Council Policy

Policy Title:	Treasury Policy (Investment and Liability Management) 2021
Responsibility:	Finance and Strategy
First Adopted:	June 2006
Review Frequency:	Six yearly, or as otherwise required
Last Reviewed:	May 2021
Next Review Due:	May 2027

Investment Policy

1 Policy Objectives

1.1 This policy developed pursuant to Section 102 Local Government Act (LGA) 2002. It seeks to outline the suggested content for an Investment Policy in compliance with Section 105 of the LGA 2002. It discloses Council's principles of prudent financial management and risk mitigation strategies as they relate to investments.

1.2 The objectives of this policy are:

(a) To comply with sections 102 and 105 of the LGA 2002.
(b) To promote long term prudent financial management.
(c) To outline how investment risk associated with investment activities is assessed and managed.
(d) To outline how investments (strategic, equity, and treasury) are managed and reported on.
(e) To safeguard RDC's financial market investments by establishing and regularly reviewing investment parameters and ensuring that all investment activities are carried out within these parameters
(f) Ensure the integrity of RDC's financial market investments by only investing in appropriately rated organisations and in appropriate financial instruments, as detailed in this policy
(g) Produce accurate and timely information that can be relied on by senior management and Council for control and exposure monitoring purposes in relation to the investment activities of RDC.

2 Background

2.1 STATUTORY REQUIREMENTS

2.1.1 Section 105 of the LGA 2002 outlines the content of an investment policy:

"105 Investment Policy

A policy adopted under section 102(1) must state the local authority's policies in respect of investments, including—

(a) [Repealed]
(b) The mix of investments; and
(c) The acquisition of new investments; and
(d) An outline of the procedures by which investments are managed and reported on to the local authority; and
(e) An outline of how risks associated with investments are assessed and managed."

2.2 RELATIONSHIP TO OTHER COUNCIL STRATEGIES AND POLICIES

2.2.1 It is important when reading this policy that it is read in conjunction with other related Council strategies and policies. Council strategies and policies often reference and inform each other so that any issue before Council can be dealt with in an integrated and comprehensive fashion.

2.2.2 Strategies and policies that have a clear relationship with this Investment Policy are:

(a) The Financial Strategy which specifies the Council's objectives for holding and managing financial investments and equity securities and its quantified targets for returns on those investments and equity securities;

(b) The **Liability Management Policy** (for borrowing by the Council and guarantees by the Council which are ultimately a liability);

(c) Council's **Significance and Engagement Policy** (which, if triggered by a proposal to make an investment will mean that the proposal will be subject to further decision-making and consultation requirements).

3 Policy Statement

3.1 MIX OF INVESTMENTS

3.1.1 Council is a risk adverse entity and therefore takes a prudent approach to managing its investments. Council seeks to maintain diversity in its investment portfolio to spread and minimise risk.

3.1.2 Council generally has three types of investments:

(a) **Strategic Investments** - investments made or held in alignment to Council's strategic direction and typically retained on a long term basis. These include property investments - i.e. land and buildings (including subdivisions) – quarries, forestry and property vested in the Council.

(b) **Equity Investments** - equity (ownership) participation in a private (unlisted) company (including Council Controlled Organisations) or a start-up (a company being created or newly created). Such investments may not necessarily provide a financial return to Council, and may be held for wider social, tactical and/or economic reasons. Notwithstanding, Council will continue to actively seek opportunities for a financial return from all such investments.

(c) **Treasury Investments** – short to medium term financial investments that maximise financial return but ensure an appropriate level of liquidity for forecast expenditure.

3.1.3 RDC shall manage its short to medium or long term money market and longer term fixed interest investments in accordance with the parameters contained in Appendix 1 of this policy.

3.2 NEW INVESTMENTS

3.2.1 Prior to making new strategic or equity investments Council will consider (where relevant):

(a) The expected financial return.

(b) How the investment will contribute in furthering the Ruapehu District's Community Outcomes as documented in the Long Term Plan.

(c) The existing investment portfolio and how the proposed investment 'fits' in terms of Council's preference to spread and minimise risk.

(d) Any other consideration Council deems appropriate.

3.2.2 Despite anything earlier in this Policy on Investment, the 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.

3.2.3 The Council's objective in making any such investment will be to:
(a) Obtain a return on the investment; and
(b) Ensure that the LGFA has sufficient capital to become and remain viable, meaning that it continues as a source of debt funding for the Council.

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

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

3.3 MANAGEMENT AND REPORTING

3.3.1 Investments will generally be monitored and reported through Council's established reporting procedures and Annual Report).

3.3.2 For equity investments:
(a) Transparency and reporting mechanisms will be key elements in any governance arrangements. The frequency and nature of reporting will depend on the nature and size of each investment.
(b) In general terms reporting will comply with generally accepted accounting practice and International Financial Reporting Standards.
(c) Performance of investments will be reported in accordance with any governance arrangements, but no less than on a six monthly and annual basis.

3.4 RISK MANAGEMENT

3.4.1 Council is a risk adverse entity and therefore takes a prudent approach to managing its investments. Council seeks to maintain diversity in its investment portfolio to spread and minimise risk.

3.4.2 Where material risk to Council is apparent (e.g. equity investments) Council will commission an independent risk assessment and management report prior to entering into the investment.

3.4.3 To ensure the protection of Treasury investments Council will only invest with credit worthy counter parties. Low risk counter parties are defined as those having a Standard and Poors rating of AA- or better.

4 Annotations

Date	Description
June 2009	Reviewed/amended as part of LTP process
June 2012	Reviewed as part of LTP process (no changes)
February 2018	Reviewed/amended as part of LTP process
May 2021	Reviewed/amended as part of the LTP process (changed to a six yearly review, delegations moved to Delegations Manual and responsibility updated)

SCHEDULE 1

Authorised Investment Criteria for Short Term Funds and Long Term Funds

Authorised Asset Classes	Overall Portfolio Limit as a Percentage of the Total Portfolio	Approved Financial Market Investment Instruments (must be denominated in NZ dollars)	Credit Rating Criteria – Standard and Poor's (or Moody's or Fitch equivalents)	Limit for each issuer subject to overall portfolio limit for issuer class
New Zealand Government	100%	• Government Stock • Treasury Bills	Not Applicable	Unlimited
Local Authorities where rates are used as security	70%	• Commercial Paper • Bonds/Medium Term Note's/Floating Rate Note's	Not Applicable	$2.0 million $2.0 million
New Zealand Registered Banks	100%	• Call/Deposits/Bank Bills/Commercial Paper • Bonds/Medium Term Note's/Floating Rate Note's	Short term S&P rating of A1 or better Long term S&P rating of A+ or better	$7.5 million $2.5 million
State Owned Enterprises	60%	• Commercial Paper • Bonds/Medium Term Note's/Floating Rate Note's	Short term S&P rating of A1 or better Long term S&P rating of BBB+ or better Long term S&P rating of A+ or better	$2.0 million $1.0 million $2.0 million
Corporates	60%	• Commercial Paper • Bonds/Medium Term Note's/Floating Rate Note's	Short term S&P rating of A1 or better Long term S&P rating of BBBA- or better Long term S&P rating of AA+ or better	$2.0 million $1.0 million $2.0 million

Investments that no longer comply with minimum rating criteria due to a rating downgrade must be sold within one month of the downgrade being notified unless Council formally approves the continued holding of the investment.

Liability Management Policy

1 Policy Objectives

1.1 The following policy is developed pursuant to Section 102 of the LGA. It seeks to outline the suggested content for a Liability Management Policy in compliance with Section 104 of the LGA 2002. It discloses Council's principles of prudent financial management and risk mitigation strategies as they relate to liability management.

1.2 The objectives of this Policy are:

(a) To comply with Sections 102 and 104 of the LGA 2002.
(b) To promote long term prudent financial management.
(c) To outline how liability risk associated with borrowing activities is assessed and managed.
(d) To outline how liabilities (current and non-current) are managed and reported on.
(e) Ensure that RDC has an ongoing ability to meet its debts in an orderly manner as and when they fall due in both the short and long-term, through appropriate liquidity and funding risk management
(f) Arrange appropriate funding facilities for RDC, ensuring they are at market related margins utilising bank debt facilities and/or capital markets as appropriate.
(g) Maintain lender relationships and RDC's general borrowing profile in the local debt market and, if applicable, capital markets, so that RDC is able to fund itself appropriately at all times.
(h) To provide appropriate levels of funding for investments (in accordance with Sections 3.0, 5.0, 6.0 and 8.0 of the Council's Investment Policy) and as may be authorised from time to time by way of Council resolution.
(i) Control RDC's cost of borrowing through the effective management of its interest rate risk, within the rate risk management limits established by the liability management policy.
(j) Ensure compliance with any finance/borrowing covenants and ratios.
(k) Maintain adequate internal controls to mitigate operational risks.
(l) Produce accurate and timely information that can be relied on by senior management and Council for control and exposure monitoring purposes in relation to both the debt raising and financial market investment activities of RDC.

2 Definitions

2.1 Forward Rate Agreement

An agreement between RDC and a counterparty (usually a bank) protecting RDC against a future adverse interest rate movement. RDC and the counterparty agree to a notional future principal amount, the future interest rate, the date and the benchmark rate (BKBM).

2.1.1 ***Objective***

To provide RDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. A Forward Rate Agreement (FRA) typically applies to a 3 month period, starting at some point within the next 12 months.

2.2 Interest Rate Swap

An interest rate swap is an agreement between RDC and a counterparty (usually a bank) protecting RDC against a future adverse interest rate movement. RDC pays a fixed interest rate and receives a floating interest rate. The parties agree to a notional principal amount, the future interest rate, the settlement dates and the benchmark floating rate (BKBM).

2.2.1 ***Objective***
To provide RDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. Floating rate sets are typically every 1 or 3 months over the life of the swap.

2.3 Forward Start Interest Rate Swap
A Forward Start Interest Rate Swap is a financial instrument that fixes the interest rate for a set amount of debt at some date in the future (generally up to 2 years). These transactions are negotiated with Banks.

2.3.1 ***Objective***
To provide RDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period, commencing at a future point in time. All other conditions are as with an interest rate swap.

2.4 Options on a Swap – Swaption
A ‘Swaption’ is an option to enter into an interest rate swap. In exchange for an option premium, the buyer gains the right but not the obligation to enter into a specified swap agreement with the issuer on a specified future date.

2.4.1 ***Objective***
To provide RDC with the right but not the obligation to enter into a fixed rate swap at a future point in time on an agreed principal amount for an agreed period. A swaption is an option on a swap and typically requires a premium to be paid.

2.5 Interest Rate Options
The purchase of an interest rate option gives the holder (in return for the payment of a premium) the right but not the obligation to borrow (described as a cap) or invest (described as a floor) at a future date. RDC and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark floating rate (BKBM).

2.5.1 ***Objective***
To provide RDC with worst case cover on its interest rate cost on an agreed principal amount for an agreed period. As for an interest rate swap, rate sets are typically at each 1 or 3 month date for the life of the option. A premium is payable for entering into an interest rate option.

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

2.6.1 ***Objective***
To provide RDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period, but at the same time avoid the need to pay an upfront premium.

2.7 Fixed Rate Term Loans
A Fixed Rate Term Loan is an agreement between RDC and a counterparty (usually a bank) protecting RDC against a future adverse interest rate movement. RDC pays a fixed interest rate as set by the counterparty on an agreed principal amount for the term of the loan.

2.7.1 ***Objective***

To provide RDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period.

3 Background

3.1 The Local Government Act 2002 (LGA 2002) empowers a local authority to undertake any activity or business on behalf of its communities.

3.2 The legislation requires that Councils' must conduct their business in an open and transparent manner and be accountable for the decisions made by them. Council must undertake any commercial transactions in accordance with sound business practices and abide by significant procedural requirements especially with regard to financial management. These are aimed to ensure that decisions are made in light of community views; decisions are subject to public scrutiny; and ultimately electoral accountability.

3.3 The requirement to have a Liability Management Policy is an example of these procedural requirements. This requirement is designed to ensure that local government is transparent and accountable when exercising its stewardship role.

3.4 STATUTORY REQUIREMENTS

3.4.1 Section 104 of the LGA 2002 outlines the content of a liability management policy:

"104 Liability Management Policy

A policy adopted under section 102(1) must state the local authority's policies in respect of both borrowing and other liabilities including:

(a) Interest rate exposure; and
(b) liquidity; and
(c) credit exposure; and
(d) Debt repayment."

3.5 RELATIONSHIP TO OTHER COUNCIL STRATEGIES AND POLICIES

3.5.1 It is important when reading this Policy that it is read in conjunction with other related Council policies. Council policies often reference and inform each other so that any issue before Council can be dealt with in an integrated and comprehensive fashion. Policies that have a clear relationship with this Liability Management Policy are:

(a) The **Policy on Investments** (outlines principles of prudent financial management and risk mitigation strategies as they relate to investments).
(b) Council's **Significance and Engagement Policy** (which if triggered by a proposal will mean that the proposal will be subject to further decision-making and consultation requirements).
(c) The **Revenue and Financing Policy** (which outlines that proceeds from assets sales will be applied to debt repayment).
(d) The **Financial Strategy** (which outlines the limits of borrowings and guidelines for investments)

4 Policy Statement

4.1 INTEREST RATE EXPOSURE

4.1.1 Interest rate risk is the risk of significant unplanned changes to interest costs as a result of financial market movements.

4.1.2 The objective of managing interest rate risk is to have a framework in place under which Council can actively manage its borrowings within overall guidelines to spread and reduce risk and stabilise interest costs.

4.1.3 Borrowings can only be made in New Zealand dollars (Section 113 of the LGA 2002).

4.1.4 The interest rate exposures of RDC shall be managed according to the parameters detailed in the following table and shall apply to the projected core debt of RDC. Core debt is defined as that contained in the Annual Plan or as otherwise determined by the Financial Controller or Equivalent Senior Finance Officer.

4.1.5

Fixed Rate Cover Percentages		
	Minimum Fixed Rate Amount	**Maximum Fixed Rate Amount**
Less than 2 years	40%	100%
2 years to 5 years	25%	80%
5 years to 10 years	0%	60%

4.1.6 Fixed rate cover in excess of 10 years is permissible provided that it is carried out in conjunction with, or aligns with, an underlying debt instrument.

4.1.7 To manage the interest rate risk associated with its debt RDC may use the following interest rate risk management instruments:
(a) Interest rate swaps.
(b) Swaptions.
(c) Interest rate options, including collar type structures but only in a ratio of 1:1.
(d) Forward rate agreements.
(e) Fixed Rate Term Loans.
(f) Refer to Definitions clause 2 for definitions and objectives for each of the interest rate risk management instruments)

4.1.8 Council may retain the services of an Independent Treasury Advisor to assist in managing the funding and interest rate risks of RDC.

4.2 LIQUIDITY AND FUNDING

4.2.1 The objective of managing liquidity is to ensure that Council has adequate financial resources available to meet all its obligations as they fall due.

4.2.2 To avoid a concentration of debt maturity dates Council will, where practicable, aim to have no more than 50% of debt subject to refinancing in any rolling 12 month period.

4.2.3 Council's main revenue sources are cyclical in nature and therefore committed bank facilities are required to ensure sufficient funds can be called upon when required.

4.2.4 RDC shall aim to maintain committed funding lines of not less than 110% of projected core debt. (Core debt is defined as that contained in the Annual Plan or as otherwise determined by the Financial Controller or Equivalent Senior Financial Officer).

4.3 CREDIT EXPOSURE

4.3.1 Credit risk is the risk that a party to a transaction will default on its contractual obligation. A credit risk may exist when the credit rating of an entity with which Council has borrowings with deteriorates.

4.3.2 Council will only enter into borrowing agreements with creditworthy counterparties. Creditworthy counterparties are selected on the basis of their Standards and Poor's rating which must be AA- or better.

4.4 FUNDING METHODS

4.4.1 RDC may obtain funding utilising the following methods:
(a) Bank debt.
(b) Capital markets issuance comprising Fixed Rate Bonds, Medium Term Notes and Floating Rate Notes.

4.5 LOCAL GOVERNMENT FUNDING AGENCY

4.5.1 Despite anything earlier in this Liability Management Policy, the 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:
(a) Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA;
(b) Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;
(c) Commit to contributing additional equity (or subordinated debt) to the LGFA if required;
(d) Subscribe for shares and uncalled capital in the LGFA; and
(e) 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.

4.6 DEBT REPAYMENT

4.6.1 The objective of managing debt repayment is to ensure that Council is able to repay debt on maturity with minimum impact on Council operations.

4.6.2 Borrowings will be repaid as they fall due in accordance with the applicable loan agreement. Subject to borrowing limits, a loan may be rolled over or re-negotiated as and when appropriate.

4.6.3 All borrowings are deemed to be corporate borrowings. Debt repayments will be made from general funds, by funds raised specifically to repay debt and by proceeds from asset sales. Funds derived from any asset sales are applied first to offset borrowing in the relevant activity from which the asset is sold.

4.6.4 The cost of capital is spread over significant activities using internal loans. Internal loans are raised to cover the economic life of capital projects over a 25 year period.

4.7 SPECIFIC BORROWING LIMITS

4.7.1 Council will borrow to fund its total funding needs in accordance with the annual plan. Borrowing includes funding of short term working capital and long term capital investment. In general terms, Council approves borrowing through the Annual Planning process with public disclosure by way of resolution.

4.7.2 Ratios based on revenue and debt servicing and debt to equity are used for measuring a prudent borrowing level. Council borrowing limits are based on the following LGFA ratios:

(a) Net interest will not exceed 20% of total revenue.
(b) Net debt will not exceed 175% of total [cash] revenue.
(c) Net interest will not exceed 25% of annual rates.
(d) Available financial accommodation will not exceed 110% of External indebtedness.

4.8 THE GIVING OF SECURITIES

4.8.1 Objective: To enable Council to secure finance for borrowings.

Risk	Risk Management
Adequate funding for Council activities may not be raised without security. Security will not be given over one or more of Councils assets without prior Council resolution.	• Security will be provided over rates (as per section 115 of LGA) revenue unless special circumstances require security over assets or specially deemed rates. • Where borrowing is by way of finance lease, or some other form of trade credit under which it is normal practice to provide security over the asset concerned, Council may offer security over the asset.

Annotations

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