

HURUNUI DISTRICT COUNCIL

POLICY

TREASURY RISK MANAGEMENT



Adopted: Council meeting 28 June 2018
Replaces: Treasury Risk Management Policy February 2015
Review date: **2021**

1. Introduction

This Treasury Risk Management Policy incorporates what were previously the Liability Policy and the Investment Policy.

Purpose of the policy

The purpose of the Treasury Risk Management Policy is to outline approved policies and procedures in respect of all treasury activity to be undertaken by Hurunui District Council. The formalisation of such policies and procedures will enable treasury risks within the Council to be prudently managed.

As circumstances change, the policies and procedures outlined in this policy will be modified to ensure that the Council will manage treasury risks. In addition, regular reviews will be conducted to test the existing policy against the following criteria:

- Industry “best practices” for a Council the size and type of Hurunui.
- The risk bearing ability and tolerance levels of the underlying revenue and cost drivers.
- The effectiveness and efficiency of the Treasury Risk Management Policy and treasury management function to recognise, measure, control, manage and report on Hurunui’s financial exposure to market interest rate risks, funding risk, liquidity, investment risks, counterparty credit risks and other associated risks.
- The operations of a pro-active treasury function in an environment of control and compliance.
- The robustness of the policy’s risk control limits and risk spreading mechanisms against normal and abnormal interest rate market movements and conditions.
- Assistance to the Council in achieving strategic objectives relating to ratepayers.

All staff involved in any aspect of the Council’s financial management must be completely familiar with their responsibilities under the policy at all times.

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2. Scope and objectives

Scope

- This document identifies the Council's policy and procedures in respect of treasury management activities.
 - The policy does not cover other aspects of the Council's operations, particularly transactional banking management, systems of internal control and financial management. Other Council policies and procedures cover these matters.
 - Planning tools and mechanisms are also outside of the scope of this policy.
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Objectives

The objective of this Treasury Risk Management Policy is to control and manage costs and investment returns that can influence operational budgets and public equity. Specifically:

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.
- The Council is governed by the following relevant legislation;
 - Local Government Act 2002, in particular Part 6 including sections 101,102,104 and 105.
 - 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. Details of relevant sections can be found in the Trustee Act 1956 Part II Investments.
 - Public bodies Lease Act 1969 and Property Law Act 2007.
- All projected borrowings are to be approved by the Council as part of the Annual Plan process or Council resolution before the borrowing is effected.
- All legal documentation in respect to borrowing and financial instruments will be approved by the Council's approved solicitors prior to the transaction being executed.
- The Council will not enter into any borrowings denominated in a foreign currency.
- The Council will not transact with any Council Controlled Trading Organisation (CCTO) on terms more favourable than those achievable by the Council itself.
- A resolution of the 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, an amount determined by resolution of Council.

General Objectives

- To manage investments to optimise returns in the long term whilst balancing risk and return considerations.
 - Minimise the Council's costs and risks in the management of its borrowings.
 - Minimise the Council's exposure to adverse interest rate movements.
 - Monitor, evaluate and report on treasury performance.
 - Borrow funds and transact risk management instruments within an environment of control and compliance under the Council approved
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Treasury Risk Management Policy so as to protect the Council's financial assets and costs.

- Arrange and structure long term funding for the Council at the lowest achievable interest margin from debt lenders. Optimise flexibility and spread of debt maturity within the funding risk limits established by this policy statement.
- Monitor and report on financing/borrowing covenants and ratios under the obligations of the Council's lending/security arrangements.
- Comply with financial ratios and limits stated within this policy.
- Monitor the Council's return on investments.
- 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.
- Maintain appropriate liquidity levels and manage cash flows within the Council to meet known and reasonable unforeseen funding requirements.
- To minimise exposure to credit risk by dealing with and investing in credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- To ensure adequate internal controls exist to protect the Council's financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, LGFA investors and investment counterparties.

Policy setting and management

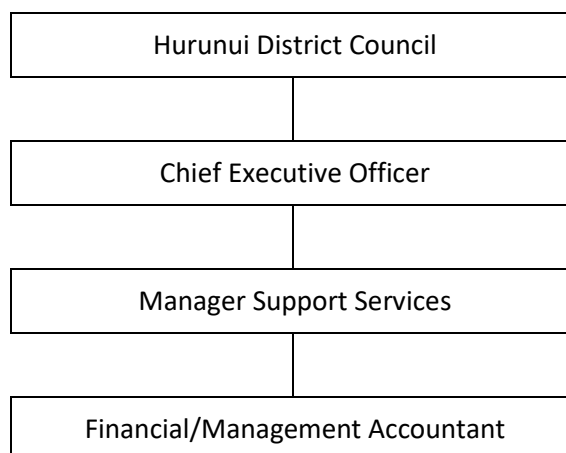
The Council approves policy parameters in relation to its treasury activities. The Council's Chief Executive Officer has overall financial management responsibility for the Council's borrowing and investments.

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

3. Management responsibilities

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:



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, according to its underlying objectives.

The Council is responsible for approving the Treasury Management 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 its long-term financial position through the Long Term Plan (LTP) and Financial Strategy along with the adopted Annual Plan.
- Approving new debt through the adoption of the Annual Plan, specific Council resolution and approval of this policy.
- Approving the Treasury Management Policy incorporating the following delegated authorities:
- borrowing, investment and dealing limits and the respective authority levels delegated to the CEO, MSS and other management;
- counterparties and credit limits;
- risk management methodologies and benchmarks;
- guidelines for the use of financial instruments;
- receive an triennial review report on the policy.
- Evaluating and approving amendments to policy.
- Approving budgets and high level performance reporting.
- Approve opening and closing of bank accounts.
- Delegate authority to the CEO and other officers.

The Council should also ensure that:

- It receives regular information from management on risk exposure and financial instrument usage in a form, that is understood, and that enables it to make informed judgements as to the level of risk undertaken.
 - Issues raised by auditors (both internal and external) in respect of any significant weaknesses in the treasury function are resolved in a timely manner.
 - Submissions are received from management requesting approval for one-off transactions falling outside policy guidelines.
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**Chief Executive Officer
(CEO)**

While the Council has final responsibility for the policy governing the management of Council's risks, it delegates overall responsibility for the day-to-day management of such risks to the Chief Executive Officer.

In respect of treasury management activities, the Chief Executive Officer's responsibilities include:

- Ensuring the Treasury Management policies comply with existing and new legislation;
 - Approving the register of cheque and electronic banking signatories;
 - Approve new counterparties and counterparty limits;
 - Approve new borrowing undertaken in line with the Council resolution and approved borrowing strategy;
 - Approve interest rate strategy;
 - Receive advice of breaches of Treasury Management Policy and significant treasury events from the MSS;
 - Approve all amendments to Council records arising from checks to bank confirmations.
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**Manager Support
Services (MSS)**

The MSS' responsibilities are as follows:

- Management responsibility for borrowing and investment activities;
 - Recommend policy changes to the Council for approval;
 - Ongoing risk assessment of borrowing and investment activity including procedures and controls;
 - Approve treasury transactions in accordance with delegated authority;
 - Authorise the use of approved interest rate risk management instruments within discretionary authority;
 - Recommend authorised signatories and delegated authorities in respect of all treasury dealing and banking activities;
 - Propose new funding requirements to the CEO for consideration and submission to the Council;
 - Review and make recommendations on all aspects of the Treasury Risk Management Policy to the CEO, including dealing limits, approved instruments, counterparties, and general guidelines for the use of financial instruments;
 - Conduct a review, at least triennially, of the Treasury Management Policy, treasury procedures and counterparty limits;
 - Manage the long-term financial position of the Council as outlined in the LTP;
 - Ensure management procedures and policies are implemented in accordance with this Treasury Management Policy;
 - Ensure all financial instruments are valued and accounted for correctly in accordance with current best practice standards;
 - Monitor and review the performance of the treasury function in terms of achieving the objectives of minimising and stabilising funding costs;
 - Monitor treasury exposure on a regular basis, including current and forecast cash position, investment portfolio, interest rate exposures and borrowings;
 - Oversee relationships with financial institutions/brokers;
 - Negotiate borrowing facilities;
 - Authorise interest rate hedge transactions (swaps, Forward Rate Agreements (FRAs) and options) with bank counterparties to change the fixed:floating mix to re-profile the Council's interest rate risk profile on borrowing;
 - Design, analyse, evaluate, test and implement risk management strategies to position the Council's net interest rate risk profile to be protected against adverse market movements within the approved policy limits;
 - Execute treasury transactions in accordance with set limits;
 - Complete deal tickets for treasury transactions;
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- Update treasury spread sheet for all new, re-negotiated and maturing transactions;
- Monitor credit ratings of approved counterparties;
- Investigate financing alternatives to minimise borrowing costs, margins and interest rates, making recommendations to the CEO as appropriate;
- Account for all treasury transactions in accordance with legislation and generally accepted accounting principles, Council’s accounting and funding and financial policies.
- Prepare treasury reports;
- Update credit standing of approved counterparty credit list on a quarterly basis.
- Check compliance against limits and prepare report on an exceptions basis;
- Forecast future cash flow and debt requirements.

**Financial/
Management
Accountant**

Responsibilities are as follows:

- Co-ordinate the compilation of cash flow forecasts and cash management;
- Manage the operation of all bank accounts;
- Handle all administrative aspects of bank counterparty agreements and documentation such as loan agreements and ISDA swap documents;
- Monitor all treasury exposures daily;
- Check all treasury deal confirmations against deal documentation and treasury spreadsheet, and report any irregularities immediately to the CEO;
- Reconcile monthly summaries of outstanding financial contracts from banking counterparties to internal records;
- Review treasury spreadsheet reconciliation to general ledger.

**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, the following procedures must be complied with:

- All delegated authorities and signatories must be reviewed at least annually to ensure that they are still appropriate and current.
- A comprehensive letter must be sent to all bank counterparties at least annually to confirm details of all relevant current delegated authorities empowered to bind the Council.

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.

The Council has the following responsibilities, either directly itself, or via the following stated delegated authorities.

Activity	Delegated Authority	Limit
Approving and changing policy	The Council	Unlimited
Approve external borrowing for year as set out in the AP/LTP.	The Council	Unlimited (subject to legislative and other regulatory limitations)
Acquisition and disposition of investments other than financial investments	The Council	Unlimited
Approval for charging assets	The Council	Unlimited

as security over borrowing		
Approving new and reviewing re-financed bank facilities.	CEO (delegated by Council)	Unlimited
Appoint Debenture Trustee	The Council	N/A
Overall day-to-day risk management	CEO (delegated by Council) MSS (delegated by CEO)	Subject to policy
Re-financing existing debt	CEO (delegated by Council) MSS (delegated by CEO)	Subject to policy
Negotiate bank facilities	MSS	N/A
Manage borrowing and interest rate strategy	MSS	N/A
Approving transactions outside policy	The Council	Unlimited
Adjust interest rate risk profile	MSS	Per risk control limits
Managing funding maturities in accordance with Council approved risk control limits	MSS	Per risk control limits
Maximum daily transaction amount (borrowing, investing, interest rate risk management and cash management) excludes roll-overs on floating rate borrowing and interest rate roll-overs on swaps	The Council CEO (delegated by Council) MSS	Unlimited \$5M \$1M
Manage cash/liquidity requirements	MSS	Per risk control limits
Authorising lists of signatories	CEO	Unlimited
Opening/closing bank accounts	The Council	Unlimited
Triennial review of policy	MSS	N/A
Ensuring compliance with policy	MSS	N/A

All management delegated limits are authorised by the CEO

4. Liability management policy

Explanation Council's liabilities comprise borrowings and various other liabilities.

Debt ratios and limits Debt will be managed within the following macro limits.

Ratio	Hurunui	LGFA Lending Policy Covenants
Net external debt as a percentage of equity	<10%	n/a
Net external debt as a percentage of total revenue	<100%	<175%
Net Interest on external debt as a percentage of total revenue	<6.25%	<20%
Net Interest as a percentage of annual rates income (debt secured under debenture)	<12.5%	<25%
Liquidity (External, term debt + committed loan facilities + available liquid investments/cash equivalents to existing external debt)	>110%	>110%

Total revenue is defined as earnings from rates, government 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 liquid financial assets/investments.

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).

Disaster recovery requirements are to be met through the liquidity ratio and special funds.

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

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

- Available terms from banks, LGFA, debt capital markets and loan stock issuance;
- The Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time;

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- Prevailing interest rates and margins relative to term for loan stock issuance, debt capital markets, LGFA and bank borrowing;
 - The market's outlook on future interest rate movements as well as its own;
 - Ensuring that the implied finance terms and conditions within the specific debt (e.g. project finance) are evaluated in terms such as cost/tax/risk limitation compared to the terms and conditions Hurunui could achieve in its own right;
 - Legal documentation and financial covenants together with credit rating considerations:
 - For internally funded projects, to ensure that finance terms for those projects are at least as equitable with those terms from external borrowing;
 - 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.

The 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 its investors, LGFA and financial institutions/brokers.

Security

The Council's borrowings and interest-rate risk management instruments will generally be secured by way of a charge over rates and rates revenue. The utilisation of special funds and reserve funds and internal borrowing of special funds / reserve funds and other funds will be on an unsecured basis.

Under the Debenture Trust Deed, the Council's borrowing is secured by a floating charge over all Council rates levied under the Rating Act, excluding any rates collected by the Council on behalf of any other local authority. In such circumstances, the security offered by the Council ranks 'Pari Passu' with other lenders.

The Council offers deemed rates as security for general borrowing programs. From time to time, with prior Council and Debenture Trustee approval, security may be offered by providing a charge over one or more of the Council's assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds (e.g. an operating lease, or project finance).
- The Council considers a charge over physical assets to be appropriate.
- Any pledging of physical assets must comply with the terms and conditions contained within the security arrangement.

Debt repayment

The funds from all asset sales and operating surpluses 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 loan agreement. Subject to the debt limits, a loan may be rolled over or re-negotiated as and when appropriate.

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

Internal borrowing

Refer to the Council's Internal Financing Policy.

**New Zealand Local
Government
Funding Agency
Limited Investment**

Despite anything earlier in this Treasury Risk 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, for example Borrower Notes;
 - 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.
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5. Investment policy and limits

General policy

The 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 regularly reported to the Council. Specific purposes for maintaining investments include:

- a) For strategic purposes consistent with the Council's Long Term Plan;
- b) To reduce the current ratepayer burden;
- c) The retention of vested land;
- d) Holding short term investments for working capital requirements;
- e) Holding investments that are necessary to carry out Council operations consistent with Annual Plans, to implement strategic initiatives, or to support inter-generational allocations;
- f) Holding assets (such as property) for commercial returns;
- g) 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;
- h) Invest amounts allocated to accumulated surplus, Council created restricted reserves and general reserves;
- i) Invest proceeds from the sale of assets.

The Council recognises that as a responsible public authority, all investments held should be low risk. The Council also recognises that low risk investments generally means lower returns.

The Council can internally borrow from reserve funds in the first instance to meet future capital expenditure requirements, unless there is a compelling reason for establishing external debt.

In its financial investment activity, the Council's primary objective when investing is the protection of its investment capital and that a prudent approach to risk/ return is always applied within the confines of this policy. Accordingly, only approved credit worthy counterparties are acceptable. The Council will act effectively and appropriately to:

- Protect the Council's investments.
- Ensure the investments benefit the Council's ratepayers.
- Maintain a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements.

Investment mix

The Council maintains investments in the following assets from time to time:

- Equity investments, including investments held in CCO/CCTO and other shareholdings.
- Property investments incorporating land, buildings, a portfolio of ground leases and land held for development.
- Forestry investments.
- Financial investments.
- Loan advances for staff and rural housing purposes.
- Other.

Equity Investments

The Council maintains equity investments and other minor shareholdings. The Council's equity investments fulfil various strategic, economic development and financial objectives as outlined in the LTP. Equity investments may be held where the Council considers there to be strategic community value.

The Council's equity investments fulfil various strategic, economic development and financial objectives as outlined in the LTP.

The Council seeks to achieve an acceptable rate of return on all its equity investments consistent with the nature of the investment and their stated philosophy on investments.

Dividends received from CCO's and unlisted companies not controlled by the Council are recognised when they are received in the consolidated revenue account.

Any purchase or disposition of equity investments requires Council approval and any profit or loss arising from the sale of these investments is to be recorded in accordance with appropriate accounting standards.

Any purchase or disposition of equity investments will be reported to the next meeting of the Council.

Unless otherwise directed by the Council, the proceeds from the disposition of equity investments will be used firstly to repay any debt relating to the investment and then included in the relevant consolidated capital account.

The Council recognises that there are risks associated with holding equity investments and to minimise these risks, the Council through the relevant sub-committee, monitors the performance of its equity investments on a twice yearly basis to ensure that the stated objectives are being achieved. The Council seeks professional advice regarding its equity investments when it considers this appropriate.

Property Investments

The Council's overall objective is to only own property that is necessary to achieve its strategic objectives. As a general rule, the Council will not maintain a property investment where it is not essential to the delivery of relevant services, and property is only retained where it relates to a primary output of the Council. The 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. The Council generally follows similar assessment criteria in relation to new property investments.

The Council reviews the performance of its property investments on a regular basis.

All income, including rentals and ground rent from property investments is included in the consolidated revenue account.

Forestry

Forestry assets are held as long term investments on the basis of net positive discounted cashflows, factoring in projected market prices and annual maintenance and cutting costs.

All income from forestry is included in the consolidated revenue account.

Any disposition of these investments requires Council approval. The proceeds from forestry disposition are used firstly to repay related borrowings and then included in the relevant consolidated capital account.

Financial Investments

The 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. The 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.
- Interest income from financial investments is credited to general funds, except for income from investments for special funds, reserve funds and other funds where interest may be credited to the particular fund.
- Internal borrowing will be used wherever possible to avoid external borrowing.
- Financial investments do not include shares.

Financial Investment Objectives

The Council's primary objectives when investing is the protection of its investment capital. Accordingly, the Council may only invest in approved creditworthy counterparties. Creditworthy counterparties and investment restrictions are covered in section 6.3. Credit ratings are monitored and reported quarterly to the Council.

The Council may invest in approved financial instruments as set out in section 6.1.2. These investments are aligned with the Council's objective of investing in high credit quality and highly liquid assets.

Special Funds and Reserve Funds

Liquid assets are not required to be held against special funds and reserve funds. Instead the Council will internally borrow or utilise these funds where ever possible.

Unless otherwise directed by the Council, internal borrowing to/(from) reserves will be undertaken at the external cost of borrowing.

Trust Funds

Where the 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. If the Trusts investment policy is not specified then this policy should apply.

New Zealand Local Government Funding Agency Limited

Despite anything earlier in this Investment Policy, 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. 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.

Because of these dual objectives, 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.

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

**Investment
management and
reporting procedures**

The Council's investments are managed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed through the Daily Cash Position Report, and long-term cash flow through the annual Cash flow Forecast. To best manage funding gaps, the Council's financial investment maturities are matched with the Council's forecast cash flow requirements.

The performance of Council investments is regularly reviewed to ensure the Council's strategic objectives are being met. Both performance and policy compliance are reviewed through regular reporting.

6. Risk recognition/identification/management

The definition and recognition of interest rate, liquidity, funding, investment, counterparty credit, market, operational and legal risk of the Council will be as detailed below and applies to both the Liability Management policy and Investment policy.

Interest rate risk

Risk Recognition

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

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

Approved Financial Instruments

Dealing in interest rate products must be limited to financial instruments approved by the Council.

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

Category	Instrument
Cash management and borrowing	Bank overdraft Committed cash advance and bank accepted bill facilities (short term and long term loan facilities) Loan stock /bond issuance Floating Rate Note (FRN) Fixed Rate Note (Medium Term Note/Bond) Uncommitted money market facilities Commercial paper (CP) / Promissory notes
Investments	Short term bank deposits Bank certificates of deposit (RCDs) Treasury bills NZ Government, Local Authority bonds and FRNs (secured/senior) LGFA borrower notes / CP / bills / bonds/ FRNs (floating rate notes) Local Authority promissory notes, Commercial paper (secured/senior)

Interest rate risk management	<p>Forward rate agreements (“FRAs”) on:</p> <p>Bank bills</p> <p>Government bonds</p> <p>Interest rate swaps including:</p> <p>Forward start swaps (start date <24 months, unless linked to existing maturing swaps)</p> <p>Amortising swaps (whereby notional principal amount reduces)</p> <p>Swap extensions and shortenings</p> <p>Interest rate options on:</p> <p>Bank bills (purchased caps and one for one collars)</p> <p>Government bonds</p> <p>Interest rate swaptions (purchased swaptions and one for one collars only)</p>
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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.

All unsecured investment securities must be senior in ranking. The following types of investment instruments are expressly excluded;

Structured debt where issuing entities are not a primary borrower/ issuer.

Sub-ordinated debt, junior debt, perpetual notes and debt/equity hybrid notes such as convertibles.

Interest Rate Risk Control Limits

Net Debt/Borrowings

Exposure to interest rate risk is managed and mitigated through the risk control limits below. Council debt/borrowings should be within the following fixed/floating interest rate risk control limit:

Master Fixed/Floating Risk Control Limit

Minimum Fixed Rate	Maximum Fixed Rate
50%	90%

“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 net debt level calculated by management (signed off by the CEO, or equivalent). Net debt is the amount of total debt net of cash and cash equivalent financial investments. This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to ensure compliance with the policy minimums and maximums.

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

Fixed Rate Maturity Profile Limit		
Period	Minimum Cover	Maximum Cover
1 to 3 years	15%	60%
3 to 5 years	15%	60%
5 years plus	10%	60%

A fixed rate maturity profile that is outside the above limits, but self corrects in less than 90-days is not in breach of this Policy. However, maintaining a maturity profile beyond 90-days requires specific approval by the 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 the Council.
- Interest rate options must not be sold outright. However, 1:1 collar option structures are allowable, whereby the sold option is matched precisely by amount and maturity to the simultaneously purchased option. During the term of the option, only the sold side of the collar can be closed out (i.e. repurchased) otherwise, both sides must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate “in-the-money”.
- Purchased borrower swaptions mature within 12 months.
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00% above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation.
- Forward start period on swaps and collar strategies to be no more than 24 months, and the underlying cap or swap starts within this period, unless the forward start swap/collar starts on the expiry date of an existing swap/collar and has a notional amount which is no more than that of the existing swap/collar.

Special and General Reserve Funds

Given that the Council may require funding for capital expenditure cash shortfalls over the remaining life of the existing special and general reserve funds, where such funds are deemed necessary they should be used for internal borrowing purposes when external borrowing is required. Accordingly the 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.

This will negate counterparty credit risk and any interest rate repricing risk that occurs when the Council borrows at a higher rate compared to the investment rate achieved by Special / Reserve Funds.

Liquid assets will not be required to be held against special funds or reserve funds unless such funds are held within a trust requiring such, instead the Council will manage these funds using internal borrowing facilities.

Foreign Currency

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

Generally, all significant commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts can be used by the Council.

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

**Liquidity
Risk/Funding
Risk**

Risk Recognition

Cash flow deficits in various future periods based on long term financial forecasts are reliant on the maturity structure of cash, 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 the same or more favourable pricing (fees and borrowing margins) and maturity terms of existing loans and facilities.

The management of the Council's funding risks is important as several risk factors can arise to cause an adverse movement in borrowing margins, term availability and general flexibility including:

- Local Government risk is priced to a higher fee and margin level
- The Council's own credit standing or financial strength as a borrower deteriorates due to financial, regulatory or other reasons
- A large individual lender to the Council experiences their own financial/exposure difficulties resulting in the Council not being able to manage their debt portfolio as optimally as desired
- New Zealand investment community experiences a substantial "over supply" of Council investment assets
- Financial market shocks from domestic or global events.

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 if any of the above events occur, the overall borrowing cost is not unnecessarily increased and desired maturity profile compromised due to market conditions.

Liquidity/Funding Risk Control Limits

- 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.
 - External, term loans and committed debt facilities together with available liquid investments/cash equivalents must be maintained at an amount of 110% over existing external debt.
 - The CEO has the discretionary authority to re-finance existing debt on more favourable terms. Such action is to be reported and ratified by the Council at the earliest opportunity.
 - The Council has the ability to pre-fund up to 12 months of forecast debt requirements including re-financings.
 - The maturity profile of the total committed funding in respect to all external debt/loans and committed debt facilities, is to be controlled by the following system and apply when external debt exceeds \$25 million:
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Period	Minimum	Maximum
0 to 3 years	15%	60%
3 to 5 years	15%	60%
5 years plus	10%	60%

A maturity schedule outside these limits will require specific Council approval.

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 the 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 Council. Treasury related transactions would only be entered into with organisations specifically approved by the Council.

Counterparties and limits can only be approved on the basis of long-term credit ratings (Standard & Poor’s, Fitch or Moody’s) being A+ and above or short term rating of A-1 or above.

Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

The following matrix guide will determine limits.

Counterparty/Issuer	Minimum S&P long term / short term credit rating – stated and possible	Investments maximum per counterparty (\$m)	Interest rate risk management instrument maximum per counterparty (\$m)	Total maximum per counterparty (\$m)
NZ Government	N/A	Unlimited	none	Unlimited
Local Government Funding Agency LGFA	AA-/A-1	20.0	N/A	20.0
NZ Registered Bank [name]	A+ / A-1	10.0	10.0	20.0
Local Government Stock/ Bonds/ FRN/ CP [name]*	A+ / A-1	2.0	none	5.0
<ul style="list-style-type: none"> * Subject to a maximum exposure no greater than 10% of the portfolio being invested in Local Government debt at any one point in time. The maximum portfolio exposure limit does not apply to the LGFA. <p>This summary list will be expanded on a counterparty named basis which will be authorised by the CEO</p>				

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

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

Each transaction should be entered into a treasury spreadsheet and a quarterly report prepared to show assessed counterparty actual exposure versus limits.

Individual counterparty limits are kept in a spreadsheet by management and updated on a day to day basis. Credit ratings should be reviewed by the MSS on an ongoing basis and in the event of material credit downgrades; this should be immediately reported to the CEO and assessed against exposure limits. Counterparties exceeding limits should be reported to the Council.

Investments are normally held to maturity date. Where investments are liquidated before legal maturity date, approval is obtained from the CEO.

Risk Management

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

Operational risk

Operational risk is the risk of loss as a result of human error (or fraud), system failures and inadequate procedures and controls.

Operational risk is very relevant when dealing with financial instruments given that:

- Financial instruments may not be fully understood
- Too much reliance is often placed on the specialised skills of one or two people
- Most treasury instruments are executed over the phone
- Operational risk is minimised through the adoption of all requirements of this policy.

Dealing Authorities and Limits

Transactions will only be executed by those persons and within limits approved by the Council.

Segregation of Duties

As there are a small number of people involved in borrowing and investment activity, adequate segregation of duties among the core borrowing and investment functions of deal execution, confirmation, settling and accounting/reporting is not strictly achievable. The risk will be minimised by the following process:

- The MSS reports directly to the CEO.
- The FO independently cross checks the external bank confirmations with any irregularities reported directly to the CEO.
- There is a documented approval process for borrowing, interest rate and investment activity.

Procedures

All treasury instruments should be recorded and diarised within a treasury spreadsheet, with appropriate controls and checks over journal entries into the general ledger. Deal capture and reporting must be done immediately following execution/confirmation. Details of procedures including templates of deal tickets should be compiled in a treasury procedures manual separate to this policy.

Procedures should include:

- Regular management reporting.
- Regular risk assessment, including review of procedures and controls as directed by the Council or appropriate sub-committee of Council.
- Organisational, systems, procedural and reconciliation controls to ensure:
 - All borrowing, interest rate and investment activity is bona fide and properly authorised.
 - Checks are in place to ensure Council accounts and records are updated promptly, accurately and completely.
 - All outstanding transactions are revalued regularly and independently of the execution function to ensure accurate reporting and accounting of outstanding exposures and hedging activity.

Organisational Controls

- The MSS, or equivalent has responsibility for establishing appropriate structures, procedures and controls to support borrowing, interest rate and investment activity.
- All borrowing, investment, cash management and interest rate risk management activity is undertaken in accordance with approved delegations authorised by the Council.

Cheque /Electronic Banking Signatories

- Positions approved by the CEO as per register.
- Dual signatures are required for all cheques and electronic transfers.
- Cheques must be in the name of the counterparty crossed “Not Negotiable, Account Payee Only”, via the Council bank account.

Authorised Personnel

- All counterparties are provided with a list of personnel approved to undertake transactions, standard settlement instructions and details of personnel able to receive confirmations.

Recording of Deals

- All deals are recorded on properly formatted deal tickets by the MSS and approved as required by the CEO. Deal summary records for borrowing, investments, interest rate risk management and cash management transactions (on spreadsheets) are maintained by the MSS and updated promptly following completion of transaction.

Confirmations

- All inward letter confirmations including LGFA/bank funding registry confirmations are received and checked by the FO against completed deal tickets and the treasury spreadsheet records to ensure accuracy.
- All deliverable securities are held in the Council’s safe.
- Deals, once confirmed, are filed (deal ticket and attached confirmation) by the FO in deal date/number order.
- The MSS checks all dealing activity, deal tickets and confirmations monthly, to ensure documentation is in order.
- Any discrepancies arising during deal confirmation checks which require amendment to the Council records are signed off by the CEO.

Settlement

- The majority of borrowing, interest rate and investment payments are settled by direct debit authority.
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- For electronic payments, batches are set up electronically. These batches are checked by the MSS to ensure settlement details are correct. Payment details are authorised by two approved signatories as per Council registers or by direct debit as per setup authority by the Council.

Reconciliations

- Bank reconciliations are performed monthly by the FO and checked and approved by the MSS. Any unresolved unreconciled items arising during bank statement reconciliation which require amendment to the Council's records are signed off by the CEO.
- A monthly reconciliation of the treasury spreadsheet to the general ledger is carried out by the FO and reviewed by the CEO.
- Interest income from the treasury spreadsheet is reconciled to bank statements by the FO.

Legal risk

Legal and regulatory 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. While legal risks are more relevant for banks, the Council may be exposed to such risks. In the event that the Council is unable to enforce its rights due to deficient or inaccurate documentation.

The 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.

Agreements

Financial instruments can only be entered into with banks that have in place an executed ISDA Master Agreement with the Council.

The Council's internal/appointed legal counsel must sign off on all documentation for new loan borrowings, re-financings and investment structures.

Financial Covenants and Other Obligations

The Council must not enter into any transactions where it would cause a breach of financial covenants under existing contractual arrangements.

The Council must comply with all obligations and reporting requirements under existing funding facilities and legislative requirements.

7. Measuring treasury performance

In order to determine the success of Hurunui District 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 (operational performance and management of debt and interest rate risk) are to be reported to Hurunui District Council or an appropriate sub-committee of Hurunui District Council on a quarterly basis.

Operational performance

All Treasury Risk Management Policy limits must be complied with including (but not limited to) counterparty credit limits, control limits and exposure limits.

All treasury deadlines are to be met, including reporting deadlines.

Management of Debt and Interest Rate Risk (borrowing risks)

The actual borrowing cost for Hurunui District Council (taking into consideration costs/benefits of entering into interest rate risk management transactions) should be below the budgeted YTD/ annual interest cost amount.

Actual wholesale interest costs must be benchmarked to a market interest rate. The market interest rate is the mid-point policy benchmark rate. The benchmark is constructed as follows:

- 27.50% 3-month BKBM interest rate (average of reporting month)
 - 14.50% 5-year fixed swap interest rate, 1 year ago
 - 14.50% 5-year fixed swap interest rate, 2 years ago
 - 14.50% 5-year fixed swap interest rate, 3 years ago
 - 14.50% 5-year fixed swap interest rate, 4 years ago
 - 14.50% 5-year fixed swap interest rate, 5 years ago
- = 100%.
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8. Cash management

The MSS has the responsibility to carry out the day-to-day cash and short-term debt management activities. All cash inflows and outflows pass through bank accounts controlled by the finance function.

The daily cash management function and investment of operational surpluses for Hanmer Springs Thermal Pools and Spa is managed by local accounting staff.

- The MSS will calculate and maintain comprehensive cash flow projections on a daily (two weeks forward), weekly (four weeks forward) and monthly (12 months forward) basis. These cash flow forecasts determine Hurunui District Council's borrowing requirements and surpluses for investment.
 - On a daily basis, electronically download all Hurunui District Council bank account information.
 - Co-ordinate Hurunui District Council's operating units to determine daily cash inflows and outflows with the objective of managing the cash position within approved parameters.
 - Undertake short term borrowing functions as required, minimising overdraft costs.
 - Ensuring efficient cash management through improvement to accurate forecasting using spreadsheet modelling.
 - Minimise fees and bank/government charges by optimising bank account/facility structures.
 - Monitor Hurunui District Council's usage of overdraft and cash advance facilities. Overdraft facilities are utilised as little as practical. Committed bank overdraft facilities of not more than \$500,000 are maintained.
 - Ideally, Hurunui District Council will hold \$100,000 in the cheque account, with surplus cash transferred to an interest bearing current account.
 - Match future cash flows to smooth overall timeline.
 - Provide reports detailing actual cash flows during the month compared with those budgeted.
 - Maximise the return from available funds by ensuring significant payments are made within the vendor's payment terms, but no earlier than required, unless there is a financial benefit from doing so.
 - Interest rate management on cash management balances is not permitted.
 - Cash is invested for a term of no more than 3 months and in approved instruments and counterparties only.
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9. Reporting – performance measurement

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

Treasury reporting

Reporting

The following reports are produced:

Report Name	Frequency	Prepared by	Recipient
Daily Cash Position Treasury Spreadsheet	Daily	Management/Financial Accountant	MSS
Treasury Report <ul style="list-style-type: none"> • Treasury Risk Management Policy compliance • Borrowing limits • Funding and Interest Position Profile • Funding facility • New treasury transactions • Cost of funds vs. budget • Cashflow forecast report • Liquidity risk position • Counterparty credit • Treasury performance • Funding and interest rate strategy commentary • Treasury exceptions 	Monthly	MSS	FARC
Half-yearly Financial Statements Half-yearly Reporting Certificate	Six monthly	MSS	Trustee
Annual Report Annual Reporting Certificate Auditors Report Insurance Certificate Annual Plan/Long Term Plan	Annual	MSS	Trustee
Revaluation of financial instruments	Annual	MSS	FARC
LGFA compliance report	Annual	MSS	LGFA

**Accounting
Treatment of
Financial
Instruments**

Hurunui District Council uses financial arrangements (“derivatives”) for the primary purpose of reducing financial risk to fluctuations in interest rates. The purpose of this section is to articulate Hurunui District Council’s accounting treatment of derivatives in a broad sense. Further detail of accounting treatment is contained within the appropriate operations and procedures manual.

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

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

The MSS is responsible for advising the CEO of any changes to relevant New Zealand Public Sector PBE Standards, which may result in a change to the accounting treatment of any financial derivative product.

**Valuation of
Treasury
Instruments**

All treasury financial instruments must be revalued (marked-to-market) at least annually for risk management purposes. This includes those instruments that are used only for hedging purposes.

Underlying rates to be used to value treasury instruments are as follows:

- Official daily settlement prices for established markets;
 - Official daily market rates for short term treasury instruments (e.g. FRA settlement rates calculated by Reuters from price maker quotations as displayed on the BKBM page);
 - Relevant market mid-rates provided by Hurunui District Council’s bankers at the end of the business day (5.00pm) for other over-the-counter treasury instruments;
 - For markets that are illiquid, or where market prices are not readily available, rates calculated in accordance with procedures approved by the MSS.
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10. Policy review

This Treasury Risk Management Policy is to be formally reviewed on a triennial basis and annually for internal purposes.

The MSS, or equivalent, has the responsibility to prepare the annual review report that is presented to the Hurunui District Council or the Finance Audit and Risk Committee. The report will include:

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

The Hurunui District Council receives the report, approves Treasury Risk Management Policy changes and/or reject recommendations for Treasury Risk Management Policy changes.

END OF POLICY