

Treasury Management Policy

Introduction

Otorohanga District Council ("Council") undertakes borrowing and investment activities, referred to in this document as "treasury activity". Council's treasury activities are carried out within the requirements of the Local Government Act 2002.

In particular Sections 104 and 105 of the Act outline the requirements of the underlying Liability Management Policy and Investment Policy.

This treasury policy document provides the policy framework for all of Council's treasury activities, defines key responsibilities and the operating parameters within which borrowing and investment activity is to be carried out.

The Treasury Management Policy allows Council to manage its, investment and borrowing requirements in a co-ordinated manner. Together these funds form one pool from which Council can manage its treasury requirements.

Council now has the flexibility to finance the capital expenditure or short term operating deficit for one activity from surpluses.

By establishing an internal borrowing and investment portfolio Council is able to ensure that the borrowing activity is charged for the costs of the borrowing and the lending activity receives a return on its "investment".

Philosophy

Council acknowledges that there are various financial risks such as interest rate risk, liquidity risk and credit risk arising from its borrowing and investment activities.

The Council is a risk adverse entity and does not wish to incur additional risk from its treasury activities.

Council's treasury function is a risk management function focused on protecting Council's budgeted interest costs and stabilising the Council's cashflow.

The Council will not undertake any treasury activity unrelated to its underlying cashflow or is purely speculative in nature.







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

Policy Setting and Management

Council approves policy parameters in relation to treasury activities.

The Chief Executive and Finance and Administration Manager have overall financial management responsibility for Council's borrowings and investments.

The following broad objectives provide direction for Council's borrowing, investment and cash management activities:

-  To minimise Council's cost of borrowing and to maximise its return on investment within authorised limits;
-  To ensure that Council's investments are risk averse and secure;
-  To ensure Council's liquidity is managed in order to meet its operating obligations;
-  To manage Council's interest rate risk and maintain its exposure within acceptable limits for both borrowings and investments;
-  To protect Council's investments by reviewing the viability of equities and the credit ratings of approved financial institutions; and
-  To maintain good internal control to ensure that funds are invested and borrowed in accordance with Council Policy.

Liability Management Policy

General Policy

Council borrows as it considers appropriate within the flexible and diversified borrowing powers of the Local Government 2002.

Council approves borrowing in general terms during the Annual Planning process with specific resolutions to follow.

Projected debt levels are ascertained from cashflow forecasts prepared during the Long Term Financial Strategy and Annual Plan preparation process.

The Council raises borrowing for the following primary purposes:

- General borrowing to fund the Council's ongoing activities;
- Specific borrowing associated with "special one-off" projects; and
- To fund assets with intergenerational qualities.

Council is able to borrow through a variety of market mechanisms including the issue of stock and debentures and direct bank borrowing or through accessing the capital markets.

In evaluating new borrowings (in relation to source, term, size and pricing) the Finance and Administration Manager takes into account the following:

- The size and the economic life of the project;
- The impact of the new debt on Council's borrowing limits;
- Relevant margins under each borrowing source;
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time;

- Prevailing interest rates relative to term for both stock issuance and bank borrowing and management's view of future interest rate movements;
- Available term from bank and stock issuance;
- Ensuring that the implied finance terms within the specific debt are at least as favourable as the Council could achieve in its own right; and
- Legal documentation and financial covenants.

Borrowing Limits

In managing borrowing, Council will generally adhere to the following limits:

- Borrowings will not exceed 10% of total assets;
- The annual interest expense of all external borrowings will not exceed 15% of annual rates; and
- Council may exceed the above limits provided the reasons and amount that the limit is being exceeded is disclosed in the Draft Annual Plan which is subject to the Special Consultative Procedure.

Liquidity and Credit Risk Management

Council's ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet as well as its ability to rate, manage its image in the market and its relationships with bankers.

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high for reasons within or beyond Council's control, Council ensures debt maturity is spread over a wide band of maturities.

Council manages this specifically by ensuring that:

- No more than 25% of total borrowing is subject to refinancing in any financial year. Total borrowing includes any forecast borrowing.

Interest Rate Risk Management

Council's borrowing gives rise to direct exposure to interest rate movements. Generally, given the long term nature of Council's assets, projects and intergenerational factors, and Council's preference to avoid an adverse impact on rates, there is a general tendency to have a high percentage of long term fixed rate or hedged borrowing.

The Finance and Administration Manager sets the interest rate risk management strategy by monitoring the interest rate markets on a regular basis and evaluating the outlook for short term rates in comparison to rates payable on its fixed rate borrowing.

The Council's general tendency is to have a high percentage of fixed rate or hedged borrowing. Notwithstanding the above, it may be appropriate from time to time, depending on the Council's outlook on interest rates to have a floating rate profile (any debt or interest rate risk management instrument where interest rates are being reset on a frequency of 180 days or less). The Council manages this specifically using the following operating parameter:

- The Finance and Administration Manager can approve up to 50% of the total debt to have a floating rate profile.

Management implements an interest rate risk management strategy through the use of the following:

- Adjusting the average maturity of its borrowings, thereby managing interest rate risk; and
- Interest rate risk management products to convert fixed rate borrowing into floating rate, floating rate borrowing into fixed or hedged borrowing.

The following interest rate risk management instruments may be used for interest rate risk management activity, after seeking formal prior approval of the Council:

- Forward rate agreements.
- Interest rate swaps;
- Purchase of interest rate options products; and
- Interest rate collar type option strategies.

Security

Generally, Council offers rates as security for general borrowing programmes. From time to time, with prior Council approval, security may be offered by providing a charge over one or more of Council's assets.

Credit Exposure

The Finance and Administration Manager will monitor the risk to Council of the part of any Counterparty.

Debt Repayment

Council repays debt by funding the internal principal repayment for each activity with borrowings over 25 years. The internal principal repayment is funded from General Rates, Targeted Rates or utilization of depreciation reserves.

Short – Term Overdraft Facilities

Overdraft facilities are utilised as little as practical but it is acknowledged that, from time to time, they may be necessary. The Finance and Administration Manager, is authorised to arrange an overdraft facility with the Council's primary Banker of up to \$750,000. Overdraft facilities over this amount require prior Council approval. The use of overdraft facilities is to be reported to Council quarterly.

Fixed Term Overdrafts and Revolving Credit Facilities

The Finance and Administration Manager is authorised to arrange Fixed Term overdrafts and Revolving Credit facilities provided that no more than 50% of total debt has a floating rate profile and subject to Council approval.

Contingent Liabilities




Council provides financial guarantees to community and service organisations. Management ensures that the business plan of the guaranteed party furthers the strategic objectives of the Council and that financial statements are received on a regular basis. Should the guarantee be called up, Council takes immediate action to recover the money.




Internal Borrowings

Council may adopt internal loan funding mechanisms to fund capital projects from existing surplus funds.




The treasury function is responsible for administering the Council's internal borrowings.

Loans are set up within the internal debt portfolio based on planned loan funded capital expenditure and allocated to the activity incurring the capital expenditure to achieve the following objectives:

-  To minimise interest rate variations between invested funds and borrowed funds of the Council;
-  To best utilise and manage any surplus funds generated to fund depreciation;
-  To provide consistency in interest rates and conditions of borrowing for all Council activities, irrespective of the time capital expenditure is incurred;

-  To obtain maximum benefits from the higher degree of predictability of rate cashflows and all other funds required for capital expenditure;
-  To reduce or eliminate the need for refinancing loans borrowed to fund infrastructural projects that have a 'useful life span' longer than loan repayment periods available from financial institutions; and
-  To reduce the overall cost of funds to Council.

The following operational parameters apply to the management of the Council's borrowings:

-  A notional internal loan is set up for all capital expenditure and allocated in the internal portfolio to the activity incurring the expenditure;
-  Interest is charged to activities on year-end loan balances at an agreed rate; and
-  The interest rate is based on the Council's expected weighted average cost of funds, and takes into account factors such as the Council's long term cost of funds, anticipated cost of new debt over the next eighteen months and a buffer which provides for certainty in the charging rate and avoids frequent adjustments. The rate is reviewed by the Council and is fixed for the next financial year.





The Finance and Administration Manager uses the internal debt portfolio as an input into determining Council's external debt requirements.

Where possible, the Council's reserves are used to reduce external debt, effectively reducing the Council's net interest cost.

Investment Policy




General Policy

Council maintains investments in the following financial assets:




-  Treasury investments incorporating longer term and liquidity instruments for the management of cash surpluses;
-  Property Investments;
-  Equity investments.
-  Loan and mortgage advances for community facility purposes.




Council's philosophy to managing investments is to optimise returns in the long term while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk. It also recognises that lower risk generally means lower returns.

Council seeks to:

-  Optimise investment returns;
-  Ensure, where possible, investments are liquid; and
-  Manage potential capital losses due to interest rate movements if investments need to be liquidated before maturity.

Other than treasury investments, investments in companies, organisations and property must be approved by specific resolution of Council having regard to all relevant information, including (but not limited to) the following:

-  Legislative authority to hold such investments;
-  The degree of equity interest or control able to be exercised;
-  Prudence generally;





-  The likely returns on the investment compared with lower risk investments;
-  Re-saleability of real property held for investment purposes; and
-  Other advantages.

Council currently maintains investments in the following financial assets:

Treasury Investments

From time to time, Council has daily cashflow surpluses and borrowing requirements due to the mismatch of daily receipts and payments.

Management monitor cash flow on a daily basis and prepare cash flow forecasts, in broad terms, up to 12 months in advance. These cash flows determine the Council's surpluses for investment which must be undertaken within the following parameters:

-  To ensure Council can meet its commitments as they fall due, in both the short and long term, through cashflow and investment management;
-  To effectively manage the Council's return on its investments. Interest rate risk management on Treasury Investments is not permitted;
-  To protect Council's investment by reviewing credit worthiness of institutions with whom the Council invests; and
-  To ensure internal controls are adequate, in place and followed such that funds are invested in accordance with Council policy.

Acquisition of New Investments

New investments may be acquired if an opportunity arises or if investment supports Council's outcomes and is considered the best means of achieving the outcome.

Council does not have any plans to acquire any major new investments in the current planning horizon. Property investments are required to provide a better investment mix to any individual portfolio.

Approved Issuers, Instruments and Limits

Issuers	Instruments	Limits (% of total treasury portfolio)
Risk Free	Treasury Bills	100%
Government Guaranteed	Government Stock	
Near Risk Free		
Local authorities and other institutions with the ability to levy rates or taxes.	<ul style="list-style-type: none"> Local authority Stock Local authority Debentures 	Up to 100% subject to not more than 30% of total treasury investment portfolio with one issuer.
Low Risk		
Major banks registered with the Reserve Bank with a short term credit rating of at least A1 or better and/or long term credit rating of at least A or better as rated by Australian Rating Agency or	<ul style="list-style-type: none"> Money market call deposits Money market term deposits Transferable certificates of deposit Negotiable certificates of deposit 	No more than 30% of total treasury investment portfolio with one registered bank except for Council's bank which may from time to time exceed this ratio. Up to 30% but no more than 20% of

Issuers	Instruments	Limits (% of total treasury portfolio)
equivalent rating of other international agencies Other issuers as long as they have a short term credit rating of at least A2 or better and/or long term credit rating of at least A or better as rated by Australian Rating Agency or equivalent rating of other international agencies.	<ul style="list-style-type: none"> Bank Bills Promissory notes Corporate Bonds 	total treasury investment portfolio with any single issuer.

Application of Proceeds from Treasury Investments

Upon maturity of a treasury investment the following must be determined and specifically addressed relating to the proceeds:

Was the investment held for short term or long term investment?

Are the withdrawal proceeds required for cashflow purposes, if so, was it formally addressed (Long Term Council Community, Plan, Asset Management Plan etc). If not, what action will be required to replace the investment, or is a specific resolution required to reduce the level of investments?

If an investment matures, which is not required for cashflow purposes, then the proceeds are to be reinvested as per the Investment Policy.

Property Investments

Council may from time to time invest in property if it is seen as a benefit to the District.

Council accepts that investment in property is not without risk. However it believes that the risks are more than offset by the benefits of Council ownership to the residents and ratepayers of the District.

These benefits include Council's ability to provide facilities for community use at less than commercial rates and where the private sector might be unwilling to make a property available.

Risks are that the value of the properties decrease, maintenance is required at a cost greater than expected and rents received are less than expected. Council believes that these risks are minimal and is happy to accept them. Equity Investments

In general, Council will not become involved in equity investments purely for income earning purposes. Council will only become involved when there are strategic or other similar reasons for doing so, or where it is considered to be the most appropriate way to administer a Council function.

Loan and Mortgage Advances

Council will not become involved in any new Loan and Mortgage Advances of a General Nature.

It will consider from time to time making an advance to ratepayers to fund their Capital Contribution towards defined projects, which will be repaid over a period of time through levying a targeted rate.





Interest Rate Risk Management

Council's investments give rise to a direct exposure to a change in interest rates, impacting on the return and capital value of its investments.

The District Accountant sets the rate interest risk management strategy by monitoring the interest rate markets on a regular basis and after taking appropriate advice, evaluates the outlook and determines the interest rate profile to adopt for investments.

Management implements interest rate risk management strategy by reviewing rolling cashflow forecasts and by using risk management instruments to protect investment returns and /or to change the interest rate and maturity profile.

The following interest rate risk management instruments may be used for interest rate risk management activity, after formal prior approval of the Council:

-  Forward rate agreements;
-  Interest rate swaps;
-  Purchase of interest rate options products; and
-  Interest rate collar type strategies.

Selling interest rate options for the purpose of generating premium income, which are not part of a collar type strategy or unwinding cover already in place, are not permitted.

Reporting Procedure

Treasury investments will be managed by the Finance Division and the Council will receive a report every three months.

All other investments will be approved by Council who will also consider reporting procedures for each investment.