CENTRAL HAWKE'S BAY DISTRICT COUNCIL

together we thrive

# Rural Ward Fund Investment Commercial Structuring Discussion Paper

Supporting documentation for community consultation
Annual Plan 2019/2020

January 2019

## Introduction

For many years, Central Hawke's Bay has been immersed in a conversation about the future prospects of the Ruataniwha Water Storage Scheme. The reality is that the Ruataniwha Water Storage Scheme as proposed is unlikely to ever be fully implemented.

Water security however, is the greatest challenge to overcome the environmental, social and economic challenges the District faces now and in the future.

The requirement for water storage in some form is required to not only ensure water security and resilience for the District, but to allow for future growth and economic development.

As a Council and key infrastructure provider responsible for ensuring the long term social, cultural, environmental and economic development of the District, the need for some form of investment in finding and implementing a solution to the current requirements and demands for water security need to be considered. The reality is the scale required to achieve the District and Region wide outputs will require collaboration and partnership across a range of stakeholder groups.

What was learnt from the Ruatanwhia proposal is no one entity alone will have the resources or ability to enable any water storage proposal of the required scale or scope alone.

How Council support such initiatives will vary and will need to be carefully managed as both a regulator and potential partner and funder of public funds.

Council have explored with Water Holdings CHB Limited (Water Holdings CHB) the proposition of providing financial assistance to support Water Holdings CHB in completing a review of the Ruataniwha Intellectual Property to identify potential water storage solutions and commercialisation opportunities.

## Purpose of this paper

This paper sets out a proposal to provide a $250,000 suspensory loan from Council's Rural Ward Funds to Water Holdings CHB.

Council have confirmed any such investment would require public consultation.

The purpose of this paper is to provide the public with an assessment of potential commercial and legal structures that Council considered and to provide additional information so that members of the community can make a submission to the Annual Plan 2019/2020.

The paper provides a high-level assessment of who Water Holdings CHB are, a review of the strategic and policy fit for any investment by Council, a review of the structures available to Council for making the investment and recommendations on the preferred option as well as condition precedents for any investment being made.

# Water Holdings CHB Limited

Water Holdings CHB Limited is a limited liability company, 100% owned by private shareholders and describes itself as a conglomerate of community and business leaders in Central Hawke's Bay with an interest in securing the long term and sustainable water security for the region.

The entity, whilst a private business, promotes itself as being not for private profit from the assets which have been purchased.

Water Holdings CHB shareholding (of 9999 shares) is split between six shareholders being:

- Hugh Ritchie
- Gavin Streeter
- Tim Gilberston
- Bruce Stephenson
- Bruce Worsnop
- Arthur Rowlands

In addition to the shareholder/ directors, Water Holdings CHB has an independent chair, Angus Mabin.

All shareholders are actively involved in local businesses throughout Central Hawke's Bay and the wider Hawke's Bay region.

Water Holdings CHB holds the intellectual property for the Ruataniwha Water Storage Scheme that was developed by Hawke's Bay Regional Investment Company Ltd and was sold in 2018 following Hawke's Bay Regional Council's decision not to pursue the feasibility of the Ruataniwha Water Storage Scheme.

The investment made by the Shareholders is relatively modest in the context of the overall investment that will be required and having visibility of this and their longer-term strategy is recommended.

# Proposed Investment

The investment being sought by Water Holdings CHB from Council is for $250,000.

Water Holdings CHB have proposed that these funds will be matched by the shareholders/ private investors and a funding grant being sought from the Government's Provincial Growth Fund (PGF).

The following table provides a breakdown of the funding split that makes up the total proposed quantum of funds being sought.

**Table 1. Water Holdings CHB Investment Split**

| FUNDER | QUANTUM | COMMENT |
|---|---|---|
| Provincial Growth Fund | $250,000 | Not confirmed |
| Water Holdings CHB | $100,000 | Investment to date in purchasing IP |
| Other | $50,000 | To be confirmed from other partners |
| CHBDC | $250,000 | Council investment being sought |
| **Total** | **$650,000** | |

It is proposed Council's funding will be made available via the Rural Ward Funds.

The funds were established to provide funds for the provision or maintenance of recreational, cultural or infrastructural assets within the Aramoana / Ruahine Wards.

The Special Funds Policy is the Council policy that governs the use of the Rural Ward Funds. The Rural Funds, also known as the Aramoana / Ruahine Ward Disbursement Reserve Accounts were established following the 1989 Central Hawke's Bay Councils amalgamations.

The Special Funds Policy states that unless otherwise stated, only the interest earned on each fund shall be available to be spent, thereby preserving the individual fund amounts. A decision by Council to provide $250,000.00 by way of suspensory loan to Water Holdings CHB, would require an amendment to the Special Funds Policy given the current policy is limited to only granting interest earned.

The Aramoana / Ruahine Rural Ward Funds have a current balance of $811,114. By drawing on the reserve funds there would be no further impact on rates.

As reported in the Annual Plan 2017/18, the Ruataniwha Water Storage Scheme was supported by Council and viewed as a key infrastructure development, from which Council would consider to take water to service the community's needs.

In addition to providing a water source, the project as proposed was projected to result in significant economic benefit. Water Holdings CHB believe any such adaptation of the original proposal will have comparable 'scaled' benefits for the region and further economic development, as to a range of further value add outputs for the District and Region as a whole, that could include:

- Improved summer flows in the Tukituki River
- Improved river health and habitat
- A predicted increase of between 1.9-5.5% in current GDP (between $130 to $380million a year by full water uptake)
- The potential to create between 1,130 and 3,580 jobs across Hawke's Bay through increased activity and its flow-on impacts

(Based on RWSS benefits assessment)

Water Holdings CHB, as the holder of the intellectual property associated with the RWSS, is in a unique position to explore what value remains in the science, consents and construction plans to create a new approach to water storage as a part of the regional solutions for water security.

The direction of work has its foundational intent to store sufficient water during the winter period to secure minimum river flows during the summer months.

The scope of work that Water Holdings CHB are seeking financial support for intends to work through the intellectual property and engage with key stakeholders on a number of factors involved in the current consented structure. The work will measure and prioritise the role of each factor in reaching a water storage solution that has wide community benefits and acceptance.

These factors include:

1. The volumes of water required in the main Makaroro, Waipawa and Tukituki tributaries to achieve minimum flow rates
2. The volume of water able to be held behind different wall heights
3. The breadth and composition of distribution network required to achieve coverage of the catchment, or parts thereof
4. The role water storage in this project could play in the wider regional approach to water security in the Tukituki Catchment – including Managed Aquifer Recharge and other private or community based water storage initiatives

There is clearly a relationship between the minimum flow level and the volume of storage required to guarantee that flow level in drier years. This, in turn, implies that there is a significant trade-off between the provision of the minimum flow and the availability of water for irrigation purposes. The focus of the assessment work is to evaluate this basic trade off to find an option that is acceptable to a majority of the community that look at the priority brining environmental flow to the river and how that could be leveraged to support the land use changes we want to achieve in Central Hawke's Bay.

We believe the proposed structure of the funding is consistent with the intent of the fund and the potential benefits to the district could be significant. While the Rural Ward Fund have typically been used for Council owned assets, the policy does not specify that it must be Council assets.

Council's current investments policy limits equity investments to shares.

The proposition to provide funding to Water Holdings CHB via a suspensory loan is considered an investment because of the nature of the proposed key terms and conditions.

For Council to go ahead with this proposal a small change to the current Investment Policy would be required to allow this structure.

This would include the addition of **"and other appropriate structures"** in the definition of equity investments. The change is outlined below in red.

It may be appropriate to have limited investment(s) in equity (shares) and other appropriate structures when Council wishes to invest for strategic, economic development or social reasons, such as Local Government Insurance Corp[1].

Council will approve equity investments on a case-by-case basis, if and when they arise.

[1] *Council currently holds 8,290 shares in the NZ Local Government Insurance Corporation Ltd. The purpose of the entity, in which most local authorities are shareholders, is to ensure that adequate insurance arrangements are available to local authorities at the lowest possible cost. The shares are not readily transferable.*

Both changes to the Special Funds Policy and Investments Policy (attached to this paper) can be achieved via Council resolution and would only be recommended following community consultation when Council make deliberations on the Annual Plan 2019/20.

# Funding Structure

The proposed investment being sought by Water Holdings CHB is not a unique investment precedent. There are multiple examples whereby private/ public investment has been made into large scale infrastructure/ social infrastructure projects by Government and Councils, where there is a direct tangible community benefit and return.

What is unique with Water Holdings CHB proposal is the level of investment made to date in validating and designing a scaled water storage development. It is worth nothing that the investment to date was via the Hawke's Bay Regional Investment Company before the transfer of the IP to Water Holdings CHB.

In Council making any form of investment, whether by way of a grant, loan or as a direct investment; careful consideration needs to be given to how the funds will be used and what caveats or conditions will be imposed so as to ensure Councils position is protected. The nature of the caveats or conditions will largely depend on the commercial structure Council elects to choose.

There are a range of options for Council in making the investment proposed, the following options have been considered by Council.

| | |
|---|---|
| **Grant** | A grant would comprise of a one off non repayable grant of monies provided as payment for a set of outputs. Payment can made in advance, milestoned or upon the successful completion of the contracted outputs. |
| | The grant would be documented between the parties via a funding agreement. The funding agreement would set out the mechanism by which the investment would be made, timings for payments, requirements and outputs of the funding. |
| | This approach is similar to how Government allocates its investment in similar activities. |
| **Non interest bearing loan** | Non interest bearing – A non interest bearing loan is a repayable facility that accrues nil interest. In the instance of the investment proposed, the interest would be registered over the all of the IP and repayment could be time bound i.e. a set term or upon a agreed trigger being effected (implementation or divestment). |
| | The legal and accounting structures around establishing such a facility would be a lot more complex than that of a grant or suspensory loan and the establishment and ongoing compliance requirements would be costly. The facility would also need to be accounted for as a liability on Council's books. |
| | If Council were going to pursue this option further legal and accounting advice on this matter would be required. |
| **Interest bearing loan** | An interest bearing loan would see Council investments being treated as conventional loan facility at an agreed rate of return. The level of return could be based on Council's cost of borrowing plus an agreed basis points adjustment to cover the cost of administration. This is likely to be circa 3.5 to 3.7%. |
| | The legal and accounting structures around establishing such a facility would be a lot more complex than that of a grant or suspensory loan and the establishment and ongoing compliance requirements would be costly, however recoverable via the cost of funding. The facility would also need to be accounted for as a liability on Councils books. |
| **Investment for ownership stake** | An alternative to Council making a grant or providing a loan would be Council making a direct investment into the Water Holdings CHB for a shareholding in the entity and Councils ongoing role could be passive or active whereby it seeks a governance and decision making position in the entity. Investment in ownership would also trigger the need to assess whether it meets the test to become a Council Controlled Organisation, adding a further layer of audit and legislative requirements. |
| | The risk of assuming such a role will be an ongoing requirement or potential for further investment being required as to Council's role potentially becoming confused. |
| **Make no contribution to Water Holdings CHB Limited** | An option that Council may consider is to provide no contribution to Water Holdings CHB. This will ultimately reduce any financial contribution from the reserve funds. |
| | In doing this Council limits the ability for water storage solutions based on the already established IP to be developed without alternative other funding streams been identified, as well as potentially compromising the Provincial Growth Funding money that has been applied for. |

While the options on the previous page were considered, Council's preferred option is the proposition of a suspensory loan and we are seeking feedback from the community.

A suspensory loan is generally a non-repayable loan that is dispensated over time or upon the completion of a set of agreed outputs.

A suspensory loan normally is not repayable; however, there can be mechanisms whereby repayment can be required.

In the instance of the investment being proposed, this could include Water Holdings CHB commercialisation of the IP or the sale, divestment or transfer of IP or the company who holds the IP.

With a suspensory loan there is normally no requirement for a guarantee or security interest to be noted.

It is worth noting that Council in providing a suspensory loan would be foregoing the annual interest which could be gained, which is at today's rates of 3.5% is $8,750 on $250,0000.

It is deemed that the suspensory loan will best achieve the outcomes that are sought from Water Holdings CHB while still managing risk and protecting Central Hawke's Bay District Council's interests.

It is worth noting that the proposed suspensory loan is not dependent on Provincial Growth Funding, but Council acknowledges that without Provincial Growth Funding, Water Holdings CHB will need to explore other funding avenues.

# Strategic Alignment

Water Holdings CHB's work strategically aligns with the Regional Economic Development Strategy – Matariki, the CHB Water Taskforce objectives of providing security/ quality of supply of water across the District.

The proposal and the economic benefits of the proposal also aligns directly with Council's own development objectives - Thrive. Which upon the successful implementation will result in further economic growth and development, attract and retain business and whanau and result in an environmentally responsible response to providing additional resilience and water security for the region.

Water Holdings CHB have also proactively engaged with mana whenua at a Taiwhenua level, who passed a motion at the most recent board meeting supporting the funding applications and a review of the intellectual property.

# Conditions

Whilst the investment being sought is not significant in the context of the overall potential opportunity, it is still a significant sum of monies for Council to consider and the final implementation and commercialisation of the IP will require a significant level of investment to be made.

In terms of the investment being treated as a loan, we believe the most appropriate mechanism would be for Councils investment into Water Holdings CHB to be a suspensory loan, with the following condition precedents for repayments or dispensation of liabilities:

**Repayment:**

- The sale or divestment of Water Holdings CHB.
- The transfer of IP to a subsidiary entity or third party, other than Council.

**Dispensation:**

- The development of water storage facilities and measureable economic benefits being created and realised; being:

1. Water security (agreed m3 quantum).
2. Employment.
3. New business/ investment.
4. The review of IP does not identify any tangible or financially sustainable water storage solution that can be implemented.

We believe if Water Holdings CHB do receive a dispensation under point 4 Council should as condition of the loan agreement have access to all IP obtained and developed by Water Holdings CHB as part of the investigation exercise.

The basis of payment of any funds we would also recommend are made on a milestoned basis being the completion or satisfaction of agreed outputs. This will protect Councils position and the potential for any loss. It will also ensure if the initiative is not feasible there will be a short NO rather than a long NO with any unnecessary Council expenditure not occurring. This will also provide a feedback loop for reporting purposes.

# Next Steps

Council and Water Holdings CHB will need to agree the upfront Key Commercial Terms (KCTs) in advance of any funding agreement being confirmed. The KCTs will form the basis of the funding agreement.

This will also mitigate any unnecessary costs in drafting the agreements between the parties as well as confirm upfront and earlier the expectations of the two parties.

The KCTs will set out the requirements of the parties, expectations and key deliverables tagged to the funding. The KCTs will provide the framework for documenting the agreement.

In terms of recommendations in making any payment, suggested conditions are as follows:

1. Prior to any funds being released Water Holdings CHB provide a full work programme and budget for expenditure
2. Water Holding CHB confirm the funding sources for undertaking the works and commitment of funds
3. The release of Council funds are milestoned and ideally matched (prorated) by shareholder, private or other investment.
4. Failure to complete will provide for a default of the IP to Council. We believe this will be of benefit to Council for other purposes.
5. There is regular reporting.

# Community Consultation

It is important to note at this point that the proposed investment is only that – a proposal.

Council have deemed community engagement and consultation an important step so that Elected Members can make an informed decision whether this investment should be made. Council will be consulting with the community as part of the Annual Plan 2019/20 consultation.

# Conclusion

The proposed investment being sought by Water Holdings CHB from Council is not inconsistent with investments made by Government and Councils into strategic infrastructure/ social infrastructure projects.

The proposal aligns strategically with Council's and the Region's wider economic strategies and the uniqueness of the investment made to date can be augmented into a potential project of significant value to the District, subject to a range of external variables being confirmed.

There are a range of commercial structuring options available to Council in making this investment. On the basis of wanting to manage risk, Council preferred option is the proposition of a suspensory loan. The loan will be subject to the parties agreeing a set of KCTs prior to any agreement drafting is undertaken.

<table>
<tr><td>Central Hawke's Bay District Council</td><td colspan="2">POLICY MANUAL</td></tr>
<tr><td rowspan="6">SPECIAL FUND ACCOUNTS POLICY</td><td>Document #</td><td>7.20</td></tr>
<tr><td>Approved by:</td><td>Council</td></tr>
<tr><td>Adoption Date:</td><td>14-12-2017</td></tr>
<tr><td>Last Amended:</td><td>14-12-2017</td></tr>
<tr><td>Review Date:</td><td>December 2020</td></tr>
<tr><td>Page:</td><td>Page 1 of 3</td></tr>
</table>

That Council operate Special Fund Accounts in terms of this Policy.

All Special Fund Accounts shall be pooled for the purpose of accounting and investment.

That investments made from the Special Fund Account Pool be made in accordance with Council's Investment Policy.

That at no time will any Special Fund Account be taken into a debit balance position.

That interest payments, capital gains or losses be credited/charged on a pro-rata basis to all Special Fund Accounts within the pool.

Unless otherwise stated, only the interest earned on each fund shall be available to be spent thereby preserving the individual fund amounts.

## DESCRIPTION OF PURPOSES STATEMENT

Special Funds are those funds, or reserves, which Council has established by resolution, the terms of which restricts the use of the funds. Each fund has been set up as a separate account to maintain a degree of independence from Council's general funds. All funds are invested as part of a larger pool of funds and are not available for any other purpose.

### ELECTION AND BY-ELECTION FUNDING RESERVE

To provide for the smoothing of election expenses by the annual transfer of funds to the account.

### MAYOR'S FUND

To provide for payments to worthy individuals or groups at the sole discretion of the Mayor.

Income for this fund comes from public donations, and if required, an allocation of interest from Special Fund Investments.

The balance of the Fund will be maintained at a minimum of $5,000 as at each 30$^{th}$ June.

The Mayor will report to Council on a 6 monthly basis on expenditure from this Fund.

## RURAL FIRES RESERVE

To provide funds for the non-recoverable costs incurred by Council in fighting rural fires.

The value of the fund should be preserved by transfers from the Fire Control Account so that a level of $25,000 is maintained and annually adjusted for inflation using the cost of construction index.

### ESPLANADE RESERVE FUND

To provide immediate finance to; purchase land, pay legal costs, pay survey costs or pay acquisition costs associated with the purchase or access to Esplanade Reserve land as and when it becomes available.

Withdrawals from this fund will only be made when the purchase or access to Esplanade Reserve land has been approved by Council.

### TE AUTE DRAIN CHANNEL CLEARING RESERVE

To provide funds for the programmed clearing of channels and major maintenance of the system. Funds may be provided annually from the Te Aute Drainage Rate for the maintenance of this account.

### RETIREMENT HOUSING DEPRECIATION RESERVE ACCOUNT

To provide for extensions, major upgrading, major maintenance or capital purchases whenever such is necessary in the provision of Retirement Housing or other social housing facilities within the district. Funds will be provided annually from the Retirement Housing rentals for the maintenance of this account.

The fund may also be used at the discretion of Council for any reviews undertaken of Retirement Housing and consideration of future options with regards to social housing generally in Central Hawke's Bay.

### ADVERSE EVENTS CONTINGENCY

To provide funds to assist with the repairs to or to replace damaged Council assets in the event of an unforeseen, major, short duration, natural event. Adverse events include those that would not normally be covered by operational expenditure and those not covered by insurance. Each adverse event will be assessed on a case by case basis. In the case of an adverse roading event the New Zealand Transport Agency definition of an emergency will be used.

The value of the fund should be preserved by transfers from the appropriate operational rate so that a level of $500,000 is maintained and annually adjusted for inflation using the cost of construction index.

### CATASTROPHIC EVENTS FUND

To provide funds for the financial protection of the district in the event of an unforeseen catastrophic natural event.

This event would be such that substantial damage occurred to the vital infrastructure of the district.

Each catastrophic event will be assessed on a case by case basis.

There are three ways these funds may be used.

1. The capital sum used to repair damage to infrastructure assets.
2. The sum used to provide the "first cover" of an insurance policy for the district's infrastructural assets.
3. The sum used as part or all of Council's contribution to a proposed co-operative national emergency fund.

The value of this fund should be preserved by transfers from the appropriate operational rate so that a level of $2.0 million is maintained and annually adjusted for inflation using the cost of construction index.

**INFRASTRUCTURE PROTECTION RESERVE**

To provide funds for the financial protection of the district in the event of an unforeseen catastrophic natural event on infrastructure assets.

The fund may be used to replace/repair damage to assets or infrastructure caused by a natural disaster/event.

**ARAMOANA WARD DISBURSEMENT FUND**

To provide funds for the provision or maintenance of recreational, cultural or infrastructural assets within the Aramoana Ward.

**RUAHINE WARD HALLS MAINTENANCE RESERVE**

To provide funds for the larger maintenance items of the Ward Halls in the Ruahine Ward to enable them to operate without large fluctuations in rate requirements due to major maintenance.

**RUAHINE WARD DISBURSEMENT RESERVE ACCOUNT**

To provide funds for the provision or maintenance of recreational, cultural or infrastructural assets within the Ruahine Ward.

**RUATANIWHA WARD DISBURSEMENT RESERVE ACCOUNT**

To provide funds for the provision or maintenance of recreational, cultural or infrastructural assets within the Ruataniwha Ward.

**CAPITAL PROJECTS FUND**

To provide funds for the purchase or construction of recreational, cultural or infrastructural assets anywhere in the district.

The funds will be used to provide substantial assistance for the provision of new facilities.

The net proceeds from the sale of Council owned Infrastructure, Land and Buildings, shall be credited to this Fund.

**WAIPAWA BUILDING SOCIETY SCHOLARSHIP TRUST FUND**

A fund held in trust for the trustees of the scholarship to enable them to allocate grants to assist with further education for selected residents of Central Hawke's Bay district who are intending to attend, or are attending, a course of tertiary education.

**ERIC TATE SCHOLARSHIP TRUST FUND**

A fund held in trust for the trustees of the scholarship to enable them to allocate grants to assist with further education for selected CHB College students who normally reside in the district served by the former Waipawa District High School.

# CONTENTS

# 1 Introduction

## 1.1 Policy purpose

The purpose of the Treasury Management Policy ("Policy") is to outline approved policies and procedures in respect of all treasury activity to be undertaken by Central Hawke's Bay District Council ("Council"). The formalisation of such policies and procedures will enable treasury risks within Council to be prudently managed.
As circumstances change, the policies and procedures outlined in this Policy will be modified to ensure that treasury risks within Council continue to be well managed.
It is intended that the Policy be distributed to all personnel involved in any aspect of the Council's financial management. In this respect, all staff must be completely familiar with their responsibilities under the Policy at all times.

# 2 Scope and objectives

## 2.1 Scope

- This document identifies the Policy of Council in respect of treasury management activities, incorporating both borrowing and investment activity.
- The Policy has not been prepared to cover other aspects of Council's operations, particularly transactional banking management, systems of internal control and financial management. Other policies and procedures of Council cover these matters.

## 2.2 Treasury management objectives

The objective of this Policy is to control and manage costs, investment returns and risks associated with treasury management activities, incorporating both borrowing and investment activity.

**Statutory objectives**

- All external borrowing, investments and incidental financial arrangements (e.g. use of interest rate hedging financial instruments) will meet requirements of the Local Government Act 2002 and incorporate the Liability Management Policy and Investment Policy.
- Council is governed by the following relevant legislation:
    - Local Government Act 2002, in particular Part 6 including sections 101,102, 104, 105 and 113.
    - Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.
    - Trustee Act 1956. When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.
- Council will not transact with any Council Controlled Trading Organisation (CCTO) on terms more favourable than those achievable by Council itself, without charging any rate or rates revenue as security.
- A resolution of Council is not required for hire purchase, credit or deferred purchase of goods if:
    - The period of indebtedness is less than 91 days (including rollovers); or
    - The goods or services are obtained in the ordinary course of operations on normal terms for amounts not exceeding in aggregate, 5.0% of the Council's consolidated annual operating budget for the year (as determined by Council's Significance and Engagement Policy).

**General objectives**

- Ensure that all statutory requirements of a financial nature are adhered to.
- Minimise Council's costs and risks in the management of its external borrowings.
- Minimise Council's exposure to adverse interest rate movements.
- Arrange and structure external long term funding for Council at a favourable margin and cost from debt lenders. Optimise flexibility and spread of debt maturity terms within the funding risk limits established by this Policy statement.
- Maintain appropriate liquidity levels and manage cash flows within Council to meet known and reasonable unforeseen funding requirements.
- Manage investments to optimise returns in the long term whilst balancing risk and return considerations.
- Develop and maintain relationships with financial institutions, brokers and LGFA.
- Comply, monitor and report on borrowing covenants and ratios under the obligations of Council's lending/security arrangements.
- To minimise exposure to credit risk by dealing with and investing in credit worthy counterparties.
- Borrow funds, invest and transact risk management instruments within an environment of control and compliance.
- Monitor, evaluate and report on treasury performance.
- Ensure the Council, management and relevant staff are kept abreast of the latest treasury products, methodologies, and accounting treatments through training and in-house presentations.
- Ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions.

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

## 2.3 Policy setting and management

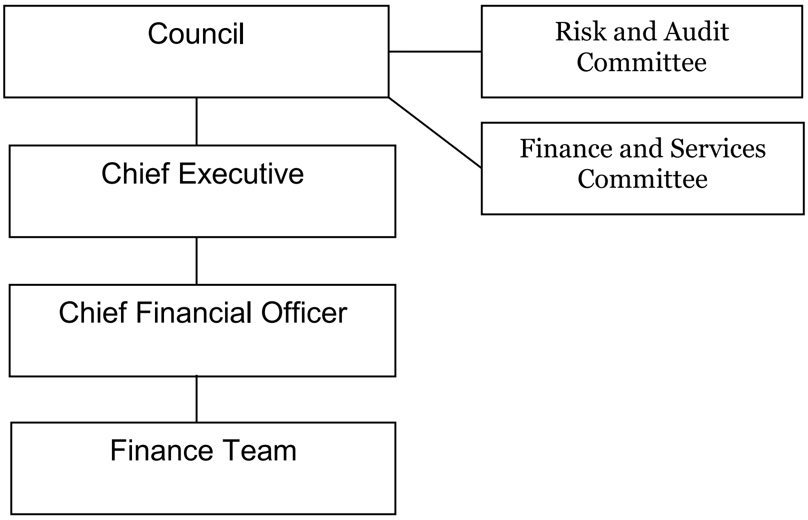
Council approves Policy parameters in relation to its treasury activities. The CE has overall financial management responsibility for the Council's borrowing and investments, and related activities.

The Council exercises ongoing governance over its subsidiary companies (CCO/CCTO), through the process of approving the Constitutions, Statements of Intent, and the appointment of Directors/Trustees of these organisations.

# 3 Governance and management responsibilities

## 3.1 Overview of management structure

The following diagram illustrates those individuals and bodies who have treasury responsibilities. Authority levels, reporting lines and treasury duties and responsibilities are outlined in the following section:




## 3.2 Council

The Council has ultimate responsibility for ensuring that there is an effective Policy for the management of its risks. In this respect the Council decides the level and nature of risks that are acceptable, given Council's statutory objectives.

The Council is responsible for approving the Policy. While the Policy can be reviewed and changes recommended by other persons, the authority to make or change Policy cannot be delegated.

In this respect, the Council has responsibility for:

- Approving the long-term financial position of Council through the Long Term Plan (LTP) and Financial Strategy along with the adopted Annual Plan.
- Approve and adopt the Liability Management and Investment Policies (the Treasury Management Policy).
- Approval for one-off transactions falling outside Policy.

## 3.3 Finance and Services Committee

Under delegation from Council:

- Monitor and review treasury activity through at least six monthly reporting, supplemented by exception reporting.

## 3.4 Risk and Audit Committee

Under delegation from Council:

- Review formally, on a three yearly basis, the Treasury Management Policy document.
- Evaluate and recommend amendments to the Treasury Management Policy to Council.

### 3.5 Chief Executive Officer (CE)

While the Council has final responsibility for the Policy governing the management of treasury risks, it delegates overall responsibility for the day-to-day management of such risks to the CE. The CE has approval and monitoring responsibilities over the treasury function.

### 3.6 Chief Financial Officer (CFO) and Finance Team

The CFO along with the Finance Team share the treasury tasks and responsibilities of the treasury function ensuring an adequate segregation of treasury duties and cross-checking of treasury activity. Oversight is maintained by the CE through regular reporting and approval delegations.

### 3.7 Delegation of authority and authority limits

Treasury transactions entered into without the proper authority are difficult to cancel given the legal doctrine of “apparent authority”. Also, insufficient authorities for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays).

To prevent these types of situations, Council’s Delegations Register must be complied with at all times.

## 4 Liability Management Policy

### 4.1 Introduction

Council’s liabilities comprise of borrowings and various other liabilities. Council maintains external borrowings in order to:

- Raise specific debt associated with projects and capital expenditures.
- Raise finance leases for fixed asset purchases.
- Fund the balance sheet as a whole, including working capital requirements.
- Fund assets whose useful lives extend over several generations of ratepayers.

Borrowing provides a basis to achieve inter-generational equity by aligning long-term assets with long-term funding sources, and ensure that the cost are met by those ratepayers benefiting from the investment.

### 4.2 Borrowing limits

Debt will be managed within the following limits:

| Item | Council Limit |
|---|---|
| Net External Debt / Total Revenue | <95% |
| Net Interest on External Debt / Total Revenue | <10% |
| Net Interest on External Debt / Annual Rates Income | <20% |
| External, term debt + committed bank facilities + unencumbered cash/cash equivalents to existing external debt. | >130% |
| Total debt per head of population | <$2,000 |

- Total Revenue is defined as cash earnings from rates, government capital grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non-government capital contributions (e.g. developer contributions and vested assets).
- Net external debt is defined as total external debt less unencumbered cash/cash equivalents.

- The liquidity ratio is defined as external debt plus committed bank facilities, plus unencumbered cash/cash equivalents divided by external debt.
- Net interest on external debt is defined as the amount equal to all interest and financing costs (on external debt) less interest income for the relevant period.
- Annual Rates Income is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 (including volumetric water charges levied) together with any revenue received from other local authorities for services provided (and for which the other local authorities rate).
- Financial covenants are measured on Council only not consolidated group.
- Disaster recovery requirements, urgent financing of emergency-related works and services are to be met through the special funds and liquidity policy.

## 4.3 Asset management plans

In approving new debt Council considers the impact on its external borrowing limits as well as the economic life of the asset that is being funded and its overall consistency with Council's LTP and Financial Strategy.

## 4.4 Borrowing mechanisms

Council is able to externally borrow through a variety of market mechanisms including issuing stock/bonds, commercial paper (CP), direct bank borrowing, accessing the short and long-term wholesale debt capital markets either directly or through the LGFA, or internal borrowing of reserve and special funds. In evaluating strategies for new borrowing (in relation to source, term, size and pricing) the following is taken into account:

- The size and the economic life of the project.
- Available terms from banks, the LGFA and debt capital markets.
- 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 debt issuance, the LGFA, debt capital markets and bank borrowing.
- The market's outlook on future interest rate movements as well as its own.
- Legal documentation and financial covenants considerations.
- Alternative funding mechanisms such as leasing should be evaluated with financial analysis in conjunction with traditional on-balance sheet funding. The evaluation should take into consideration, ownership, redemption value and effective cost of funds.

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 the LGFA, and financial institutions/brokers.

## 4.5 Security

Council's external borrowings and interest rate management instruments will generally be secured by way of a charge over rates and rates revenue offered through a Debenture Trust Deed. Under a Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Local Government Rating Act. The security offered by Council ranks equally or pari passu with other lenders.

From time to time, and with Council approval (or through an approved person as per the delegations register), security may be offered by providing a charge over one or more of Councils assets, where it is beneficial and cost effective to do so.

- Any internal borrowing will be on an unsecured basis.

- Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.

### 4.6 Debt repayment

The funds from all asset sales, operating surpluses, grants and subsidies will be applied to specific projects or the reduction of debt and/or a reduction in borrowing requirements, unless the Council specifically directs that the funds will be put to another use.

Debt will be repaid as it falls due in accordance with the applicable borrowing arrangement. Subject to the appropriate approval and policy limits, a loan may be rolled over or re-negotiated as and when appropriate.

Council will manage debt on a portfolio basis and will only externally borrow when it is commercially prudent to do so.

### 4.7 Guarantees/contingent liabilities and other financial arrangements

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

Council is not allowed to guarantee loans to Council-controlled trading organisations under Section 62 of the Local Government Act.

Council will ensure that sufficient funds or lines of credit exist to meet amounts guaranteed. Guarantees given will not exceed any amount agreed by Council in aggregate. The Finance Team monitors guarantees and reports six-monthly to the CE.

### 4.8 Internal borrowing of special funds

Special Funds must generally be used for the purposes for which they have been set aside. Council currently has a Capital Projects Fund, a Disaster Fund and an Adverse Event Fund, held for the benefit of all ratepayers. Council may, however, modify such purposes from time to time. Funds held in excess of the special funds requirement are held as ratepayers equity reserves, and can be utilised as needed. Recorded special fund balances must be used for their intended purpose.

Council maintains its funds in short term maturities emphasising counterparty credit worthiness and liquidity. The interest rate yield achieved on the funds therefore is a secondary objective. Liquid assets are required to be held physically against Special Fund amounts.

Any internal borrowing of equity reserves must be reimbursed for interest revenue lost.

The cost of internal borrowing is set by the Finance Team from time to time.

For reasons of cost distribution, records on internal borrowings will be maintained to ensure Funds are not disadvantaged.

### 4.9 New Zealand Local Government Funding Agency (LGFA) Limited

Despite anything earlier in this Policy, 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:

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

- Subscribe for shares and uncalled capital in the LGFA.

# 5 Investment Policy

## 5.1 Introduction

Council generally holds investments for strategic reasons where there is some community, social, physical or economic benefit accruing from the investment activity. Generating a commercial return on strategic investments is considered a secondary objective. Investments and associated risks are monitored and managed, and reported at least six-monthly to the Finance and Services Committee. Specific purposes for maintaining investments include:

- For strategic and intergenerational purposes consistent with Council's LTP and AP.
- The retention of vested land.
- Holding short term investments for working capital and liquidity requirements.
- Holding assets (such as property and land parcels) for commercial returns.
- Provide ready cash in the event of a natural disaster. The use of which is intended to bridge the gap between the disaster and the reinstatement of normal income streams and assets.
- Invest amounts allocated to specific reserves.
- Invest funds allocated for approved future expenditure.
- Invest proceeds from the sale of assets.

Council recognises that as a responsible public authority all investments held, should be low risk, giving preference to conservative investment policies and avoiding speculative investments. Council also recognises that low risk investments generally mean lower returns.

To minimise raising external debt, Council can internally borrow from equity, reserves and investment funds, in the first instance to meet operational and capital spending requirements.

## 5.2 Policy

Council's general Policy on investments is that:

- Council may hold financial, property, and equity investments if there are strategic, commercial, and economic or other valid reasons.
- Council will keep under review its approach to all investments and the credit rating of approved creditworthy counterparties.

## 5.3 Mix of investments

Council maintains investments in the following assets:

- Equity investments
- Property investments
- Financial investments

## 5.4 Equity investments

It may be appropriate to have limited investment(s) in equity (shares) when Council wishes to invest for strategic, economic development or social reasons, such as Local Government Insurance Corp[1].

Council will approve equity investments on a case-by-case basis, if and when they arise.

[1] Council currently holds 8,290 shares in the NZ Local Government Insurance Corporation Ltd. The purpose of the entity, in which most local authorities are shareholders, is to ensure that adequate insurance arrangements are available to local authorities at the lowest possible cost. The shares are not readily transferable.

Generally such investments will be (but not limited to) Council Controlled Trading Organisations (CCTO) or Council Controlled Organisations (CCO) to further district or regional economic development. Council does not invest in offshore entities.

Council reviews performance of these investments as part of the annual planning process to ensure that stated objectives are being achieved.

Any disposition of these investments requires approval by Council. Acquisition of new equity investments requires Council approval. The proceeds from the disposition of equity investments will be taken to the Capital Projects Fund. .

All income, including dividends, from Council's equity investments is included in general revenue.

Equity investment performance is reported to the Finance and Services Committee at least annually, along with the consideration of and approval of the Statement of Intent.

### 5.4.1 New Zealand Local Government Funding Agency Limited

Despite anything earlier in this Policy, 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:

- 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.

As a borrower, Council's LGFA investment includes borrower notes.

## 5.5 Property investments

Council's overall objective is to only own property that is necessary to achieve its strategic objectives as stated in the LTP or deemed to be a core Council function. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements which could deliver the same results. This assessment is based on the most financially viable method of achieving the delivery of Council services. Council generally follows similar assessment criteria in relation to new property investments.

Council reviews the performance of its property investments at least annually and ensures that the benefits of continued ownership are consistent with its stated objectives. Council's policy is to dispose of any property that does not achieve a commercial return having regard to any restrictions on title or other requirements or needs to achieve Council objectives. All income, including rentals and ground rent from property investments is included in the consolidated revenue account. All rented or leased properties will be at an acceptable commercial rate of return so as to minimise the rating input, except where Council has identified a level of subsidy that is appropriate.

Proceeds from the disposition of property investments are used firstly in the retirement of related debt and then are credited to the Capital Projects Fund.

Council's investment in properties, other than reserves and those required for own occupation and infrastructural services, will not exceed 50% of total fixed assets.

Any purchased properties must be supported by a current registered valuation, substantiated by management including a fully worked capital expenditure analysis.

## 5.6 Financial investments

**Objectives**

Council's primary objectives when investing is the protection of its investment capital. Accordingly, Council may only invest in approved creditworthy counterparties. Creditworthy counterparties and investment restrictions are covered in section 5.4. Credit ratings are monitored and reported at least six-monthly.

Council may invest in approved financial instruments as set out in section 6.2. These investments are aligned with Council's objective of investing in high credit quality and liquid assets. The CE approves the investment strategy within the scope and parameters of this policy and does so with input from Council's investment advisors.

Council's investment portfolio will be arranged to provide sufficient funds for planned expenditures and allow for the payment of obligations as they fall due. Council prudently manages liquid financial investments as follows:

- Any liquid investments must be restricted to a term that meets future cash flow and capital expenditure projections.
- Council may choose to hold specific reserves in cash and financial investments. Interest income relating to special reserves is allocated to those accounts annually based on the opening balance.
- Internal borrowing will be used wherever possible to minimise external borrowing.
- Financial investments do not include shares/equities.
- All unsecured financial investment must be senior in ranking. Subordinated and perpetual debt instruments are not permitted.

**Special funds**

Liquid assets are required to be held against recorded Special Fund amounts.

### Trust funds

Where Council hold funds as a trustee, or manages funds for a Trust then such funds must be invested on the terms provided within the Trust Deed. If the Trust's Investment Policy is not specified then this Policy should apply.

## 5.7 Investment management and reporting procedures

Council's policy for the management and reporting of investments includes:

- The legislative necessity to maintain efficient financial systems for the recording and reporting (inter alia) of:
    - All revenues and expenditures;
    - All assets and liabilities; and
    - The treatment and application of special funds.
- Adherence to Council's financial processes and delegations to Council's staff to invest surplus short-term funds and negotiate reinvestments, subject to the provision of adequate cash resources to meet normal expected cash demands;
- Treasury reporting is completed on at least a six-monthly basis.

# 6 Risk recognition / identification management

The definition and recognition of liquidity, funding, investment, interest rate, counterparty credit, operational and legal risk of Council is detailed below and applies to both the Liability Management Policy and Investment Policy.

## 6.1 Interest rate risk on external borrowing

### 6.1.1 Risk recognition

Interest rate risk is the risk that funding costs (due to adverse movements in market wholesale interest rates) will materially exceed or fall short of projections included in the LTP or Annual Plan so as to adversely impact revenue projections, cost control and capital investment decisions.

The primary objective of interest rate risk management is to reduce uncertainty relating to interest rate movements through fixing/hedging of interest costs. Certainty around interest costs is to be achieved through the management of underlying interest rate exposures.

### 6.1.2 Interest rate risk control limits

Exposure to interest rate risk is managed and mitigated through the risk control limits below. Council's forecast core external debt should be within the following fixed/floating interest rate risk control limit, and will apply when forecast 12 month core debt exceeds $10 million.

Core external debt is defined as gross external debt. When approved forecasts are changed, the amount of fixed rate protection in place may have to be adjusted to ensure compliance with the Policy minimums and maximums.

| **Master Fixed / Floating Risk Control Limits** | |
|---|---|
| Minimum Fixed Rate | Maximum Fixed Rate |
| 50% | 95% |

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

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

The percentages are calculated on the rolling 12 month projected core debt level calculated by management (signed off by the CE).

The fixed rate amount at any point in time should be within the following maturity bands:

| **Fixed Rate Maturity Limit** | | |
|---|---|---|
| Period | Minimum Hedge % | Maximum Hedge % |
| 1 to 3 years | 15% | 60% |
| 3 to 5 years | 15% | 60% |
| 5 years plus | 0% | 60% |

A fixed rate maturity position that is outside the above limits, however self corrects within 90-days is not in breach of this Policy. Maintaining a maturity profile beyond 90-days requires specific approval by Council.

- Floating rate debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months.
- Any interest rate swaps with a maturity beyond 10 years must be approved by Council.

- Hedging outside the above risk parameters must be approved by Council.
- At all times these instruments must be used within the context of the prudent financial objectives of Council's treasury function.

## 6.2 Approved financial instruments

Approved financial instruments (which do not include shares or equities) are as follows:

| Category | Instrument |
|---|---|
| Cash management and borrowing | Bank overdraft<br>Committed cash advance and bank accepted bill facilities<br>Loan stock /bond issuance<br>▪ Floating Rate Note (FRN)<br>▪ Fixed Rate Note (Medium Term Note/Bond)<br>▪ Commercial paper (CP)/Promissory notes |
| Financial investments – no more than 12-month term (except for LGFA borrower notes, investments linked to debt pre-funding and bank bonds) | Bank call/term deposits<br>Bank registered certificates of deposit (RCDs)<br>Secured/unsecured senior bank bonds for terms up to 5-years<br>LGFA borrower notes |
| Interest rate risk management | Forward rate agreements ("FRAs") on:<br>▪ Bank bills<br>Interest rate swaps including:<br>▪ Forward start swaps. Start date <24 months, unless linked to existing maturing swaps<br>▪ Swap maturity extensions and shortenings<br>Interest rate options on:<br>▪ Bank bills (purchased caps and one for one collars)<br>▪ Interest rate swaptions (purchased swaptions and one for one collars only) |
| Foreign exchange management | ▪ Spot foreign exchange<br>▪ Forward exchange contracts (including par forwards) |
| Carbon price risk management | ▪ New Zealand Units (NZUs) and Assigned Amount Units (NZAAUs)<br>▪ Emission Reduction Units (ERUs), Certified Emission Reduction Units (CERs), Removal Units (RMUs) – until such time as inadmissible on the NZ Emission Trading Scheme (ETS) |

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

## 6.3 Liquidity risk/funding risk

### 6.3.1 Risk recognition

Cash flow deficits in various future periods based on long term financial forecasts are reliant on the maturity structure of cash, short-term financial investments, loans and bank facilities. Liquidity risk management focuses on the ability to access committed funding at that future time to fund the gaps. Funding risk management centres on the ability to re-finance or raise new debt at a future time at acceptable pricing (fees and borrowing margins) and maturity terms of existing loans and facilities.

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

### 6.3.2 Liquidity/funding risk control limits

To ensure funds are available when needed Council ensures that:

- There is sufficient available operating cash flow, liquid investments (cash/cash equivalents) and unused committed bank facilities to meet cash flow requirements between rates instalments as determined by the Finance Team.
- For liquidity purposes Council maintains the following;
    - External term debt plus committed bank facilities, plus unencumbered cash/cash equivalents to existing external debt of at least 110%.
    - Unencumbered liquid financial investments (cash/cash equivalents) used for liquidity management purposes are to not have a maturity term greater than 30-days.
- Council has the ability to pre-fund up to 12 months forecast debt requirements including re-financings.
- The CE has the discretionary authority to re-finance existing external debt.
- Council will only borrow from strongly rated banks with a minimum long-term credit rating of at least “A+” (S&P, or equivalent Fitch or Moody’s rating).
- The maturity profile of the total committed funding in respect to all external term debt and committed bank facilities is to be controlled by the following system. The limits will apply when core debt exceeds $10 million:

| Period | Minimum % | Maximum % |
|---|---|---|
| 0 to 3 years | 15% | 60% |
| 3 to 5 years | 15% | 60% |
| 5 years plus | 0% | 60% |

A funding maturity profile that is outside the above limits, however self corrects within 90-days is not in breach of this Policy. Maintaining a maturity profile beyond 90-days requires specific approval by Council.

## 6.4 Counterparty credit risk

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. The credit risk to Council in a default event will be weighted differently depending on the type of instrument entered into.

Credit risk will be regularly reviewed by the Finance and Services Committee at least six-monthly. Treasury related transactions would only be entered into with approved counterparties.

Counterparties and limits are only approved on the basis of the following Standard & Poor's (S&P, or equivalent Fitch or Moody's rating) long and short-term credit ratings matrix. Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

| Counterparty /Issuer | Minimum S&P long term / short term credit rating | Investments maximum per counterparty ($m) | Risk management instruments maximum per counterparty ($m) | Total maximum per counterparty ($m) |
|---|---|---|---|---|
| NZ Government | N/A | Unlimited | None | Unlimited |
| Local Government Funding Agency (LGFA) | A+/A-1 | 10.0 | None | 10.0 |
| NZ Registered Bank | A+ /A-1 | 8.0<br>(with the exception of Council's transactional bank which may exceed this for up to 5 working days) | 5.0 | 13.0 |

In determining the usage of the above gross limits, the following product weightings will be used:

- Investments (e.g. Bank Deposits) – Transaction Principal × Weighting 100% (unless a legal right of set-off exists).
- Interest Rate Risk Management (e.g. swaps, FRAs) – Transaction Notional × Maturity (years) × 3%.
- Foreign Exchange / Carbon Credit - Transactional face value amount x (the square root of the Maturity (years) x 15%).

Credit ratings should be reviewed by the Finance Team on an ongoing basis and in the event of material credit downgrades should be immediately reported to the CE and assessed against exposure limits. Counterparties exceeding limits should be reported to the Council.

**Risk management**

To avoid undue concentration of exposures, financial instruments should be used with as wide a range of approved counterparties as possible. The approval process must take into account the liquidity of the market and prevailing market conditions the instrument is traded in and repriced from.

## 6.5 Foreign currency

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

All individual commitments over NZ$100,000 equivalent are hedged using approved foreign exchange instruments, once expenditure is approved, legal commitment occurs and the purchase order is placed, exact timing, currency type and amount are known. Only approved foreign exchange instruments are used.

Council shall not borrow or enter into incidental arrangements, within or outside New Zealand, in currency other than New Zealand currency.  Council does not hold investments denominated in foreign currency.

## 6.6 Emissions Trading Scheme (ETS)

The objective of the ETS carbon credit policy is to minimise the financial impact of carbon price movements on Council's forward carbon liability. The objective requires balancing Council's need for price stability with the benefit of realising market opportunities to reduce costs as they arise. ETS is risk managed on a case-by-case basis, with any strategy approved by the CE.

## 6.7 Operational risk

Operational risk is the risk of loss as a result of human error (or fraud), system failures and inadequate procedures and controls.Detailed controls and procedures are agreed between the CE and CFO on an annual basis.

## 6.8 Legal risk

Legal risks relate to the unenforceability of a transaction due to an organisation not having the legal capacity or power to enter into the transaction usually because of prohibitions contained in legislation.

Council will seek to minimise this risk by adopting Policy regarding:

- The use of standing dealing and settlement instructions (including bank accounts, authorised persons, standard deal confirmations, contacts for disputed transactions) to be sent to counterparties.
- The matching of third party confirmations and the immediate follow-up of anomalies.
- The use of expert advice.

### 6.8.1 Agreements

Financial instruments can only be entered into with banks that have in place an executed ISDA Master Agreement with Council. All ISDA Master Agreements for financial instruments and carbon units must be signed under seal by Council.

### 6.8.2 Financial covenants and other obligations

Council must not enter into any transactions where it would cause a breach of financial covenants under existing contractual arrangements.  Council must comply with all obligations and reporting requirements under existing bank funding facilities, LGFA, Trustee and legislative requirements.

# 7 Measuring treasury performance

In order to determine the success of Council's treasury management function, the following benchmarks and performance measures have been prescribed.

Those performance measures that provide a direct measure of the performance of treasury staff are to be reported to the Finance and Services Committee on, at least,  a six-monthly basis.

| Management | Performance |
|---|---|
| Operational performance | • All Policy limits must be complied with, including (but not limited to) counterparty credit limits, control limits and exposure limits.<br>• All treasury deadlines are to be met, including reporting deadlines. |
| Management of debt and interest rate risk (borrowing costs) | • The actual borrowing cost (taking into consideration any costs/benefits of entering into interest rate management transactions) should be below the budgeted YTD/annual interest cost amount. |
| Treasury investment returns | • The actual investment income should be above the budgeted YTD/annual interest income amount. |

# 8 Cash management

The Finance Team has responsibility to manage the day-to-day cash and short-term cash management activities of Council.  The Finance Team prepares rolling cash flow and debt forecasts to manage Council's cash management and borrowing requirements.  The overdraft facility is utilised as little as practical with any operational surpluses prudently invested.

# 9 Reporting

When budgeting interest costs and investment returns, the actual physical position of existing loans, investments, and interest rate instruments must be taken into account.

## 9.1 Treasury reporting

Regular treasury reporting on at least a six monthly is provided to the Finance & Services Committee.

## 9.2 Accounting treatment of financial instruments

Council uses financial arrangements ("derivatives") for the primary purpose of reducing its financial risk to fluctuations in interest rates.

Under New Zealand Public Benefit Entity (PBE) International Public Sector Accounting Standards (IPSAS) changes in the fair value of derivatives go through the Statement of Comprehensive Revenue and Expense unless derivatives are designated in an effective hedge relationship.

Council's principal objective is to manage Council's interest rate risks within approved limits and chooses not to hedge account. Council accepts that the marked-to-market gains and losses on the revaluation of derivatives can create potential volatility in Council's financial accounts.

The Finance Team is responsible for advising the CE of any changes to relevant New Zealand Public Sector PBE Standards which may result in a change to the accounting treatment of financial arrangements.

All derivative instruments must be revalued (marked-to-market) at least six-monthly for reporting purposes.

# 10 Policy review

The Policy is to be formally reviewed on a triennial basis in conjunction with the LTP.

The CFO has the responsibility to prepare the annual review report (following the preparation of annual financial statements) that is presented to the CE. The report will include:

- Recommendation as to changes, deletions and additions to the Policy.
- Overview of the treasury function in achieving the stated treasury objectives and performance benchmarks.
- Summary of breaches of Policy and one-off approvals outside Policy.

Council receives the report, approves Policy changes and/or rejects recommendations for Policy changes. The Policy review should be completed and presented to the Council, through the Finance and Services Committee within five months of the financial year-end.

# 11 Appendix 1: Glossary of Terms

**BKBM -** The bank bill mid market settlement rate, as determined at 10.45 am 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 floors, caps and collars.

**Bank Bill** - A “bill of exchange” security document issued by a corporate borrower, but guaranteed by a bank, who then in turn sells the security into the bank/investor market to re-liquefy itself with cash. Normally for terms of 30, 60, 90 or 180 days.

**Benchmark** -An agreed market related yardstick that investor returns, funding costs or average exchange rate achieved are compared against for performance measurement purposes.

**Bond** - The security instrument that is issued by a borrower whereby they promise to repay the principal and interest on the due dates. A bond’s interest rate is always fixed.

**Borrower Notes.** On occasion when Council borrows from the LGFA it will be required to contribute part of that borrowing back as equity in the form of “Borrower Notes”. A Borrower Note is a written, unconditional declaration by a borrower (in this instance the LGFA) to pay a sum of money to a specific party (in this instance the Council) at a future date (in this instance upon the maturity of the loan). An interest return is paid on the Borrower Notes and can take the form of a dividend if the Borrower Notes are converted to redeemable preference shares.

**Cap** - A series or string of interest rate put options whereby a borrower can have protection against rising short term interest rates, but participate in the lower rates if market rates remain below the “capped rate.” A cap is normally for more than one 90-day funding period. Also called a “ceiling”.

**Certificate of Deposit “CD”** - A debt instrument (normally short term) issued by a bank to borrow funds from other banks/investors.

**Closing-Out** - The cancellation/termination of a financial instrument or contract before its maturity date, resulting in a realised gain/loss as the current market rate differs from the contract rate.

**Collar** - Two option contracts linked together into the one transaction or contract. A borrower’s collar is normally a “cap” above current market rates and a “floor” below current rates. Over the term of the collar contract, if rates go above the cap the borrower is protected and pays an interest cost no more than the cap rate. Likewise, if market rates fall below the floor, the borrower pays the floor rate and does not participate in the lower market rates. Also called a “cylinder”.

**Commercial Paper** - The debt security instrument issued by a prime (and normally credit-rated) borrower to raise short-term funds (30, 60, 90 or 180 days). Also called “one-name paper” and “promissory notes” issued by competitive public tender to investors, or by private treaty to one investor.

**Counterparty** - The contracting party to a financial transaction or financial instrument.

**Covenants** - Special conditions and financial ratios required to be met or maintained by a borrower for a lender under the legal security documents.

**Cover** - A term used to describe any action of entering financial instruments that reduces risk or puts protection in place against adverse future price movements.

**Credit Rating** – The credit rating of a Corporation/Council is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Standard & Poor's, Moody's or Fitch Ratings and have letter designations such as AAA, B, CC. A poor credit rating indicates a high risk of defaulting, therefore constitutes a higher level of interest rates.

**Credit Risk** - The risk that the other party to a financial transaction (bank deposit, interest rate swap contract) will default on or before the maturity date and not be able to fulfil their contractual obligations.

**Credit Spread** - The interest rate difference (expressed as basis points) between two types of debt securities. The credit spread being a reflection of the difference in credit quality, size and liquidity between the two securities e.g. five year corporate bonds may be at a credit spread of 200 basis points above Government bonds.

**Debenture** - A debt instrument similar to a bond whereby a borrower (normally a finance company) borrowers for a longer term at a fixed rate. Also a legal instrument provided as security to a lender.

**Derivative(s)** - A “paper” contract whose value depends on the value of some “underlying” asset e.g. share market stocks, bank bills, bonds or foreign currency. Also called a “synthetic”. The value of the assets will change as its market price changes, the derivative instrument will correspondingly change its value.

**Exercise Date/Price** - The day and fixed price that an option contract is enforced/actioned or “exercised” because it is in the interests of one of the parties to the contract to do so.

**Fair Value** - The current market value of an off-balance sheet financial instrument should it be sold or closed-out on the market rates ruling at the balance date.

**Fixed Rate** - The interest rate on a debt of financial instrument is fixed and does not change from the commencement date to the maturity date.

**Floating Rate** - The interest rate on a loan or debt instrument is re-set at the ruling market interest rates on the maturity date of the stipulated funding period (usually 90-days).

**Floor** - The opposite of a “cap”. An investor will buy a floor, or a series/string of call options (the right to buy) to protect against falling interest rates, but be able to invest at higher interest rates if rates move upwards.

**Forward Exchange Contract** - A contract to buy and sell one currency against another at a fixed price for delivery at some specified future date.

**Forward Rate Agreement** - A contract (“FRA”) whereby a borrower or investor in Bank Bills agrees to borrow or invest for an agreed term (normally 90-days) at a fixed rate at some specified future date. A FRA is an “over-the-counter” contract as the amount and maturity date is tailored by the bank to the specific requirements of the borrower/investor.

**Forward Starting Swap** - An interest rate swap contract that commences at a future specified date. The rate for the forward starting swap will differ from the current market rate for swaps by the shape and slope of the yield curve.

**Funding Risk** - The risk that a borrower cannot re-finance its debt at equal or better terms at some date in the future, in terms of lending margin, bank fees and funding time commitment. Funding risk may increase due the company’s own credit worthiness, industry trends or banking market conditions.

**Guaranteeing borrower LGFA –** a Council borrower that guarantees the interest and loan principal obligations of other Councils borrowing from the LGFA and the LGFA itself.

**Hedging** - The action of reducing the likelihood of financial loss by entering forward and derivative contracts that neutralise the price risk on underlying financial exposures or risks. The gain or loss due to future price movements on the underlying exposure is offset by the equal and opposite loss and gain on the hedge instrument.

**ISDA** - International Security Dealers Association: a governing body that determines legal documentation/standards for over-the-counter swaps/options/FRAs and other derivative instruments for interest rates, currencies, commodities etc. Corporate users of such instruments sign an ISDA Master Agreement with banking counterparties that covers all transactions.

**Interest Rate Collar Strategy -** The combined purchase (sale) of a floor or cap with the sale (purchase) of another floor or cap. This can be a zero premium cost strategy. See the interest rate option for further details. This product can be used by both an investor and a borrower. From a borrower's perspective, this product is transacted to provide a limited amount of participation in a downward movement in interest rates to an agreed strike rate. If the interest rate continues to move downwards, Council cannot participate in any movement beyond the strike rate. If interest rates move in an unfavourable direction (upwards) then the predetermined strike rate provides certainty through a known worst case rate. For an investor, the zero cost collar allows some participation in an increase in rates and provides a worst case rate if interest rates decline.
This product outperforms the forward rate agreement if rates fall but under performs if rates rise. This product would be used by a borrower, for known exposures, where the interest rate is expected to decline moderately from current levels.

**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 invest (described as a floor) or borrow (described as a cap) 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, swaptions and bond options.
From a borrower's perspective, these products offer Council maximum flexibility, protecting Council from a rise in rates but allowing full participation in a fall in rates. When used by an investor, this product protects Council from a decline in rates and allows full participation in rising rates.
This product is used either where there is some uncertainty in the underlying debt exposure or the outlook for interest rates is favourable but the policy requires some form of protection.

**Interest Rate Swaps** - A binding, paper contract where one party exchanges, or swaps, its interest payment obligations from fixed to floating basis, or floating to fixed basis. The interest payments and receipts under the swap contract being offsetting, equal and opposite to the underlying physical debt.

**Liability Management** - The policy, strategy and process of actively managing a portfolio of debt.

**Limit(s)** - The maximum or minimum amount or percentage a price or exposure may move to before some action or limitation is instigated. Also called "risk control limits".

**Liquidity Risk** - The risk that a company cannot obtain cash/funds from liquid resources or bank facilities to meet foreseen and unforeseen cash requirements. The management of liquidity risk involves working capital management and external bank/credit facilities.

**LGFA Bonds** - A medium term note (MTN) where a fixed coupon payment is made semi-annually to the LGFA by the Council borrower over the term of the bond, or a floating rate notes (FRN) where interest is paid quarterly at a margin over the bank bill bid rate over the term of the bond.

**LGFA guarantee** – Provided by a guaranteeing borrower, Council guarantees the interest and principal loan obligations of other Councils that are borrowing from the LGFA and the LGFA itself. The guaranteeing amount is to proportionate to Council's rate revenue relative to the rate revenue of all other LGFA borrowing guaranteeing Councils.

**Marked-to-Market** - Financial instruments and forward contracts are revalued at current market rates, producing an unrealised gain or loss compared to the book or carrying value.

**Margin** - The lending bank or institution's interest margin added to the market base rate, normally expressed as a number of basis points.

**Medium Term Notes (MTN)** - A continuous program whereby a prime corporate borrower has issuance documentation permanently in place and can issue fixed rate bonds at short notice under standard terms.

**Non - guaranteeing borrower LGFA –** a Council borrower that does not guarantee the interest and loan principal obligations of other Councils borrowing from the LGFA or the LGFA itself. The Council borrower has no more that $20 million of borrowing from the LGFA.

**Revaluation** - The re-stating of financial instruments and option/forward contracts at current market values, different from historical book or carrying values. If the contracts were sold/bought back (closed-out) with the counterparty at current market rates, a realised gain or loss is made. A revaluation merely brings the contract/instrument to current market value.

**Roll-over** - The maturity date for a funding period, where a new interest rate is reset and the debt re-advanced for another funding period.

**Spot Rate** - The current market rate for currencies, interest rates for immediate delivery/settlement, and normally two business days after the transaction is agreed.

**Subordinated debt** – Upon liquidation of a company, subordinated debt holders rank behind other senior unsecured and secured creditors.

**Strike Price** -The rate or price that is selected and agreed as the rate at which an option is exercised.

**Swaption** - An option on an interest rate swap that if exercised the swap contract is written between the parties. The option is priced and premium paid similar to bank bill and bond interest rate options.

**Swaption Collar** – The simultaneous position of entering into 2 option contracts on 2 interest rate swaps linked together into one transaction. A swaption collar performs similarly to a 'collar' where from a borrower's perspective a top-side position above current market rates and a bottom-side position below current market rates are entered into. On maturity of the options and depending on current interest rates relative to the strike levels on the swaps will determine if either swap is transacted.

**Treasury** - Generic term to describe the activities of the financial function within a company that is responsible for managing the cash resources, debt, foreign exchange risk, and sometimes the commodity price and energy price risk.

**Treasury Bill** - A short term (<12 months) financing instrument/security issued by a Government as part of its debt funding program.

**Volatility** - The degree of movement or fluctuation (expressed as a percentage) of an asset, currency, commodity or financial instrument price over time. The percentage is calculated using mean and standard deviation mathematical techniques.

**Yield** - Interest rate, always expressed as a percentage.

**Yield Curve** - The plotting of market interest rate levels from short term (90-days) to long term on a graph i.e. the difference in market interest rates from one term (maturity) to another.