

HURUNUI DISTRICT COUNCIL
POLICY
INTERNAL FINANCING



Adopted by: Council dated 27 February 2024

Replaces: Internal Financing Policy dated 25 June 2020

Objectives

Council has developed a system of internal financing for various activities within the organisation. Positive balances held by some Council activities offset the negative balances of others. Accordingly it is only necessary to seek external funding (debt) for the net amount.

The objectives of this system are:

- (a) It facilitates the funding of capital expenditure over several years, rather than funding both capital and operating expenditure from rates in the year in which expenditure is incurred. This helps to smooth the peaks and troughs in rating which might otherwise occur.
- (b) By only seeking external funding for net debt, it is not necessary to pay interest margins to financial institutions/other counterparties.
- (c) The notional margin on internal debt offsets the costs of treasury activities and is applied to reduce district wide rates.

Relevant Activities

The internal financing system is applicable to those activities that are funded by a targeted rate, which requires the Council to ensure that the funds generated from rates are only applied to that activity, or there are reasons to separately account for an activity. As a result, the internal financing system is applied to the following:

- Ward Amenities
- Roadside Construction
- Household Refuse Collection
- Water Supplies
- Sewerage Schemes
- Stormwater and Drainage Schemes
- Medical Centres
- Foreshore Protection Schemes
- Special Funds including Development Contribution Funds
- Hanmer Springs Thermal Pools and Spa

In addition, interest charges are applied to the balance in the Earthquake Recovery account.

Mechanics of the System

Each activity has an internal account. Receipts for that activity – Rates, Fees & Charges, Development Contributions etc. – are deposited into that account. Payments for that activity – Employment Costs, Direct Operating Expenditure, Internal Interest Charges, Council Overheads and Capital Expenditure – are withdrawn from that account. The result is that, at any stage, that account may be in funds, or it could be overdrawn.

If there are funds in the account for that activity, then the Council will pay interest to that activity. Conversely, if the account is overdrawn, then that activity will be charged interest.

Debt Repayment and Depreciation Funding

There is also a need for those activities whose accounts are overdrawn to make provision to get out of overdraft. This is most likely done by setting rates at a level to not only pay the annual operating costs and interest charge, but to also fund additional amounts that will offset the overdraft.

The Council's policy is that internal debt should be repaid over 10 years (or such term Council deems appropriate in particular circumstances having regard for factors such as the lifespan of assets acquired using the funds and feasibility).

For Three Waters Assets (Water, Sewer and Stormwater) and the Hanmer Springs Thermal Pools and Spa Assets; there is the requirement for the activity to fully fund depreciation, although implementation of this requirement may be staged. The cash generated by increasing rates to cover the cost of depreciation will be used to repay internal debt.

Positive balances

For some activities, the Council may agree that an activity may build up a positive balance over time in anticipation of major future expenditure.

Interest Rates

To ensure consistency throughout the entire organisation, with the exception of the Hanmer Springs Thermal Reserve, the interest rates have been set as follows:

- Interest rate on Overdrawn Activity Accounts is charged interest at 100 basis points (1%) above the base interest rate.
 - As the Hanmer Springs Thermal Pools and Spa activity is of a commercial nature, there is an increased level of risk involved and as such, the interest rate charged has been increased to reflect this level of risk. The rate charged for any debt drawn down by the Hanmer Springs Thermal Pools and Spa is set at 200 basis points (2%) above the base interest rate.
 - The base interest rate is the "All Up Weighted Average Cost of Funds Including Margin", as reported in the Council's Treasury Reporting Dashboard at the end of each quarter.
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- The resulting interest rates shall be charged on any overdrawn activity account for the succeeding three months.

For those Activity accounts that have funds on hand, the rate of interest credited to the account should be set at the rate the Council's transactional bank advertised as their three month term deposit rate at the applicable reset dates above. The resulting interest rates shall be applicable for the succeeding three months.

Use of Interest

All interest derived from internal financing is accumulated by the Council's treasury function. Costs associated with treasury activities, such as any external interest charges or fees, external advice, and Council overheads, are paid from the interest derived. The overall surplus from the treasury function used to offset the District Rate requirement.

END OF POLICY