CANTERBURY REGIONAL COUNCIL

Kaunihera Taiao ki Waitaha

Treasury Policy

1 July 2021

Treasury Policy

Introduction

The purposes of the Liability Management Policy and Investment Policy are to outline the treasury activities of Canterbury Regional Council (Environment Canterbury). The policies state when and how Council borrows and invests. They also ensure the risks associated with these activities are prudently managed.

The Liability Management Policy and Investment Policy together form the Treasury Policy and are required by the Local Government Act (LGA) 2002. The Treasury Policy is reviewed and, where necessary, amended at least every three years.

Council acknowledges the various financial risks arising from treasury activities, such as interest rate risk, currency risk, liquidity and funding risk, and credit risk. Council takes a risk averse approach to its treasury activities. It does not undertake any treasury activities that are unrelated to its underlying cash flows or that are speculative in nature.

The Council's Chief Executive Officer is responsible for the operations of Council. The Director of Finance and Corporate Services is responsible for the day-to-day operation of treasury with assistance from finance personnel.

Liability Management Policy

Purpose

This policy covers Council's management of all borrowing including interest rate exposure, credit exposure, liquidity, funding and debt repayment, as defined in Section 102(1) and 104 of the LGA 2002.

Policy overview

Council may borrow for the primary purposes of:

- funding capital works primarily on infrastructure assets or natural capital assets. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to Council's assets and investments
- funding significant 'one-off' projects
- hire purchase, credit, deferred payment, or lease arrangements in the ordinary course of Council business
- managing timing differences between cash inflows and outflows and to maintain the Council's liquidity.

The Council has two key types of assets:

1. Infrastructural assets – river control and drainage systems, and Council buildings.
2. Natural capital assets – natural assets providing natural resource inputs and environmental services for economic production which are the result of operational expenditure on policy frameworks governing land, soils and water.

Objectives

The objectives of the Liability Management Policy are consistent with borrowing best practice and take into account Council's Long-Term Plan, as follows:

- Prudently manage Council's borrowing to ensure appropriate liquidity and funding risk management practices are adopted.
- Borrow only under Council approved facilities and as permitted by this policy.
- Minimise the cost of the Council's borrowing by monitoring and implementing the most cost-effective financing techniques giving consideration to balance sheet and other strategic limitations.
- Mitigate the impact of interest rate volatility.
- Ensure the Council's continued ability to meet its financial obligations in an orderly manner through active liquidity and funding risk management.
- Maintain an external credit rating to ensure Council's funding providers are provided reassurance that Council's borrowings are prudently managed.
- Ensure compliance with the Council's financing and borrowing covenants and ratios specified in this document.
- Evaluate on an ongoing basis the appropriateness of the current risk management processes.

- Maintain adequate internal controls to minimise operational risk while recognising the limited number of personnel who participate in the Council's treasury activities.
- Control cash in an effective and efficient manner.
- Produce accurate and timely information that can be relied on by the elected members and management of the Council that ensures policy compliance and maintains appropriate exposure monitoring procedures.

Funding

Council may obtain funding using:

- bank debt
- capital markets issuance, such as Fixed Rate Bonds, Medium Term Notes, Floating Rate Notes or Commercial Paper
- other sources of debt finance following the specific approval of Council
- the New Zealand Local Government Funding Agency (LGFA).

Despite anything earlier in this Liability Management Policy, the Council may borrow from the LGFA and, in conjunction 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.
- 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.
- Subscribe for shares and uncalled capital in the LGFA.
- Secure its borrowing from the LGFA and the performance of other obligations to the LGFA or its creditors with a change over the Council's rates and rates revenue.

Borrowing management and internal controls

Council approves policy parameters in relation to borrowing activities.

Council approves, by resolution, the borrowing requirement for each financial year in the Annual Plan or Long-Term Plan or by later resolution during the year.

To measure performance, the actual borrowing performance of the Council shall be compared with the external benchmark outlined in the policy's guidelines.

Finance leases and hire purchase agreements will be used for specific operating assets only, not for infrastructural assets. No finance lease or hire purchase arrangement will be more than $600,000 (excl GST) unless approved at a meeting of Council.

A resolution of Council is not required for hire purchase, leased, credit or deferred purchase of goods if:

- the period of indebtedness is less than 365 days
- the goods or services are obtained in the ordinary course of operations on normal commercial terms for amounts not exceeding in aggregate $600,000 (excl GST).

Environment Canterbury's borrowing activities are managed centrally through its accounting function. The accounting function is broadly charged with the following responsibilities:

- manage Environment Canterbury's borrowing programme to ensure funds are readily available at margins and costs favourable to Council
- raise authorised and appropriate borrowing, in terms of both maturity and interest rate strategies
- manage the impact of interest rate risks by undertaking appropriate hedging activity in the financial markets
- minimise adverse interest rate related increases on ratepayer charges and maintain overall interest costs within budgeted parameters
- provide timely and accurate reporting of treasury activity and performance.

Council's systems of internal controls over borrowing activity include adequate segregation of duties among the core borrowing functions of deal execution, confirmation, settling and accounting/reporting.

There are a small number of people involved in Environment Canterbury's borrowing activity, however the risk from this will be further minimised by the following processes:

- a documented approval process for borrowing activity

- regular management reporting and review
- regular operational risk control reviews by an independent audit function.

Organisational, systems, procedural and reconciliation controls ensure:

- all borrowing activity is bona fide and properly authorised
- reviews are in place to ensure Environment Canterbury's accounts and records are updated promptly, accurately and completely.

Environment Canterbury is prohibited from borrowing in a foreign currency by section 113 of the LGA 2002.

Managing interest rate risk

Movements in interest rates can have favourable and unfavourable impacts on cash flows. The following instruments are authorised for interest rate risk management activity in relation to borrowing:

- forward rate agreements
- interest rate swaps
- purchase of interest rate options products including caps, floors, bond options and swaptions
- interest rate collar-type option strategies
- Fixed Rate Term Loans
- Fixed Rate Bonds.

Note: Interest rate risk management instruments are only used to hedge an underlying asset or borrowing.

The following interest rate risk management instruments are not permitted for use:

- Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature
- Structured or leveraged interest rate option strategies
- Interest rate futures contracts.

Interest is incurred on any bank funding facility, issuance of debt instruments and other borrowing arrangements. This policy recognises that the longer the term of borrowing, the greater the interest rate risk. A balance is achieved through having

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variable terms with regard to interest rate resets. The following table details the interest rate risk management parameters that Council is required to adhere to for all externally sourced core debt.

Period (years)	Fixed Rate Hedging percentages	
	Minimum Fixed Rate	**Maximum Fixed Rate**
0 to 2 years	40%	100%
2 years to 4 years	20%	80%
4 years to 8 years	0%	60%

Any fixed rate hedging beyond eight years shall be carried out in conjunction with, or aligned with, any underlying debt.

The level of core debt is to be determined by the Director of Finance and Corporate Services in consultation with the Finance Operations Manager and the Chief Financial Officer.

Any hedging outside of these parameters must be approved by the Chair of the Performance Audit & Risk Committee before being initiated and then reported accordingly.

Details of Council's overall interest rate risk management position shall be reported to the Performance Audit & Risk Committee.

The hedging parameters are cumulative. For example if total debt was a $25 million portfolio, $5 million of hedging entered into for a period of five years would increase the hedging profile for all time buckets up to five years, by 20% ($5m/$25m). Fixed rate debt is defined as any debt that has an interest rate reset beyond three months.

Council decides the interest rate risk management strategy by monitoring the interest rate markets on a regular basis, evaluating the outlook for short-term rates in comparison with the rates payable on fixed rate borrowing. Council may use interest rate risk management products to convert fixed rate borrowing into floating rate and floating rate borrowing into fixed or hedged borrowing.

Counterparty exposure rating (credit risk)

Interest rate hedging can only be undertaken with New Zealand registered banks with a minimum Standard and Poor's long-term rating of 'A', or the equivalent Moody's Investors Service and Fitch Ratings long-term ratings of 'A' respectively. An up-to-date list of New Zealand registered banks and current credit ratings can be obtained from the Reserve Bank of New Zealand's website.

Liquidity and funding risk

Liquidity management refers to the timely availability of funds when needed, without incurring penalty costs. Funding risk management centres on the ability to refinance or raise new debt at a future time, at the same or more favourable pricing (fees and borrowing margins) and terms, than that of existing facilities. A key factor of funding risk management is to reduce the concentration of risk at any one point in time so that if one-off internal or external negative credit events occur, the overall interest cost is not unnecessarily increased.

The following guidelines have been established to provide Council with appropriate levels of liquidity at all times:

- Cash flow forecasts will be produced to assist with the matching of operational and capital expenditure to revenue streams and borrowing requirements.
- Council will maintain its financial market investments in liquid instruments.

Control of funding risk – to avoid a concentration of debt maturity dates, no more than 50% of debt will be subject to refinancing in any 12-month period.

Liquidity shall be maintained at a minimum of 10% of projected external debt over the next 12 months.

Liquidity is defined as external debt plus committed loan facilities plus liquid investments divided by external debt.

Debt repayment

Council repays borrowings from general or targeted rates, general funds or renewal loans. Proceeds from the sales of assets shall be used to finance replacement assets via a capital reserve, or to further develop or enhance existing assets.

Repayment of debt (interest and principal) is governed by:

- affordability of debt servicing costs
- intergenerational equity principles
- maintenance of prudent debt levels and borrowing limits.

Borrowing limits

In managing its borrowings, Council will adhere to the Local Government Funding Agency financial covenants.

Definitions:

- **Total revenue** is defined as cash earnings from rates, grants and subsidies, user charges, interest dividends, financial and other revenue and excludes non-government capital contributions (eg developer contributions and vested assets).
- **Net debt** is defined as total debt less liquid financial assets and investments.
- **Liquidity** is defined as external debt plus committed loan facilities plus liquid investments divided by external debt.
- **Net interest** is defined as the amount equal to all interest and financing costs less interest income for the relevant period.
- **Annual rates income** is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 together with any revenue received from other local authorities for services provided (and for which the other local authorities rate).

Security

All loans are secured over either the separate general and targeted rates of the Council. This formal security requires prior Council approval.

The Council in general will not offer assets, other than special rates, as security for general liability management programmes without a separate Council resolution, other than for financing leases or hire purchase arrangements.

Borrowing mechanisms

In developing strategies for new borrowing (in relation to source, term, size and pricing) Council takes into account the following:

- available and Council-approved sources, terms and types of borrowing
- Council’s overall debt maturity profile to ensure concentration of debt is avoided at reissue/rollover time
- prevailing interest rates, margins and total cost relative to term and nature of the borrowing
- the market’s and Council’s outlook on future interest rate movements
- legal documentation and financial covenants.

Investment Policy

Purpose

To present Council's policy for investments, including:

- management of investment
- mix of investments
- acquiring new investments
- outline of how investments are managed and reported to Council
- outline of how risks associated with investments are assessed and managed.

Ethical investments

The Council will practise an ethical investment approach.

Council will avoid investing in companies whose principal business activity includes manufacture and sale of arms, tobacco or alcohol, gambling, fossil fuels or any illegal activity.

Mix of investments

Environment Canterbury holds financial investments which include:

- special funds and reserves
- funds set aside for approved future expenditure
- proceeds from the sale of assets
- forestry
- temporary surpluses and working capital funds.

Council holds equity investments which include:

- Marlborough Forestry Corporation
- Civic Financial Services Ltd
- the New Zealand Local Government Funding Agency.

Managing investments

Council approves policy parameters in relation to investment activities.

Council's investment activities are managed centrally through an accounting function. To decide on the suitability of any investment the following are considered:

- the desirability of diversifying investments
- the nature of existing investments
- the risk of capital loss or depreciation
- the potential for capital appreciation
- the likely income returns
- the length of the term of the proposed investment
- the effect of the proposed investment in relation to tax liability
- the marketability of the proposed investment
- the likelihood of inflation affecting the value of the proposed investment.

Internal controls

Council's systems of internal controls over investment activity include:

- Adequate segregation of duties among the core investment functions of deal execution, confirmation, settling and accounting/reporting. There are a small number of people involved in investment activity, however the risk from this will be further minimised by the following processes:
    - a documented approval process
    - regular management reporting and review
    - regular operational risk control reviews by an independent audit function
- Organisational, systems, procedural and reconciliation controls to ensure:
    - all investment activity is bona fide and properly authorised
    - reviews are in place to ensure Environment Canterbury's accounts and records are updated promptly, accurately and completely
    - the Council's transactional banking relationships will be reviewed at least every three years
    - overall assessment of performance of funds management.

Managing financial market risk

Council's primary objective when investing is the protection of its capital. Accordingly, only creditworthy counterparties are acceptable. Specifically, Council minimises its credit exposure by ensuring that all financial market investments meet the criteria outlined in the 'Authorised Criteria' table in the guidelines. These limits are cumulative and relate to the combined 'short- and long-term' funds portfolios.

Liquidity risk is managed by ensuring that all investments are readily tradable on the secondary market. In practice this is achieved by the credit rating and financial market instrument criteria contained in the investment table.

Counterparty risk shall be managed by only permitting financial market transactions with New Zealand registered banks with a minimum S&P Global Ratings long-term rating of 'A', or the equivalent Moody's Investors Service or Fitch Ratings long term ratings of A1 and A+ respectively.

NZ Local Government Funding Agency (LGFA)

Despite anything mentioned earlier in this Investment Policy, the Council may invest in shares and other financial instruments of the New Zealand Local Government Funding Agency (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.

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

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

Interest Rate Risk Management

Movements in interest rates can have favourable and unfavourable impacts on cash flows. Council's financial investments give rise to direct exposure to interest rate movements. The following instruments are authorised for interest rate risk management activity in relation to borrowing:

- interest rate swaps including swaptions
- interest rate options
- forward rate agreements.

Duration Control for Investment Portfolio

Duration represents the effective average term of an investment portfolio by combining all individual investments and weighting all the cash flows using a series of net present value calculations. Duration is then reported as the average life of the portfolio as if it was effectively one investment instrument, eg 2.9 years.

The duration for the investment portfolio shall be controlled by referencing its duration against an appropriate external benchmark. Environment Canterbury is able to vary the duration of the portfolio by no more than 25% either side of the benchmark portfolio's duration. Compliance with the duration control is not required if the nominal value of the portfolio is less than $10M.

Benchmarking

Benchmarking measures the performance of a portfolio against an appropriate external benchmark, thus providing Environment Canterbury with an indication as to the effectiveness and suitability of the current investment parameters and the manner in which the parameters are being implemented at an operational level.

Environment Canterbury shall benchmark the performance of the Financial Market Investment Fund against the performance of an appropriate external benchmark portfolio listed in the borrowing management and internal controls section of the Liability Management Policy. Compliance with the benchmarking standard is not required if the nominal value of the portfolio is less than $10M.

Equity investments

Significant dispositions and acquisitions require Council approval.

Council is not planning to make any future equity investments; to do so would require a specific Council resolution.

Loans and advances

Loans and advances can be made to community organisations to facilitate the ongoing provision of community services or recreational opportunities. These are usually at a lower than commercial interest rate.

Council sets the criteria for applications for any other loans or advances as they are granted. Council as a rule is not a lender of money.

Council must be satisfied that the potential for capital loss is minimal by applying the following:

- where possible, securing a charge over collateral security realisable on default
- ensuring the organisation is financially stable and the ongoing cashflow is sufficient to service the loan
- the total value of non-commercial loans and guarantees shall not exceed 2 per cent of the Council's investment portfolio.

Foreign Exchange Policy (currency risk)

Council may incur minor foreign exchange exposures through the occasional purchase of foreign exchange denominated plant, equipment and services. All significant commitments defined as an exposure in excess of $100,000 equivalent (GST exclusive) are hedged using foreign exchange contracts or foreign exchange options.

The Council shall not borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

Taking action together to shape a thriving and resilient Canterbury, now and for future generations.
Toitū te marae o Tāne, toitū te marae o Tangaroa, toitū te iwi.
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