MASTERTON DISTRICT COUNCIL

Treasury Management Policy

Including Liability Management and Investment Policies

Final

Council Approved: 25th March 2015

CONTENTS

1.0 Introduction

1.1. Policy purpose

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

As circumstances change, the policies and procedures outlined in this Policy will be modified to ensure that treasury risks within MDC continue to be well managed. 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 MDC.
- The risk bearing ability and tolerance levels of the underlying revenue and cost drivers.
- The effectiveness and efficiency of the Policy and treasury management function to recognise, measure, control, manage and report on MDC'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 MDC in achieving strategic objectives.

It is intended that the Policy be distributed to all personnel involved in any aspect of the MDC's financial management. In this respect, all staff must be completely familiar with their responsibilities under the Policy at all times.

2.0 Scope and objectives

2.1 Scope

- This document identifies the Policy of MDC in respect of treasury management activities.
- The Policy has not been prepared to cover other aspects of MDC's operations, particularly transactional banking management, systems of internal control and financial management. Other policies and procedures of MDC cover these matters.

2.2 Treasury management objectives

The objective of this Policy is to control and manage costs, investment returns and risks associated with treasury management activities.

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.
- MDC 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 ll Investments.

- All projected external borrowings are to be approved by Council as part of the Annual Plan or the Long Term Plan (LTP) process, or resolution of Council before the borrowing is effected.
- All legal master documentation in respect to external borrowing and financial instruments will be approved by Council's solicitors prior to the transaction being executed.
- Council will not enter into any borrowings denominated in a foreign currency.
- Council will not transact with any Council Controlled Trading Organisation (CCTO) on terms more favourable than those achievable by Council itself.
- A resolution of Council is not required for hire purchase, credit or deferred purchase of goods if:
  - The period of indebtedness is less than 5 years (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

- Minimise Council's costs and risks in the management of its external borrowings.
- Minimise 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 Policy so as to protect Council's financial assets and manage costs.
- Arrange and structure external long term funding for Council at a favourable margin and cost from debt lenders. Optimise flexibility and spread of debt maturity terms within the funding risk limits established by this Policy statement.
- Monitor and report on financing/borrowing covenants and ratios under the obligations of Council's lending/security arrangements.
- Comply with financial ratios and limits stated within this Policy.
- Manage investments to optimise returns in the long term whilst balancing risk and return considerations.
- Safeguard Council's financial assets and investment capital.
- Monitor 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 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.
- Ensure that financial planning will not impose an unequitable spread of costs/benefits over current and future ratepayers.
- To ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, LGFA, investors and investment counterparties.

In meeting the above objectives Council is, above all, a risk averse entity and does not seek risk in its treasury activities. Interest rate risk, liquidity risk, funding risk, default or credit risk, and operational risks are all risks which the Council seeks to manage, not capitalise on. Accordingly activity which may be construed as speculative in nature is expressly forbidden.

2.3 Policy setting and Management

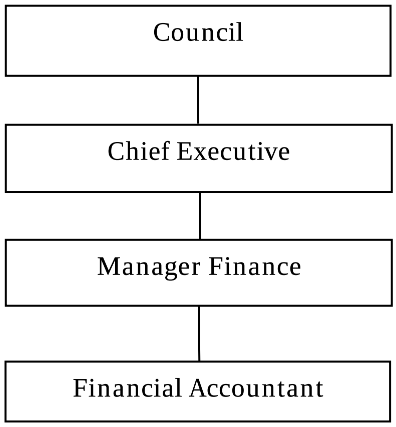
The Council approves Policy parameters in relation to its treasury activities. The Council's Chief Executive has overall financial management responsibility for the Council's borrowing and investments.

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

3.0 Governance and management responsibilities

3.1 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:



3.2 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, given the underlying objectives of MDC.

The Council is responsible for approving the 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 the long-term financial position of MDC through the Long Term Plan (LTP) and Financial Strategy along with the adopted Annual Plan.
- Approve and adopt the Liability Management and Investment Policies (the Treasury Management Policy).
- Approval for one-off transactions falling outside Policy.
- Approve amendments to various control limits and approved instruments.
- Review the treasury management process through regular standard reporting.
- Review formally, on a three yearly basis, the Treasury Management Policy document.
- Report to the public via the Council's Annual Plan and Annual Report.

3.3 Chief Executive (CE)

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.

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

- Overall responsibility for all activities relating to implementation and maintenance of the approved Treasury Management Policy. The CE has oversight, and approves actions undertaken by the Manager Finance and Financial Accountant per delegated authority.
- Approve amendments to bank facilities.
- Review with the Management Team the quarterly management reports to monitor compliance with policies, procedures and risk limits.
- Recommend with the Management Team, amendments to the treasury policies and procedures for Council approval.

3.4 Manager Finance

The Manager Finance's responsibilities are as follows:

- Responsibility for setting investment, borrowing and risk management strategy.
- Determines the most appropriate source of borrowing and investment strategy. Reviews and approves borrowing and investment activities.
- Manage Council's interest rate profile within prescribed limits.
- Approves all treasury deal tickets and approves actions undertaken by the Financial Accountant per delegated authority.
- Signs and checks all treasury deal confirmations against the treasury spreadsheet/deal ticket.
- Check all settlement of external borrowing, investment, cash management, and interest rate management transactions.
- Make day-to-day investment decisions, in conjunction with the Financial Accountant, based on competitive rate quotes and knowledge of the Council's cash flow requirements.
- Responsible for keeping the CE informed of significant treasury activity and market trends.
- Manage the process of selecting fund managers and appointing brokers/investment advisers and oversee negotiations of borrowing facilities with financial institutions.
- Manage Council's relationship with financial institutions, LGFA, brokers, and fund managers.
- Liaise and negotiate with bankers/brokers/the LGFA for issue of debt.
- Review and manage Council's cashflow forecasts.
- Review and approve reconciliations of investment/cash management spreadsheet to general ledger.
- Review and approve bank reconciliations.
- Approve cancellation of bank facilities.
- Act as back up dealer in Financial Accountant's absence.
- Report quarterly to Management group and annually to Council on Council indebtedness, interest rate and debt maturity profiles, debt servicing costs to budget, investment income and investment portfolio profile.
- Ensure compliance to Policy risk control limits.
- Conduct review of Policy.

3.5 Financial Accountant

The Financial Accountant's responsibilities are as follows:

- Execution of external borrowing, investment, and interest rate management transactions in accordance with set limits, including the completion of deal tickets to record transactions.
- Liaise with banks and brokers regarding investment options and market rate quotes.
- Update treasury spreadsheets for all new, re-negotiated and maturing transactions.
- Complete monthly reconciliation of all treasury spreadsheets to general ledger.
- Complete Council's cashflow forecasts and report to Manager Finance.

- Manage the day-to-day cash position, including short term investment of surplus funds.
- Reconciles bank statements, including responsibility for accuracy of cash receipts and payments records.

3.6 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 Council.

Whenever a person with delegated authority on any account or facility leaves 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.

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

Activity	Delegated Authority	Limit
Approving and changing Policy	Council	Unlimited
Approve external borrowing for year as set out in the AP/LTP.	Council	Unlimited (subject to legislative and other regulatory limitations)
Acquisition and disposition of investments other than financial investments	Council	Unlimited
Approval for charging assets as security over borrowing	Council	Unlimited
Arranging new and reviewing re-financed bank facilities/debt issuance.	CE (delegated by Council) Manager Finance	Per Council resolution Subject to Policy
Approving transactions outside Policy	Council	Unlimited
Overall day-to-day treasury management	CE (delegated by Council) Manager Finance	Subject to Policy
Approve new external borrowing in accordance with Council resolution or through the adoption of the AP/LTP.	CE	Per Council approved AP/LTP
Approve financial investments	CE Manager Finance	Subject to Policy Per risk control limits
Manage borrowing and interest rate strategy, debt and investments	CE Manager Finance	N/A
Adjust debt/investment interest rate risk, and debt/investment profiles	CE Manager Finance	Per risk control limits
Managing funding and investment maturities	CE Manager Finance Financial Accountant	Per risk control limits
Maximum daily transaction amount (borrowing, investing, interest rate risk management and cash management) excludes roll-overs on debt and interest rate swaps.	Council CE Manager Finance	Unlimited $2oM $10M

Manage cash/liquidity requirements	Manager Finance Financial Accountant	Per risk control limits
Authorising list of signatories	CE	Unlimited
Opening/closing bank accounts	CE	Unlimited
Triennial review of Policy	Manager Finance	N/A
Ensuring compliance with Policy	Manager Finance	N/A

All management delegated limits are authorised by the CE.

4.0 Liability Management Policy

4.1 Introduction

Council's liabilities comprise of borrowings (external/internal) and various other liabilities. Council maintains external borrowings in order to:

- Raise specific debt associated with projects and capital expenditures.
- Fund the balance sheet as a whole, including working capital requirements.
- Fund assets whose useful lives extend over several generations of ratepayers.

Borrowing provides a basis to achieve inter-generational equity by aligning long-term assets with long-term funding sources, and ensure that the cost are met by those ratepayers benefiting from the investment.

4.2 Borrowing limits

Debt will be managed within the following limits:

Item	Borrowing Limit
Net External Debt / Total Revenue	<150%
Net Interest on External Debt / Total Revenue	<10%
Net Interest on External Debt / Annual Rates Income	<15%
Net Interest on Internal and External Debt / Annual Rates Income	<20%
Liquidity (External, term debt + committed loan facilities + cash/cash equivalents to existing external debt)	>110%

- Total Revenue is defined as cash earnings from rates, government capital 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 cash/cash equivalent financial investments (excluding the long term portion of Council's externally managed investment funds).
- As Council's externally managed investment funds are managed and reported separately, this investment is excluded from the liquidity ratio and net interest ratios.
- The liquidity ratio is defined as external term debt plus committed bank facilities, plus cash/cash equivalents divided by current external debt. The liquidity ratio excludes cash/cash equivalents held within Council's externally managed investment funds.
- 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 (and excludes interest from Council's externally managed investment funds).
- 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).
- Financial covenants are measured on Council only not consolidated group.
- Disaster recovery requirements are to be met through the liquidity ratio and special funds.

4.3 Asset management plans

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

4.4 Borrowing mechanisms

Council is able to externally borrow through a variety of market mechanisms including issuing stock/bonds, commercial paper (CP) and debentures, direct bank borrowing, the LGFA, accessing the short and long-term wholesale/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 following is taken into account:

- Available terms from banks, the LGFA, debt capital markets and loan stock issuance.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and margins relative to term for loan stock issuance, the LGFA, debt capital markets and bank borrowing.
- The market's outlook on future interest rate movements as well as its own.
- Legal documentation and financial covenants 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.

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, the LGFA, and financial institutions/brokers.

4.5 Security

Council's external borrowings and interest rate management instruments will generally be secured by way of a charge over rates and rates revenue offered through a Debenture Trust Deed. Under a Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Local Government Rating Act. The security offered by Council ranks equally or pari passu with other lenders.

From time to time, and with Council approval, security may be offered by providing a charge over one or more of Councils 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. project finance).
- 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.

4.6 Debt repayment

The funds from all asset sales, operating surpluses, grants and subsidies will be applied to specific reserves and may be applied to 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 borrowing arrangement. An annual sum of debt repayment will be budgeted and funded to ensure intergenerational equity is achieved for those ratepayers who are receiving the benefit of the project which has been debt-funded. Subject to the appropriate approval and debt limits, a loan may be rolled over or re-negotiated as and when appropriate.

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

4.7 Guarantees/contingent liabilities and other financial arrangements

Council may act as guarantor to financial institutions on loans or enter into incidental arrangements for organisations, clubs, Trusts, or Business Units, when the purposes of the loan are in line with Council's strategic objectives.

Council is not allowed to guarantee loans to Council-controlled trading organisations under Section 62 of the Local Government Act.

Council will ensure that sufficient funds or lines of credit exist to meet amounts guaranteed. Guarantees given will not exceed any amount agreed by Council or an appropriate Council Committee in aggregate. The Manager Finance monitors guarantees and reports quarterly to Council.

Other financial arrangements include:

- Rural water supply loans/deficit funding.
- Guarantees or advances to community organisations.

Conditions to financial arrangements, such as loan advances, are specified in section 5.8.

4.7.1 Staff Liabilities

The Council has a liability due to a number of long term staff in respect to a Retirement Gratuity scheme. The scheme has been closed or 'grandfathered' so that the liability only grows with salary market movements and is reduced as those long term staff reach retirement.

4.8 Internal borrowing

Internal loans sourced from the Council's reserve funds are allowed as a valid means of funding projects, minimising the cost of borrowing while providing a market return on investment funds.

Council's internal borrowing needs have traditionally revolved around expansion or renewal of its assets. Hence the existing internal borrowing is tied to assets and the cost centres associated with those assets.

Council has sought to minimise loan administration costs by structuring loans to enable repayments to be spread over a sanctioned period based on repayments tables, without the use of sinking funds.

This Policy anticipates a continuation of the use of internal borrowing structures where interest and repayments are sourced from operating budgets (generally funded by rates income). Where appropriate, inflation factors may be built into loan repayment tables to better reflect the ability of the community to pay in the future and avoid overcharging current ratepayers. The inflation adjusted debt service cost allows room to absorb interest rate fluctuations and provide more predictable cash flow projections.

In general Council, in arranging future internal borrowing under this Policy, will seek to build repayment flexibility into the loan structures. The Council has sought to manage the risks associated with interest rate movement through the use of flexibly structured repayment loan tables.

The internal borrowing rate will be set as the mid-point between the actual average six month rate achieved on investments and actual average six month rate achieved on external borrowing. This interest rate will be reset six-monthly.

4.9 New Zealand Local Government Funding Agency (LGFA) Limited

Despite anything earlier in this 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:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA. For example borrower notes.

- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself.
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required.
- 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.
- Subscribe for shares and uncalled capital in the LGFA.

5.0 Investment Policy

5.1 Introduction

Council generally holds investments for strategic reasons where there is some asset, 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 Council. Specific purposes for maintaining investments include:

- For strategic purposes consistent with Council's LTP.
- The retention of vested land.
- Holding short term investments for working capital requirements.
- Holding investments that are necessary to carry out Council operations consistent with Annual Plans, to implement strategic initiatives, or to support inter-generational allocations.
- Holding assets (such as property) for commercial returns.
- 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 (including insurance recoveries).
- Invest amounts allocated to accumulated surplus, Council created restricted reserves and general reserves.
- To earn a market return to apply to reduce current rates.
- Invest proceeds from the sale of assets.
- For strategic purposes consistent with Council's local economic development initiatives.

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

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

5.2 Objectives

In its financial investment activity, 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 creditworthy 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.

5.3 Policy

The Council's general Policy on investments is that:

- The Council may hold financial, property, forestry, and equity investments if there are strategic, commercial, economic or other valid reasons (e.g. where it is the most appropriate way to deliver or administer a Council function).
- The Council will keep under review its approach to all major investments and the credit rating of approved financial institutions.
- The Council will review its policies on holding investments at least once every three years.

5.4 Acquisition of new investments

With the exception of financial investments, new investments are acquired if an opportunity arises and approval is given by Council, based on advice and recommendations from Council officers. Before approving any new investments, Council gives due consideration to the contribution the investment will make in fulfilling Council's strategic objectives, and the financial risks of owning the investment.

The authority to acquire financial investments is delegated to the CE and Manager Finance and reported to Council on a quarterly basis.

5.5 Equity investments

Equity investments, including investments held in CCO/CCTO and other shareholdings.

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

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.

Any purchase or disposition of equity investments requires Council approval. Council may also acquire shares that are gifted or are a result of restructuring.

Dividends received from CCO's/CCTO's and unlisted companies not controlled by Council are used firstly to repay debt in relation to that investment. Then, unless otherwise directed by Council, used to reduce other Council debt.

Any dividends received, and/or profit or loss arising from the sale of these investments must be recorded in accordance with appropriate accounting standards. Unless otherwise directed by Council, the proceeds from the disposition of equity investments will be used firstly to repay any debt relating to the investment and then utilised to reduce other council debt. Council recognises that there are risks associated with holding equity investments and to minimise these risks Council, through the relevant Council-committee, monitors the performance of its equity investments on a twice yearly basis to ensure that the stated objectives are being achieved. Council seeks professional advice regarding its equity investments when it considers this appropriate.

5.5.1 Current Equity / Share Investments

Council's shareholdings are minor. A shareholding is held in the New Zealand Local Government Insurance Co. Limited (trading as Civic Assurance), along with almost all other local authorities. This holding was increased in 2012 and is, in part, a risk management strategy to ensure there is adequate competition in the specialist local government insurance market, however since the Canterbury earthquakes Civic have not been an insurance provider. The success of this investment is best measured as the long term stability of the availability of insurance to Council.

Council became an establishment shareholder of the NZ Local Government Funding Agency Limited (LGFA) in 2011, supporting the establishment of the entity which seeks to enable councils to source debt funding at margins which reflect the sector's quality security/low risk nature.

Council also has a small shareholding in a local company (Airtel Ltd) which operates radio telephone channels utilised by the Council and a number of other local businesses.

It is envisaged that any other equity investments which the Council may hold in the future will only be as a result of gift or through the restructuring of the Council and the formation of a Council Controlled Organisation (CCO).

5.5.2 New Zealand Local Government Funding Agency Limited

Despite anything earlier in this 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:

- Obtain a return on the investment.
- Ensure that the LGFA has sufficient capital to remain viable, meaning that it continues as a source of debt funding for the Council.

Council may invest in LGFA bonds and commercial paper as part of its financial investment portfolio.

As a borrower, Council's investment is recognised through shares and borrower notes. As an investor in LGFA shares and as a Guarantor, Council subscribes for uncalled capital in the LGFA.

5.6 Property investments

Council owns property investments for strategic and commercial purposes. Council reviews ownership through assessing the benefits including financial returns, in comparison to other arrangements that could deliver the similar results.

Surpluses generated from commercial and semi commercial property investments are treated as an internal dividend to Council. Other surpluses from property are treated as income in the related Council activity.

Property disposals are managed to ensure compliance with statutory requirements and where appropriate consultation with local communities.

Property purchases are supported by registered valuations and where appropriate a full business case analysis. Council will not purchase properties on a speculative basis.

Council's property holdings for the provision of such services as Housing for the Elderly, the district building and housing of community groups are not considered property investments under this Policy. Council may acquire property related to the provision or expansion of a service i.e. sewage treatment land or a commercially leased portion of a Council facility. Again, these will not be considered as property investments.

Council defines as Investment Property, those properties owned by the Council which the Council is actively seeking to sell/dispose or those properties held for strategic purposes but are not part of Council's current service delivery needs. As a general rule, Council does not hold properties as commercial investments. Council may undertake property development initiatives and hold strategic property assets as it thinks appropriate within the local economy.

Property investments for commercial gain are not prohibited by this Policy (as they provide some protection against inflation) but there are liquidity risks associated with property and a limited local property market,. Where strategically valuable property becomes available, such investments are allowed under this Policy.

5.7 Other Investments

(1) Masterton Airport

The Airport is regarded by Council to be a strategic investment to ensure the provision of an adequate airport in the district. Investment in the extension of services will be done on the basis of serviced and potentially serviceable properties returning the capital investment to the Council as development occurs. The governance of the airport may one day be via a Council Controlled Organisation.

(2) Production Forestry

The former Borough and County Councils, at times during the 1970s and 1980s, planted blocks of forestry on Council land which was otherwise not productive. Some blocks provide roadside stability. These blocks are managed to ensure a maximum return is achieved at harvest. Expenditure incurred on these forestry blocks is expensed in the year incurred and the forest value is calculated annually based on the discounted net present value.

The majority of the mature forestry blocks are due for harvest in some 1 to 5 years (i.e. 2015 - 2020).

5.8 Financial investments

Objectives

Council's primary objectives when investing is the protection of its investment capital. Accordingly, Council may only invest in approved creditworthy counterparties. Creditworthy counterparties and investment restrictions are covered in section 6.5. Credit ratings are monitored and reported quarterly to Council.

Council may invest in approved financial instruments as set out in section 6.3. These investments are aligned with Council's objective of investing in high credit quality and highly liquid assets.

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. 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.
- Council may choose to hold specific reserves in cash and direct what happens to that investment income. In effect the income from financial investments will be an interest income stream into the Finance activity. The Finance activity then transfers interest into equity/special funds and reserves.
- Internal investments/borrowing can be used as an alternative to external borrowing.
- Financial investments do not include shares.

Special funds and reserve funds

Liquid assets are not required to be held against all special funds and reserve funds. Council may internally borrow or utilise these funds where possible.

Trust funds

Where 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 Trust's investment Policy is not specified then this Policy should apply.

Loan Advances

Council may provide advances to CCOs, CCTOs, charitable trusts and community organisations for strategic and commercial purposes. New loan advances are by Council resolution only. Council does not lend money, or provide any other financial accommodation, to a CCO or CCTO on terms and conditions that are more favourable than those that would apply if Council were borrowing the money or obtaining the financial accommodation.

Council does not lend to CCTO's on more favourable terms than what it can achieve itself, without charging any rate or rate revenue as security. Council is not allowed to guarantee loans to CCTO's under Section 62 of the Local Government Act.

Advances to charitable trusts, and community organisations do not have to be on a fully commercial basis. Where advances are made to charitable trusts and community organisations at below Councils cost of borrowing. The additional cost is treated as an annual grant to the organisation.

Council reviews performance of its loan advances on a regular basis to ensure strategic and economic objectives are being achieved.

The Manager Finance monitors loan advances and reports to Council quarterly.

5.8.1 External funds management

External fund managers will be appointed in the knowledge of and operate the portfolio according to, the investment guidelines outlined in this Policy.

Investments made through an external fund manager will be to a maximum of $10 million. Investments are limited to fixed income and cash/cash equivalent securities only.

Although fund managers have autonomy to manage the investments, Council has set parameters on their management of the portfolio as per the Council's Investment Policy. This Policy requires the following portfolio construction:

Asset	Allocation	Credit range
Government stock	30%-70%	AA to AAA
NZ registered bank	0%-70%	A to AA
Local authority stock & LGFA	10%-40%	A- to AAA
Corporate bonds & SOEs	10%-35%	BBB* to AAA
Disc. securities & cash	0% - 25%	

* Council restricts the fund manager to hold BBB rated corporate bonds and above, subject to the following restrictions: BBB rated bonds will be restricted to a maximum value $0.15m in any single bond and 5% of the total portfolio.

The credit restrictions for funds placed with any one institution (per section 6.5) do not apply to externally managed funds as the portfolio is required to be spread as above and funds are managed via a trustee. Having a separate Trustee for these funds (ANZ Nominees), has reduced the credit risk exposure for Council to the fund manager. In the unlikely event of the fund manager's demise, their creditors cannot call upon Council's funds.

- The investment objective is for Council's portfolio to exceed the return on the domestic fixed interest benchmark by 0.75% on a rolling twelve-month basis. Currently, the benchmark index is the ANZ Government Bond Index.
- Monthly and Quarterly Investment Reports provide a performance summary along with a Certificate of Continued Compliance, to ensure the investment guidelines are being adhered to.
- The fund manager's continuing appointment remains subject to satisfactory performance (i.e. exceeding the index by 0.75%) averaged over four years.
- Asset allocation is to be reviewed every three years.
- Any sustained unsatisfactory performance will lead to a re-tendering process.

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

5.8.2 Interest rate risk management for external funds management

This section refers to the externally managed investment portfolio which has a direct exposure to a change in interest rates, impacting the return and capital value of its fixed rate investments.

Management through the external fund manager implements interest rate risk management strategy by:

- Changing interest rate profiles by adjusting the average maturity of its investment portfolio.
- The use of risk management instruments to protect investment returns and/or to change interest rate and maturity profiles is permissible within this Policy, subject to independent external advice being sought.

The following interest rate risk management instruments may be used for interest rate risk management activity:

- Forward rate agreements (investor).
- Interest rate swaps (investor).
- Interest rate investor option products including floors, bond options and swaptions.
- Interest rate investor collars.

Selling interest rate options for the purpose of generating premium income is not permitted.

5.9 Internal loans / investments

The Policy permits the use of Council investment funds to be invested in Council capital projects, subject to Council's adoption of project debt funding via the annual planning cycle.

No more than half of the value of special funds and reserves balances is available for internal borrowing/investment. In general, smaller projects will be funded by way of internal loans.

The repayment period of any such internal investment/loan will match the life of the asset or a maximum of 20 years.

The internal borrowing rate will be set as the mid-point between the actual average six month rate achieved on investments and actual average six month rate achieved on external borrowing. This interest rate will be reset six-monthly. This interest rate reset approach will also apply in section 4.8 (internal borrowing).

Provision for repayment of the internal loan/investment will be by way of a repayment table designed to return the funds back to the Council's investment pool over the term of the internal loan. An inflation adjustment of the repayments is permitted as a means to achieve some intergenerational equity where capital projects are paid for by those who benefit from them.

Internal investments and loans will be accounted for within the Council's general ledger, but be shown net in the Annual Report, in line with generally accepted accounting practice (GAAP).

5.10 Departures from normal Policy

The Council may, in its discretion, depart from the Investment Policies where is considers that the departure would advance its broader social or other Policy objectives. Any resolution authorising an investment under this provision shall note that it departs from the Council's ordinary Policy and the reasons justifying that departure.

5.11 Investment management and reporting procedures

Investments that are managed directly by the Council are a mix of term and current fixed interest investments, 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 cashflow through the annual Cashflow Forecast. To best manage funding gaps, Council's financial investment maturities are matched with Council's forecast cash flow requirements.

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

6.0 Risk recognition / identification management

The definition and recognition of liquidity, funding, interest rate, counterparty credit, operational and legal risk of Council is detailed below and applies to both the Liability Management Policy and Investment Policy.

The following section excludes investment funds under external management outlined in section 5.8.1.

6.1. Interest rate risk on external borrowing

6.1.1 Risk recognition

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

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

6.1.2 Interest rate risk control limits

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

Net external debt is defined as total external debt less available cash/cash equivalents. 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.

Master Fixed / Floating Risk Control Limits	
Minimum Fixed Rate	Maximum Fixed Rate
55%	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 CE).

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

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

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 beyond 90-days requires specific approval by Council.

- "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 CE).
- 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 Council.
- Hedging outside the above risk parameters must be approved by Council.
- Interest rate options must not be sold outright. However, one for one 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 hedge percentage calculation.
- The forward start period on swap/collar strategies to be no more than 24 months, 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.

6.2. Financial investment interest rate/maturity limits

The following control limits are designed to manage interest rate and maturity risk on the financial investment portfolio managed internally by Council (i.e. excludes externally managed funds). The portfolio comprises treasury financial investments.

An important objective of the financial investment portfolio is to match the portfolio’s maturity term to planned expenditure thereby ensuring that investments are available when required. Financial investments should be restricted to a term that meets future cash flow projections and be mindful of forecast debt associated with future capital expenditure programmes as outlined within the LTP.

Period	Minimum %	Maximum %
0 to 6 months	30%	80%
6 to 12 months	20%	70%
1 to 3 years	0%	50%
3 years plus	0%	20%

The repricing/maturity mix can be changed, within the above limits through sale/purchase of financial investments.

6.3. Approved financial instruments

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) Commercial paper (CP)/Promissory notes

Investments	Bank call/term deposits Bank registered certificates of deposit (RCDs) Treasury bills LGFA FRNs/bonds/CP/borrower notes Local Authority/State Owned Enterprise (SOE) Medium Term Notes (MTNs)/CP/bonds and FRNs (senior) Corporate CP/MTNs/FRNs bonds (senior) Building societies short term deposits (up to three months)
Interest rate risk management	Forward rate agreements ("FRAs") on: ▪ Bank bills Interest rate swaps including: ▪ Forward start swaps. Start date <24 months, unless linked to existing maturing swaps ▪ Swap extensions and shortenings Interest rate options on: ▪ Bank bills (purchased caps and one for one collars) ▪ Interest rate swaptions (purchased swaptions and one for one collars only)
Foreign exchange management	▪ Spot foreign exchange ▪ Forward exchange contracts (including par forwards) ▪ Purchased options and collars (1:1 only)

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

6.4. Liquidity risk/funding risk

6.4.1 Risk recognition

Cash flow deficits in various future periods based on long term financial forecasts are reliant on the maturity structure of cash, short-term 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 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.
- Council's own credit standing or financial strength as a borrower deteriorates due to financial, regulatory or other reasons.
- A large individual lender to Council experiences its own financial/exposure difficulties resulting in 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.

6.4.2 Liquidity/funding risk control limits

To ensure funds are available when needed Council ensures that:

- There is sufficient available operating cash flow, liquid investments and committed bank facilities to meet cash flow requirements between rates installments as determined by the Manager Finance. Cash flow management will be used to identify and manage maturity mismatches between external borrowings, internal loans and investments.
- External term loans and committed debt facilities together with available cash/cash equivalents investments must be maintained at an amount of 110% over existing external debt. The liquidity ratio excludes externally managed funds.
- Council has the ability to pre-fund up to 12 months forecast debt requirements including re-financings.
- The Manager Finance has the discretionary authority to re-finance existing external debt on more favourable terms. Such action is to be reported to be ratified and approved by Council at the earliest opportunity.
- 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:

Period	Minimum %	Maximum %
0 to 3 years	15%	60%
3 to 5 years	15%	60%
5 years plus	10%	40%

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

6.5. 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. Council will only borrow from strongly rated banks with a minimum long-term credit rating of at least “A” (S&P, or equivalent Fitch or Moody’s rating).

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 are only approved on the basis of the following Standard & Poor’s (S&P, or equivalent Fitch or Moody’s rating) long and short-term credit ratings matrix. Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

Counterparty /Issuer	Minimum S&P long term / short term credit rating	Investments maximum per counterparty ($m)	Risk management instruments maximum per counterparty ($m)	Total maximum per counterparty ($m)	Maximum investment portfolio percentage (internal managed funds)
NZ Government	N/A	Unlimited	None	Unlimited	Unlimited
Local Government Funding Agency (LGFA)	AA-/A-1	10.0	None	10.0	< 35%
NZ Registered Bank (minimum rating)	A /A-1	5.0. (with the exception of Council's transactional banker* which may exceed this for up to 5 working days)	10.0	15.0	100%
Local authorities	A /A-1	1.5	None	1.5	< 35%
SOEs and Corporates	BBB /A-2	No more than 0.15 with any single issuer with BBB credit rating.	None	1.5	<35% exposed to SOEs/ corporates < 5% exposed to BBB credit ratings.
Building Societies, incl Wairarapa Building Society	BB+ (long term)	1.5	None	1.5	< 5%

Note: *Limit for Council's principal banker excludes balances in current and call accounts designated as working funds required for operational cash management purposes.

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

- Investments (e.g. Bank Deposits) – Transaction Principal × Weighting 100% (unless a legal right of set-off exists).
- Interest Rate Risk Management (e.g. swaps, FRAs) – Transaction Notional × Maturity (years) × 3%.
- Foreign Exchange - Transactional face value 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 Manager Finance on an ongoing basis and in the event of material credit downgrades should be immediately reported to the CE and assessed against exposure limits. Counterparties exceeding limits should be reported to the Council.

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 and prevailing market conditions the instrument is traded in and repriced from.

6.6. Foreign currency

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

Generally, all individual commitments over NZ$100,000 equivalent are hedged using forward foreign exchange contracts, once expenditure is approved, legal commitment occurs and the purchase order is placed, exact timing, currency type and amount are known.

The following foreign exchange risk management instruments may be used for foreign exchange risk management activity:

- Spot and Forward Exchange Contracts.
- Purchase of foreign exchange options, and collar-type instruments (1:1 only).

Independent external advice would be sought before the use of such instruments.

Selling foreign exchange options for the purpose of generating premium income is not permitted.

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

6.7. 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 the treasury activities, adequate segregation of duties among the core functions of deal execution, confirmation, settling and accounting/reporting is not strictly achievable. The risk will be minimised by the following process:

- A 'two authorisations' process is strictly enforced for all funds transfers.
- The Manager Finance reports directly to the Chief Executive and has control over the transactional activities of the Financial Accountant.
- There is a documented approval and reporting process for borrowing, interest rate and liquidity management 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 an appropriate operations and 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, investing, interest rate and cash management 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 Manager Finance has responsibility for establishing appropriate structures, procedures and controls to support borrowing, investing, interest rate and cash management activity.
- All borrowing, investing, 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 CE as per register.
- Two signatories from the following list must sign together to operate the Council's accounts, endorse cheques or other lodgements for credit or debit of the said accounts. The list includes the Chief Executive, Manager Assets and Operations, Manager Finance, Manager Community Facilities, Manager Strategic Planning and Roading Services Manager.
- Authorisation of all electronic funds transfers requires two designated authorisers, one of whom must include the Manager Finance, the Financial Accountant or the Revenue Accountant.
- Cheques must be in the name of the counterparty crossed “Not Negotiable, Account Payee Only” or “Not Transferable, 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 Financial Accountant and approved where required by the Manager Finance.
- Market quotes for deals (other than cash management transactions) are perused by the Manager Finance before the transaction is executed.
- Deal summary records for borrowing, investments, interest rate risk management and cash management transactions (on spreadsheets) are maintained and updated promptly following completion of transaction.

Confirmations

- All inward deal confirmations including LGFA/bank funding and registry confirmations are received and checked by the Manager Finance 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) in deal date/number order.
- The Manager Finance 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 CE.

Settlement

- The majority of borrowing, investing, interest rate and cash management transactions are settled by direct debit authority.

- For electronic payments, batches are set up electronically. These batches are checked by the Manager Finance 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 Council.

Reconciliations

- Bank reconciliations are performed monthly by the Financial Accountant and checked and approved by the Manager Finance. Any unresolved un-reconciled items arising during bank statement reconciliation which require amendment to the Council's records are signed off by the CE.
- A monthly reconciliation of the treasury spreadsheet to the general ledger is carried out by the Financial Accountant and approved by the Manager Finance.

6.8. Legal risk

Legal 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, MDC may be exposed to such risks.

MDC 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.

6.8.1 Agreements

Financial instruments can only be entered into with banks that have in place an executed ISDA Master Agreement with Council. All ISDA Master Agreements for financial instruments must be signed under seal by the Council.

Council's CE and/or internal/appointed legal counsel must sign under seal all documentation for new loan borrowings, re-financings and investment structures.

6.8.2 Financial covenants and other obligations

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

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

7.0 Measuring treasury performance

Measuring the effectiveness of Council's treasury activities is achieved through a mixture of subjective and objective measures. The predominant subjective measure is the overall quality of treasury management information. The Chief Executive has primary responsibility for determining this overall quality.

In order to determine the success of 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 Council or an appropriate sub-committee of Council on a quarterly basis.

Management	**Performance**
Operational performance	• All 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. • Number and cost of processing errors (generally measured by unplanned overdraft costs). • Comparison of the Council's financial ratios to financial and non-financial performance measures included within the Annual Plan.
Management of debt and interest rate risk (borrowing costs)	• The actual borrowing cost (taking into consideration any costs/benefits of entering into interest rate 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. Council's policy mid-point represents an average maturity term of 5-years. The market benchmark rate will be calculated every month and represent the 5-year swap rate monthly rolling average over a 5-year period. • A margin representative of the actual weighted average term of Councils funding portfolio (for the reporting month) is used. The market benchmark margin (representing where an equivalent unrated Council funds at the equivalent funding term) is added to the benchmark interest rate to provide a correct comparison to actual all-up borrowing costs. • As an example, for an unrated Council with an average term of funding of 5-years, then the 5-year rolling average market benchmark rate for unrated Councils using the 5-year margin is applied for the month. If at the next month, Council's average term increases to 7-years, then the 7- year rolling average market benchmark rate for unrated Councils using the 7-year margin is applied for that month.
Financial performance measure targets are set in each Annual Plan and include	• Return on Investment funds held: • Internally managed funds. Actual investment returns must be benchmarked to a market interest rate. The market interest rate is the mid-point Policy benchmark rate based on 0-12 months where there are enforced minimum percentages. The benchmark is

Management	Performance
	constructed as follows: 50.0% 6-month BKBM mid-rate (average of reporting month) 50.0% 6-month BKBM mid-rate, 6 months ago (average of month) = 100% • Externally managed funds (benchmarked to ANZ Government Bond Index). • Borrowing ratios. • Interest Earned % of Total Income. • Compliance to Policy.

8.0 Cash management

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

- The Finance department will calculate and maintain comprehensive rolling cash flow projections on a daily (four weeks forward) basis. Annual cash flow forecast is completed in conjunction with the Annual Plan and updated as soon as significant expenditure/costs are known. These cash flow forecasts determine Council's borrowing requirements and surpluses for investment.
- On a daily basis, electronically download all Council bank account information.
- Co-ordinate 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.
- Ensure efficient cash management through improvement to forecasting.
- Minimise fees and bank charges by optimising bank account/facility structures.
- Monitor Council's usage of overdraft and committed bank facilities. Overdraft facilities are utilised as little as practical.
- 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 suppliers 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 in approved instruments and counterparties only.
- Cash management instruments are limited to:
    - Call deposits with approved registered banks.
    - Approved bank RCDs with a maturity of no more than three months.
    - Term deposits with approved registered banks with a maturity of no more than three months.

9.0 Reporting

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

9.1. Treasury reporting

The following reports are produced:

Report Name	Frequency	Prepared by	Recipient
Cashflow Report Investment Register (Incorporating Limits Report)	Monthly	Financial Accountant	Manager Finance
Treasury Report (1) Liability Management- - Policy compliance - borrowing limits compliance - funding and interest rate position - funding facility - interest rate derivatives - new treasury transactions - liquidity risk position - cost of funds vs. budget - loan advances (2) Investment Report - Summary of funds held - interest income vs. budget -interest rate derivatives - counterparty credit	6 monthly	Manager Finance	Senior Management Team
Trustee Report	As required by the Trustee	Manager Finance	Trustee company
LGFA Report	As required by the LGFA	Manager Finance	LGFA
Revaluation of financial instruments	Annual Report	Manager Finance	Council
Debt Maturity Profile Investment Report	Annual	Manager Finance	Council
Investment Note	Annual Report	Manager Finance	Council/Public
Term Debt Note	Annual Report	Manager Finance	Council/Public

9.2. Accounting treatment of financial instruments

Council uses financial arrangements ("derivatives") for the primary purpose of reducing its financial risk to fluctuations in interest rates. The purpose of this section is to articulate 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.

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

The Manager Finance is responsible for advising the CE 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.

All treasury financial instruments must be revalued (marked-to-market) at least every 12 monthsm for accounting and risk management purposes.

10.0 Policy review

The Policy is to be formally reviewed on a triennial basis, and annually for internal purposes.

The Manger Finance has the responsibility to prepare the annual review report (following the preparation of annual financial statements) that is presented to the Chief Executive. The report will include:

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

The Council receives the report, approves Policy changes and/or rejects recommendations for Policy changes. The Policy review should be completed and presented to the Council within five months of the financial year-end.

11.0 Appendices

11.1. Approved Investment Instruments

Investment instruments available in the market (excluding equities) can generally be discussed under five broad categories relating to the issuer of these instruments.

1. New Zealand Government

- Treasury bills are registered securities issued by the Debt Management Office (DMO) on behalf of the Government. They are usually available for terms up to a year but generally preferred by investors for 90 or 180-day terms. They are discounted instruments, and are available in the secondary market, although most banks hold them for liquidity management purposes
- Government bonds are registered securities issued by the DMO on behalf of the Government. They are available for terms ranging from one year to twelve-year maturities. Government bonds have fixed coupon payments payable by the DMO every six months. They are priced on a semi-annual yield basis and are issued at a discount to face value. They are readily negotiable in the secondary market.

2. Local Government Funding Agency

- Borrower Notes. On occasion when Council borrows from the LGFA it will be required to contribute part of that borrowing back as equity in the form of “Borrower Notes”. A Borrower Note is a written, unconditional declaration by a borrower (in this instance the LGFA) to pay a sum of money to a specific party (in this instance the Council) at a future date (in this instance upon the maturity of the loan). A return is paid on the Borrower Notes and can take the form of a dividend if the Borrower Notes are converted to redeemable preference shares.
- LGFA bonds. With a medium term note (MTN) a fixed coupon payment is made semi-annually to the holder of the security. They are priced on a semi-annual yield basis and are issued at a par/premium or discount to face value. Floating rate notes (FRN) are bonds where interest is paid quarterly at a margin over the bank bill bid rate. LGFA bonds are negotiable and can be bought and sold in the secondary market.
- LGFA Commercial Paper (CP). Issued with maturities ranging from seven (7) days to one year. The face value of the note is repaid in full to the investor on maturity.

3. Local Authorities

- Local Authority loan stock or bond are registered securities issued by a range of local government bodies. They are usually available for maturities ranging from one to ten years. A fixed or floating coupon payment is made semi-annually or quarterly to the holder of the security. They are negotiable and can usually be bought and sold in the secondary market.

4. Registered Banks

- Call and term deposits are funds accepted by the bank on an overnight basis (on call) or for a fixed term. Interest is usually calculated on a simple interest formula. Term deposits are for a fixed term and are expected to be held to maturity. Term deposits are not negotiable instruments. Termination prior to maturity date can involve penalty costs.
- Certificates of deposits are securities issued by banks for their borrowing needs or to meet investor demand. Registered certificates of deposit (RCDs) are non-bearer securities in that the name of the investor, face value and maturity date are recorded at the Reserve Bank and settled through NZClear. They are paperless securities and are able to be transferred by registered transfer only. RCDs are priced on a yield rate basis and issued at a discount to face value. The advantage of RCDs over term deposits is their saleability prior to maturity.

5. Corporates

- Corporate bonds are generally issued by companies and banks with good credit ratings. These bonds can be registered securities or bearer instruments. With a medium term note (MTN) a fixed coupon payment is made semi-annually to the holder of the security. They are priced on a semi-annual yield basis and are issued at a discount to face value. Floating rate notes (FRN) are bonds where interest is paid quarterly at a margin over the bank bill bid rate. Corporate bonds are negotiable and can be bought and sold in the secondary market.

- Promissory notes and commercial paper are issued by borrowers who usually have a credit rating and standing in the market that is sufficient to enable the notes to be issued without endorsement or acceptance by a bank. The notes are usually underwritten by a standby facility to ensure that the borrower obtains the desired amount of funds. Promissory notes/commercial paper are issued with maturities ranging from seven (7) days to one year. The most common maturity is for 90 days. The face value of the note is repaid in full to the investor on maturity.

11.2. Procedures for the Issue of Securities and Bank Borrowing

1. Procedures for the Issue of Securities

- Securities are normally issued on a fixed rate basis or floating rate basis. Stock is normally issued at par, the issue yield being the same as the coupon rendering the purchase price equal to the face value of the stock.
- Coupons are paid on a semi-annual or quarterly basis. The debt issue must be sufficient to meet investor needs. That is each issue should be of a reasonable size, have market acceptance and the maturity date should coincide if possible with that of Government benchmark bonds.
- Council normally uses a broker/bank to find prospective investors (i.e. reverse inquiry) and place its stock in the market (when issuing to the LGFA, Council will contact the LGFA directly). However Council can issue directly, using investment advice, by calling for competitive bids in a tender process. Where a broker/bank is used, correspondence with investors will be attended to by the broker. Where placement is arranged internally, tender processes will be controlled by the Chief Executive. A "notice of intention to issue stock" together with written advice to successful bidders will be arranged by the Manager Finance.
- For LGFA placements, Council is currently restricted to borrowing at LGFA scheduled tender dates, to maturities the LGFA currently offer. Ahead of tender dates, Council informs the LGFA of its required funding amount and term. The LGFA tenders, and raises funds on behalf of Council. Successful bidders are notified and forwarded an 'application for registered secured debenture stock' form for their completion and return. A stock registration form is completed by Council and sent to the third party register for stock registration.

2. Procedures for bank borrowing

- Council approves projects within its Long Term Plan and Annual Plan. For a specific bank loan, a Council report is required, stating the purpose, risks and benefits to the Council, authorising size, purpose, term and amount of the borrowing requirement. Council must adopt the report by resolution.
- Council typically utilises bank committed cash advance facilities as preferable to bank term loans.
- Delegated authorities ensure the size and maturity of the committed cash advance facility is in accordance with the resolution and the borrowing limits are within the appropriate parameters.
- The Manager Finance determines the appropriate borrowing bank and documentation from the approved list of registered banks, and may involve utilising a tendering process (RFP) based on bank margins.
- The Manger Finance manages the drawdown, rollover and repayment (in terms of amount, term and interest rate) of amounts from approved bank(s) facilities.

11.3. Risks Associated with Investment Activity

Risks associated with investment activity that need to be managed are:

- Default risk which refers to the risk that the issuer of the security will be unable to deliver maturity proceeds to the investor. Generally Government investments are assumed to have low default risk, followed by banks, local authorities and corporates of varying credit standing. It is common practice to monitor the credit standing of various institutions by referring to credit ratings regularly provided by independent rating agencies such as Standard and Poor's.

- Interest rate risk which relates to the extent to which an entity's income/expense is affected by movements in market interest rates. The value of a financial investment is impacted by a change in interest rates if sold before maturity.
- Liquidity risk which relates to the ready ability to convert the investment to cash. This can be achieved by staggering the maturity term and matching maturities to expected expenditure requirements and holding negotiable instruments where there is a willing buyer of that instrument. This is particularly important when investments need to be sold prior to maturity, where abnormal losses can be incurred due to ready buyers not being available.

11.4. Glossary of Terms

A Glossary of Terms used in the financial markets is available from the Council on request. The Glossary has been excluded from this document for the sake of brevity.