Treasury Risk Management Policy

Including Liability Management and Investment Policies

Introduction

Policy purpose

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

As circumstances change, the policies and procedures outlined in this Policy will be modified to ensure that treasury risks within the Council 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 the Council;
- 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 the Council's financial exposure to market interest rate risks, funding risk, liquidity, investment risks, counterparty credit risks and other associated risks;
- The operations of a pro-active treasury function in an environment of control and compliance;
- The robustness of the Policy's risk control limits and risk spreading mechanisms against normal and abnormal interest rate market movements and conditions;
- Assistance to the Council in achieving strategic objectives.

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, with operational authority delegated to staff as recorded in the Council's Delegations Register.

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

Scope and objectives

Scope

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

Treasury management objective

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

Governance and management responsibilities

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 the Council.

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 the Policy cannot be delegated.

In this respect, the Council has responsibility for:

- Approving the long-term financial position of the Council through the Long-term Plan (LTP) and associated Financial Strategy along with the adopted Annual Plan;
- Approving and adopting the Liability Management and Investment Policies;
- Approving the Policy following recommendation by the Finance & Performance Committee, incorporating the following delegated authorities:

    - Borrowing, investment and dealing limits and the respective authority levels delegated to the Chief Executive Officer (CEO), Chief Finance Officer (CFO) and other management;
    - Counterparties and credit limits;
    - Risk management methodologies and benchmarks;
    - Guidelines for the use of financial instruments;
- Receiving a triennial review report on the Policy.

Finance & Performance Committee (FPC)

The FPC is a Council committee responsible for advising the full Council on Treasury and related matters. Under this Policy, the FPC will:

- Evaluate and recommend amendments to Policy;
- Review debt levels for compliance with Council's Annual Plan, Long Term Plan or specific Council resolution and this Policy;
- Review treasury activity through quarterly reporting, supplemented by exception reporting;
- Review and recommend delegated authority to the CEO and other officers;
- Review and recommend approval of one-off transactions falling outside Policy.

Chief Executive Officer (CEO)

While the Council has final responsibility for the Policy governing the management of Council's Treasury risks, it delegates overall responsibility for the day-to-day management of such risks to the CEO.

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

- Ensuring the policies comply with existing and new legislation;
- Approving the register of authorised signatories;
- Signing Compliance Certificates under borrowing and hedging agreements (including under section 118 of the Local Government Act 2002), as required;
- In conjunction with the Chief Financial Officer (CFO), approving the opening and closing of bank accounts;
- Receiving advice of non-compliance of Policy and significant treasury events from the CFO.

Liability management policy

Introduction

The Liability Management Policy focuses on borrowing (external and internal) as this is the most significant component of Council's liabilities and exposes the Council to the most significant risks. Other liabilities are generally non-interest bearing. Cash flows associated with other liabilities are incorporated in cash flow forecasts for liquidity management purposes and for determining future borrowing requirements.

Council maintains external borrowings in order to:

- Raise debt associated with specific projects and capital expenditures;
- Fund assets where their useful lives extend over several generations of ratepayers;
- Fund investment in CCOs;
- Provide funding to CCOs;
- Fund short term borrowing for working capital requirements.

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

Generally when the Council borrows money the debt is not linked to a specific activity it is considered to be part of the overall cost of operating the Council. This general rule is not followed for debt which is linked to a service covered by a targeted rate. In those cases the debt repayment is recovered from within the targeted rate.

Borrowing limits

Debt will be managed within the following limits:

Item	Borrowing Limit
Net Debt / Total Revenue	<250%
Net Debt / Equity	<20%
Net Interest / Total Revenue	<20%
Net Interest / Annual Rates Income	<30%
Liquidity	>110%

- Total Revenue is defined as cash earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non government capital contributions (e.g. development 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 bank facilities plus liquid investments divided by external debt.
- Net Interest is the amount equal to all interest and financing costs less interest income for the relevant period.
- Annual Rates Income is 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 the consolidated group.

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.

Borrowing Mechanism

Council is able to borrow externally through a variety of market mechanisms including issuing stock/bonds, commercial paper (CP) and debentures, direct bank borrowing, borrowing from the Local Government Funding Agency, (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, 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, LGFA, debt, capital markets and bank borrowing;
- The market's outlook on future interest rate movements;

- Legal documentation and financial covenants considerations;
- For internally funded projects, assurance 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, LGFA, Standard and Poor's and financial institutions/brokers.

Security

Council's external borrowings 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.

Debt repayment

The funds from all asset sales, operating surpluses, grants and subsidies will be applied to specific projects or the reduction of debt and/or a reduction in borrowing requirements, unless the Council specifically directs that the funds will be put to another use.

Debt will be repaid as it falls due in accordance with the applicable borrowing arrangement. 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.

Debt acquired to fund strategic land purchases and equity investments in CCTOs will be interest-only borrowing and will not be repaid until the underlying asset is disposed of.

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's significant contingent liability is its $1.3 billion of un-called redeemable preference shares in CCHL, which exist to support CCHL's credit worthiness and ensure that it can obtain services and funding at an efficient cost.

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.

Other financial arrangements include advances to community organisations and trusts.

Internal borrowing

Council also uses its reserves and external borrowing to internally fund both capital expenditure and working capital. The finance function is responsible for administering Council's internal loan portfolio.

The primary objective in funding internally is to use funds efficiently, by eliminating the margin that would be paid through Council separately investing and borrowing externally.

New Zealand Local Government Funding Agency (LGFA) Limited

Under its shareholding agreement with LGFA, Council has agreed to:

- Provide guarantees of the indebtedness of other local authorities to LGFA, and of the indebtedness of LGFA itself;
- Secure its borrowings from LGFA (and the performance of other obligations to LGFA or its creditors) with a charge over Council's rates and rates revenues; and
- Each time Council borrows from LGFA, contribute a portion of that borrowing back to LGFA as an equity contribution (eg. in the form of Borrower Notes).

To the extent that it considers it necessary or desirable, Council may also commit to contributing additional equity (or subordinated debt), and/or subscribe for shares and uncalled capital in LGFA.

Approved financial instruments

Approved financial instruments (which do not include shares or equities) are shown in the following table:

Category	Instrument
Cash management and borrowing	Bank deposits Bank overdraft Bank term loans Committed cash advance and bank accepted bill facilities (short term and long term loan facilities) Loan stock /bond issuance (floating or fixed rate) Commercial paper (CP)/Promissory notes NZD denominated Private Placement Loans
Interest rate risk management	Forward rate agreements (FRAs) on bank bills Interest rate swaps (including forward-starting swaps) Interest rate options on: • Bank bills (purchased caps and one for one collars) • Interest rate swaptions (purchased swaptions and one for one collars 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.

Investment Policy

Introduction

Council generally holds investments for strategic reasons where there is some community, social, physical or economic benefit accruing from the investment activity. Generating a commercial return on strategic investments is considered a secondary objective. Investments and associated risks are monitored and managed, and regularly reported to Council. Specific purposes for maintaining investments include:

- For strategic purposes consistent with Council's LTP;
- To reduce the current ratepayer burden;
- The retention of vested land;
- Holding short-term investments for working capital requirements and liquidity management;
- 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;
- Investing amounts allocated to accumulated surplus, Council created restricted reserves and general reserves;
- Investing proceeds from the sale of assets.

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 funds in the first instance to meet future capital expenditure requirements, unless there is a compelling reason for establishing external debt.

Policy

The Council's general policy on investments is that:

- The Council may hold financial, property, and equity investments if there are strategic, commercial, economic or other valid reasons (e.g. where it is the most appropriate way to 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.

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 staff as recorded in Council's Delegation Register.

Investment mix

Equity investments

Equity investments, include investments held in CCO/CCTO and other shareholdings (including Christchurch City Holdings Ltd).

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 the 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 CCOs/CCTOs and unlisted companies not controlled by Council are normally credited to general funds and help reduce general rates

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.

New Zealand Local Government Funding Agency Limited investment

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.

Because of these dual objectives, the Council may invest in LGFA shares in circumstances in which the return on that investment is potentially lower than the return it could achieve with alternative investments. In connection with the investment, Council subscribes for uncalled capital in the LGFA and is a Guarantor.

Property investments

Council owns property investments for strategic and commercial purposes. Council reviews ownership through assessing the benefits including financial return, in comparison to other arrangements that could deliver 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 after consultation with Community Boards and Committees.

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 owns land and buildings for the purposes of providing services and to provide parks and reserves. These holdings are not considered to be investments for the purposes of this Policy.

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.

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. Interest is credited to general funds unless the terms of the special fund or reserve fund state that interest is to accrue.
- Internal borrowing will be used wherever possible to avoid external borrowing.

Special funds and reserve funds

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

Advances to charitable trusts and community organisations must meet the criteria set out in Council's Strengthening Communities Strategy, but do not have to be on a fully commercial basis.

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

Approved financial instruments

Approved financial instruments (which do not include shares or equities) are as detailed in the table below:

Category	Instrument
Investments	Bank deposits Treasury, bank, and corporate discounted bills (up to 1 year) Government, SOE, and Corporate Bonds or Floating Rate Notes (FRN). Bonds or FRNs issued by local authorities or LGFA LGFA borrower notes

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.

Risk recognition / identification management

Interest rate risk

Risk recognition

Interest rate risk is the risk that funding costs will materially exceed or fall short of projections included in the LTP or Annual Plan (due to adverse movements in market wholesale interest rates) 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.

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 liquid financial assets and investments.

This policy 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.

Debt Interest Rate Policy Parameters		
Debt Period Ending	**Minimum Fixed**	**Maximum Fixed**
Year 1	55%	95%
Year 2	50%	90%
Year 3	45%	85%
Year 4	40%	80%
Year 5	35%	75%
Year 6	30%	70%
Year 7	25%	65%
Year 8	20%	60%
Year 9	0%	55%
Year 10	0%	50%
Year 11	0%	45%
Year12	0%	40%
Year 13	0%	35%
Year 14	0%	30%
Year 15	0%	25%

- 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 CFO).
- Floating rate debt may be spread over any maturity out to 12 months.
- Hedging outside the above risk parameters must be approved by the Council.
- Hedging is to be achieved through the use of swaps. If it is considered that options are more appropriate prior approval must be obtained from the Head of Financial Management.
- 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.
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2% above the appropriate swap rate, cannot be counted as part of the fixed-rate hedge percentage calculation.

Liquidity risk/funding risk

Risk recognition

Management of cash flow deficits in various future periods as identified in long term financial forecasts is 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 its debt portfolio as optimally as desired;
- New Zealand investment community experiences a substantial over-supply of Council investment assets;
- Financial market shocks from domestic or global events.

A key factor of funding risk management is to spread and control the risk to reduce the concentration of risk at one point in time so that if any of the above events occur, the overall borrowing cost is not unnecessarily increased and desired maturity profile compromised due to market conditions.

Liquidity/funding risk control limits

- External term loans and committed debt facilities together with available liquid investments must be maintained at an amount in excess of 110% over existing external debt.
- Council has the ability to pre-fund up to 18 months forecast debt requirements including re-financings.
- The CFO has the discretionary authority to re-finance existing external debt on more favourable terms. Such action is to be reported to the CEO and the Finance and Performance Committee 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%	60%

Counterparty credit risk

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where the Council is a party. The credit risk to the Council in a default event will be weighted differently depending on the type of instrument entered into.

Credit risk will be regularly reviewed by the Finance & Performance Committee. Credit limits are dependent on the counterparty's Standard & Poors', (S&P) rating.

The following matrix guide will determine limits:

Counterparty	Minimum S&P credit rating	Maximum per counterparty ($m)
NZ Government	N/A	Unlimited
LGFA	A-	$100
NZ Registered Bank	AA band A band BBB+	$200 $150 $50
NZD Registered Supranationals	AAA	$50
Local Authority	BBB+ Un-rated	$40m $25m
SOE	BBB+	$20m
Other Corporate	BBB+	$10m

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

- Financial investments (e.g. deposits, bonds) – 100% of the principal value;
- Interest Rate Risk Management (e.g. swaps, Forward Rate Agreements) – month-end mark to market value (as provided by the treasury management system) ***plus***:
  - 1.0% of the notional principal for instruments maturing within 1-5 years of the reporting date, OR

    - 1.5% of the notional principal for instruments maturing beyond 5 years of the reporting date.

- Foreign Exchange instruments (e.g. Forward Exchange Contracts) – month-end mark to market value plus 30% of the notional value of the instrument as provided by the treasury management system.