Liability Management and Investment Policy

Authorisation and Status

Policy Owner	Finance & Corporate Development Group	**Version**	Final
Policy Contact	Finance & Corporate Development Group Manager	**Last Reviewed By**	Policy unit
Approved By	Council	**Last Reviewed Date**	2020
Approved Date	Adopted 21 July 2020	**Date of Next Review**	2023
Notes			

Contents

1. Introduction

The Waitaki District Council (Council) undertakes borrowing, investment and risk management activities (in total referred to in this document as the Liability Management and Investment Policy). Council's borrowing and investment activities are carried out within the requirements of the Local Government Act 2002.

This Liability Management and Investment Policy document provides the policy framework for all of Council's borrowing and investment activities.

1.1 Philosophy

Council acknowledges that there are various financial risks such as interest rate risk, liquidity risk and credit risk arising from its borrowing and investment activities. Council is a risk adverse entity and does not wish to incur unnecessary risk from its borrowing and investment activities.

In relation to Council's borrowing and investment activities, the management focus is on prudent risk management in order to protect Council's budgeted interest costs and stabilise Council's cashflows. Council is able to invest in the development of the district. It is acknowledged that some investments and associated borrowings may carry a higher degree of risk than Council normally associates with cash investments.

2. Borrowing Policy

2.1 Objective

Council's objective is to achieve the lowest possible net borrowing cost within policy parameters by prudently managing funding risk and interest rate exposure. This is achieved by maximising benefits from favourable interest rate movements whilst having levels of protection in place against prolonged and significant adverse interest rate movements.

2.2 General Policy

Council approves, by resolution, the external borrowing requirement (including financial leases) for each financial year during the annual planning process. A resolution of Council is not required for indebtedness in connection to hire purchase, deferred purchase or the giving of credit, the aggregate amount Council determines as not being so significant as to require specific authorisation is $50,000 or where the period of indebtedness is less than 91 days.

Council must confirm all new loans required to fund expenditure that has arisen subsequent to the Annual Plan. In approving new debt Council considers the impact on its borrowing limits as well as the size and the economic life of the asset that is being funded and consistency with Council's long term Plan.
Council's infrastructural 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.

Council's ability to readily attract cost effective borrowing is largely driven by its ability to rate and manage its relationships with investors and financial institutions.

2.3 Principles

The following principles are embedded within the policy:

- Borrowed funds will be used to fund capital expenditure and equity investment, except as provided for working capital purposes under Cash Management policies.
- Debt will be used as a residual source of funds after Council has considered all other available options.
- The mix of debt, reserve and revenue funding will be determined by Council.

- Debt raised will be repaid over the economic life of the asset generally restricted to a maximum of 20 years but may be extended to 30 years.
- Unless Council otherwise resolves, interest costs will be treated as part of the operational expenditure and will be funded annually from operating revenue.
- The repayment of principal on debt generally will be funded from operating revenue. Although Council may resolve to repay loans from other capital sources.
- Loans raised by Council where security is required are to be secured as a charge over rates or rate revenue.
- Debt financing is recognised as a component in Council's Revenue and Financing policies and long term plan to provide intergenerational equity which prevents costs being incurred by the current users which are for the benefit of future users.
- Council may raise specific debt associated with significant "one-off" projects and non-financial investments from time to time, including investments in CCTOs.
- Council may borrow through hire purchase, credit, and deferred payment or lease arrangements in the ordinary course of Council business.
- Loans are raised to meet cash management requirements, as internal borrowing is preferred.

2.4 Borrowing Limits

In managing debt, Council will adhere to the following limits (as calculated from Council's latest financial statements):

- Net debt will not exceed 175% of total revenue.
- Net interest will not exceed 20% of total revenue.
- Net interest will not exceed 25% of annual rates.
- Net debt per rateable property will not exceed $4,000.

where:

- interest expense includes all external and internal costs of borrowing
- general revenues include all income recognised in accordance with Council's accounting policies but exclude vested assets or write-up of assets to fair value
- net debt is gross external and internal debt, less any funds held by external parties or separately invested by Council for the purpose of repayment of the borrowing; and
- per rateable property will be based the number of rating units contained in the rating database at the start of the financial year.

That when considering new borrowing Council should have regard not only to the limits of this policy but also to how the debt will be funded, and the ability to pay of the group of ratepayers that will be rated for the refinancing and repayment of that debt.

Council recognises that in the event of a disaster, at a time where borrowing levels are close to these limits, Council may, after using all other options provided in section 2.5, need to borrow above these limits. This additional borrowing will only be made after Council has considered the Districts ability to pay the cost of financing the additional debt.

2.5 Borrowing Mechanisms

Council is able to borrow through a variety of market mechanisms including:

- issuing stock and debentures,
- direct bank borrowing,
- accessing the short and long term capital markets directly, and
- the Local Goverenment Funding Agency (LGFA).

In evaluating strategies for new borrowing (in relation to source, term, size and pricing) Council takes into account the following:

- Available terms from banks, capital markets and the LGFA.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and margins relative to term for both loan stock issuance, bank borrowing and LGFA debt.

- The total cost of raising borrowing.
- The market's outlook on future interest rate movements as well as Council's own.
- Legal documentation and financial covenants.

Council is able to use a mixture of short term facilities (which generally have lower credit margins) as well as longer term facilities to achieve an effective borrowing mix, balancing the requirements of liquidity and cost. Council will also maintain committed bank floating rate facilities to enable the repayment and drawdown of debt.

2.6 Liquidity and Funding Risk Management

Liquidity risk management refers to the timely availability of funds to Council when needed, without incurring penalty costs.

Council minimises its liquidity risk by:
- Matching operational and capital expenditure closely to its revenue streams and managing cashflow timing differences to its favour.
- Matching borrowing drawdowns to its major capital expenditure and managing cashflow timing differences to its favour.
- Maintaining its financial investments in liquid instruments.
- Maintaining a committed overdraft facility with its relationship bank.
- Avoiding concentration of debt maturity dates (refer below).

To manage liquidity risk the Council must maintain committed funding facilities at a minimum of 110% of the projected peak debt level over the ensuing twelve month period. Liquidity includes cash and term deposits and financial market investments e.g bonds.

For funding risk, Council minimises 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, by ensuring debt maturity is generally spread widely over a band of maturities.

Specifically, Council manages this by ensuring that:
- No more than 30% or $10 million (whichever is the higher) of total debt is subject to refinancing in any rolling 12 month period.
- Total debt in this context includes existing as well as planned debt.

2.7 Interest Rate Risk Management

Interest rate risk refers to the impact that movements in interest rates can have on Council's financial budgets and cashflows. Council's borrowing gives rise to direct exposure to interest rate movements. Council seeks to minimise this interest rate risk given the following:
- Council's desire to have predictable, certain interest costs.
- The need to avoid large adverse impacts on annual rates arising from interest rate related rises.
- The long term nature of Council's assets and intergenerational factors.

For the purposes of interest rate hedging, core debt projections should be supported by budgetary analysis contained in the Annual Plan and the Long Term Plan. Core debt is defined as the level of current and projected future debt as determined by the Group Manager Finance and Corporate Development in consultation with the Chief Executive.

The Council will maintain fixed interest rate cover of its core debt within the control limits detailed in the table below. Fixed rate debt is defined as all debt that has at least one more rate reset outstanding (typically quarterly), or has more than three months to maturity in the case of a fixed rate term loan. Compliance with these parameters is not necessary if gross external debt is less than $7.5 million.

Fixed Rate Cover Percentages		
Period	**Minimum**	**Maximum**
0 to 2 years	40%	100%
2 to 4 years	20%	80%
4 to 8 years	0%	60%

The Finance and Corporate Development Group Manager is primarily responsible for the monitoring and managing the interest rate hedging profile of the Council. If the fixed rate cover is below or above the Fixed Rate Cover Percentages, the reasons for the non-compliance with the policy must be documented in an exception report.

The approved Interest Rate Risk Management strategy is implemented through the use of the following:

- Using interest rate risk management instruments (refer note below) to convert fixed rate borrowing into floating rate or hedged borrowing and floating rate borrowing into fixed rate or hedged borrowing.
- Using interest rate risk management instruments to hedge re-pricing risk on existing fixed rate debt and issue yield on planned new borrowing.

The use of interest rate risk management instruments is approved by Council. A current list of approved interest rate risk management instruments with appropriate definitions is included in Appendix ll. Additions to and deletions from this list are approved by Council.

All hedging contracts are only to protect the interest rate arising on actual debt and forecast debt planned to be raised. Hedging can only take place with counterparties who have a long term credit rating of strong or better.

2.8 Security

Council may borrow on an unsecured basis or if it decides to offer security for borrowing and other financial obligations then it will generally offer security over rates and rate revenue. In unusual circumstances with prior Council approval, security may be offered in the form of a charge on specific assets.

2.9 Repayment

Council normally repays borrowings on maturity, from general funds. However, other sources of funds may be identified when the loan is approved. Typical examples are development contributions and asset sales.

Table loans provide for the full repayment of the loan over the term of the loan authority. For loans drawn for the purpose of separate rate accounts, Council will consider offering those ratepayers a lump sum option under the provisions of the early payment of rates under Sections 55 and 56 of the Local Government (Rating) Act 2002.
When the repayment provisions for any specific loan have been fully funded, no further contributions will be required for that loan.

Council may select specific debt to be repaid in any one year to optimise the mix of debt.

2.10 Local Government Funding Agency

Council may borrow from the LGFA and, in connection with that borrowing, may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA.

- Provide guarantees for the indebtedness of 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 the Council's rates and rates revenue.

3. Internal Debt Management

3.1 Objective

Council's primary objective in funding debt internally is to use cash held in capital replacement, depreciation, separate rate, and special and trust funds effectively by establishing an internal loan portfolio that provides funding to internal cost centres. This creates operational efficiencies as savings are created by eliminating the 'bankers margin' that would be owing through Council simultaneously investing and borrowing with the bank.

3.2 Legal Compliance

Internal borrowing was authorised by the Local Government (Rating) Act 2002. Council considers that by applying available funds against debt through this internal debt management policy it is using its funds to most efficient use at low risk.

3.3 General Policy

The internal loan portfolio is used as an input into determining Council's external debt requirements. Where possible, reserves are used to reduce external debt, effectively reducing Council's net interest cost. Where debt financing is approved by the Annual Plan, Council in setting the quarterly treasury strategy will determine the effectiveness of using either external or internal debt.
Internal borrowing activities are consistent with the parameters set out in Section 2.

3.4 Principles

The following principles apply to the management of Council's internal loan portfolio:

- The internal loan is recorded on a schedule of internal loans reported to Council Quarterly as part of the Quarterly Treasury Report.
- Principal and interest amounts are repaid in quarterly instalments. Instalment amounts are agreed on establishment of the loan and determined on a table mortgage basis.
- Interest is charged to each internal loan and for short-term operational deficits in separate rate accounts.
- Interest will be paid to separate rate, depreciation reserves and special and trust funds quarterly, based on average quarterly account balances at the weighted rate of earnings of internal and external investments.
- All rate income collected for the purpose of a loan will be repaid to the loan. Where the actual interest rate varies from the budgeted interest rate Council first applies the interest charge then applies the balance of the income to the loan principal.

3.5 Interest Rates

Interest rates applied to the internal investments and debt is calculated using the following guidelines: In setting the rates Council estimates the likely internal borrowing interest rate. The actual interest rate is calculated quarterly.

The interest rate is based on Council's actual weighted average cost of funds and takes into account the following factors:

- Actual earnings on cash invested for the quarter.
- Actual cost of External borrowings for the quarter.

4. Investment Policy

4.1 Objective

Council's primary financial objective is the protection of its investment capital while striving to achieve an optimal return on investment. In its non-financial investment activity, Council's primary objective is the attainment of its strategic and economic development objectives as well as the protection of its investment capital.

4.2 Legal Compliance

This policy records Council's policy on the management of its financial assets including, but not limited to, trust funds, special funds, shares, property held in whole or part for investment purposes and financial reserves.

4.3 General Policy

Council's philosophy on the management of investments is to optimise returns in the long term while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk. It also recognises that lower risk generally means lower returns. It is noted that Council may have significant reasons other than financial in investing in Council Controlled Trading Organisatios (CCTOs) and other organisations.

Council does not hold financial investments other than those involving special and trust funds, asset replacement reserves, disaster funds, and cash management balances. In its financial investment activity, Council's primary objective when investing is the protection of its investment. Accordingly, only creditworthy counterparties are acceptable. Council's policy on managing credit risk is contained in Section 7.

Council is required to consider its continuing involvement in any investment and the expected return from that investment for the ensuing year. Performance measurement guidelines are contained in Section 8.

4.4 Principles

The following principles are embedded within the policy:
- The reasons for investments other than cash will be recorded by way of Council resolution.
- Council has set cash management targets and surplus cash funds held in Council's main bank account will be managed in accordance with those targets. Refer Section 5.
- Credit ratings of counterparties are against updated Standard and Poor's (S&P) advices.
- Council does not hold non-financial investments other than those held at the commencement date of this policy and those specifically approved by Council resolution and in terms of the intentions expressed above.

4.5 Investment Mix

Council maintains investments in the following assets:
- Equity investments, including CCTO's and other shareholdings (covered in Section 4.7).
- Property investments incorporating land, buildings and a portfolio of ground leases (covered in Section 4.8).
- Loans and guarantees for community development purposes (covered in Section 4.10).
- Financial assets incorporating longer term and liquidity investments (covered in Section 4.11).

4.6 Local Government Funding Agency

Council may invest in shares and other financial instruments of the LGFA, and may borrow to fund that investment. The Council's objective in making any such investment will be to:
- Obtain a return on the investment; and

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

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

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

4.7 Equity Investments

Council maintains equity investments, including investment in its CCTO's, and other relatively smaller historic shareholdings in various local government sector companies. Council's investments in these assets fulfil various strategic, economic development and financial objectives as outlined in Council's long term financial strategy. Council's liability in these entities is restricted to any uncalled share capital.

Council reviews performance of the CCTO investments on a twice annual basis to ensure that their stated objectives are being achieved. Performance criteria are set in the Statements of Corporate Intent of each organisation. All others are reviewed on an annual basis on receipt of annual reports. Any disposition of these investments, as well as acquisition of new equity investments requires Council approval and are subject to provisions within the Local Government Act 2002. Council decides on the allocation of proceeds from the disposition of equity investments on a case by case basis.

4.8 Property Investments

Council's primary objective is to only own property that is necessary for the economic, physical, social development and heritage of the District and to achieve an acceptable rate of return. Council seeks to actively develop its property holdings and is not a passive player in the market.

Proceeds from the disposition of property investments are used for meeting development costs, retirement of debt relating to such property, alternative property investments or for other capital projects, as approved by Council.

Council from time to time (subject to an assessment of the strategic value of the property, including return on investment), will sell the freehold interest of its leased land to the occupiers. Sales are at market value established by an independent valuer. Sales may be under deferred payment terms. Council retains security of the land title until payment is received in full.

Income from reserves under the Reserves Act 1977 must be returned to the reserve properties and is either used to reduce the annual rate requirement or placed in a cash reserve for future projects.

Council holds some strategic properties where there are few alternative uses for the land. As a result Council has a small holding of forestry assets, many on its various parks and reserves. The forestry assets primarily exist to provide protection to the land or to meet aesthetic requirements. Economic gains are incidental to holding these assets. Council decides on the allocation of any surplus proceeds (after repayment of loans) from the disposition of forestry investments on a case by case basis.

4.9 Endowment Property

An endowment is a 'gift of money or property to an institution for a specific purpose, especially one in which the principal is kept intact indefinitely and only the interest income is used'. Council endowment properties are held in two portfolios, Harbour Endowment which is for the benefit and development of the harbour with some land in trust for a dock and Council Endowment which is held for general purposes, municipal purposes or purposes of public utility.

Council is responsible for ensuring that the endowment trusts maximise their earnings. The endowment investments generate returns commensurate to the low risk of the investment. Council intends to actively manage these accounts to maximise the returns as was originally intended.

The consideration of properties for divestment is to allow for the free-holding of sites to encourage the economic development of the district through the private sector and to maximise the income from endowments. Divestment allows for the strengthening of the capital base for increased earnings and additional revenue streams.

Endowment properties will be reviewed with consideration to form a commercial investment model that allows up to 40% of endowment capital investment outside the district.
Divestment of endowment properties will be considered on a property by property basis as per prudent and best management practices with reference to statutory requirements and the terms of endowment.

There are restrictions in how Council must deal with endowment properties in the Local Government Act 2002.

Section 140 of the Local Government Act 2002 requires Council to retain endowment trust property for the purpose for which the property was vested in Council. However, section 140 (4) (b) authorises a Council:

- To sell or exchange such property unless disposal is expressly prohibited by the terms of the endowment or trust; and
- To use the proceeds of sale or exchange for a purpose identified in accordance with section 141.

Section 141 LGA allows Council to sell or exchange endowment property subject to due process.

Additional requirements apply where the Crown was the donor of the property (section 141(1)(c). In other cases, the Council must make a reasonable attempt to notify the donor of the property, or his or her successor of its intention to sell the property (section 141(1)(d).

4.10 Loans, Advances and Guarantees

Council makes loans to other parties for various projects that are considered to be economic or community development or for works under the Local Government Act 2002.

Council administers funds provided to Council by other organisations where these funds may be advanced in the form of a loan, and which may be secured or unsecured. Council reviews performance of these loan advances on a regular basis and ensures that interest and principal repayments are made in accordance with the loan agreement.

Council may also agree to guarantee advances made by other parties where Council considers the advance to be in the nature of economic or community development in accordance with Council's policies in these issues. Council 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.

Given that a number of investments are made for community purposes, there may not be a financial return from all investments. Where income is received, disposition will be determined on a case by case basis. Where loans from Councils funds are at non-commercial interest rates the forgone interest (as compared with the internal borrowing rate) will be recognised as an expense to that activity.

Council will generally negotiate interest rates close to the Council's internal borrowing rate.

Council will resolve for each new loan:

- The value of the loan.
- The term of loan.
- Repayment criteria.

- Security requirements.
- Interest.
- Penalty interest and other default requirements.

All loans will be documented with a signed loan agreements appropriately documented given the size and potential risk exposure to Council.

4.11 Financial Investments

Council maintains financial investments for the following primary reasons:

- Invest surplus cash and working capital funds (also see Section 5 Cash Management).
- Provide ready cash in the event of a natural disaster. This cash is intended to assist reinstatement and to finance short-term needs between the disaster and the resumption of normal income streams (see Section 4.11.4 below).
- Invest amounts allocated to special and trust funds, separate rate accounts, sinking funds and loan repayment reserves.

Normally financial investments are held to maturity. Proceeds from the disposition of financial investments are used for operational expenditure purposes or for the purpose for which they have been established.

Interest income from financial investments is credited to general funds, except for income from investments for separate rates, special funds and sinking funds where interest is credited to the particular fund.

4.11.1 Financial Investment Objectives

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 S&P rating which must be strong or better (A1 for short-term, A+ for long term). Council monitors credit ratings in the Quarterly Treasury Report from updated S&P advices.

Within the above credit constraints, Council also seeks to:

- Maximise investment return.
- Ensure investments are liquid.
- Match maturity of investments in line with expenditure requirements to avoid realisation of investments prior to maturity date.
- Minimise potential capital losses due to interest rate movements if investments need to be liquidated before maturity.

The above objectives are captured in Section 7, Counterparty Exposure Limits which provides operating parameters for investment activity including approved counterparties and relevant credit limits.

4.11.2 Approved Investment Instruments

Within the constraints of Section 7 of this policy, Council invests in the following instruments:

- Government investments.
- Registered bank investments.
- Local authority investments.
- SOE investments.
- Corporate investments.

A full list of approved instruments and their definitions is contained in Appendix III.

4.11.3 Interest Rate Risk Management

Council sets overall investment strategy quarterly. Council implements the interest rate risk management strategy by:

- Using risk management instruments to protect investment returns and to change the interest rate profile.
- The use of interest rate risk management instruments is approved by Council. A current list of approved interest rate risk management instruments with appropriate definitions is included in Appendix ll.

Additions to and deletions from this list are approved by Council.

4.11.4 Disaster Fund

Council maintains a disaster fund for the purposes of providing immediate cash resources to fund reinstatement of services/assets following a major unforeseen event, such as a natural disaster, and to meet its obligations under the National Disaster Recovery Plan. Council established policies for the disaster fund in October 1993. The fund is required to be readily available. The fund is set at $10 million and may be held in cash or other appropriate negotiable investment instrument or committed bank funding facilities. Council will make case by case decisions as to whether funds drawn from the Fund are required to be replenished at the earliest opportunity from the area of benefit.

5. Cash Management Policy

Cash management policy deals with the net balance in Council's main bank accounts with its principal banker. Council will maintain a three month rolling (by week) Money Management Report that forms the basis of its cash management activity. Generally these surpluses are available for periods less than 90 days. Any cash which is to be invested for a period longer than three months is covered by Section 4 of this policy document.
Council manages its working capital balances by matching expenditure closely to its revenue streams and managing cashflows timing differences to its favour.

Cash management activities must be undertaken within the following parameters:

- A daily nil balance is targeted in Council's main bank account, with surplus monies transferred to call deposits.
- Cash management instruments are limited to:
  - Call deposits with registered banks.
  - Registered certificates of deposit and promissory notes with maturities less than three months.
  - Term deposits (less than three months) with registered banks.
- Cash may only be invested with approved counterparties within the limits detailed in Section 7.
- Council has a committed bank overdraft facility. This facility will be used when there is expected to be a net benefit.
- The use of interest rate risk management instruments on cash management balances is not permitted.

6. Foreign Exchange Policy

Council has minimal foreign exchange exposure arising through the purchase of foreign exchange denominated plant, equipment, materials and library books.

As required by the Local Government Act 2002, Council does not borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

7. Counterparty Exposure Limits

Council ensures that all financial investment, interest rate risk management as well any foreign exchange activity is undertaken with institutions that are of high quality credit to ensure amounts owing to Council are paid fully and on due date.

More specifically, Council minimises its credit exposure by:

- Ensuring all investment, cash management, interest rate risk management and any foreign exchange transactions are undertaken with entities (excluding Government) that have a strong or better (A1 for short term, A+ for long term) S&P credit rating.
- Limiting total exposure to prescribed amounts.
- Rigorously monitoring compliance against set limits.

The following table summarises credit requirements and limits:

Institution	Minimum S&P Short Term Credit Rating[1]	Minimum S&P Long Term Credit Rating[2]	Total Exposure Limit for each Counter Party	Portfolio Limit for each counter-party[3]
Government	N/A	N/A	Unlimited	100%
Registered Bank - On balance sheet exposures - Off balance sheet exposures	A1 A1	A+ A+	$5 million $5 million	60%
Strongly Rated Local Authorities, Corporates and SOEs (on balance sheet exposures only)	A1	A+	$2 million	20%

1. For investments with maturities less than 12 months.
2. For investments with maturities greater than 12 months.
3. Exposure limits do not apply when cash balance is less than $5m.

If any counterparty's credit rating falls below the minimum specified in the above table then all practical steps are taken to reduce the credit exposure to that counterparty to zero as soon as possible.

Exposures to each counterparty are computed as follows:

On-balance sheet

- Total amounts invested with that counterparty (excluding current account balances with Council's main banking service provider).

Off- balance sheet (eg. approved interest rate risk management instruments in Appendix ll).

- Credit exposure on interest rate contracts is computed by multiplying face value of outstanding transactions by an interest rate movement factor of 5%.

8. 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. Objective measures are established by Council resolution on an annual basis in conjunction with management as follows:

8.1 Borrowing

- Adherence to policy.
- Unplanned overdraft costs.
- Comparison of actual interest costs vs budget borrowing costs.
- Comparison of actual borrowings with budgeted borrowings.

Comparison of financial ratios to budgeted measures as per the Annual Plan and Forecast Financial Statements.

8.2 Equity Investments

- Adherence to policy.
- Return on investment.
- Six monthly review of performance measures, comparison of actual to budgeted measures as per Statement of Corporate Intent.

8.3 Property Investments

- Adherence to policy.
- Quarterly comparison of actual gross and net income to budgeted gross and net income.
- Quarterly comparison of actual rental yield to budgeted rental yield.
- Quarterly comparison of actual property sales to budgeted property sales.

8.4 Financial Investments

- Adherence to policy.
- Comparison of actual quarterly 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.

9. Content of Appendices

Appendix I
Approved Borrowing Instruments and Definitions.

Appendix II
Approved Interest Rate Risk Management Instruments and Definitions.

Appendix III
Approved Financial Investment Instruments, and Definitions.

Appendix I

Approved Borrowing Instruments and Definitions

1. Bank Sourced Borrowing

1.1 Bank Bill Facilities

Commercial bills cover all types of bills of exchange, which are defined under the Bills of Exchange Act 1908 as:

> *"An unconditional order in writing, addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at fixed or determinable future time, a sum certain in money to, or to the order of a specified person, or to bearer."*

Bank bill facilities are normally for a term of up to three years but may be for as long as five years. Bank bills are bills of exchange, drawn or issued usually by the original borrower and accepted or endorsed by a bank.

For a bank accepted bill, the bank makes the payment of the face value of the bill on maturity. Most bank bills traded in the New Zealand market are bank accepted bills.

Bank endorsed bills have been endorsed by a bank with another party as acceptor. In the event of default of the original acceptor, payment can be sought through the chain of endorsers to the bill.

An investor in bank bills can sell the bills prior to maturity date and receive the cash. Bank bills are a longer term borrowing instrument than cash loans. Bills are normally drawn for terms of 30, 60 or 90 days with a few being drawn for 180 days.

The 90 day bank bill is the underlying traded benchmark instrument for the short end of the market.

Costs

The principal costs to the borrower are the discounting bank's yield at which it discounts the bill at the time of drawdown, an arrangement fee, an acceptance fee, a line fee (expressed in basis points or percentage per annum) and margin. Acceptance fees, arranger fees, line fees and margins in aggregate normally range between 35 - 300 basis points (i.e. 0.35% - 3.00%), depending on the credit worthiness of the borrower.

1.2 Revolving Credit Facilities (Variable Amount Term Loans)

Revolving credit facilities are similar from a borrower's perspective except interest is paid in arrears rather than upfront as in the case of bank bills. Revolving credit facilities are usually for a term of up to three years but may be for as long as five years and like bank bills drawings under the facility are priced off the bank bill bid rate. Most facilities allow for the borrower to draw up to the facility amount in various tranches of debt and for various terms out to a maximum term of the maturity date of the facility. Like bank bills most borrowers use these facilities to borrow on a 90 day basis.

Costs

The principal costs are the same as with bank bills, the lending bank's yield sets the base rate at the time of lending, an arrangement fee, an acceptance fee, a line fee (expressed in basis points or percentage per annum) and the margin. Acceptance fees, arranger fees, line fees and margins in aggregate normally range between 35 - 300 basis points (i.e. 0.35% - 3.00%), depending on the credit worthiness of the borrower.

1.3 Short Term Money Market Lines

Short term money market loans or cash loans can be committed or uncommitted. A customer pays for a guarantee of the availability of the funds in a committed loan. In an uncommitted loan, funds are provided on a best endeavours basis and no line/commitment fee is payable. In addition to a line fee, a margin may be charged on any line usage.

The minimum amount for a cash loan is $1,000,000. Smaller loans can be arranged, although the interest rate quoted will be a reflection of the size of the loan.

The main usage of cash loans is to cover day-to-day shortfalls in funds. The interest rate is governed by the term of the borrowing and the implied or implicit credit rating of the borrower. Cash loans are short term only and are normally drawn for a term of one (overnight) to seven days. Interest collection can be daily.

2. Capital Markets Programme

Commercial Paper (CP) programmes normally provide for issuance with tenors of between 7 and 364 days. The majority of CP issued in the New Zealand market is for terms of 30, 60, or 90 days.

Corporate bonds commonly in existence in the New Zealand market have essentially the same characteristics as government stock. These are a source of longer term fixed or variable rate finance that can be sold either in bearer or registered form (normally registered). Bonds are normally issued with coupon interest paid in arrears on a six monthly basis for fixed rate instruments, and three monthly for floating rate instruments. Local authority bonds are issued by a variety of local governments by tender or private placement. The bonds are registered securities. They are repayable on a fixed date, and are generally issued for terms ranging from one to fifteen years.

Local authority bonds are priced twice annually and issued at a discount to face value. A fixed coupon payment is made twice annually to the holder of the security. The pricing formula is the same as government bonds.

The term bond is usually reserved for securities with terms longer than a year, to clearly distinguish between short term (CP) and long term (bonds) debt instruments. CP and bonds usually constitute unconditional, unsecured and unsubordinated obligations of the issuer, except indebtedness given preference by operation law.

3. Structured and Project Finance

Project and structured financing matches up debt to suit the quantifiable income stream from the project. This type of financing is appropriate for the funding of standalone assets that are able to be ring-fenced and over which security can be taken. The sort of assets to which this usually applies are assets which are transferable, and for which an international equity market exists, e.g. infrastructural assets. The owner of the asset usually retains an equity interest in the asset.

Appendix II

Approved Interest Rate Risk Management Instruments and Definitions

1. Approved Interest Rate Risk Management Instruments

A. Interest rate risk management instruments approved for use, consistent with the policy contained in Section 2.7 are:
   - Fixing through physical borrowing instruments - loan stock, debentures, bank term loan.
   - Floating through physical borrowing instruments - short term revolving stock, and bank borrowing.
   - Forward rate agreements and bond forward rate agreements.
   - Interest rate swaps.
   - Purchase of interest rate options products including caps, floors, bond options.
   - Interest rate collar type option strategies.

B. The following interest rate risk management instruments are not permitted for use:
   - Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.
   - Structured or leveraged interest rate option strategies where there is any possibility of Council's total interest expense increasing in a declining interest rate market or where Council's total interest cost is increasing faster than the general market rate.
   - Interest rate futures contracts, mainly for administrative ease.

2. Interest Rate Risk Management Instruments - Definitions

Bank Bill Mid-Market Settlement Rate
The bank bill mid-market settlement rate as determined at 10:45am each business day on Reuters page BKBM. This is the standard rate for the settlement of interest rate swaps, forward rate agreements and interest rate caps and collars.

Bond Options
Council when purchasing a bond option, has the right but not the obligation to buy or sell a specified government stock maturity on an agreed date and time and at an agreed rate.

Forward Rate Agreement
An agreement between Council and a counterparty (usually a bank) protecting Council against a future adverse interest rate movement for a specified period of time. Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM). This definition includes the bond forward rate agreement where the benchmark rate is the underlying government bond yield.

Interest Rate Collar Strategy
The combined purchase (or sale) of a cap or floor with the sale (or purchase) of another floor or cap.

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 for a specified period. Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM). Interest rate option products include caps, floors and bond options.

Interest Rate Swap
An interest rate swap is an agreement between Council and a counterparty (usually a bank) whereby Council pays (or receives) a fixed interest rate and receives (or pays) a floating interest rate. The parties to the contract agree notional principal, start date of the contract, duration of the contract, fixed interest rate and the bench mark rates (usually BKBM).

Appendix III

Approved Financial Investment Instruments and Definitions

1. Approved Financial Investment Instruments and Definitions

Investment instruments available in the market (excluding equities and property) can generally be discussed under four broad categories relating to the issuer of these instruments.

1.1 New Zealand Government

- Treasury bills are registered securities issued by the Reserve Bank of New Zealand (RBNZ) on behalf of the government. They are usually available for terms up to a year but generally preferred by investors for 90 day or 180 day terms. They are discounted instruments, and are readily negotiable in the secondary market.
- Government stocks are registered securities issued by the RBNZ on behalf of the government. They are available for terms ranging from one year to twelve year maturities. Government stocks have fixed coupon payments payable by the RBNZ every six months. They are priced on a twice annual yield basis and are issued at a discount to face value. They are readily negotiable in the secondary market.

1.2 Local Authorities

- Local authority stock is registered securities issued by a wide range of local government bodies. They are usually available for maturities ranging from one to ten years. A fixed coupon payment is made semi-annually to the holder of the security. They are negotiable and usually can be bought and sold in the secondary market.

1.3 Registered Banks

- Call and term deposits are funds accepted by the bank on an overnight basis (on call) or for a fixed term. Interest is usually calculated on a simple interest formula. Term deposits are for a fixed term and are expected to be held to maturity. Term deposits are not negotiable instruments. Termination prior to maturity date can often involve penalty costs.
- Registered certificates of deposits (RCD) are securities issued by banks for their funding needs or to meet investor demand. They are registered at the RBNZ or held on behalf of by the dealing bank. Details include the name of the investor, face value and maturity date. They can be transferred by registered transfer only. RCDs are priced on a yield rate basis and issued at a discount to face value or a grossed up basis. They are generally preferred over term deposits because investors can sell them prior to maturity.
- Bank bills are bills of exchange drawn or issued, usually by a corporate borrower and accepted or endorsed by a bank. The investor is exposed to bank credit risk when investing in such instruments. Bank bills are readily available for any maturity up to 180 days, although 30 to 90 day terms are more common. They are priced on a yield basis and issued at a discount to face value. Investors in bank bills can sell the bills prior to maturity date.

1.4 Corporates

- Companies with good credit ratings generally issue corporate bonds. These bonds can be registered securities or bearer instruments. There are two types of bond, the medium term note (MTN) and the floating rate note (FRN). The MTN has a fixed coupon payment that is made semi-annually to the holder of the security. They are priced on a semi-annual yield basis and are issued at a discount/premium to face value. The interest rate on the FRN is set on a floating rate basis usually off the bank bill 90 day bid rate.
- Corporate bonds are negotiable and can be bought and sold in the secondary market.
- Promissory notes are issued by borrowers who usually have a credit rating and standing in the market that is sufficient to enable the notes to be issued without endorsement or acceptance by a bank. The notes are usually underwritten by financial institutions to ensure that the borrower obtains the desired amount of funds. Promissory notes are issued with maturities ranging from 7 days to over one year. The common maturities are for 30 and 90 days. The face value of the note is repaid in full to the bearer on maturity.