Treasury Management Policy

Comprising the Liability Management Policy and Investment Policy

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DRAFT (FOR DISCUSSION)

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1 Introduction

This Treasury Management Policy ("Policy") document has been prepared to fulfil the Kaikōura District Council's ("Council") statutory obligations under the Local Government Act 2002.

Section 102 of Part 6 of the Local Government Act 2002 ("LGA") requires local authorities to adopt a Liability Management Policy and an Investment Policy.

The requirements for each are detailed in Sections 104 and 105 of the LGA:

- The Liability Management Policy must state the Council's policies on how it will manage its borrowings and other liabilities, including interest rate exposure, liquidity, credit exposure, borrowing limits, giving of security, and debt repayment.
- The Investment Policy must set out the Council's policies on investments including the mix of investments, acquiring new investments, management and reporting procedures, and risk assessment and management.

Together these policies comprise the framework for the Council's treasury management activities and define the parameters within which all investment and borrowing activities are carried out.

Treasury management activities are undertaken by the Council's finance function.

All projected borrowings are to be approved by the Council as part of the Long-Term Plan or Annual Plan process or by resolution of Council before the borrowing is undertaken. The Council will not enter into any borrowings denominated in a foreign currency.

All legal documentation in respect of treasury management activities will be subject to legal review prior to execution.

2 Scope and objectives

The objective of this Policy is to control and manage costs and investment returns that can influence operational budgets and Council-approved debt levels.

This Policy supports the Council's wider objectives, specifically:

- Efficient and effective management of Council activities and assets;
- Prudent stewardship of Council and Community assets and resources;
- Transparency of decision-making processes undertaken by the Council;
- Accountability for the decisions taken; and
- Compliance with statutory obligations.

3 Delegated authorities and responsibilities

While the Council has final responsibility for the policies governing the management of liabilities, investments, and treasury activities, it delegates overall responsibility for the day-to-day management of such risks to the Chief Executive Officer (“CEO”). The CEO assigns specific responsibilities to the Senior Manager Corporate Services and the Finance Manager.

In all instances, Council authority is subject to relevant legislative and regulatory limitations.

Activity	**Responsible or delegated party**	**Limit**
Approving and changing Policy	Council	Unlimited
Approving borrowing programme	Council	Unlimited
Acquisition and disposition of investments, other than treasury investments	Council	Unlimited
Approval for charging assets as security over borrowing	Council	Unlimited
Approve new and re-financed bank facilities and debt programmes	Council	Unlimited
Approving transactions outside Policy	Council	Unlimited
Day-to-day execution of treasury activities, including ensuring compliance to Policy	CEO	Subject to Policy
Ensuring the policies comply with existing and new legislation.	CEO	Subject to Policy
Approving new bank counterparties and opening and closing of accounts	CEO	Subject to Policy
Authorising list of signatories	CEO	Unlimited
Approve new and refinanced borrowing in accordance with Council resolution	CEO	Per Council approved borrowing programme
Management responsibility for treasury activities in accordance with the Policy	SMCS and/or FM	N/A
Reporting instances of non-compliance to the CEO	SMCS and/or FM	Per risk control limits
Managing the long-term financial position as outlined in the LTP.	CEO	Per risk control limits
Conducting the Policy review	SMCS and FM	N/A

4 Liability Management Policy

4.1 Objective

All current and term liabilities of the Council are managed prudently and effectively.

Current liabilities are defined as those liabilities that will be repaid in a short period, not exceeding 12 months, and include accounts payable, cash advance facilities, and other short-term liabilities. For the purposes of this section of the policy, the current portion of term liabilities do not apply, these are to be considered as term liabilities.

Accounts payable are to be paid in full by the due date wherever possible. Those current liabilities that incur a late payment penalty are to be paid in full by the due date in all cases.

Term liabilities are defined as those liabilities which are for a term exceeding 12 months, and include council borrowings, and liabilities associated with the Marlborough Regional Forestry joint venture.

4.2 Borrowing Mechanisms

The Council is able to borrow external funds in local currency through bank borrowing and the Local Government Funding Agency ("LGFA"). The Council's finance function manages its borrowing activities in accordance with this Policy.

In evaluating strategies for new and refinanced borrowing, the following is taken into account:

- Available terms from banks and the LGFA.
- The Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and credit margins relative to term for LGFA and bank borrowing.
- The outlook on future interest rate and credit margin movements.
- Legal documentation and financial covenants.
- For internally funded projects, to ensure that finance terms for those projects are at least as equitable with those terms from external borrowing.

The following instruments are approved for the raising of external debt:

- Bank overdraft.
- Bank committed cash advance and debt facilities.
- LGFA instruments, specifically:
    - Floating rate bonds.
    - Fixed rate bonds.
    - Committed stand-by facilities.

4.3 Internal Borrowing

The Council may utilise its reserves and external borrowing to internally fund capital expenditure and working capital. The primary objective in funding internally is to use funds efficiently, by eliminating the margin that would be paid through the Council separately investing and borrowing externally.

Internal borrowing will not be subject to the interest rate risk management limit system.

4.4 Borrowing Limits

The Council must comply with all relevant financial covenants and ratios. In managing debt, the Council will adhere to the following limits:

Limit	**Council Limit**	**LGFA Lending Policy Limit**
Net external interest expense as a percentage of annual rates income	<15%	<25%
Net interest expense as a percentage of total revenue	<10%	<20%
Net external debt as a percentage of total revenue	<150%	<175%
Total external debt	$15m	n/a
Liquidity ratio	>110%	>110%

The liquidity ratio is defined in section 2.8 of this Policy document.

4.5 Security

Under the Local Government Rating Act 2002, the Council has the powers to set, access and collect rates to fund local government activities. This allows the Council to provide its rating powers as security for borrowing and risk management purposes in the form of a Debenture Trust Deed.

The Council will grant a Debenture Trust Deed which includes a charge over the Council's rates and rates revenue in favour of a trustee. Council creditors can be conferred the benefit of that charge through the issuance of security stock under the Deed.

The Council has the right to enter into a borrowing facility with the Bank of New Zealand (BNZ) and secured by a charge over the Council's rates revenue, or negative pledge if this is appropriate. The Council will not pledge assets as security except where it has received a suspensory loan (as has been given for the housing for the elderly units).

When arranging funding facilities from lenders other than LGFA or the BNZ, the Council will have a preference for unsecured facilities unless a cost benefit accrues from offering security. Where security is to be provided, Council's preference will be to offer security for issuing security stock.

4.6 Debt Repayment

The Council will ensure that loan principal budgeted amounts are set aside in a special fund established to repay specific borrowing, a tabled mortgage is used, or it will repay debt from special reserves or special funds associated with the activity for which the loan has been raised. From time to time, where investment funds are surplus, those funds may be used to reduce term debt as provided in the Council's Investment Policy.

Debt may be repaid at maturity, or when conditions are favourable to do so.

4.7 Local Government Funding Agency Limited (LGFA)

The Council's preference is to borrow from the LGFA. In connection with that borrowing, the Council 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 subordinate debt that could in limited circumstances, be converted to equity if required by LGFA; and
- Secure its borrowing from the LGFA, and the performance of the other obligations to the LGFA or its creditors, through the issuance of security stock.

The Council must ensure that it retains LGFA borrowing capacity headroom of at least $2 million.

4.8 Liquidity Risk

Liquidity refers to the availability of financial resources to meet all obligations as they arise, without incurring penalty costs. The Council requires a minimum level of surplus liquidity to meet unexpected cash expenditure or revenue shortfall.

The Council's policy is to maintain a liquidity ratio of at least 110% (which means $1.10 is available for every $1.00 payable). This minimum is also a requirement of the LGFA and is calculated as:

$$Liquidity\ ratio = \frac{External\ debt + unutilised\ committed\ facilities + liquid\ assets}{existing\ external\ debt}$$

Liquid assets include:

- Overnight bank cash deposits
- Bank term deposits maturing in less than 30 days

Short-term liquidity management is monitored and controlled through daily cash management activities with long-term liquidity management being monitored and controlled through the Annual Plan and Long-Term Plan.

As part of its overall liquidity policy, the Council seeks to avoid a concentration of debt maturity dates and may maintain an overdraft facility to meet cash requirements.

4.9 Cash Management

Cash management is the process used for managing cash effectively and efficiently, using the Council's short-term cash and liquidity resources to sustain its ongoing activities, mobilise funds and optimise liquidity. The most important elements are:

- The systematic planning, monitoring, and management of the Council's cash receipts, payments, and bank accounts.
- The gathering and management of information to use available funds effectively and identify funding gaps.
- Optimal usage of transactional banking services to streamline efficiencies of cash payments and receipts.

4.10 Funding Risk

Funding risk management is concerned with ensuring that debt funding can be secured or refinanced in the future at acceptable terms regarding both cost and duration. At a single point in time, credit markets may face constraints and offer pricing and conditions that are unfavourable.

A key control of funding risk management is to spread and smooth debt maturities. This aims to minimise the concentration of risk to ensure that overall borrowing costs are not unnecessarily increased, or the debt maturity profile compromised.

The debt maturity profile, in respect to all external debt and committed bank facilities, is to be maintained within the following limits:

Period	Minimum	Maximum
0 to 3 years	15%	60%
3 to 7 years	25%	85%
7 years plus	0%	60%

A debt maturity profile that is outside the above limits, but self corrects within 90 days, is not in breach of this Policy.

Maintaining a maturity profile outside of the above limits beyond 90 days requires specific approval from the Council.

The Council may pre-fund forecast debt requirements, including new and re-financed debt, for a period of up to 18 months. Re-financing that has been pre-funded will remain included within the funding maturity profile until maturity date.

4.11 Interest Rate Risk

Interest rate risk refers to the impact that movements in wholesale interest rates have on the Council's financial performance (when compared to projections included in the LTP and Annual Plan). The Council's objective in managing interest rate risk is to minimise and maintain stability of debt servicing costs.

Exposure to interest rate risk is managed and mitigated through maintaining the percentage of gross forecast external debt that is subject to a 'fixed rate', rather than a 'floating rate', within the following limits (calculated on a rolling monthly basis):

Period	Minimum	Maximum
0 to 2 years	40%	90%
2 to 4 years	20%	80%
4 to 15 years	0%	60%

Gross forecast external debt is the amount of total external debt for a given period. Debt associated with the Marlborough Regional Forestry joint venture is excluded.

Fixed rate is defined as all known interest rate obligations, such as where borrowing is conducted for a defined term at a defined interest rate.

Floating rate is defined as any interest rate obligation that changes periodically over the term of the borrowing.

Fixed interest rate percentages are calculated based on the average amount of fixed interest rate obligations relative to the average gross forecast external debt amounts for the given period (as defined in the table above).

A fixed rate maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this Policy. However, maintaining a maturity profile that is outside the above limits greater than 90 days requires specific approval by the Council.

Compliance with the interest rate risk limits is maintained by altering the mix of fixed and floating rate debt raised. Derivative instruments, such as interest rate swaps, may be approved on specialist financial advice such as from PriceWaterhouseCoopers (PWC), the Council's treasury and financial services advisors.

5 Investment Policy

5.1 Scope and Objectives

This policy aims to ensure that the Council's investments are managed prudently and effectively, optimising value and return, and increase the size and value of its investment portfolio to enable increased levels of revenue to be returned to the community over time.

The Council's investment portfolio consists of short, medium and long-term investments, and these must be optimised to provide sufficient funds for planned expenditure, including the Council's ability to meets its payments as they fall due. Investments must therefore be chosen which:

- Are for the period of time that the funds are surplus,
- Are able to be liquidated for the right price at the appropriate time,
- Provide a spread of investments covering short, medium and long-term.

A report will be prepared quarterly on the Council's investment portfolio. The contents of this report are detailed in section 8 of this Policy document.

5.2 Investment mix

In order to optimise the Council's investment portfolio, and maintain an appropriate mix of short, medium and long-term investments, no investment type should exceed 50% of the total investment portfolio where practical. Diversification of investments is encouraged.

The Council's investments shall include (but not be limited to) at least three of the following:

- Treasury investments
- Property investments
- Forestry investments
- Equity investments

The following instruments are approved for the purposes of treasury investment:

- Overnight bank cash deposits
- Bank term deposits (to a maximum term of 12 months)
- LGFA borrower notes

Under the LGFA borrowing programme, the Council is required by LGFA to hold borrower notes. These are subordinated debt instruments that are required to be held by each local authority that borrows from LGFA in an amount equal to a defined percentage of the aggregate borrowings. In limited circumstances these borrower notes can be converted to equity if required by LGFA.

If this were to occur, a Council resolution will be required to manage these shares. The Council may therefore be required to invest in LGFA shares in circumstances in which the return on its investment is potentially lower than the return it could achieve with alternative investments.

5.3 Acquisition of new investments

All proposed acquisition of new investments is to be approved by the Council, with the exception of treasury investments, which are managed on a day-to-day basis by the Senior Manager Corporate Services and/or the Finance Manager.

5.3 Funding of new investments

At least two members of the Leadership Team (Senior Managers and third tier Managers) shall be required to authorise electronic payments associated with new investments.

5.4 Use of Revenue from Investments

Income generated from investment should be used initially to offset costs associated with owning and operating that investment. The use of surplus revenues will then be used according to:

- The source and criteria attached to the initial investment sum, or the criteria attached to the fund from which the investment fund came, or
- In accordance with any resolution of the Council, or
- For general operating revenue

On maturity, investments held for a specific purpose will only be used for that purpose or reinvested for a further period. The capital portion of any investment will not be used to offset general operating expenditure unless the purpose for which the investment was initially set up no longer exists. The Council may determine by resolution (on a case-by-case basis) to deviate from the above.

5.5 Proceeds from sale of assets

Council assets will be disposed of from time to time. Income received from the disposal of vehicles and operating plant will be credited to the Council's plant renewal account while income from the disposal of property will go into the Council's property account.

The capital from these accounts will be used to repay debt associated with the asset in the first instance, and then may either be reinvested in asset replacement, or used to purchase other assets. The funds could also be used to offset the rates requirement, but such a move would only be by resolution of the Council.

5 Counterparty credit risk

Credit risk, with reference to treasury activities, is the risk that a party to a transaction will default on its contractual obligation. The Council is exposed to credit risk when there is a deterioration in the credit rating of a bank with which the Council places its treasury investments.

The Council may only place treasury investments with a New Zealand registered bank with a minimum Standard and Poor's long-term credit rating of at least A (or the Moody's or Fitch rating equivalent).

Diversification of treasury investments is encouraged. Where possible, treasury investments should be placed across a minimum of two counterparty banks.

The following matrix determines limits for treasury investment activity:

Counterparty	Minimum S&P long term credit rating	Maximum per counterparty
NZ Government	N/A	Unlimited
LGFA	AA-	100% of investable funds
Approved, NZ Registered Bank	AA-	100% of investable funds
Approved, NZ Registered Bank	A	50% of investable funds

For the purposes of determining the usage of the above limits, investment exposures will be calculated as:

$$Credit\ exposure = transaction\ principal\ x\ 100\%$$

Each transaction should be entered into a treasury spreadsheet or system of record.

Credit ratings should be reviewed on an ongoing basis and in the event of material credit downgrades should be immediately reported to the Senior Manager Corporate Services and/or the Finance Manager and assessed against exposure limits. Counterparty exposures exceeding limits should be reported to the Council.

In the instance of a split rating across multiple rating agencies, the lower rating will apply.

5.1 Counterparty signatory management

All delegated authorities and signatories must be reviewed at least annually to ensure that they are still appropriate and current.

Whenever a person with delegated authority on any account or facility leaves the Council, all relevant banks and other counterparties must be advised in writing in a timely manner to ensure that no unauthorised instructions are to be accepted from such persons.

6 Operational risk

Operational risk refers to the potential for the Council to incur losses due to various factors, including people, systems, inadequate or failed internal processes, or external events. This risk encompasses reputational damage and financial losses stemming from mismanagement, errors, fraud, or the unauthorised use borrowing and investment instruments.

The CEO bears the responsibility of monitoring the emergence of new risk situations. If existing controls are deemed inadequate to provide sufficient protection, they are tasked with implementing additional preventive safeguards.

Operational risks related to treasury activities are mitigated through the following mechanisms:

- Operating within the risk management frameworks of the Policy.
- Producing timely, meaningful, and accurate reporting of treasury exposures, performance, and Policy compliance.
- Proactively managing all treasury risks and undertaking all treasury activities within an environment of control and compliance.
- Promptly reporting all instances of non-compliance with the Policy to the CEO.
- Maintaining documented procedures, systems, and staffing competencies in relation to treasury activities.

7 Policy review

The Policy is to be reviewed annually to ensure its continued relevance alignment with best practices. Additionally, a thorough external independent review is conducted every three years.

For the annual review, the following aspects should be included:

- An assessment of how well the finance function and the Policy have achieved stated objectives and fulfilled the purpose.

Identifying any breaches of the Policy, and any one-time approvals that deviate from the Policy, to highlight areas of Policy tension.

- Relevant feedback and recommendations from Council’s advisors and/or bankers.
- Recommendations for changes, removals, or additions to the Policy, supported by appropriate analysis.

The Senior Manager Corporate Services and/or the Finance Manager has the responsibility to prepare the review report that is presented to the Council.

The Council, or the Committee with delegation to adopt policies, receives the report and approves or rejects recommendations for Policy changes.

8 Reporting

The following schedule of reporting is to be maintained.

Report	Frequency	Prepared by	Recipient
Daily Cash Position Treasury Spreadsheet	Daily	Accounts Payable	SMCS and FM
Treasury Exceptions Report	As required, escalated on the same day	Finance team	CEO
Treasury Report - Policy limit compliance - Borrowing limits - Funding and interest position - Funding facility - New treasury transactions - Cost of funds vs. budget - Liquidity risk position - Counterparty credit - Treasury performance - Debt maturity profile	Quarterly	Finance team	Finance Audit and Risk Committee
Investments report - value and mix of investments - changes from the previous report - treasury investment summary - net rental yields (property) - earnings per share (equity) - RoI on each investment type - actual vs. budgeted returns	Quarterly	Finance team	Finance Audit and Risk Committee
LGFA covenant reporting	Annually	TBAFinance team	LGFA