POLICY

TE KAUNIHERA Ā ROHE O WHAKAAHURANGI
STRATFORD DISTRICT COUNCIL

Policy:	Treasury Management
Department:	Corporate Services
Approved by:	Council
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Introduction

A Liability Management Policy and an Investment Policy must be adopted by all local authorities, in accordance with Section 102 of the Local Government Act 2002. Stratford District Council ("Council") has incorporated the two policies into one Treasury Management Policy.

Council has an obligation to manage its affairs prudently and in the interests of the Stratford community. Council is a risk averse entity, and does not wish to seek risk from its treasury activities. This policy establishes limits for council officers to operate within, to ensure prudent management of council's treasury risk.

Purpose

The purpose of this policy is to ensure investments and liabilities are managed in a prudent manner, and in compliance with legislation and covenant obligations. The objectives are:

- To achieve the lowest possible net interest costs obtainable within the policy parameters, by proactively managing funding and interest rate exposures.
- To limit council exposure to liquidity risk, interest rate risk, and credit risk.
- To ensure that adequate provision is made for the funding requirements of Stratford District, as identified in the Long Term Plan ("LTP") and Annual Plans.
- To ensure mechanisms are in place to enable staff and elected members to monitor, report, and evaluate treasury performance and compliance.

Part One – Liability Management Policy

1. Section 104 of the Local Government Act 2002

The Liability Management Policy must state the Council's policies, in respect of the management of borrowings and other liabilities, including:

- Interest Rate Exposure;
- Liquidity;
- Credit Exposure; and
- Debt Repayment

In line with good practice, this Policy also covers funding risk and foreign exchange risk.

2. Liability Management Framework

The council has a large number of infrastructure assets which have a long life and provide long term benefits. Council sees the use of debt as an appropriate and efficient mechanism for upholding intergenerational equity between current and future ratepayers.

The council will borrow for infrastructure asset capital expenditure relating to service level improvements, ie. New assets or significant improvements or upgrades to existing assets, and Council may borrow for growth related infrastructure if Financial Contributions are insufficient to cover the full capital expenditure.

Capital renewals and replacement of existing assets will be funded from the appropriate reserves. However, where an *emergency event* occurs and an asset requires replacement and the reserve is insufficient to fund the asset replacement, borrowing may be used after exhausting all other options – including insurance claims, and the contingency reserve. This will require approval by elected members on a case by case basis.

Gross external debt is approved by council during the LTP and Annual Plan processes. Projected debt levels are determined from cash flow forecasts prepared during the preparation of the LTP and/or Annual Plan.

3. Interest Rate Exposure (Section 104 (a))

Interest rate risk is the risk that net interest costs will materially exceed the budget in the LTP or Annual Plan due to adverse movements in market interest rates. Council is exposed to interest rate fluctuations on floating debt, when fixed interest rates mature, and when debt needs to be refinanced.

Council will minimise interest rate risk by managing its floating and fixed interest rate exposures as per the following control limits.

Fixed/Floating Interest Rate Risk Control Limits

Minimum - Fixed Rate	Maximum - Fixed Rate
60%	100%

The percentages are calculated on the gross external debt, as calculated by the Director Corporate Services. Debt is regarded as fixed, where the interest rate is protected, through a fixed rate or through hedging, for more than 6 months on a continuous rolling basis. Floating rate is defined as an interest rate re-pricing within 6 months.

Fixed Interest Rate Maturity Profile Limit

Period	Minimum Cover	Maximum Cover
1 to 3 years	10%	60%
3 to 5 years	10%	60%
5 to 10 years	5%	60%
10 years plus	Council Approval	Council Approval

The following interest rate risk management instruments may be used to protect interest costs and to improve the interest rate profile:

- Fixing through physical borrowing instruments - loan stock, debentures, and bank term loan.
- Floating through physical borrowing instruments - short term revolving stock, bank borrowing, and short-term borrowing programme.
- Forward rate agreements.
- Interest rate swaps.
- Forward start swaps (start date no more than 5 years).

Any other financial instrument must be separately approved by Council on a case-by-case basis.

4. Liquidity (Section 104 (b))

Liquidity risk is the risk that there are insufficient funds to meet obligations as they fall due. Liquidity risk increases when unanticipated obligations arise and when anticipated receipts do not eventuate. The Council must put in place measures to ensure that there is access to a sufficient level of funds in order to respond to an unanticipated event.

Liquidity Ratio

External debt + committed debt facilities + cash > 110% of external debt.

Debt Maturity Limit

The below limits are designed to avoid concentration of debt at the time of reissue/rollover, and the potential risk of being unable to refinance.

Period	Minimum Cover	Maximum Cover
1 to 3 years	10%	60%
3 to 5 years	10%	60%
5 to 10 years	10%	60%
10 years plus	Council Approval	Council Approval

Cash management (cash receipts and disbursements) activities will be undertaken to ensure that cash surpluses will be invested on a call account or in short term deposits to:

- Achieve a targeted optimal daily balance of zero for Council net bank balance; and to
- Ensure Council's debt facilities are only used in exceptional circumstances.

5. Credit Exposure (Section 104 (c))

Council's ability to readily attract cost effective borrowing is largely driven by its ability to rate, maintain a strong financial standing, and manage its relationships with its investors, the LGFA, and financial institutions/brokers. Although Council does not have a credit rating currently, it may obtain a Standard & Poors or Fitch credit rating if elected members approve, taking into consideration any proposal to increase debt that would result in a breach of LGFA net debt to revenue covenants, and the cost effectiveness of interest savings vs the cost of a credit rating.

Credit exposure will be managed by:

- Compliance with all treasury management limits in this policy.
- Compliance with all obligations under the Local Government (Rating) Act 2002.
- Maintaining an unqualified annual audit with Audit NZ.

6. Debt Repayment (Sections 104 (d))

The accounting for debt repayments will be in accordance with the LTP and Annual Plans. Generally, debt repayments are generally scheduled to be repaid over 25 years, but may be repaid longer for significantly longer life assets with specific council approval. Debt repayments are funded from reserves. Additional repayments may be made from surplus funds generated by asset sales or operating surpluses.

All external loans will be repaid as they fall due in accordance with the applicable borrowing arrangement. Subject to compliance with debt limits and the Long Term Plan budgets, a loan may be refinanced. The Council will manage debt on a net portfolio basis.

7. Funding Risk

Funding Risk management centres on the ability to refinance or raise new debt at a future time at the same pricing (base rate plus margin) and maturity terms of existing loans and facilities. Several risk factors can lead to increased funding risk:

- Local government is priced to a higher fee and margin level.
- Council's financial strength as a borrower deteriorates.
- A large individual lender to council experiences financial difficulties resulting in Council not being able to refinance.
- The failure of a significant Council debtor/investee.

The council will manage this risk by:

- Ensuring access to a committed facility through a registered bank that does not have more than 50% of Council's lending,
- Adhering to the liquidity and maturity profile limits within this policy, and
- Exercising financial constraint and spending within budget.
- Actively monitoring all outstanding debtor accounts and investments.

8. Borrowing Limits (Sections 101A(3)(b)(i))

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

Borrowing costs as a percentage of *Annual Operating Revenue*	<10%
Borrowing costs as a percentage of *Rates*	<15%
Net External Debt as a percentage of *Annual Operating Revenue*	<115%

9. Foreign Exchange Risk

Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated plant and equipment. Foreign exchange risk arises when the NZD cost increases, if the relative value of the NZD falls between the time of the commitment/order/contract/invoice and the time payment is made.

The use of *foreign exchange contracts* must be considered for all expenditure over $100,000 that is denominated in foreign currency where there is a time delay in payment. All potential *foreign exchange contracts* must first be approved by the Director – Corporate Services.

It is unlawful for Council to borrow money within or outside New Zealand in a currency other than the New Zealand dollar.

10. Security (Sections 101A(3)(c))

Council's ability to borrow is directly related to rates revenue. Council has granted security over its rates revenue under the Debenture Trust Deed, and Trustee Executors is appointed as the professional trustee. Council recognises that using rates revenue as security lowers the risk involved for lenders and, therefore, will lower the cost of borrowing to Council.

Council may also choose to secure certain borrowings by a charge over assets. This will only occur when;

- there is a direct relationship between the debt and the asset purchase or construction cost, and
- Council considers a pledge of the physical assets to be a more appropriate mechanism than the general charge over rates.

Any pledging of physical assets must meet the terms and conditions of the Debenture Trust Deed and the Local Government Act 2002 (which prevents water service assets from being used as security for any purpose).

11. Community Loan Guarantees:

Council may act as a guarantor to financial institutions on loans, or enter into incidental arrangements for organisations, clubs, or trusts, when the purposes of the loan are in line with Council's strategic objectives, subject to the conditions below:

- The organisation must have a Strategic Plan / Business Plan in place.
- The capital expenditure to which the loan relates is reviewed and approved by the Director - Assets.
- The production of a certificate from an independent Chartered Accountant which confirms the ability of the group or organisation to repay the loan sought (with supporting documentation as required by the Director – Corporate Services).
- The production of annual audited accounts, including a report from the Auditor as to his/her opinion of the solvency of the organisation.
- The term of any loan and guarantee is not to exceed 10 years.
- Council to be notified immediately by the bank of any default in relation to servicing the debt.
- Council representatives be given the right to attend club/board/trustee meetings, including the Annual General Meeting, and are notified accordingly of all meetings.
- Subject to appropriate legal and professional advice, the transfer to the Council of assets of the group or organisation to the value of any amount outstanding in the event of default in respect of any guarantee granted.

12. NZ Local Government Funding Agency Limited

Council may borrow from the NZ Local Government Funding Agency Limited (LGFA) and, in connection with that borrowing, 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 ("borrower's note") to the LGFA;
- provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;
- 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.

Part 2 – Investment Policy

13. Objectives (Section 101A(3)(d))

Council will seek to:

- Invest surplus cash in liquid and creditworthy investments.
- Implement a programme for managing reserve funds that reduces liquidity risk.
- Achieve the Community Outcomes of the Council through strategic investment.

Council recognises that as a responsible public authority any investment that it holds should be low risk and managed prudently, in a manner that promotes the current and future interests of the community (Section 101 of the Local Government Act 2002).

All non-financial investments must be approved by Council resolution.

14. Investment Mix and Associated Specific Objectives (Section 105 (b))

Council's portfolio of investments may include:

a) Property

Council's objective is to only own property that is necessary to achieve its strategic objectives under one of Council's four Community Outcomes. These strategic objectives may include enabling growth, responding to a community need, and reducing the rates requirement.

Farm assets are held to provide mitigation to rates increases. The asset is considered a commercial investment, and financial results are monitored and reported to the Farm and Aerodrome Committee quarterly.

Property purchases for investment purposes must be supported by registered valuations, and a full *business case* analysis. Council will not purchase properties purely for speculative reasons.

b) Financial

The primary objective of financial investing is to protect the value of reserve funds. Financial investments typically include registered bank term deposits and NZ fixed interest securities, but may include loans to third parties.

Excess cash may be used for internal borrowing. Funds borrowed by a Council Activity internally will be allocated interest equivalent to the Council's weighted average interest rate incurred on gross external borrowings.

Investments and maturities must be maintained at a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements.

c) Community Loans

The Council may consider applications from Community Groups for loans for capital purposes where there is clear social or community benefit to be achieved from the lending. Interest on the loans is to be determined by Council at the time of the application and may be at significantly discounted or nil interest rates. Community Loans granted will be subject to the same conditions referred to above with respect to Community Loan Guarantees.

An exception to the conditions will be allowed where Council determines that a loan to the community organisation operates as a commercial arms-length investment, where interest plus an additional margin is charged, and security is sufficient to cover the full amount of the loan. In this case, the terms of any loan or loan guarantee will be assessed on a case-by-case basis.

d) Equity

Council may invest in shareholdings in other entities to fulfil strategic, economic development or financial objectives outlined in the LTP. Equity investments may be held where Council considers there to be strategic community value.

e) New Zealand Local Government Funding Agency Limited (LGFA)

The Council may invest in shares and other financial instruments of the LGFA, and may borrow to fund that investment, despite section 16 of this policy.

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

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

Because of these dual objectives, 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. Council is currently a guarantor to the LGFA.

15. Council Controlled Organisations (CCO's)

The Percy Thomson Trust is the sole CCO of Stratford District Council. The Council has established the charitable trust for the objects set out in the Trust Deed. The Council is responsible for the following in relation to the Trust:

- Appointing new Trustees
- Approving any amendments to the Trust Deed
- Authorise entering into any Major Transactions (or authorise Business Plan)
- Adopt Statement of Intent, Half-yearly report, Annual Report
- Approve winding up of the Trust
- Approve the removal of a Trustee

The Trust maintains its own Investment Policy which allows for investments in:

- Bank deposits, bank accepted bills and bank issued certificates of deposit
- Short term Promissory Notes issued by companies and Local Authorities
- Stocks and bonds issued by Government, SOE's, Local Authorities and suitably rated Corporate entities
- Shares in listed public companies
- Real Estate
- Professionally managed portfolios of investments, either by direct investment or through Unit Trusts including:
    - Equities both New Zealand and overseas domiciled
    - Fixed interest both New Zealand and overseas domiciled
    - Short term cash
    - Real estate

Accordingly, the Council's Treasury Management Policy does not apply to the Trust.

16. Acquisition of New Investments (Section 105 (c))

The Council will not borrow to acquire new investments without specifical approval by Council (excludes LGFA borrower notes, required for all new borrowing with LGFA).

All acquisitions and disposals of property and farm assets (land, buildings and shares) are to be approved by Council, either through the LTP, Annual Plan, or on a case by case basis. Where significant, public consultation may be required. All property activities are managed by the Assets Department.

17. Assessment and Management of risks associated with Financial Investments (Section 105 (e))

The Council will limit financial investments to registered banks and the LGFA, unless specifically approved by Council on a case-by-case basis.

All financial investments and interest rate risk management instruments are to be undertaken with institutions that are of high quality credit (credit rating at least BBB+), to reduce the risk of a *counterparty* defaulting and the loss to Council of principal, anticipated interest payments, and non-payment of any other contractual financial obligations. Exceptions must be specifically approved by Council.

Part Three – Administration of Policy and Other Matters

18. Management and Reporting Procedure for Investments and Borrowing (Section 105 (d))

The Policy and Services Committee will, at least on a quarterly basis, discuss the debt and investment activity for the previous quarter together with likely activity for the coming months. Council is responsible for approving any treasury activity that is outside the limits of this policy.

A monthly report to the Policy and Services Committee will incorporate the following sections:

- Treasury Report including non-compliance with limits in this policy
- Statement of Public Debt including any community loan guarantees
- Investment and Share Statement including any community loans
- Cashflow Forecast – Rolling 12 month

The Farm financial and non-financial results will be reported quarterly to the Farm and Aerodrome Committee.

19. Relevant Delegations

The treasury function operates within, and is administered by, the Corporate Services department. A maturity profile that is outside the limits in this policy, but self corrects within 125-days is not in breach of this Policy. However, maintaining a non-compliant maturity profile beyond 125-days requires specific approval by Council.

Activity	**Delegated to:**
Approve policy document	Council
Amending policy following staff review	Council
Acquisition and disposition of non-cash or equity investments and new borrowings to fund investment	Council
Approval of borrowing programme for the year as set out in the AP/LTP	Council
Approval for charging assets as security over borrowing	Council
Approve interest rate risk management instruments outside policy limits	Council or Audit and Risk Committee
Approve borrowing and interest rate positions outside policy limits	Council
Approve new financial investments with *counterparties* other than registered banks or LGFA	Council
Approve *counterparty* limit exposures outside policy limits	Council
Approve Community Loan applications	Council
Approve Community Loan Guarantee applications	Council
Open/close bank accounts	Chief Executive
Approve authorised cheque/electronic signatories	Chief Executive
Transfer of stock/shares, register new debt issues	Seal register signatories
Refinance debt, rollover debt, re-negotiate existing debt on more favourable terms	Chief Executive and Director – Corporate Services
Invest surplus funds in Term Deposits or rollover existing investments	Chief Executive Director – Corporate Services Accountant (up to $1m)
Implement Treasury Management Policy, the borrowing programme, and monitor Treasury risks	Director – Corporate Services
Approve Foreign Exchange hedging contract	Director – Corporate Services
Manage compliance with policy	Director – Corporate Services
Review policy (three-yearly or earlier if required)	Director – Corporate Services

20. Glossary: Definitions

Annual Operating Revenue includes rates revenue, government grants and subsidies, user charges, interest and other revenue (excluding vested assets and financial contributions).

Business Case is required to be prepared and approved prior to significant investment.

Emergency Event – An event, most likely declared by Civil Defence, that is significant enough to cause damage to Council infrastructure, and that is recognised as such by the Chief Executive.

Net External Debt is defined as total external debt less liquid financial assets/investments.

Net Portfolio Basis is a centralised method of managing net funding (borrowings less cash instruments) and is Council's preferred method.

Counterparties are contracting parties to a financial transaction or financial instrument.

Counterparty *Credit Risk* is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where the Council is a party.

A *Foreign Exchange Contract* is an agreement to buy or sell one currency for another, for a specified future delivery, at a specified rate.

Forward Rate Agreements ("FRA") is an obligation to buy or sell a given asset on a specified future date at a price agreed at the time of transaction. Generally, the council, as buyer of an FRA is attempting to protect against a future rise in interest rates.

Interest Rate Swaps is an agreement between two counterparties to exchange interest rate obligations from a fixed or floating rate basis. The interest payments and receipts under the swap contract being offsetting, equal and opposite to the underlying physical debt.

Stock/Debentures is the debt issued to third parties by a company