

Treasury Policy

Introduction

Council is required to have a liability management policy and an investment policy. The policy sets out procedures and guidelines to be used to safeguard Council's investments, maximise returns and minimise its risks, both in investing and its borrowing liability.

Format of the Treasury Liability and Investment Management Policy and Financial Manual

Part I - Treasury Management Policy

Sets out the objectives of Council's investing and borrowing liability activities. The actions required in order to obtain each objective are detailed on an objective by objective basis.

Part II - Operations

Details the day to day administration of investments and borrowing of Council, including the controls and procedures used to ensure a clear audit trail of treasury activity and the reporting required of the Finance Manager to Council.

Appendices

Appendix I – Authorised investment Criteria for Short Term Funds and Long Term Funds

Appendix II – Authorised Interest Rate Risk Management Instruments

Appendix III – Financial Market Investment Instruments

Background Investments

Council has considerable investments in the following areas

- Cash and Cash Equivalents
- Investment Property
- Forestry
- Shares
- Other Financial Assets (i.e. bonds)

These assets form a large part of the total assets of Council, and provide significant income used to offset rates. It is therefore critical that policies are in place that firstly, ensure the risk of capital loss is minimised, and secondly, ensure the maximum return is achieved while minimising risk. This policy sets out how this will be achieved.

Liabilities

Council is faced with two types of liability, short term (current) liabilities and long term liabilities (debt). Current liabilities are those obligations that generally arise from day to day operations (such as trade creditors), and that would normally be expected to be paid (settled) within a twelve month period. These liabilities are planned for, and met, from Council's working capital cash flow management. This policy is more focused on the long term liabilities (loans) which have arisen as a result of purchasing or constructing assets.

This policy sets out the types of debt instruments that are appropriate and sets out policies to minimise the interest risks to Council from borrowings.

Internal Borrowing/Investing

This policy explicitly allows for internal borrowing against the investment pool Council maintains. This may be in lieu of borrowing externally or may be used together with external fund raising. The policy sets out matters that need to be considered when borrowing internally or externally.

Part I - Treasury Management Policy

1.1 Introduction

Council has an investment portfolio which includes:

- bank deposits,
- local authority stocks,
- corporate bonds,
- shares,
- forestry and
- property.

This combination of investments is a result of policy to minimise risk as well as specific instances where Council's choice of investment has been made on less commercial criteria e.g. Elderly Persons Housing. Council's investments in equities have arisen as a result of local authorities on a nation-wide basis trying to gain from bulk purchasing (i.e. Civic Assurance), or for strategic purposes such as the equity investment in Transwaste Canterbury Ltd.

For the purpose of managing Council's investments it is necessary to consider them as belonging to four separate categories:

- Working capital
- Investment funds
- Property I (intended to gain a market return, including forestry)
- Property II (intended for community use or held for strategic purposes and not aimed at gaining a market return)

Council raises debt to finance longer term asset creation and renewal. This policy covers how Council will borrow, and minimise the cost of borrowing.

1.2 Policy Objectives

The objectives of the Ashburton District Council treasury management policy are to ensure that:

- Council's funds are safeguarded and investments and borrowings selected are not detrimental to other areas of the Council's operations. This requires that guidelines are established to define the investment and borrowing risks acceptable to Council.
- Council's investment and borrowing activities satisfy the legislation controlling Council's ability to invest and borrow, and the prudent person concept as per the Trustee Amendment Act 1988.
- Council's investments, both in financial instruments and physical assets, are managed so as to maximise the return, given the maturity profile chosen and within acceptable risk constraints.
- Council's borrowing is managed so as to minimise total borrowing costs given the maturity profile chosen and within acceptable risk constraints.
- Additions and disposals of investments are controlled to achieve the greatest benefit for Council while minimising risk.

- The use of income and gains made by investments is regulated.
- Council is adequately informed of investments and borrowing, by way of regular reporting.
- Existing investments and debt held by Council, that do not meet the criteria contained elsewhere in this document, are reviewed individually and are either disposed of or some justification made in writing for their retention and that they be reviewed on a regular basis.
- Council's ability to meet its borrowing obligations in an orderly manner as and when they fall due, in both the short and long term, through appropriate liquidity and funding risk management.
- Appropriate funding facilities are arranged, ensuring these are at market related margins utilising bank debt facilities and /or capital markets as appropriate.
- Lender relationships are maintained and Council's general borrowing profile in the local debt and, if applicable, capital markets, enable Council to fund itself appropriately at all times.
- Accurate and timely information is produced to maintain appropriate control, exposure monitoring and performance measurement in relation to treasury activity.

1.3 Policy Implementation

1.3.1 Safeguarding Council's Investments and Other Interests

In order to safeguard Council's interests it is necessary for two things to be achieved:

1. The possibility of Council suffering financial loss due to *natural disaster and deterioration*, *interest rate risk* and/or *credit risk* must be minimised while sufficient liquidity is maintained to meet Council's day to day monetary needs.
2. Controls and procedures are implemented to ensure that Council officers are adhering to the policy requirements.

Minimisation of Interest Rate Risk, Credit Risk and the Maintenance of Liquidity

(a) Natural Disaster and Deterioration

The value of Council-owned buildings must be protected by adequate insurance being held against loss by fire and natural disaster and must be maintained as per the relevant asset management plan.

Forestry plantations are to be insured against fire and to be maintained as per the forestry asset management plan.

(b) Interest Rate Risk

The choice of a portfolio's maturity profile is the key to management of interest rate risk. Both debt and investments are subject to this risk. It is necessary to select the term of investments or debt depending on the volatility of the particular market as, the longer the term of the transaction, the greater the effect of any movement in the interest rate.

The use of risk management products as detailed in Appendix II of this document should be considered when any sizeable, long term investment is made or when large debts are incurred. Professional advice should be sought when using these products.

(c) Credit Risk

The risk of default by the other party to an investment is best minimised by combining the careful selection of investments with diversification of the investment portfolio.

As Council is effectively a trustee for public money and must act conservatively, only investments authorised in Appendix I are to be entered into without the express consent of Council. Investments outside these provisions must only be undertaken with the express consent of Council and subject to criteria specified in this policy.

Diversification of the investment portfolio ensures that only a limited sum is invested in any risk bearing instrument from a single issuer or with a single class of issuer. The lower the credit risk of the issuer or class of issuer, the larger the proportion of Council's funds that may be invested with that issuer or class of issuer.

Council has set limitations on investing with a single issuer or class of issuers for working capital and investment funds. Investment in shares for investment, other than through an equity managed fund are not permitted. This is due to the high risk nature of the share market and the potential for the loss of principal which is less likely to occur through other financial instruments.

1.3.2 Controls and Procedures for Investing & Borrowing

Internal controls and procedures for investing and borrowing are to be clearly documented. These need to ensure the risk of error and loss to Council are minimised. These procedures are detailed in Part II of this policy.

1.3.3 Meeting Legislative Requirements

Council's investment and borrowing must meet all relevant legislative requirements.

Much of the earlier legislation concerning borrowing and investment activities of local authorities is specific and allows little room for subjective decision making. It is essential that Council does not contravene any such legislation.

The concept of the prudent person as described by the Trustee Amendment Act 1988 must always be to the fore when considering risk but it leaves Treasury with only one, very broad, guideline. Ratepayers in their own capacity can make decisions on investing in high risk investments but they do not expect Council to get involved in such dealings. Council is merely a custodian of public money not an organisation whose function is dealing in investment management.

Council officers and elected representatives have a duty to ensure that investment funds are protected and that debt and investments are of an acceptable credit risk defined by this policy.

1.3.4 Managing Investments

Maximising Return

In order for returns on Council investments to be maximised it is necessary for attention to be paid to several areas:

1. What types of investments should Council be involved in?
 - Long or short term
 - Assets or financial instruments
 - When are community projects a suitable investment?
2. Does the return on these investments match or better Council's required rate of return?
 - Should there be different rates for different types of investment?
 - How should Council's required rate of return be set?

It must also be remembered that any increases in return are likely to bring increased risk. As Council must invest conservatively, the maximisation of returns has a relatively low ceiling.

Matters to be considered in determining the type of investments Council should be involved in:

(a) Duration of investments

As the achievement of prior objectives requires that Council's portfolio be diversified in terms of duration it is necessary to maintain a mix of both short and long term investments, with regard given to whether funds invested are part of the working capital or the investment fund.

Duration of the Long Term Funds Portfolio: The duration of the long term funds portfolio shall be controlled by referencing its duration against an appropriate external benchmark. Council 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 long term funds portfolio is less than \$15 million over a rolling 12 month period.

(b) Type of investment

Investment risk needs to be minimised. This is achieved, in the case of financial market investments, by restricting investments through a combination of credit criteria and limiting investment in any issuer class and in any one individual issuer.

It must also be noted that a variety of legislation applies to the purchase, sale and use of property by local authorities including:

- Local Government Act 2002
- Public Works Act 1981
- Public Bodies Leases Act 1969
- Reserves Act 1977
- Residential Tenancy Act 1986
- Resource Management Act 1991

Investments in property fall into three classes:

(i) Leased Property

The types of assets Council invests in on a commercial basis currently include residential housing, commercial property and farm land as well as a large number of commercial and residential properties which are leased via "Glasgow Leases".

At present the return on these investments is mixed. Glasgow leases have been consistently poor performers (with returns as low as 2% on some properties). Part of the reason for this level of performance is the restrictions faced by local authorities in leasing land. These restrictions mean it is likely Council will find it difficult to divest itself of these under performing assets. No further Glasgow leases are to be entered into and Council may seek professional advice before purchasing any more land for other investment purposes.

(ii) Forestry

Council's investment in forestry has been the subject of investment planning within Council and adheres to this investment plan. The key points of this are as follows:

- profit is to be maximised while minimising risks through management of the tree crop and selection of low risk land for plantings
- benefits of any new forestry projects to be measured using the Internal Rate of Return method where the target rate of return = 10 Year Govt. Bonds - Inflation + Risk

(iii) Non-commercial Properties

Council holds buildings such as the Museum and Art Gallery for non-commercial purposes and as such does not get a market return on them nor adequate provision for their eventual replacement. It also holds a number of flats let to elderly persons in the district at a

concessionary rate. Council has identified properties it holds for non-commercial purposes and a schedule of these is available.

(c) Investments in community projects

From time to time groups within the community request loans, advances or guarantees for projects that will benefit the community. As these investments are with organisations Council would not normally invest with Council needs to debate the suitability of any loan application. During this process councillors should pay particular regard to the ability of the applicant to service the debt and repay principal. Council is responsible for authorising any such loans, advances or guarantees.

(d) Share investments

Council believes it may be appropriate to have limited investment in equity (shares) when investing for strategic or social reasons. Equity investments for strategic or social reasons will be approved by Council on a case by case basis.

1.3.5 Return on Investments

(a) Categories of investment

As different investments made by Council serve different purposes it is necessary for the return from these investments to be judged by appropriate criteria. For the purpose of assessing the return received from investments, the following categories of investment are to be assessed separately:

- Working Capital
- Investment (long term) Funds
- Property I (intended to gain a market return including forestry)
- Property II (intended for community use and not aimed at gaining a market return)

(b) Required return on investments

Generally the term of any investment has a large effect on the rate of return received, with long term investments normally gaining a higher return than short term investments other than those in the interest rate markets where yield fluctuations can be pronounced. Given this, each category of investment is to be subject to a different required rate of return.

Working Capital - as the bulk of funds invested as working capital is in the form of deposits with registered banks, the required rate of return for working capital is the movement in the industry standard short term rate indices or other indices that are appropriate. The nominal value of this fund is to be determined by the Finance Manager, taking into account the working capital requirements of Council. Short term funds are defined as investments which at the time of purchase have a maturity date of less than six months.

Performance of the Working Capital (short term) Funds

To measure the performance of the short term funds portfolio the performance shall be compared on a quarterly basis against the average of the call rate and the 30, 60, 90 and 180 day bank rates for the preceding quarter. Compliance with the benchmarking standard is not required if the nominal value of the portfolio average less than \$10 million for the relevant quarter.

Investment (long term) Funds - Long term funds are defined as those which at the time of purchase have a maturity date of more than six months. The nominal value of long term funds is determined by the Finance Manager taking into account the amount of funds required for working capital purposes. Due to the large choice of investments available and the variations in their duration, the required rate of return on investments is measured against appropriate external benchmarks.

Performance of the Investment Funds

The performance of the long term funds portfolio shall be compared against an external benchmark such as one of the NZX's portfolios or a benchmark portfolio constructed for

Council. Compliance with the benchmarking standard is not required if the nominal value of the portfolio average less than \$15 million for the relevant quarter.
Investments in long term funds must comply with the criteria listed in Appendix I.

Property I - Ideally property should perform as well as a long term financial investment i.e. it should be required to have a net return equal to the 10 year Government Bond Rate - Inflation + Risk to reflect the long term nature. The benefits received from property should be assessed using the Internal Rate of Return method as this allows some estimation of capital gains to be included. This should be used as a benchmark to determine which properties should be disposed of (if possible), and which should be retained.

Property II - As these properties are acquired for specific purposes the required return will be set in each case by Council at the time the property is acquired or transferred to its non-commercial use and reviewed every three years. During this process it should first be established that the property is either required for the intended purpose or, that it is being used for some other non-commercial purpose. Secondly the return required from the use of the property should be re-established. Properties already existing in this category should be brought within this review process.

1.3.6 Management of Borrowing

In entering into a borrowing transaction sufficient inquiries should be made to enable the selection of the transaction with the lowest total costs of those currently available. These costs include internal administrative costs, managerial resources, interest expense, advisory fees and the transaction costs specific to that form of debt.

At various times it may be possible to refinance a debt in such a way as to reduce the total costs of the transaction. Any such refinancing must take into account the additional costs of refinancing and how the new transaction fits within the context of other sections of this policy.

Council will maintain an overdraft facility of at least \$500,000 for day to day cash management purposes.

Council will consider both "Interest Only" and "Principle and Interest" repayment loans at the time of raising a loan. If Interest Only loans are raised a funding reserve will be set up to accumulate funds until principle repayments are required as per the applicable loan agreement.

Where possible, Council will secure borrowing against rates revenue in order to gain lower borrowing costs. Physical assets will only be pledged where:

- There is a direct relationship between the debt and the asset purchase/construction e.g. operating lease or project finance;
- Council considers a pledge of physical assets to be more appropriate than a pledge of rates.

Debt Instruments. The following funding instruments and methods may be used to raise external debt:

- Committed bank facilities
- Uncommitted bank facilities
- Local Authority Bonds which include fixed rate bonds and floating rate notes

Long Term Debt Limits. Debt should be maintained within the following limits:

Measure	Maximum
Long Term Debt per Capita	\$2,750
Measure	Minimum
Times Interest Earned	10
Equity to Long Term Debt Ratio	7:1

Projected Long-term Debt Levels

	Target	2009/10	2010/11	2011/12	2012/13	2013/14
Long-term debt per capita	<\$2,750	\$1,454	\$1,427	\$1,372	\$1,927	\$2,319
Times interest earned	>10	18	18	18	17	15
Total equity to long-term debt ratio	>7:1	13:1	13:1	14:1	10:1	9:1

	Target	2014/15	2015/16	2016/17	2017/18	2018/19
Long-term debt per capita	<\$2,750	\$2,466	\$2,404	\$2,283	\$2,169	\$2,075
Times interest earned	>10	14	12	13	14	15
Total equity to long-term debt ratio	>8:1	8:1	9:1	9:1	10:1	10:1

Fixed Rate Hedging Percentages

	Minimum Fixed Rate Amount	Maximum Fixed Rate Amount
0-2 years	50%	100%
2-5 years	30%	80%
5-10 years	0%	50%

The fixed rate hedging percentages shall apply to the core debt of Council as detailed in the Annual Plan / LTCCP or as otherwise amended by the Finance Manager. However, if core debt is less than \$25 million interest rate hedging is at the discretion of the Finance Manager.

Debt Repayment. Council will make provision for the repayment of debt over the life of the asset for which the loan has been raised. This will be either by making regular loan repayments or provision of sinking funds to be used to extinguish debt at a future time.

Authorised Interest Rate Risk Management Instruments. The Finance Manager may use the following interest rate risk management instruments to manage the core debt of Council.

- Forward rate agreements
- Interest rate swaps
- Forward start interest rate swaps
- Swaptions (options on swaps)
- Interest rate options
- Interest rate collar type structures but only in a ratio of 1:1

Definitions of the above instruments are contained in Appendix II.

Management of Funding and Liquidity Risk. Council must ensure that it has sufficient funds available to meet its obligations as they fall due. Liquidity is improved by maintaining a diversified portfolio of debt and investment with varying degrees of liquidity and maturity dates. This is necessary to allow Council to access funds before maturity should the need arise and to prevent large amounts of debt falling due at the same time.

To avoid a concentration of debt maturity dates, no more than \$40 million of total debt can be refinanced in any 12 month period.

Council must maintain committed funding lines of not less than 110% of projected core debt. Core debt is defined as that contained in the Annual Plan /LTCCP (year 1) or as otherwise determined by the Finance Manager

Performance measurement. Council's borrowing portfolio shall be compared with the following external benchmark which is predicated off the midpoints of the risk control bands contained in the Fixed Rate hedging Percentage table in this policy.

25%	Average 90 day bank bill rate for the reporting period
12.5%	Average 1 year swap rate for the reporting period
12.5%	Average 1 year swap rate for the reporting period 1 year ago
12.5%	Average 3 year swap rate for the reporting period
12.5%	Average 3 year swap rate for the reporting period 1 year ago
12.5%	Average 7 year swap rate for the reporting period
12.5%	Average 7 year swap rate for the reporting period 7 years ago

Benchmarking of Council's external borrowing is not required if the amount of external debt is less than \$25 million.

1.3.7 Internal Borrowing

Internal borrowing against the investment pool Council maintains may be used in lieu of external borrowing. This policy applies whether the loans are internal or external and is governed by the policy covering Council investments in the document.

1.3.8 Additions and Disposals

Additions and disposals in investments are at the discretion of the Finance Manager within the limitations of this policy document and the Finance Manager's delegated authority. Exceptions to this are holdings in property and forestry.

All movements (being acquisition or disposal) in property (or forestry) holdings must be considered by the Finance Manager and Property Officer (or the Council Forester if appropriate) prior to a formal proposal being placed before the appropriate committee of Council. This exception recognises the material impact property and forestry holdings have on council's investment portfolio, in terms of return and risk of capital loss.

Funds received from the disposal of investments are generally to be returned to the pool of investment funds with the exception of capital gains which are to be considered income and can be made available to offset rates, fund capital projects, or returned to the pool of investment funds. A decision not to return capital to the investment pool will require Council's express authorisation.

1.3.9 Use of Income from Investments

As a major purpose of Council having investments is to earn income for the ratepayers of the district, rather than to increase its financial reserves, the continual compounding of interest would not serve Council's purposes. In the interests of intergenerational equity it is necessary for income earned by Council at a given time to be used primarily to benefit those who have supplied the means for that income to be raised i.e. the ratepayers existing in the district at the time the investments earn income.

In cases where the long term nature of an investment causes income to be compounded over several years measures must be taken to preserve intergenerational equity through using money already in reserves as a means to spread the benefit of investment

The net income from investments, other than special reserves, may be used to offset rates and/or capital project requirements. This net income includes capital gains on investments at the time of their disposal.

1.3.10 Reporting

Regular reporting is needed to ensure Council is kept informed on its investment pool, debt portfolio and forestry and property investments. This reporting requirement is outlined under Part II Operations.

1.3.11 Existing Other Investments

Existing investments held by Council need to be reviewed by the Finance Manager to ensure they conform to the objectives of this policy. Those that do not meet criteria contained elsewhere in this document need to be examined individually by Council and either be disposed of or some justification made, in writing, for their retention. The most obvious clashes between the existing portfolio and this policy are Council's share holdings in the following companies:

Company	Shares
Ashburton Contracting Ltd	2,500,000
N.Z. Local Government Insurance Corp. Ltd	28,008
R.D.R. Management	30,000
Transwaste Canterbury Limited	600,000
Barrhill Chertsey Irrigation	1,000

Shares are a relatively high risk market and require professional management not generally available within Council's staff.

The 100% holding in Ashburton Contracting Ltd was the result of government policy forcing councils out of performing some roading activities directly. In order to maintain a unit within the district allowed to carry out this kind of work, ACL was formed. Initially this was as a "management "L.A.T.E." and later ACL was converted to a "full L.A.T.E (now a CCTO - Council Controlled Trading Organisation)".

The advantage perceived by Council at the time this subsidiary was formed was the district would be likely to achieve lower roading costs if more competition was in the market. It was also considered to be advantageous to have a contracting firm that would put Council's needs ahead of those of other clients in emergency situations. As a result, the holding of ACL shares is not purely a commercial investment and this allows Council to make ACL an exception from the "no shares" policy.

The investment in N.Z. Local Government Insurance Corp. Ltd was the result of the then N.Z. Counties Co-operative Insurance Company Ltd selling its insurance business, to what is now called N.Z. Local Government Insurance Corp. Ltd, in 1989.

The holdings in the N.Z. Local Government Insurance Corp. Ltd do not have any strategic reason for being held. The purpose of holding these shares is purely financial.

Council also holds 100 voting rebate shares and 28,750,000 deferred non-voting shares in Electricity Ashburton, now reregistered as a co-operative company. Should holders of at least 65% of voting rebate shares sell their shares or decide to sell the principal assets of Electricity Ashburton then Council must either sell its deferred shares at the same time for the same price per share or surrender its deferred shares for \$1.00. If the right to sell the deferred shares at the same price is not given to Council then, on at least 65% of the rebate shares being transferred to a third party, Council's deferred shares will attain voting rights. In the event of such a sale of shares or assets by other shareholders Council will need to review its position with regard to these shares immediately.

Council holds 30,000 ordinary shares and 50,000 deferred shares in R.D.R. Management (Rangitata Diversion Race Management). The investment was acquired when the Ministry of Works gave up control of the scheme. The water race currently supplies three irrigation schemes in the district and its use is being considered for several others. These shares were originally obtained to safeguard Council's stockwater system and to secure our Community's investment.

The shares in Transwaste Canterbury Ltd are considered a strategic investment. Transwaste Canterbury Ltd is a joint venture between Canterbury Waste Services Ltd and a number of councils for the purpose of developing, owning and operating a Canterbury regional landfill.

The shares in the Barrhill Chertsey Irrigation scheme are considered a strategic investment.

The share holding in Ashburton Contracting Ltd is to be reviewed annually to ensure it still holds a strategic position in Council's activities, as well as returning a satisfactory dividend to Council which recognises the size and risk of the ACL investment.

Part II - Operations

This section discusses procedures and controls to be used by Treasury in order to provide a clear audit trail as to movements in the investments held by Council.

2.1 Duties and Responsibilities

Duties and responsibilities under this policy are:

Full Council

- Approve the Treasury Policy including any amendments proposed by the Finance and Community Services Committee.
- Approve any hedging outside the parameters of the Treasury Policy.
- Approve use of any risk management products not authorised by the Treasury Policy.
- Monitor Treasury performance through receipt of appropriate reporting.
- Approve overall borrowing limits on an annual basis through the Annual Plan / LTCCP process.

Finance and Community Services Committee

- Review of the Treasury Policy every three years or on an "as required" basis and submit any recommended changes to Council for approval.
- Monitor and review the ongoing Treasury performance of Council and compliance with the Treasury Policy parameters through receipt of regular reporting.
- Approve any new borrowing facilities recommended by the Finance Manager within overall borrowing limits approved by Council.

Chief Executive

- In the absence of the Finance Manager, undertake all his/her duties as detailed in the Treasury Policy or delegate the duties as appropriate.

Finance Manager

- Make decisions in respect to treasury management within the parameters of the Treasury Policy.
- Report to the Finance and Community Services Committee on overall treasury activity on a regular basis.
- Manage the bank lender and capital market relationships, providing financial information to lenders and negotiate new/amended borrowing facilities or methods for approval by the Finance and Community Services Committee within Council approved limits.
- Execute treasury transactions in the absence of the Accountant.

Accountant

- Execute treasury transactions
- Assist the Finance Manager in the preparation of reports to the Finance and Community Services Committee.
- Check external confirmations against internal records.

2.2 Controls and Procedures

Daily Operations. Before investment decisions can be made, the Finance Manager should be aware of Council's immediate and short term cash flow requirements, taking account of:

- regular identifiable payments, e.g. PAYE and other taxes, loan repayments, payroll expenditure, regional council levies,
- regular identifiable revenue, e.g. rates, subsidies, interest receipts, annual fees and charges, and debtor and creditor cashflows

Some significant payments will not be identifiable until a few days prior to payment and therefore the Finance Manager needs to leave sufficient liquidity in Council's investment policy to allow for these. Working Capital is to be a ratio of 2:1 against current liabilities. Close liaison with other Council departments is essential for stringent cash flow management.

Account must be taken on a regular basis of both working capital and investment funds to allow investment decisions to be made. Working capital funds need to be assessed more frequently than investment funds to allow Council to meet its financial commitments. Loan funds and sinking funds are of a more controlled nature, and management of these funds therefore also requires less frequent attention than the working capital fund

When making investments documentation must have the signature of the Finance Manager *and* any one of the Accountant, Accounts Officer, or Corporate Services Manager. For investments made by direct debit, coding from the bank statement must be performed by either the Accounts Officer or Accounts Clerk in order to ensure that the person responsible for the initiation of the transaction is not involved in recording it.

To assist with daily operations the Finance Manager should have a good working relationship with Council's bank manager and also with Council's financial advisor. This will enable the Finance Manager to better evaluate investment opportunities.

Portfolio Management. The Finance Manager needs to be aware of investment maturities in each portfolio for three reasons:

- To be aware of interest payment dates,
- To ensure investments are actioned upon maturity and
- To determine whether maturing investments are required to meet cash outflows or are available for reinvestment.

Each investment should be separately itemised along with the following details:

- Type of security and issuer
- Interest rate
- Commencement date
- Maturity date
- Type and amount of funds invested, e.g. Working Capital or Long term funds
- Supporting documentation to evidence the transaction

To assist this process, each investment should be numbered. A control account should be used, setting out the types of security and also the types of funds. This will provide a basis for a monthly reconciliation to the ledger and simplify the categorisation of investments held. Upon sale or maturity of each investment, details of the course of action taken should be noted, and where full or partial reinvestment is made, all details should be recorded on the maturing investment. A clear audit trail should be maintained, setting out in chronological order the various investments (by fund type) showing investment reference, amount and security type.

Matching maturities to cash flow requirements is an important part of portfolio management and the Finance Manager must be able to obtain funds when required. Working Capital investments would typically be placed on deposit from call to 90 days. In managing the portfolio the Finance Manager will need to continually monitor changes in market conditions. Timely reaction to changes in the market is an essential part of effective funds management.

Informed Decision Making. Two of the key factors in making sound investment decisions are having adequate information with respect to: the financial market; and the funding requirements and objectives of Council. It is important for staff involved in fund management to continually monitor financial markets. This can be done in a number of ways, including:

- Daily contact with financial institutions;
- Reviewing various publications ranging from the business section in the local paper, a metropolitan paper and the National Business Review, etc.
- Monitoring political statements and events in parliament,
- Reviewing Council reports and daily contact with senior staff
- Maintaining a close working relationship with Council's financial advisors.

2.3 Reporting

To ensure that Council's investment policy is being adhered to, the Finance Manager must keep abreast of significant changes in the market which could lead to an alteration in policy, strategy or the nature of investments held. The Finance Manager is ultimately responsible to Council to ensure the policy is adhered to and should report to either Council or the Chairman of the Finance and Community Services Committee on a regular basis providing relevant details of the portfolio excluding property.

A six weekly summary report should be prepared by the Finance Manager outlining:

- investments held
- term of investments
- interest rates
- movements in portfolio
- any other appropriate measures contained in this policy

Annually the Property Officer and District Forester will submit a report to the Finance and Community Services Committee detailing:

- investments held
- the rate of return received by investments
- confirming adequate insurances are held where appropriate
- movements in portfolio
- maintenance of assets has been carried out as per the relevant asset plan
- revaluations have been carried out where applicable
- a report on the benchmarked performance of the short term funds, long term funds and borrowing portfolio is the benchmark levels are reached.

Appendix I

Authorised Investment Criteria for Short Term Funds and Long Term Funds

Authorised Asset Classes	Overall Portfolio Limit as a Percentage of the Total Portfolio	Approved Financial Market Investment Instruments (must be denominated in NZ dollars)	Credit Rating Criteria – Standard and Poor's (or Moody's or Fitch Equivalents)	Limit for each issuer subject to overall portfolio limit for issuer class
New Zealand Government	100%	<ul style="list-style-type: none"> • Government Stock • Treasury Bills 	Not Applicable	Unlimited
Local authorities where rates are used as security	70%	<ul style="list-style-type: none"> • Promissory Notes • Bonds/MTN's/FRN's 	Not Applicable	\$3.0 million \$3.0 million
New Zealand Registered Banks	100%	<ul style="list-style-type: none"> • Call/Deposits/Bank Bills/Promissory Notes • Bonds/MTN's/FRN's 	Short term S&P rating of A1 or better Long term S&P rating of A+ or better	\$10.0 million \$5.0 million
State Owned Enterprises	60%	<ul style="list-style-type: none"> • Promissory Notes • Bonds/MTN's/FRN's 	Short term S&P rating of A1 or better Long term S&P rating of BBB+ or better Long term S&P rating of A+ or better	\$3.0 million \$1.0 million \$3.0 million
Corporates	60%	<ul style="list-style-type: none"> • Promissory Notes • Bonds/MTN's/FRN's 	Short term S&P rating of A1 or better Long term S&P rating of A or better Long term S&P rating of AA or better	\$2.0 million \$1.0 million \$2.0 million

Investments that no longer comply with minimum rating criteria due to a rating downgrade must be sold within one month of the downgrade being notified unless Council formally approves the continued holding of the investment, after having taken independent advice.

Appendix II

Authorised Interest Rate Risk Management Instruments

Forward Rate Agreement

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

Objective - To provide Council 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.

Interest Rate Swap

An interest rate swap is an agreement between the Council and a counterparty (usually a bank) protecting Council against a future interest rate movement. Council pays a fixed interest rate and receives 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 listed on BKBM contained on the Reuters system.

Objective - To provide Council with certainty as to its interest rate cost on an agreed principal for an agreed period. Floating rate sets are typically every 1 or 3 months over the life of the swap.

Forward Start Interest Rate Swap

Objective - To provide Council with certainty as to its interest rate cost on an agreed principal amount for an agreed period commencing at a future point in time. All other conditions are as with an interest rate swap.

Options on a Swap – Swaption

Objective - To provide Council with the right, but not the obligation, to enter into a fixed rate swap at a future point in time on an agreed principal amount for an agreed period.. A swaption is an option on a swap and typically requires a premium to be paid.

Interest Rate Options

The purchase of an interest rate option gives the holder (in return for the payment of a premium) the right, but not the obligation to borrow (described as a cap) or invest (described as a floor) at a future date. Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark floating rate which is listed on BKBM contained on the Reuters system.

Objective - To provide Council with worst case cover on its interest rate cost on an agreed principal amount for an agreed period. As for an interest rate swap, rate sets are typically at each 1 or 3 month date for the life of the option. A premium is payable for entering into an interest rate option.

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 Council with certainty to its interest rate cost on an agreed principal amount for an agreed period, but at the same time to avoid the need to pay an upfront premium.

Appendix III

Financial Market Investment Instruments

Introduction

This section of the manual provides a brief introduction to a number of financial market instruments. It covers such aspects as the security, liquidity, pricing, payment and delivery of these instruments.

Instrument Characteristics

Expected return

Government stock is a risk free investment and as such regarded as the benchmark from which the pricing of other investments is determined. For an investment with a higher risk than government stock to be accepted the return must also proportionately higher. Although greater returns may be achieved by investing in higher yielding stocks, e.g. in company debentures rather than government stock, the Finance Manager must be satisfied the higher yield represents the extra margin generally required to compensate the investor for increased risk.

Duration

The duration of investments can vary from a one day term, such as call deposits, to a long term (e.g. 10 years). Ideally, the duration of the investment selected should be determined with reference to the planned expenditure of Council, i.e. investment maturities should closely match expected cash outflows. Duration is not a major concern if the investment is particularly liquid.

If we assume a case where a cash outflow will occur in one year from date of deposit and investment opportunities are considered to be significantly better for a two year term then the decision may be to:

- (i) Invest for one year to match cash outflow, or
- (ii) Invest for at least 2 years, optimising return on investment, while ensuring the investment has liquidity characteristics which will allow its sale when required.

Note that a risk of adverse interest rate movements exists and must be recognised by the Finance Manager in the context of the overall management of the portfolio.

Liquidity

Liquidity is provided where there are sufficient buyers for an investment instrument whenever there are sellers. Lack of liquidity may force the seller to discount the price below its current market value. The liquidity of an instrument is affected by characteristics such as the creditworthiness of the issuer and the volume of supply. If Council has sufficient funds to allow a portion of the investment to be unavailable until maturity, then investments with low liquidity characteristics coupled with low default risk often represent an excellent opportunity to maximise return on investment.

Effective funds management will result in a need to liquidate investments only in unpredictable circumstances. As liquidity is important to interest rate risk management it should be considered before expected return in investment decisions.

Treasury Bills ("T. bills")

T. bills have, until recently, been used by the RBNZ to manage primary liquidity in this country. They were issued for the government, when required by the RBNZ, to reduce interest rate volatility and assist with the management of markets affected by interest rate movements. The use of T. bills has now ceased and been replaced by Reserve Bank Bills. T.

bills are still available in the market place for short term investment with maturities commonly ranging from 21 days to 180 days.

The issue of T. bills is at the discretion/instruction of the Debt Management Office of Treasury. This enables the Government to borrow in the same fashion as a private company on the short-term market.

The issuer and registrar of T. bills is the RBNZ. A T. bill is government guaranteed and as such is risk free. The liquidity is good, although it was marginally reduced when replaced by the R.B. bill as the tool for primary liquidity. However T. bills can be bought and sold through any bank, broker or merchant bank. These characteristics make the T. bill a good investment for Council in terms of minimising risk.

Pricing of a T. bill is by the standard discounting formula. Payment is by direct credit to an account nominated by the seller. As a registered document the T. bill is transferred into the investor's name at the registry (RBNZ) and a 'statement' of the position held is then mailed to the investor. This statement substitutes for the certificates used for the other securities. When a T. bill is sold, the investor must arrange to have a transfer delivered to the registry on the date of settlement, instructing that the T. bill be placed into the buyer's name. Payment would simultaneously be made to the Council by that buyer.

Upon maturity of a T. bill no delivery of title is required unless a 'Certificate of Title' has been issued. The registry (RBNZ) will automatically make a payment to the registered holder of the maturing bill. In the past T. bills have traded at yields below comparable bank bill yields. However, since T. bills ceased to be used as a tool for primary liquidity their yields have risen to levels similar to bank bills.

NZ Government Inflation Indexed Bonds

These bonds are particularly appropriate to preserve the value of capital over the long term. They are issued vary rarely and have a duration of about 20 years. Every quarter the principal sum is adjusted for movements in the CPI. Generally the index adjustments are lagged. The index adjustment will be the average percentage change of two quarters ending in the quarter two periods prior to that in which the interest payment and principal adjustment date occurs, e.g. a February 2009 principal adjustment is based on the average movement in the CPI over the two quarters ending September 2008. These bonds are tradable, allowing the investor access to their funds before maturity.

Reserve Bank Bills ("R.B. bills")

The R.B. bill was introduced in 1989 by the Government through the RBNZ as the new tool for primary liquidity management to replace the T. Bill and are risk free, by nature of their government guarantee. Banks use R.B. bills to manage their own in-house liquidity position and as a result are the major purchasers of R.B. bills. R.B. bills are issued with maturities which generally range from 7 to 120 days. Maturity dates are set to match days on which the RBNZ forecasts low levels of cash availability to smooth out the fluctuations in demand and supply for money which would otherwise occur.

R.B. bills are priced using the standard discounting formula and offer medium liquidity. However when the maturity of the bills becomes 30 days or less they may then be 'discounted' back to the RBNZ for cash during the RBNZ's daily open market operation ("OMO"). This is commonly done by the banks tendering the interest rate at which they would discount (return) the R.B. bill back to the RBNZ.

Whether or not the RBNZ accept these offers is directly related to the need to supply more cash to the market place. If in fact the RBNZ wishes to remove cash from the market R.B. bills will be offered through a tender mechanism.

R.B. bills, like T. bills, are registered in an investor's name at the RBNZ. Title is registered upon delivery of a transfer signed under seal. Payment is made by direct credit to an account nominated by the selling institution or by the RBNZ as appropriate. Repayment requires no delivery of title as the payment is made to the registered holders of the bill on maturity date.

It is unlikely the Council would choose the R.B. bill as a common short term investment since yields on R.B. bills are consistently 20 basis points (0.20%) lower than comparable bank bill yields.

Bank Bills

Bank bills may be purchased at a fixed interest rate for a given term, generally ranging between 21 days and 95 days, however, terms are negotiated up to 180 days. Bank bills can be issued by any bank registered with the Reserve Bank of New Zealand ("RBNZ") when approached by a borrower. There are always two parties involved when Bank Bills are drawn down with both being named on the bill. The secondary market for bank bills is the most liquid market for short term securities in New Zealand.

Any bank, broker or merchant bank can act as the buying or selling agent for a bank bill, however, professional investors discriminate between the bills issued by the original four trading banks, and those issued by any other registered bank. Bills issued by ANZ, BNZ, Westpac and the National Bank are more liquid than those from the other registered banks. Security is provided by the issuing bank which accepts and endorses the bills. The drawer is the institution or client wishing to borrow funds from the bank. The acceptor of the bill is the issuing bank.

A bank bill is sold at a discount with the face value payable by the borrower at maturity. All money market investments are priced by determining the present value of the cash flows which are being purchased by the investor. The face value of the bill is discounted at the market interest rate for the term remaining until maturity of the bill.

i.e. \$1,000,000 discounted at 13.75% for 90 days = \$967,207.68
or \$967,207.68 invested at 13.75% for 90 days = \$1,000,000

Delivery is usually arranged by one of two methods

- physical delivery to the purchaser
- retention of the instrument in safe custody on behalf of the purchaser at the bank where the purchase was made

A bank bill is a bearer document. Confirmation is by contract note detailing all conditions and terms of the bill. Physical delivery places a security risk on the investor's ability to safely retain such documents in-house but is generally not required where the bank holding the bill is the issuer. Where an agent, other than the acceptor, is holding the instrument on behalf of the investor, the investor is exposed to the risk that no such instrument is being held. Thus the purchaser must be absolutely satisfied with the integrity of the agent or, alternatively, take delivery of the instrument and ensure it is held in safe custody. Recent corporate failure has heightened the awareness of the necessity to obtain and have control over all documents.

Payment is usually made by direct credit to the seller's nominated bank account prior to 4.30 p.m. on the date of settlement. In the case where the bank from which the bank bill is purchased holds the Council's current account, the bank may offer to debit the Council's account for payment. Alternative arrangements can be made for payment if negotiated with the selling party at the time of the transaction.

Maturing bills are repayable on the maturity date specified on the bill. Repayment is credited to a nominated bank account. This will be done automatically by the party holding the bill. However, if the bill is being held in the Council's office it must be delivered to the issuing bank for repayment.

Registered Certificate of Deposit ("RCD")

RCDs are issued in a similar way to bank bills, enabling the investor to accept a fixed interest rate for a term ranging from 21 to 95 days. They are issued by a bank to raise funds in its own name and bear no reference to any borrower/drawer. Security is offered by the issuing bank

which endorses the RCD. An active secondary market exists as the issuing bank will often repurchase its own RCDs ensuring that there is adequate liquidity.

Internal Investing

Council may also use the investment funds to finance internal borrowings. The interest and principal would be charged to the Council activity undertaking the borrowing. Matters to be considered are:

- Market loan rates v investment pool rates
- Liquidity of investment pool, i.e. are funds available to use to finance borrowings
- The desired maturity profile for the debt and the investment
- Minimum levels of investment funds required to be held.

The aim of internal investing is to provide a win-win situation for the investment pool and the borrowing activity. Internal investment must leave the investment pool in no worse a position than if external investments had taken place. As these investments are repaid via rates, they are considered a low risk investment

Deposits

Deposits are the simplest form of short term money market investment.

To achieve a competitive rate of return interest rate quotes can be obtained by telephone. The investor will then accept the best offer taking account of the rate and the security of the offering institution. The selected institution is then notified and the monies banked to its account. A certificate or note of acceptance is provided confirming the transaction following settlement.

Generally specific security is not offered however, if a specified security is offered this usually becomes the sole security for the investment. In such a case the security instrument should be delivered to the investor. An example would be where an ANZ bank bill is offered as security for a deposit to an organisation which did not itself have a satisfactory credit rating. The credit risk then becomes that of the ANZ bank, not the borrowing organisation as in the event of default by the borrower the bill would be sold to realise the investment funds.

Interest is payable on the amount deposited and a deposit may either be repaid or renegotiated in part or in full upon the maturity date agreed to at inception. If a deposit has been secured, by delivery of some form of security, that security must be returned to the party from whom repayment is sought. Repayment will, in most cases, be made to a bank account nominated by the Council.

Stocks/Bonds ("Stocks")

In New Zealand the terms stocks and bonds are used interchangeably. For the purpose of simplicity in this report we have used the more common term 'stocks'. Stocks are issued by a wide variety of organisations, including the government, to raise long term debt at a fixed interest rate.

Typically the shortest term offered is 2 years and, while commonly the longest term is not more than 10 - 12 years, it can be as long as the issuer requires. Generally stocks are registered investments and knowledge of the registry system will enable swift and efficient transfer of ownership. Bearer stocks are rare.

Promissory Notes ("P. Notes")

P. Notes or commercial paper are a short term bearer security issued at a discount by a borrower who promises to repay the face value of the note to the bearer when the note reaches maturity. Because the only name appearing on a P. Note belongs to the issuer, these securities are sometimes referred to as "one name Paper", as distinct from bank bills

where the bank in question accepts a commercial bill on an issuer, and as a result at least two names appear on the bank bill.

The pricing and marketability of a P. Note is primarily determined by the credit worthiness of the issuer, since it is the issuer who promises to directly repay the bearer of the P. Note upon maturity. P. Notes have historically been issued via an open market tender or dealer system where appointed dealers bid competitively for a P. Note issue at the request of the corporate borrower. Bid are normally made on behalf of the prospective investor. An issuer will usually advise the market of its intention to tender P. Notes on a "same day" basis i.e. the market is usually given a few hours notice. A fixed amount is normally offered for tender, with successful bidders being allocated the notes according to the lowest yields bid.

P. Notes may be issued with a term to maturity ranging from 7 to 365 days though maturities of more than one year can and have been arranged the majority of the P. Notes issued in the New Zealand market are for terms of 30 or 90 days. Similar to bank bills, the market price is determined as a discount on the face value of the note using the following formula:

$$\text{Market price} = \text{FV} / (1 + (Y/100) * (n/365))$$

Where: FV= face value

Y = yield to maturity

n = number of days to maturity

Investors price P. Notes at a margin over bank bills for a similar maturity. The basis point margin over bank bill bid rate (BBBR) will reflect an investor's assessment of the credit risk of the particular issuer and the paper's marketability or liquidity.

Debentures

Debentures are a form of debt security issued by organisations pursuant to a trust deed. Until 1986 debenture issues were quite common in both the wholesale and retail markets. Debentures are now common only in the retail investor market.

Liquidity is low for debentures. Corporate borrowers have moved from issuing debentures, as was common in the early 1980's, to the use of P. notes or stock issues. This has reduced the volume of debentures available for financial market trading and thus their liquidity. A lack of homogeneity in maturity and interest payment dates also restricts the liquidity of the debenture market.

Security on debentures must be assessed carefully as consideration must be given to the security of the issuing organisation and to the ranking of the debenture. In a very similar fashion to the way mortgages may be registered as first or second, debentures may be first ranking or second ranking.

Debentures are priced on a yield to maturity in a similar fashion to other debt securities, such as stocks and money market investments.

Interest payment dates also vary more on debentures than on the instruments previously described. Several companies chose to debentures with semi-annual interest payments however, others issuing them with quarterly interest payments and in some cases compounding interest facilities.

Registration of debentures is often kept by the issuing company; however, it is not uncommon for a registry service to be employed. Certificates are issued to the investors and must be stored securely as return of this document is required before repayment will be made on maturity. If the certificate is lost a legal indemnity must be signed acknowledging responsibility for the loss before another will be issued.

Mortgages - Council as Mortgagor

Commercial or residential mortgages may be issued at the request of the Council. While it is not advisable for the Council to invest in mortgage secured loans as a commercial

investment, there may be times when social objectives will override commercial objectives. If such a mortgage investment is made the funds offered should not exceed 65% of an independent registered valuation obtained by Council. The mortgage security should in every case be a first mortgage security. Due consideration must be given to the borrower's ability to repay over the term of the loan. In making this assessment Council may require independent professional advice. Repayments of capital and interest should, in all cases, be made by regular automatic payments to Council's account on predetermined dates.

Equities/Registered Mortgages

Investment in equities (shares) and registered mortgages may be made by council and would need direct Council approval. Should Council wish to invest directly in equities/registered mortgages it should take professional advice.