POLICY

TREASURY MANAGEMENT

(Incorporating the Liability Management and Investment Policies)

JUNE / 2018

Waipa
DISTRICT COUNCIL

Contents

This policy is prepared pursuant to
Sections 109 and 110 of the Local Government Act 2002.

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PART 1 - INTRODUCTION

Waipa District Council (Council) undertakes liability management (borrowing), investment, cash and associated risk management activity (in total referred to in this document as treasury activity). Council's borrowing and investment activities are carried out within the requirements of the Local Government Act 2002 (the Act) and its various amendments, which define the operating environment for local authorities in relation to borrowing, investment and treasury risk management activity.

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

The scope of this policy covers treasury activity at the Council level and is formally reviewed and updated from time to time, but at least once every three years, although the review is normally in conjunction with the review of the 10-Year Plan.

Council's borrowing activity is largely driven by its capital expenditure programme.

Council also manages a portfolio of investments comprising equity, forestry, property and treasury investments.

PART 2 - TREASURY OBJECTIVES AND PHILOSOPHY

2.1 TREASURY OBJECTIVES AND PHILOSOPHY

Council's broad objectives in relation to treasury activity are as follows:

(a) Compliance with the Act and any other relevant local authority legislation

(b) To manage Council's investments according to its strategic and commercial objectives and optimise returns within these objectives

(c) Avoidance of capital losses. For treasury investments this is achieved by investing on a hold to maturity basis (unless circumstances otherwise dictate) with creditworthy counter parties

(d) Maintain funding mechanisms with an appropriate maturity profile to ensure adequate liquidity is available at margins and costs appropriate to Council's credit standing

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

(f) Mitigate potential adverse interest rate risk and minimise financing costs within acceptable risk management parameters.

(g) Develop and maintain professional relationships with Council's bankers and the financial markets in general

(h) Provide timely and accurate reporting of treasury activity and performance

In meeting the above objectives, Council acknowledges that there are financial risks such as funding, liquidity, interest rate, credit and operational risks arising from its treasury activities.

Council is a risk averse entity and does not wish to incur undue risk from its treasury activities. Accordingly, Council's finance function in relation to its treasury activities is a risk management function focused on protecting Council's budgeted interest costs and interest income and stabilising Council's cash flows. Council seeks to prudently manage these risks, and activity that is unrelated to its underlying cash flows or may be construed as speculative in nature is expressly forbidden.

PART 3 - BORROWING POLICY

3.1 GENERAL POLICY

Section 104 of the LGA 2002 provides that the Liability Management Policy required under Section 102(2)(b) must state the local authority's policies in respect of liability management, including:

(a) Interest rate exposure

(b) Credit exposure

(c) Liquidity

(d) Debt repayment

Council's infrastructure and community assets generally have long economic lives and long term benefits. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to Council's assets and investments, as well as assisting Council in meeting the infrastructure demands of its ratepayers on a timely basis. Council borrows as it considers appropriate within the flexible and diversified borrowing powers contained within the Local Government Act 2002. Borrowings not included in the current 10-Year Plan must be approved by Council resolution.

A resolution of Council is not required for hire purchase or equipment lease if goods or services are obtained in the ordinary course of operations on normal commercial terms for amounts not exceeding in aggregate $100,000.

Council raises debt for the following primary purposes:

(a) General debt to fund Council's balance sheet

(b) Specific debt associated with "special one-off" projects and capital expenditure

(c) To fund assets with intergenerational qualities

Council is able to borrow through a variety of market mechanisms including borrowing from the LGFA, the issue of bonds via the domestic capital markets or direct bank borrowing.

Council has a general preference to firstly use available internal reserves for its borrowing requirements and thereafter utilise external funding sources.

Given the relative advantages to each funding mechanism, Council may have a mix of LGFA, bank and capital markets borrowing over time. Generally, a bank facility is most appropriate to provide working capital and core funding where there is uncertainty regarding timing and amount of borrowing. When there exists a degree of certainty in terms of amount and term, the LGFA or bonds via the domestic capital markets are likely to provide an appropriate source of funding.

3.2 NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED INVESTMENT

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:

(a) contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA;

(b) provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;

(c) commit to contributing additional equity (or subordinated debt) to the LGFA if required;

(d) subscribe for shares and uncalled capital in the LGFA; and

(e) 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.

3.3 BORROWING LIMITS

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

(a) The gross interest expense on external debt for the year equal or are less than 15% of its revenue (excluding development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment) for the year[1]

(b) Net cash flows from operating activities will exceed gross annual interest expense by a minimum four times

(c) Net external debt will not exceed 175% of Total Revenue.

Council will adhere to the borrowing limit that is reached first and provides the lowest level of debt capacity. Council reports compliance to these limits on an annual basis.

[1] Local Government (Financial Reporting and Prudence) Regulations 2014, Section 21.

PART 4 - LIQUIDITY AND FUNDING RISK MANAGEMENT

Liquidity risk management refers to the timely availability of funds when needed without incurring penalty costs. Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and borrowing margins) and terms of existing facilities.

Council's ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet, levy rates and manage its relationships with capital market investors, the LGFA and its bankers. Where practical, Council seeks a diversified pool of external borrowing and ensures bank borrowings and incidental arrangements (risk management products) are only sought from strongly rated New Zealand registered banks. This helps ensure that funds are available when required and amounts owing are paid in full on the due date.

Council minimises its liquidity risk by:

(a) Matching expenditure to its revenue streams and managing cash flow timing differences through its bank facilities and/or maintaining a liquidity buffer

(b) Ensuring that any liquidity buffer investments are liquid and readily negotiable instruments

(c) Having in place a committed bank facility that allows headroom of at least $5 million compared to projected peak borrowing requirements over the next 12 months as detailed in the latest Annual/10-Year Plan.

The matching of longer term expenditure and revenue requirements is monitored through the cash flow forecast prepared during the annual planning and 10-Year Plan process and reviewed through the quarterly forecast reports.

In relation to funding risk management, Council aims to minimise the risk of debt maturing or being reissued in foreseeable periods of illiquidity or where credit margins are high, where practical, by maintaining access to multiple sources of funding, such as banks, loan stock funding and the LGFA and across a range of maturities.

Council manages funding risk by avoiding a concentration of debt maturity dates and manages this specifically by ensuring that:

(a) No more than $30 million of outstanding external debt is subject to refinancing over the next 12 months or any rolling 12 month period thereafter.

The maximum term for external debt is 20 years unless approved by Council.

4.1 INTERNAL BORROWING

Council uses its reserves and external borrowing to internally fund capital expenditure as identified in the 10-Year Plan and Annual Plan and approved by Council resolution. The finance function is responsible for administering Council's internal loan portfolio.

(a) The primary objective in funding internally is to use reserves and external borrowing effectively, by establishing a portfolio that provides funding to internal activity centres. This creates operational efficiencies as savings may be created by eliminating the negative margin that would be incurred through Council separately investing and borrowing externally

The following operational parameters apply in relation to the management of Council's internal loan portfolio:

(a) The finance function uses the internal loan portfolio as an input into determining its external debt requirements. In most cases, Council's reserves are used firstly to reduce external debt requirements, as this would normally reduce Council's net interest cost

(b) All internal borrowing activities are consistent with the principles and parameters outlined throughout this policy

(c) In determining an activity centre's internal loan amount, any depreciation reserve or other related amount is firstly allocated to that centre. Any additional funding is then provided through internal loans

(d) The maximum term of the internal loan is the lesser of either 60% of the projected economic life of the underlying asset or 30 years.

(e) A notional internal loan is set up for all new capital projects, and operating projects in special circumstances, which would require Council resolution, and allocated to the activity centre incurring the expenditure. External interest is apportioned across all internal loan balances

(f) Loans can be on an interest only basis if it is expected that the underlying asset may be sold or transferred to another party in the future and is strategic in nature. Development contribution loans can also be on an interest only basis. However, the maximum term for such loans is 5 years.

(g) Unless specified otherwise principal repayments required in relation to internal loans will be on a table mortgage basis over the expected life of the loan.

4.2 INTEREST RATE RISK MANAGEMENT

Council's borrowing gives rise to a direct exposure to interest rate movements. Generally, given the long term nature of Council's assets, projects, intergenerational factors and Council's objective to avoid any adverse impact on rates, there is a preference to have an appropriate level of long term fixed rate or hedged debt taking into account Council budget requirements, the nominal level of interest rates and other appropriate factors. In any case interest rate risk must be managed within the parameters detailed below unless an exception is approved by Council.

Timeframe	Policy Parameters	
	Minimum	Maximum
0 – 1 year	50%	100%
1 – 3 years	30%	80%
3 – 5 years	10%	60%
5 years or greater **(*)**	0%	40%

(*)Hedging beyond 10 years can only be by way of bond issuance or hedging that is directly linked to an underlying debt instrument already in place (for example floating rate note).

Interest rate risk management objectives are reflected in the table above and outline the minimum fixed or hedged rate requirements allocated to various time bands. Debt is regarded as fixed or hedged, where the interest rate is protected for a period of at least one year. The Group Manager - Business Support has discretion within the control parameters to set interest rate risk management hedging levels.

However, if total outstanding external debt (excluding short term working capital requirements) is less than $25 million, actual interest rate risk management hedging levels are at the discretion of the Group Manager - Business Support and can be outside the above bands.

4.3 APPROVED INSTRUMENTS

Council can only enter into interest rate hedging transactions by way of the following instruments:

(a) Interest rate swaps for a maximum of 10 years

(b) Interest rate collars where the nominal value of the cap bought is the same as the floor sold, for a maximum term of 10 years

4.4 CREDIT RISK MANAGEMENT

Council can only enter into hedging transactions, with approved counterparties. Unless specifically approved by the Council, counterparties must be a New Zealand registered bank with a long term credit rating of A+ or better from S&P, or the Moody's or Fitch equivalent.

4.5 DEBT SECURITY

Council's current security arrangements consist of a charge over rates by way of a debenture trust deed. Council generally does not offer assets, other than a charge over rates or rates revenue, as security for any loan or performance of any obligation under an incidental arrangement.

4.6 LOAN REPAYMENT

The Council repays borrowings from refinancing or surplus general funds. Borrowings may be refinanced by further borrowings within the maximum 20 year term.

4.7 CONTINGENT LIABILITIES

Council provides financial guarantees to community and service organisations. This is by application and after ensuring that the Business Plan of the guaranteed party is consistent with the strategic objectives of Council and that the organisation has the means to service and repay the debt. Should the guarantee be called up, Council takes immediate action to recover the money.

Individual guarantees are limited to $1 million and total guarantees will not exceed $5 million. This is supported by section 2.2.5 (Community Grants and Guarantees) of the Procedural Policy Manual. Granting of any guarantees is by Council resolution.

PART 5 - INVESTMENT POLICY

Section 105 of the Act provides that the Investment Policy required to be adopted under Section 102(2)(c) must state the local authority's policies in respect of investments, including:

(a) The mix of investments

(b) The acquisition of new investments

(c) An outline of the procedures by which investments are managed and reported

(d) An outline of how risks associated with investments are assessed and managed

Council investments may be maintained to meet specific strategic and economic objectives outlined in the 10-Year Plan. The finance function monitors the investments and reports performance on a regular basis to the Chief Executive and Council. The types of investments held include:

(a) Equity Investments

(b) Loan Advances

(c) Property Investments

(d) Forestry Investments

(e) Treasury Investments

5.1 EQUITY INVESTMENTS

Council maintains equity investments in:

(a) Waikato Regional Airport Limited

(b) New Zealand Local Government Funding Agency Limited

(c) Local Authority Shared Services Limited

(d) New Zealand Local Government Insurance Corporation Limited (Civic Assurance)

Other than to achieve strategic objectives, it is not Council's intention to undertake new equity investments. Council may periodically review investments with a view to exiting at a time when market conditions are favourable and overall strategic objectives are not compromised.

Any dividend income is included as part of general revenue.

Any purchase or disposition of equity investments not identified in the 10-Year Plan is by Council resolution.

At the time of disposal, Council determines the most appropriate use of sale proceeds.

5.2 NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED INVESTMENT

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.

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

(a) obtain a return on the investment; and

(b) ensure that the LGFA has sufficient capital to maintain an appropriate credit rating so that it continues as a source of attractively priced debt funding for the Council sector.

Because of this dual objective, the 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, the Council may also subscribe for uncalled capital in the LGFA.

5.3 LOAN ADVANCES

Council provides financial guarantees to community and service organisations but generally does not make loan advances, except in special circumstances, which would require Council resolution. Council has existing outstanding community loans which it will manage until repayment is complete.

5.4 PROPERTY INVESTMENTS

Council owns property to achieve its operational and strategic objectives. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements that could deliver the same results. This assessment is based on the most financially viable method of achieving the delivery of Council services.

The purchase or disposition of property not identified in the 10-Year Plan is approved by Council resolution. A precondition of all property purchase is the obtaining of a current registered valuation. Property holdings are sold at market values that are at least equivalent to 90% of a current registered valuation. Vendor financing may be provided to facilitate a sale, in special circumstances, which would require Council resolution.

Except where Council has identified a rental subsidy appropriate to the end use for which the property is held, all properties will be leased on commercial terms at market rates. Rental subsidies, not identified in the 10-Year Plan will be by Council resolution. All income, including rentals and ground rent from property held, except Pensioner Housing and Own Your Own properties where revenue is ring-fenced, is included as part of general revenue.

Net proceeds from the sale of property, unless subject to statutory constraints, will form part of the reserves of the District, to be reinvested in new assets or the betterment of existing assets for the benefit of the present and future residents of the District. A resolution of Council is required for expenditure from the asset sales reserve accounts.

5.5 FORESTRY INVESTMENTS

Council's investment in forestry on Pirongia Mountain is to assist with water conservation objectives and to provide a scenic reserve. The investment is managed by a specialist consultant and is expected to deliver positive cash flow over the long term.

New investment or the disposition of existing investments not identified in the 10-Year Plan is by Council resolution.

At time of harvest, Council determines the most appropriate use of both the sale proceeds and the land.

5.6 TREASURY INVESTMENTS

Council may maintain treasury investments for the following purposes:

(a) Provide cash in the event of a natural disaster

(b) Invest amounts allocated to special funds and reserves

(c) Invest amounts allocated for approved future expenditure, to implement strategic initiatives or to support intergenerational allocations

(d) Invest the proceeds from the sale of assets

(e) Invest surplus cash

Council's primary investment objective is capital protection. It utilises its surplus funds through internal lending to various activity centres within Council and through external investment to approved counter-parties.

Within the above credit constraints, Council also seeks to:

(a) Ensure investments are in liquid instruments

(b) Maximise investment return

(c) Match investment maturities to projected cash flow requirements to avoid realisations prior to maturity

(d) Manage potential capital losses due to interest rate movements if investments need to be liquidated prior to maturity

Council is also able to undertake short-term investments funded by external borrowings that mature within the current financial year, with approved Counterparties, if it is able to earn a positive margin between the borrowing and investment interest rates. This is called positive arbitrage.

The amount that Council can borrow this way can, when added to existing external debt, be no more than the peak projected debt levels for the financial year as outlined in the latest 10-year plan.

In relation to Treasury Investments credit exposure is minimised by limiting exposure to any investment sector or counter-party and from monitoring compliance against set limits as detailed in the table below:

Institution	Minimum Short Term S&P[1] Credit Rating	Minimum Long Term S&P*[1] Credit Rating	Total Exposure Limit for each Counter-party	Investment Portfolio Limit (up to)
Central Government	N/A	N/A	$500 million	100%
NZ Registered Bank	A1	A+	$40 million	100%
Local Authorities (including LGFA issues)	Rates as security	Rates as security	$10 million	50%
Strongly Rated Corporates & SOEs	A2	A- (BBB+ for SOEs)	$5 million	30%

5.7 FOREIGN EXCHANGE POLICY

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

All exposures over NZD100,000 equivalent are recognised and hedged when the exact timing and amount of the exposure is known following the Group Manager - Business Support's approval. Exposures are hedged using foreign exchange contracts.

Exposures of less than NZD100,000 equivalent are transacted at the prevailing spot rate on the day.

Council does not borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

[1] Minimum Standard &Poor's or Moody's or Fitch equivalent.

5.8 APPROVED INSTRUMENTS

Council can only enter into foreign exchange hedging transactions by way of the following instruments:

(a) Spot foreign exchange or forward foreign exchange contracts with a maturity date aligned with the timing of the confirmed exposure.

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