

# Liability management policy

Adopted 28 May 2014





# Liability management policy

## Introduction

Section 104 of the Local Government Act 2002 requires us to adopt a policy for the management of borrowing and other liabilities. Our infrastructure and community assets generally have long economic lives and long term benefits. The use of debt is seen as an appropriate and efficient way to promote intergenerational equity between current and future ratepayers in relation to our assets and investments as well as assisting us to meet the infrastructure demands of our ratepayers in a timely manner.

We borrow money as we consider appropriate within the flexible and diversified borrowing powers contained within the Local Government Act 2002 and its amendments.

We maintain borrowings and various other liabilities in order to:

- raise specific debt associated with projects and capital expenditures
- raise finance leases for fixed asset purchases
- fund assets whose useful lives extend over several generations of ratepayers

We will not borrow in foreign currency in terms of section 113 of the Local Government Act 2002.

## Objectives

The objective of the policy is to provide a framework for the prudent and effective management of borrowings and liabilities to assist in achieving Council's outcomes and objectives that are aligned to the Annual and Long Term Plans.

This will be achieved by having regard to:

- interest rate exposure
- liquidity
- credit exposure
- debt repayment
- borrowing limits
- securities

This policy covers internal and external borrowings.

## Statutory objectives

- All 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.
- All projected borrowings are to be approved as part of the Annual Plan process or resolution of Council before the borrowing is affected.
- All legal documentation in respect to borrowing and financial instruments will be approved by our solicitors prior to the transaction being executed.
- We will not enter into any borrowings denominated in a foreign currency.
- We 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 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

- Prudently manage borrowing activities to ensure our ongoing funding.
- Minimise our borrowing costs and risks in the management of our borrowings.
- Minimise our 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 our financial assets and costs.
- Arrange and structure long term funding 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 our lending/security arrangements.

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- Comply with financial ratios and limits stated within this policy.
- 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 to meet known and reasonable unforeseen funding requirements.
- To minimise exposure to credit risk by dealing with credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- To ensure adequate internal controls exist to protect our financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, brokers and investors.

### Interest rate exposure

#### Objective

To manage and minimise our costs and risks arising out of interest rate movements associated with our borrowing activities.

#### Policy

Our borrowings must be within the following fixed/floating interest rate risk control limit:

“Fixed Rate” is defined as an interest rate repricing date beyond 12 months forward on a continuous rolling basis.

Master fixed/floating risk control limit	
Minimum fixed rate	Maximum fixed rate
55%	90%

“Floating Rate” is defined as an interest rate repricing date within 12 months.

The percentages are calculated on the rolling 12 month projected net debt level calculated by management (signed off by the Chief Executive Officer). Net debt is the amount of total debt net of cash or 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 hedges 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	15%	60%

Interest rate risk management products may be used to convert fixed rate borrowing into floating rate, floating rate borrowing into fixed or hedged borrowing. Floating rate debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months. Independent external advisors will be consulted when using interest rate risk management products.

The following instruments may be used for risk management activity:

Category	Instrument
Interest rate risk management	<p><b>Forward rate agreements (“FRA”) on:</b> Bank bills Government bonds</p> <p><b>Interest rate swaps including:</b> Forward start swaps (start date &lt;24 months) Amortising swaps (whereby notional principal amount reduces) Swap extensions and shortenings</p> <p><b>Interest rate options on:</b> Bank bills (purchased caps and one-for-one collars) Government bonds Interest rate swaptions (purchased swaptions and one-for-one collars only)</p>

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### Use of interest rate instruments:

- Any interest rate swap with a maturity beyond 10 years must be approved by Council.
- Selling interest rate options for the primary purpose of generating premium income is not permitted, because of its speculative nature.
- 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 out simultaneously.
- 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 percentage calculation.
- Forward start period on swaps and collar strategies to be no more than 24 months, unless the start date of the new swap coincides with the maturity date of the existing swap. The new swap's notional amount must be no greater than that of the existing swap.
- Buying and selling of financial futures is not permitted due to the administrative burden.
- Any other financial instrument must be specifically approved by Council on a case-by-case basis and only be applied to the one singular transaction being approved.

### Liquidity/Funding

#### Objective

To ensure that we have adequate committed financial resources, to meet all of our obligations as and when they arise. Our 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 terms.

Our ability to readily attract cost effective borrowing is largely driven by our ability to maintain a strong financial position, raise general rates and manage relationships with investors and financial institutions/brokers. Where practical, we seek a diversified pool of external borrowing and ensure bank borrowings and incidental arrangements (risk management products) are only sought from strongly rated New Zealand registered banks.

### Policy

We manage liquidity/funding risk by:

- Appropriate cashflow management to ensure that sufficient funds are available to meet financial obligations as they fall due.
- Maintaining appropriate short-term borrowing facilities with Council's bank counterparties.
- Maintaining financial investments in liquid instruments.
- External term debt plus committed bank/loan facilities plus liquid investments/cash equivalents are maintained at 110% over existing external debt.
- A spread of funding maturities to reduce concentration risk so that overall borrowing costs are not unnecessarily increased due to market conditions.
- The Chief Executive Officer or delegate has the discretionary authority to re-finance existing debt on more favourable terms. Such action is to be reported and ratified by Council at the earliest opportunity.
- We have the ability to pre-fund up to 12 months of forecast debt requirements including re-financing.

The funding maturity profile of the total committed funding in respect of all loans and committed facilities is set by the following risk control limits:-

Period	Minimum	Maximum
0 to 3 years	15%	50%
3 to 5 years	15%	60%
5 years plus	10%	40%

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

### Credit exposure

#### Objective

To minimise our risk of default on the part of any counterparty that has a contractual obligation to make any payments to us.

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### Policy

Proposed counter-parties to borrowing transactions will be assessed to ensure that there is reasonable certainty that obligations under borrowing contracts will be honoured. Financial related transactions will only be entered into with organisations specifically approved by the Council. Counterparties and limits can only be approved on the basis of long-term single “A” and above credit ratings (Standard & Poors’, Fitch, or Moody’s) and/ or short-term ratings of “A-1” or above. Positions should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

The following matrix guide will determine limits:-

Counterparty	Minimum long term / short term credit rating	Risk management instrument maximum per counterparty (\$m)	Total maximum per counterparty (\$m) <sup>1</sup>
NZ Local Government Funding Agency (LGFA)	N/A	N/A	N/A
NZ Registered Bank	A / A-1	10.0	30.0

<sup>1</sup> Total counterparty exposure includes; financial instruments for investments and risk management instruments.

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

- Investments (e.g. bank deposits) – transaction principal amount 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 face value amount x the square root of the maturity (years) x 15%.

### Debt repayment

#### Objective

To ensure that we are able to repay debt in a timely manner from appropriate sources.

#### Policy

We will manage debt on a net portfolio basis and will only externally borrow when it is commercially prudent to do so. We may determine that all or any part of the following cashflows may be used for the repayment of debt or reduction in borrowing requirements:

- depreciation charges for activities
- the proceeds of asset sales if we consider it appropriate
- contributions from other parties in terms of any contractual arrangements
- specific revenue streams as determined by us (e.g. repayment of rental housing loans from rental housing income or loan repayment rates).

### Borrowing limits

#### Objective

To ensure that our debt is maintained within prudent limits.

#### Policy

Borrowings will be managed to ensure that the following parameters are not exceeded:

Item	Borrowing limit
Net debt as a percentage of total revenue	<150%
Net interest as a percentage of total revenue	<15%
Net interest as a percentage of annual rates income (debt secured under debenture)	<20%



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- Revenue is defined as earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue. Revenue excludes developer contributions and vested assets.
- Net debt is defined as total debt less cash or cash equivalents.
- 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.
- Disaster recovery requirements are to be met through the liquidity ratio.

### Securities

#### Objective

To provide appropriate security that does not restrict our operations or limit control of our strategic assets, whilst being sufficiently attractive to lenders to secure competitive borrowing margins, fees, interest rates and terms.

#### Policy

We offer security by way of a charge over rates and rates revenue through the 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 2002. From time to time, with Council and Trustee approval, specific security may be offered by providing a charge over one or more of our 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).
- We consider a charge over physical assets to be appropriate.
- Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.

### Source of funds

#### Objective

To specify appropriate sources of funding.

### Policy

The following are considered to be appropriate sources:

- the LGFA
- any registered bank
- Council reserves or special funds
- borrowing by deed of charge
- lease to own arrangements – the counter parties shall be the open market
- Council issued stock and debentures
- short and long-term wholesale/retail debt capital markets

In evaluating strategies for new borrowing (in relation to source, term, size and pricing) we take into consideration the following:

- available terms from the LGFA, banks, debt capital markets including loan stock issuance
- our overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time
- prevailing interest rates and margins relative to the term for loan stock issuance, LGFA, debt capital markets and bank borrowing
- the outlook on LGFA, bank and debt capital market credit margins
- ensuring that the implied finance terms and conditions within the specific debt (e.g. project finance) are evaluated in terms such as cost/risk limitation compared to the terms and conditions we could achieve in our own right
- legal documentation and financial covenants.

Our ability to readily attract cost effective borrowing is largely driven by our ability to rate, maintain a strong financial position and manage our relationships with our investors and financial institutions/brokers.

### New Zealand Local Government Funding Agency Limited (LGFA)

Despite anything in this Policy, we may borrow from the LGFA and, in connection with that borrowing, may enter into the following related transactions to the extent we consider necessary or desirable:

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- Contribute a portion of our borrowing back to the LGFA as an equity contribution to the LGFA. For example in the form of 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 our borrowing from the LGFA and the performance of other obligations to the LGFA or our creditors with a charge over our rates and rates revenue.
- Subscribe for shares and uncalled capital in the LGFA.

### Management procedures and reporting

#### Objective

To implement appropriate procedures and delegations to ensure the efficient and effective implementation of the Liability Management Policy.

#### Policy

The Chief Executive Officer shall ensure that reports on Council's borrowings are provided on at least a quarterly basis.

The Chief Executive Officer shall be delegated the authority to initiate any actions in terms of this policy, including the authority to execute any documents on behalf of Council.

Documented treasury and operational procedures for borrowing activities shall be approved by the Group Manager Business Support, and shall be administered by the Finance and Business Service Manager.

### Policy review

#### Objective

To uphold and maintain current Liability Management Policy best practice standards.

#### Policy

This Policy is to be formally reviewed on at least a triennial basis. The General Manager Business Support, or equivalent, has the responsibility to prepare a review report that is presented to the Council or Council sub-committee. 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, including performance trends in actual borrowing cost against budget (multi-year comparisons)
- summary of breaches of policy and one-off approvals outside policy to highlight areas of policy tension
- analysis of bank lender service provision, share of financial instrument transactions etc
- comments and recommendations from our external auditors on the treasury function, particularly internal controls, accounting treatment and reporting
- an audit of the treasury system/spreadsheets and procedures should be undertaken
- adherence to debt limits specified in the covenants of bank lenders to Council

The Council receives the report, approve policy changes and/or rejects recommendations for policy changes.