases, creditor or deferred purchase of goods.

- The period of indebtedness is less than 91 days; or
- The goods or services are obtained in the ordinary course of operations on normal terms for amount not exceeding in aggregate, an amount determined by resolution of Council, subject to Chief Executive approval.

### 4.3 Specific borrowing limits:

In managing borrowing, Council will adhere to the following limits which are consistent with its external financing agreements:

- The gross interest expense of all borrowings will not exceed 15% of total annual revenues
- Debt to total income ratio of not more than 2.5 times
- Term of loans is not to exceed a maximum term of 30 years

"Total Revenue" is defined as earnings from rates, government grants and subsidies, user charges, interest and other revenue.

"Rates" is defined as all income under the Local Government Rating Act 2002.

### 4.4 Risk recognition

Council has identified the following risks:

- Local government risk is priced to a higher fee and marginal level
- The Council's own credit standing, or financial strength as a borrower, deteriorates due to financial, regulatory or other reasons
- A large individual lender to the Council experiences their own financial/exposure difficulties, resulting in the Council not being able to manage their debt portfolio as efficiently as desired.
- New Zealand investment community experiences a substantial "over supply" of Council investment assets.

A key factor of funding risk management is to spread and control the risk to reduce the concentration of risk at one point in time. This is so that if any of the above events occur, the overall borrowing cost is not unnecessarily increased, and the desired maturity profile is not compromised due to market conditions.

### 4.5 Credit risk management

Council's ability to readily attract cost-effective borrowings is largely driven by its ability to maintain a strong balance sheet, as well as its ability to rate, manage its image in the market and its relationships with bankers. Council is able to borrow through variety of market mechanism including stock and bank borrowings. Council will ensure that borrowings are only sought from the approved list of registered banks and the Local Government Funding Agency.

### 4.6 Liquidity risk control limits (borrowings)

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 35% of total borrowings is subject to refinancing in any financial year. Total borrowing includes any forecast borrowing.
- Council will manage the maturity profile of the total committed funding in respect to all loans and committed facilities by avoiding the concentration of debt maturity dates.

### 4.7 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 inter-generational 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.

Council debt/borrowings and financial risk management instruments must be within the following fixed/floating interest rate risk control limit:

## Master Fixed/Floating Risk Control Limited

| Minimum Fixed Rate | Maximum Fixed Rate |
|--------------------|--------------------|
| 40%                | 95%                |

**4.7.1** "Fixed Rate" is defined as an interest rate repricing date beyond 12 months forward on a continuous rolling basis.

**4.7.2** "Floating Rate" is defined as an interest rate repricing within 12 months.

### 4.7.3 Loan Repayments

Debt will be repaid as it falls due usually by refinancing with new debt. External loans are repaid on due date. The length of external loans are based on projected internal loans and cash requirements.

## 4.8 Approved financial instruments

Dealing in interest rate products must be limited to financial instruments approved by Council.

|                               |  |
|-------------------------------|--|
| Cash management and Borrowing | Bank overdraft,<br>Committed cash advance and bank accepted bill facilities (term facilities)<br>Uncommitted money market facilities (call accounts)<br>Stock/Bond issuance.   |
| Interest rate risk management | Forward rate agreements ("FRA's") on:<br>- Bank bills<br>- Government Bonds.<br>Interest rate swaps including:<br>- Forward start swaps (start date <24 months)<br>- Amortising swaps (whereby notional principal amount reduces).<br>Interest rate options on:<br>- Bank bills (purchased caps and one for one collars)<br>- Government bonds.<br>Interest rate swaptions (purchased only). |

Any other financial instrument must be specifically approved by Council on a case-by-case basis and can only be applied to the one singular transaction being approved.

## 4.9 Security

The Council normally will secure its borrowings against its rates revenue. Generally, Council does not offer assets or deemed rates as security for general borrowing programmes.

In some circumstances, with prior Council approval, security may be offered:

- On borrowing by granting a special deemed rate and floating charges over general rates.
- By providing a charge over one or more of the Council's assets.

## 4.10 Internal Funding

Council operates an internal borrowing system for funding infrastructural improvements as well as funding current accounts. The internal borrowings will be permitted to a maximum of investments or as restricted by the banking covenant.

Internally funded projects will be charged interest at the market rate of investments deposit at the time the funds are drawn down.

## 4.11 Contingent Liabilities

The Council from time to time provides financial guarantees to recreation and service organisations. Where possible Council shall obtain cross guarantees. Management 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.

## 4.12 New Zealand Local Government Financing Agency (LGFA)

Despite anything earlier in this Liability Management Policy, Council may borrow from the New Zealand 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;
- 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 Council's rates and rates revenue.

## 5. Investment Policy

Section 102(4) (c) of the Local Government Act 2002 states that a local authority must adopt an investment policy. The investments policy must state the local authority's policy in respect of its investments.

|                                      |  |
|--------------------------------------|--|
| Investments and loan advances        | Treasury Investments   |
|                                      | Loan advances to Charitable trusts and incorporated societies – eg sporting and community organisations.   |
| Equity investments and loan advances | Investments include shareholding in trading and service enterprises and loan advances to charitable trusts, incorporated societies, residential and rural housing which are consistent with Council's Long Term Plan, eg Council's shareholding in Buller Holdings Limited   |
|                                      | Advances and loans are only provided to organisations where Council has significant interest. In default, the assets of the organisation may not revert to Council, however personal guarantees are obtained from the principals of the organisation.  |
| Property Investments                 | Council's overall objective is to only own property that is necessary to achieve its outcomes. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements which could deliver the same results. Council from time to time may own property solely for investment purposes. |
|                                      | Council holds a number of residential leasehold properties and endowment land, from the time of amalgamation in 1989. These are freeholded, subject to Council policy, at the resident's request.  |
| Other Investments                    | Forestry investments   |

### 5.1 Disposition of Revenue

- Proceeds from investments are applied to the general revenue of Council.
- Net income from other residential leases is used as a source of operating revenue for the "Property & Housing" activity.
- Net proceeds from freeholding or asset sales are transferred to special funds.

### 5.2 Treasury Investments Rationale

Council maintains treasury investments for the following primary reasons:

- 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 and assets.
- Invest amounts allocated to cover Council created restricted reserves, sinking funds and other reserves.
- Invest funds allocated for approved future expenditure.
- Invest proceeds from the sale of assets.
- Invest surplus cash, and working capital funds.

### 5.3 Treasury Investment Objectives

Council's primary objective when investing is the protection of its investment. Accordingly, only creditworthy counterparties are acceptable.

Council also seeks to:

- Maximise investment return.
- Preserve the capital base of the Council.
- Council gives preference to conservative investment policies and avoids speculative investments.

Council will consider as part of the annual plan process each year, any allocation of income to the capital base to offset inflation.

**5.4** Credit risk is minimised by limiting investments to registered banks, strongly rated SOE's, and corporates within prescribed limits.

**5.5** Liquidity risk is minimised by ensuring that all investments must be capable of being liquidated in a regularly available secondary market. Where practical, Council maintains at least \$1 million of its investments with a maturity less than one year

### 5.6 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.

Interest rate risk will be managed by reviewing rolling cash flow forecasts and using risk management instruments to protect investment returns and or to change interest rate and maturity profile.

## 5.7 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.

## 5.8 Aquisition and Disposal of Assets

Any disposal of assets requires the approval of Council except those assets within delegated authority. Disposal of assets signalled in the Annual Plan or Long Term Plan process is approved by resolution on adoption of those plans.

## 5.9 Counterparty Credit Risk

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where Council is a party. The credit risk to Council in a default event will be weighted differently depending on the type of instrument entered into.

Council will regularly review credit risk. Treasury related transactions would only be entered into with organizations specifically approved by Council.

Counterparties and limits can only be approved on the basis of long term credit ratings (Standard and Poor's or Moody's) being A- and above.

## 5.10 The following matrix guide will determine limits:

| Authorised Asset Class                             | Limit as a percentage of the Total Portfolio | Approved Financial Market Investment Instruments               | Credit Rating Criteria                | Limit for each issuer |
|--|--|--|---------------------------------------|-----------------------|
| New Zealand Government or Government Guarantee     | 100%   | Treasury Bills (mature within 6 months)                        | Not Applicable                        | No limit              |
| Local Authorities where rates are used as security | 60%  | P/Notes (mature within 6 months)                               | Not Applicable                        | \$3 million           |
| New Zealand Registered Banks                       | 100%   | Call/Deposits/ Bank Bills/Promissory Notes<br>Bonds/MTNs/ FRNs | Short term S&P rating of A1 or better | \$10 million          |
|  |  |  | Long term S&P rating of A- to A+      | \$2 million           |
|  |  |  | Long term S&P rating of A+ or better  | \$5 million           |
| State Owned Enterprises and District Health Boards | 50%  | P/Notes (mature within 6 months)<br>Bonds/MTNs/ FRNs           | Short term S&P rating of A1 or better | \$ 3 million          |
|  |  |  | Long term S&P rating of BBB to A+     | \$ 1 million          |
|  |  |  | Long term S&P rating of A+ or better  | \$2 million           |
| Corporate and other rated issues                   | 50%  | P/notes (mature within 6 months)                               | Short term S&P rating of A1 or better | \$2 million           |
|  |  |  | Long term S&P rating of A to AA-      | \$1 million           |
|  |  |  | Long term S&P rating of AA or better  | \$3 million           |

| Authorised Asset Class | Limit as a percentage of the Total Portfolio | Approved Financial Market Investment Instruments | Credit Rating Criteria | Limit for each issuer   |
|------------------------|--|--|------------------------|---|
| Building Societies     | 10%  | Call/Deposits (mature within 6 months)           | Not Applicable         | The lesser of \$1 million or a maximum of 4% of total assets of Society |

**The following investments by Council Resolution only:**

**Australasian Equities:**

|   |     |   |                |                          |
|---|-----|---|----------------|--------------------------|
| Common shares, unit trusts, investment trusts, convertible notes, warrants, rights contributory shares. | 15% | NZSX50 Gross Index – ASX 200 Index<br><br>A minimum of 80% must be NZSE 40 or top 50 companies on NZSE 40X or ASX 200 Index<br><br>Maximum 20% in ASX SCI Index or NZ SCL | Not applicable | 15% of total investments |
| Council also has strategic share holding (NZLG Investment Corp.)  |     |   |                |                          |

**International Equities:**

|  |     |  |                |   |
|--|-----|--|----------------|---|
| Common shares, unit trusts, investment trusts, warrants, rights, contributory shares<br><br><i>*Recommended hedging between 0-65% of the International Exposure.</i> | 15% | New York SE<br>Hong Kong SE<br>London SE<br>Tokyo SE<br>Singapore SE<br>West European SE | Not applicable | The lesser of \$1 million or 15% of total investments |
|--|-----|--|----------------|---|

Council is currently in breach of the policy as Council has exceeded the \$1 million. The breach will be rectified when the sponsorship agreement ends in 2019.

## 5.11 Repayment

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

## 5.12 External Advisors

The Council may appoint Investment Managers to continually monitor the Council's portfolio and provide recommendations within the scope of the Prudential Guidelines which safeguard the portfolio against risk and maximize its performance.

## 5.13 New Zealand Local Government Financing Agency (LGFA)

Despite anything earlier in this Investment Policy, Council may invest in shares and other financial instruments of the New Zealand LGFA, and may borrow to fund that investment. 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 Council.

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

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

## 6. Foreign Exchange Policy

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

Generally, all significant commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is approved. Council uses both spot and forward foreign exchange contracts. All commitments for foreign exchange over \$10,000 are to be hedged.

The use of other foreign exchange risk management products is not permitted.

## 7. 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 Finance and Audit Committee has prime responsibility for determining this overall quality. Objective measures are as follows:

### 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
- Council to use competitive tendering for its borrowing from time to time.

### Equity Investments:

- Adherence to policy
- Comparison of financial ratios to budgeted benchmark levels.
- Comparison of actual and budget return.

### Property Investments:

- Adherence to policy
- Comparison of actual rental costs to budgeted costs

### Treasury Investments:

- Adherence to policy
- Number and cost of processing errors

Council measures the performance of the investments portfolio on a quarterly basis by benchmarking the performance of the portfolio against the following indicators evenly weighted.

- 12 month rolling average of the official cash rate
- 12 month rolling average of the investor 90 day bank bill rate
- 12 month rolling average of the 3 year investor swap rate

## 8. Reporting

The following reports are produced.

| Report Name                          | Frequency | Prepared by          | Reviewer                   | Recipient   |
|--------------------------------------|-----------|----------------------|----------------------------|---|
| Cash Position                        | Daily     | Financial Accountant | Corporate Services Manager | Corporate Services Manager                            |
| Investment reconciliation            | Monthly   | Financial Accountant | Corporate Services Manager | Corporate Services Manager                            |
| Bank Reconciliation                  | Monthly   | Financial Accountant | Corporate Services Manager | Corporate Services Manager                            |
| Review of investments and borrowings | Monthly   | Financial Accountant | Corporate Services Manager | Monthly review by Council Finance and Audit Committee |