

# Treasury Policy Contents

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# Treasury Policy

## 1. PHILOSOPHY

The Papakura District Council (“PDC, The Council”) incurs risks arising from debt raising, investments and associated interest rate management activity. PDC carries out its borrowing and investment activities (referred to in this document as treasury activity) within its finance function.

PDC’s broad objectives in relation to treasury activity are as follows:

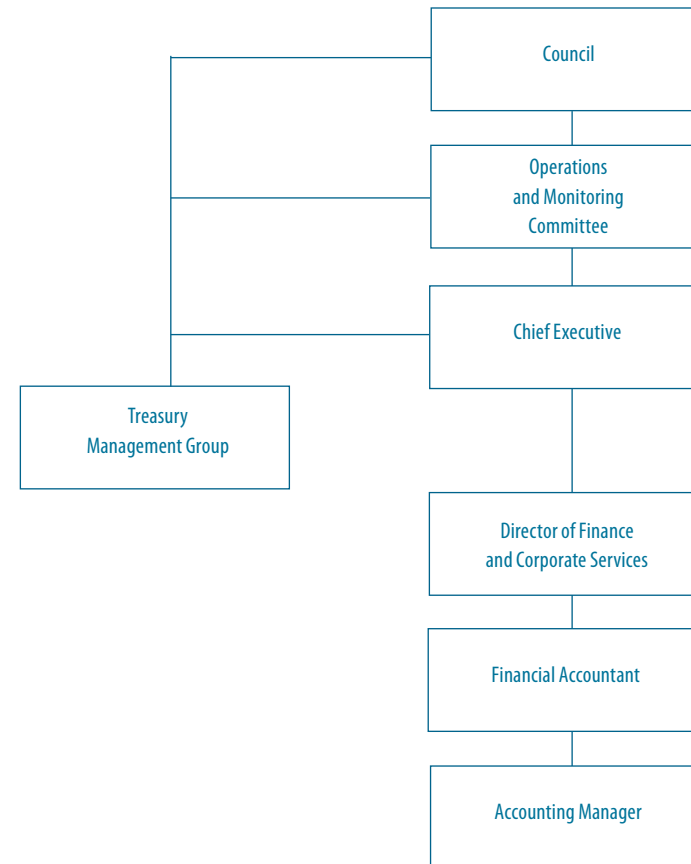
- Compliance with the Local Government Act 2002 and amendments thereto, and other relevant local authority legislation.
- Develop and maintain professional relationships with the financial markets.
- Manage all of Council’s investments within treasury policy parameters ensuring that investments are made in liquid and credit worthy investments.
- Raise appropriate finance, in terms of both maturity and interest rate.
- Effectively manage the overall cash position of the Council.
- Provide timely and accurate reporting on treasury activities including appropriate performance measurement.

PDC’s finance function in relation to treasury activity is a risk management function and PDC does not undertake any treasury activity that is unrelated to the underlying cashflows and exposures of PDC or is purely speculative in nature.

## 2. STRUCTURE

### 2.1 Treasury Organisational Structure

The organisation chart for treasury activity is as follows:



## 2.2 Treasury Responsibilities

The key responsibilities of the above positions are as follows:

### COUNCIL

- Approve treasury policy (incorporating borrowing and investment management policies) document.
- Approve amendments to various control limits, bank facilities and approved instruments.
- Approve hedging strategies outside policy parameters after recommendation from Operations and Monitoring Committee.
- Approve amendments to treasury policy after reviewing recommendations from Operations and Monitoring Committee.
- Review financial covenant control limits on an annual basis.

### OPERATIONS AND MONITORING COMMITTEE

- Review the treasury management process through regular standard reporting including compliance with policy, procedures and risk limits.
- Review formally on a three yearly basis, the treasury policy document and make any recommendation for change, to Council.
- Review hedging strategies outside policy parameters and make recommendations to Council.

### CHIEF EXECUTIVE

- Recommend amendments to the treasury policy to Operations and Monitoring Committee after reviewing recommendations from Treasury Management Group.
- Overview treasury risk management processes through monitoring of regular reporting.

### TREASURY MANAGEMENT GROUP

- Review regular treasury reports to ensure compliance by treasury with policies, procedures and risk limits.
- Overall responsibility for setting risk management strategies in relation to the implementation of this treasury policy.
- Oversee the management of Council's relationship with financial institutions.
- Oversee the negotiation of borrowing facilities with bankers, the appointment of brokers/arrangers/managers.

The Treasury Management Group ("TMG") meets at least quarterly to review the risk management strategies in place and other treasury related issues as appropriate. Members of the TMG are Director of Finance and Corporate Services, Financial Accountant, Accounting Manager and a representative of PDC's Independent Treasury Advisor (if one is appointed) as an ex-officio member

# Treasury Policy

## DIRECTOR OF FINANCE AND CORPORATE SERVICES

- Report treasury activities to Chief Executive, TMG and Council.
- Manage Council's relationship with financial institutions
- Negotiate borrowing facilities with bankers, appoint brokers/arrangers/managers.
- Responsibility to rectify any deal ticket discrepancies.
- Approve bids for stock tenders.
- Approve deal tickets.
- Backup dealer in Financial Accountant's absence.
- Approve journals prepared by Financial Accountant.

## FINANCIAL ACCOUNTANT

- Day-to-day management responsibility for borrowing and investment activity.
- Responsible for keeping TMG and Director of Finance and Corporate Services informed of significant treasury activity and market trends.
- Assist in managing Council's relationship with financial institutions.
- Review Council's daily cash flow position and cash flow forecasts.
- Liaise with brokers/arrangers/managers for issue of debt; co-ordinate tenders if handled in-house.

- Execute borrowing, investment and related risk management activities.
- Complete deal tickets for all transactions.
- Reconcile external confirmations to internal records for transactions undertaken by other Council officers.
- Review and approve bank reconciliations.
- Review credit standing of investments on a regular basis.
- Produce reports and work papers on treasury activity.
- Approve journals prepared by Accounting Manager.

## ACCOUNTING MANAGER

- Reconcile external confirmations to internal records for transactions undertaken by other Council officers.
- Arrange payment and receipt of approved treasury transactions.
- Check and reconcile direct debits/credits.
- Prepare journals.
- Reconcile bank statements.

### 3. LIABILITY MANAGEMENT

#### 3.1 General Policy

Council exercises its flexible and diversified borrowing powers within the Local Government Act 2002. Council approves the borrowing programme by resolution during the Annual Planning process.

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 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.

Council borrows through a variety of market mechanisms which primarily comprise the issue of stock, issuing debentures, through accessing the capital markets and direct bank borrowing.

In evaluating any new or renewal of existing borrowings (in relation to source, term, size and pricing) the Director of Finance and Corporate Services takes into account the following:

- The size and the economic life of the project.
- The impact of the new debt on the borrowing limits.
- Relevant margins under each borrowing source.
- Council's overall debt maturity profile, to avoid concentration of debt at reissue/rollover time.

- Prevailing interest rates relative to term for both stock issuance and bank borrowing and management's view of future interest rate movements.
- Available term from bank and stock issuance.
- Legal documentation and financial covenants.

#### 3.2 Borrowing Limits

In managing its borrowings, Council determines appropriate control limits based on the following covenants:

- The gross interest expense of all borrowings will not exceed a specified percentage of total annual rates income. The maximum limit is 20%.
- Net Debt will not exceed a specified percentage of Total Revenue. The maximum limit is 200%.
- A control ratio of EBIT/Net Interest (EBIT has to be a multiple of net interest) will be determined. The minimum limit is 5:1.
- A ratio of net cash inflow from operating activities to gross annual interest expense is specified. The minimum limit is 5:1.

The applicable control limits will be set by the full Council and reviewed on an annual basis.

# Treasury Policy

## 3.3 Liquidity and Credit Risk Management

Council’s ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet as well as its ability to rate, to manage its image in the market, and its relationship with its banker(s).

To ensure funds are available on repayment of debt, reserves may be maintained in liquid assets and/or funds will be available through committed bank facilities.

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high for reasons within or beyond Council’s control, Council’s preference is that where the total amount of Council’s debt allows, debt is spread over a band of maturities and pricing so that:

- No more than 50% of total borrowing or a maximum of \$30 million, whichever is the greater, is subject to refinancing in any rolling 12 month period.

## 3.4 Interest Rate Risk Management

Interest is incurred on any bank funding facility, issuance of local authority stock and other borrowing arrangements. This policy recognises that the longer the term of borrowing, the greater the interest rate risk. Longer term fixed rate borrowings may be of benefit if market interest rates rise, but equally may not allow PDC to take advantage of periods of low interest rates.

A balance is achieved through having variable terms with regard to interest rate resets. The table below outlines the minimum and maximum hedged or fixed rate exposure requirements within various time buckets.

The Director of Finance and Corporate Services (“DFC”) is responsible for developing risk management strategies for approval by the Treasury Management Group (“TMG”). Any hedging outside the parameters detailed below or for longer than 10 years must be reviewed by the Operations and Monitoring Committee (“OMC”) and approved by the Council, before initiation.

### INTEREST RATE MATURITY PROFILE LIMIT

	Minimum Fixed Rate	Maximum Fixed Rate
Less than 1 year	50%	100%
1 year to 3 years	30%	70%
3 years to 5 years	20%	50%
5 years to 10 years	0%	40%

The following interest rate risk management instruments (refer glossary for definitions) may be used for interest rate risk management activity.

- Forward rate agreements.
- Interest rate swaps.
- Interest rate collar type option strategies.

Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.

## 3.5 Security

Council offers deemed rates as security for general borrowing programmes. From time to time, with prior Council approval, security may be offered by providing a charge over one or more of Council’s assets.

### 3.6 Repayment

Council repays borrowings from general funds or reserves established for this purpose.

### 3.7 Contingent Liabilities

Council from time to time provides financial guarantees to organisations, groups or bodies for recreational and community purposes. Prior to loan approval management reviews the latest audited financial reports and cashflow forecasts.

Council limits its total loan guarantees provided to 5% of total annual rates income net of GST, and ensures that guarantees to individual organisations, groups and bodies, are limited to a maximum of 10% of the total guarantees given by Council.

Where possible Council registers a charge over the organisation's building. Financial statements are received annually.

Should the guarantee be called upon, Council will take immediate steps to recover the money.

## 4. INVESTMENT

### 4.1 Investment Mix

Council maintains investments in the following financial assets:

- loans advances (covered in Section 4.3);
- shares in Watercare Services Ltd Local Government Insurance Corporation (covered in Section 4.4); and
- financial investments (covered in section 4.5).

### 4.2 General Policy

Council's philosophy in the management of investments is to optimise returns in the long term while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk, giving preference to conservative investment policies and avoiding speculative investments.

It also recognises that lower risk generally means lower returns.

Council does not hold financial investments other than those involving general and specific reserves and cash management balances. In its financial investment activity, Council's primary objective when investing is the protection of the investment capital value and to minimise the risk of loss. Accordingly, only credit worthy counterparties are acceptable. Council's policy on managing credit risk is contained in Section 4.6.

Within the credit constraints contained in Section 4.6, Council also seeks to:

- Optimise investment return.
- Ensure investments are liquid and sufficiently flexible.
- Diversify the mix of financial investments.
- Manage potential capital losses due to interest rate movements if investments need to be liquidated before maturity.

### 4.3 Loan Advances

Loan advances include loans to recreational and community organisations which further the Council's community objectives.

# Treasury Policy

Internal loan advances are made from specific reserves for specific Council purposes. Before raising external borrowings, management firstly reviews its ability to make loans internally from existing reserves.

All loan advances are approved by Council.

External loan advances are secured by first mortgage over that organisation's property. Interest earned is credited to the Parks Capital Reserve Account which is used for the purchase and development of community parks and reserves.

The DFC reviews performance of these investments on a regular basis to ensure objectives are being achieved and that interest and principal repayments are being made in accordance with the loan agreement. Exceptions are reported to OMC on a timely basis.

Council's policy is that it does not intend to dispose of these investments before maturity.

## 4.4 Shares

The shares in Local Government Insurance Corporation (LGIC) were acquired by virtue of Council being a local authority. The purpose of the company in which almost all local authorities are shareholders is to ensure that adequate insurance arrangements are available to local authorities at the lowest possible cost. The shares in LGIC are held as the shares are not readily transferable.

Annual Reports are received and reviewed by Council. Election of Directors takes place at the AGM held at the Local Government New Zealand annual conference. The Council votes by proxy. Council's policy is to review the continuance of the LGIC scheme on a regular basis.

In 1998/99 Council was vested with shares in Watercare Services Ltd. Legislation vesting the shares in Council stipulates that Council cannot sell the shares and that Watercare Services Ltd cannot pay a dividend to its shareholders.

## 4.5 Financial Investments

Council maintains financial investments for the primary reasons below:

- Invest proceeds from the sale of assets.
- Invest amounts allocated to general and specific reserves e.g. disaster reserve.
- Invest funds allocated for approved future expenditure. Invest surplus cash and working capital funds (see Section 6).

## 4.6 Credit Risk

Council's primary objective when investing is the protection of its investment. Accordingly, only credit worthy counterparties are acceptable. Investments can only be made with the following counterparties unless there is prior approval by the full Council.

- New Zealand registered banks with a Standard and Poor's ("S&P") long term credit rating (or accepted equivalent) of 'A+' or better with an individual limit of \$20 million per individual entity.
- Other entities that have an S&P credit rating (or accepted equivalent) of 'A' or better, unrated local authorities that give general security over rates or State Owned Enterprises with a rating of BBB or better, subject to a maximum of \$5 million for any one entity.

#### 4.7 Interest Rate and Liquidity Risk Management

The TMG sets interest rate risk management strategy by monitoring the interest rate markets on a regular basis, evaluating the outlook and determines the interest rate profile to adopt for investments. In general terms Council will look to use surplus funds to decrease its overall level of borrowings by proactive management of its bank facilities.

Liquidity risk management is implemented by ensuring that any investments are capable of being liquidated. Committed bank facilities are also held to assist in the management of short term funding requirements as well as contributing to the funding of core debt.

### 5. FOREIGN EXCHANGE POLICY

Council may incur 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 NZD50,000 equivalent are hedged using foreign exchange contracts, once expenditure is approved by management and/or the Council, under relevant delegation.

### 6. CASH MANAGEMENT

From time to time, Council has daily cashflow surpluses and borrowing requirements due to the mismatch of daily receipts and payments. All cash inflows and expenses pass through bank accounts controlled by the finance function.

Finance maintains a daily cash forecast. Daily bank account balances and transaction logs are taken from the Council's transactional banker.

Generally any cash to be invested for longer than three months is covered by Section 4 of this policy.

Cash management activities must be undertaken within the following parameters:

- Cash management instruments are limited to:
  - Call deposits with registered banks.
  - Negotiable instruments with a maturity less than three months.
  - Term deposits with registered banks (less than three months).
- Cash may only be invested with approved counterparties as detailed in Section 4.6.
- If practical, a targeted minimum of \$200,000 is invested at call.
- Council may have bank overdraft facilities. However any overdraft facilities are utilised as little as practical.

Interest rate risk management on cash management balances is not permitted.

### 7. PERFORMANCE MEASUREMENT AND REPORTING

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 including the development of Key Performance Indicators (KPI's) by the Chief Executive and Management Team. In accordance with standard practice the reporting of PDC's treasury activity will be provided as part of the monthly financial reporting process.

# Treasury Policy

## 8. REPORTING

The following reports are produced:

Report Name	Frequency	Prepared by	Recipient
Cash Forecast Report	Daily	Accounting Manager	Financial Accountant
Treasury Spreadsheet	Daily	Accounting Manager	Financial Accountant
Treasury Report	Monthly	Financial Accountant	Director of Finance Operations and Monitoring Committee
Limits Report (included within Treasury Report)	Once a month, reported daily on an exceptions basis	Financial Accountant	Director of Finance Operations and Monitoring Committee
Budget Report	Quarterly	Financial Accountant	Operations and Monitoring Committee
Statement of Public Debt	Annually	Financial Accountant	Council

## 9. DELEGATED AUTHORITIES AND KEY CONTROLS

### 9.1 Delegated Authorities

Activity	Responsibility
Alter policy document	Council
Authorise bank facilities	Council
Open/close bank accounts	Cheque signatories
Cheque signatories	As approved by Council
Direct funds transfer signatories (eg electronic approval of transfers between accounts)	Cheque Signatories
Develop investment and borrowing strategies	Treasury Management Group
Manage investments	Director of Finance and Corporate Services
Approve loans within annual Council approvals	Chief Executive
Implementing TMG developed strategy and related risk management	Director of Finance and Corporate Services
Transfer of Stock/Register new issues	Seal register signatories
Approve risk management strategies outside policy parameters	Council
Approve annual borrowing programme	Council

## 9.2 Key Internal Controls

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

- Adequate segregation of duties among the core treasury functions of deal execution, confirmation, settling and accounting/reporting. There are a small number of people involved in treasury activity and accordingly strict segregation of duties is not always achievable. The risk from this is minimised by the following processes:
  - a documented approval process for treasury activity.
  - regular management reporting.
- Organisational, systems, procedural and reconciliation controls to ensure:
  - all treasury activity is bona fide and properly authorised.
  - checks are in place to ensure Council's accounts and records are updated promptly, accurately and completely.

More specifically, key internal controls are as follows:

## 9.3 General

### ORGANISATIONAL CONTROLS

- The Chief Executive has overall responsibility to ensure appropriate structures, procedures and controls to support treasury activity are in place.
- All treasury activity is undertaken in accordance with approved delegations contained within the treasury policy.

### CHEQUE / ELECTRONIC BANKING SIGNATORIES

- Signatories approved by Council.
- Dual signatures are required for all cheques and electronic transfers. Access to the electronic banking system is limited and password protected.
- Cheques must be in the name of the counterparty crossed "Not Transferable" via the Council bank account and paid to order.

### 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 initiator and approved by the DFC. Deal summary records for borrowing, investments, interest rate risk management and cash management transactions are maintained and updated promptly following completion of transaction.

### CONFIRMATIONS

- All inward confirmations are received and checked by someone other than the initiator against the approved deal ticket and treasury spreadsheet records to ensure accuracy.
- Deals, once confirmed, are filed (deal ticket and attached confirmation) in deal date order.

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- Any discrepancies arising during deal confirmation checks which require amendment to the Council records are signed off by the DFC.

## SETTLEMENT

- A facsimile signed by two cheque signatories is provided to banks who have direct debiting authority. A confirmation letter is received next day and checked to the authorised deal ticket.
- For direct payments, the transaction originator is denied access to transaction data after transaction approval is granted.

## RECONCILIATIONS

- Any discrepancies arising during bank statement reconciliation are dealt with by the Accounting Manager and signed off by the Financial Accountant.
- Any discrepancies arising during deal confirmation checks are dealt with by the Financial Accountant and signed off by the DFC.
- The Financial Accountant reviews the monthly reconciliation of the treasury spreadsheet to the general ledger, carried out by the Accounting Manager.
- Interest income as per the treasury spreadsheet is reconciled by the Financial Accountant to bank statements to ensure income is received.

## 9.4 Borrowing and Investments

In addition to the controls listed in Section 9.2, the following controls apply to borrowings and investments:

- Investment activity is undertaken within counterparty limits specified in this policy.

- Normally financial investments are held to maturity date. Where investments are liquidated prior to maturity, approval is obtained from the DFC.
- All deliverable certificates of investment (eg bank bills) are held with Council's dealing bank.
- NZ Government stock, Treasury bills, local authority stock and debentures are registered with Computershare. The Council receives notice of the stocks transferred into its name from Computershare. This notice is checked to the Council's treasury spreadsheet.
- Borrowing activity is undertaken within borrowing limits specified in this policy.
- All borrowing is undertaken with either the Council's banker(s), by private placement or by using a competitive bidding process.

## 9.5 Incidental Arrangements

In addition to the controls listed under Section 9.2, the following controls apply to incidental arrangements:

- The use of incidental arrangements is confined to managing interest rate risk of Council's borrowing and investments and are used within the confines of the parameters and instruments specified in this policy.
- Standard master agreements for incidental arrangements are completed by Council with its dealing banks.

## GLOSSARY

### Approved Risk Management Instruments

- Forward rate agreements (“FRA”).
- Interest rate swap (“IRS”).
- Interest rate collar.

### Examples of the use of Derivative Products

#### Forward Rate Agreement

An agreement between PDC and counterparty (usually a bank) protecting PDC against a future adverse interest rate movement. PDC and the counterparty agree to a notional future principal amount, the future interest rate, the date and the benchmark rate, which is contained on the Reuters system.

#### Objective

To provide PDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. A Forward Rate Agreement (FRA) typically applies to a 3-month period, starting at some point within the next 12 months.

#### Example

PDC wishes to provide certainty on a portion of its floating rate borrowings over the event risk posed by an expected change in monetary policy at a point in the future. A borrower’s FRA is purchased in say, March, at 6.00% for protection through the June to September period. It is described as a 3X6 FRA, ie the rate applies to a borrowing for 3 months starting in 3 months time.

#### Outcome

If on the rate set date in June, the 3-month interest rate has climbed to, say, 8.00%, PDC receives the difference between this and the FRA rate of 6.00%. It then borrows at 8.00%, the payment received making the effective borrowing rate 6.00%, plus its margin.

## INTEREST RATE SWAP

An interest rate swap is an agreement between PDC and a counterparty (usually a bank) protecting PDC against a future adverse interest rate movement. PDC pays (or receives) a fixed interest rate and receives (or pays) a floating interest rate. The parties agree to a notional principal amount, the future interest rate, the settlement dates and the benchmark floating rate, which is usually off the Reuters page containing the daily rate sets for BKBM (bank bill reference rates).

#### Objective

To provide PDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period. Floating rate sets are typically every 3 or 6 months over the life of the swap.

#### Example

PDC fixes its interest rate for 3 years at 6.50%, on a quarterly basis on a portion of its planned borrowings by entering into a 3 year 6.50% fixed rate swap. The floating rate reference is 3 month BKBM.

# Treasury Policy

## Outcome

On a swap-reset date, the 3 month bank bill rate is at, say 4.75%. PDC borrows from its bank the principal, for 3 months at 4.75% plus PDC's margin. At the same time the bank pays PDC 4.75% on the principal amount for a 3 month period. PDC then pays the bank 6.50% on the principal amount for a 3 month period. This means that PDC's effective interest rate is 6.50% plus its margin. In practice cashflows would be netted off if the swap and the underlying borrowing facility were with the same bank.

## INTEREST RATE COLLAR

The combined purchase (or sale) of a cap or a floor with the sale (or purchase) of another floor or cap.

## Objective

To provide PDC with certainty as to its interest rate cost on an agreed principal amount for an agreed period, but at the same time avoid the need to pay an up front premium.

## Example

PDC wishes to secure a worst case borrowing rate of 7.50% for the next 5 years, but wishes to avoid paying a premium. In exchange for the worst case protection at 7.50%, PDC accepts a best case outcome at 6.00%. In this structure PDC has bought and sold options, with the respective option premiums offsetting each other. On each quarterly rate set date PDC will have a rate between 6.00% and 7.50%, the parameters of the collar.

## Outcome

If on each rate set date the 3-month interest rate is in excess of 7.50% PDC exercises its option and pays 7.50%, for that 3-month period, its worst case rate. If on each rate set date the 3-month interest rate is below 6.00%, the bank exercises its option on PDC and PDC pays 6.00%, PDC's best case rate. If on any rate set date the 3-month interest rate is between 6.00% and 7.50%, PDC borrows at the market rate.