INVESTMENT POLICY

Effective from 9 June 2021

Purpose

Council holds financial investments sufficient to match reserve accounts created by Council resolution and as a result of short term cash flow surpluses.

Local Government Act 2002 Requirements

Section 105 of the Local Government Act 2002 provides that the Investment Policy adopted under Section 102(1) must state Council policies in respect of investments, including:

(a) The mix of investments,

(b) The acquisition of new investments,

(c) An outline of the procedures by which investments are managed and reported on to Council.

(d) An outline of how risks associated with investments are assessed and managed.

Objectives

The objectives of this Investment Policy are consistent with market best practices and will take into account the requirements of Council's Annual Plan and Long-Term Plan. The key Investment Policy objectives are to:

- Prudently manage Council's investment assets in the interests of the Council's district and its inhabitants and ratepayers, only for lawful purposes and so as to safeguard against loss.
- Manage investments in accordance with the Local Government Act 2002; administer, manage and account for its funds and exercise the care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.
- Maximise investment income within a prudent level of investment risk. Council recognises that as a responsible public authority any investments that it does hold should be of relatively low risk. It also recognises that lower risk generally means lower returns.
- Invest only in approved securities and asset classes as permitted by this policy. Accordingly, only creditworthy counterparties are acceptable.
- Ensure investments are maintained at an appropriate level of liquidity to enable the provision of cash flow when required.
- Minimise potential risk due to adverse interest rate movements.
- Regularly review the performance and credit worthiness of all investments.

- Maintain operational controls and procedures to best protect Council against financial loss, opportunity cost and other inefficiencies.

Investment Management and Internal Controls

Council approves policy parameters in relation to borrowing and investment activities.

In making any investment decisions the Group Manager Finance and Assurance considers:

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

Council's Chief Executive has overall responsibility for the operations of Council.

The Group Manager Finance and Assurance has financial management responsibility over Council's investments.

Investment Portfolio

An investment is an asset held by Council that provides service potential or future economic benefit to Council. Investments include property; ownership in Council related trading entities and financial assets. A financial asset is any asset that is cash or the contractual right to receive cash including the financial investment instruments.

Council invests in the following assets:

- Financial investments (excluding day to day cash management activity).
- Property investments.
- Cash and working capital management.

Financial Investments

Council maintains financial investments for the following primary reasons:

- Invest amounts allocated to special reserves.
- Invest surplus cash and working capital funds.

The following are approved financial investments:

- Government investments (treasury bills, government stock).
- New Zealand Registered Bank investments (call and term deposits, registered certificates of deposit), subject to Counterparty Exposure Limits.
- Local authority investments subject to Counterparty Exposure Limits.
- State Owned Enterprise investments subject to Counterparty Exposure Limits.

- Corporate investments (corporate bonds, promissory notes) subject to Counterparty Exposure Limits.

Acquisition/Disposition and Revenue

Interest income from financial investments is credited to general funds or special reserves and is included in the Statement of Comprehensive Revenue and Expenses.

Proceeds from the disposition of financial investments are used for operational and capital expenditure purposes or for the purpose for which they have been established, as approved in the Annual Plan or Long-Term Plan.

Management Procedures

Financial investment strategy is set by the Group Manager Finance and Assurance and implemented by the Finance Team of Council with day to day management centrally through its treasury function. The treasury function is broadly charged with the following responsibilities:

- Assist the Group Manager Finance and Assurance in developing its investment strategy by reviewing on a regular basis, cash flow forecasts incorporating plans for approved expenditure and strategic initiatives, evaluation of the outlook for interest rates and the shape of the yield curve, and where applicable, seeking appropriate financial advice.
- Develop and maintain professional relationships with the financial markets in general and Council's main relationship bank in particular.
- Manage Council's investments within its strategic objectives and ensure that surplus cash is invested in liquid and creditworthy instruments.
- Manage the impact of market risks such as interest rate risk and liquidity on Council's investments and currency risk on investments by undertaking appropriate hedging activity in the financial markets.
- Minimise adverse interest rate related increases on ratepayer charges and maintain overall revenues within budgeted parameters.
- Manage the overall cash and liquidity position of Council's operations.
- Provide timely and accurate reporting of treasury activity and performance for management and the Council.

Investment Risk: Credit Risk – Counterparty Exposure Limits

Council's primary objective when investing is the protection of its capital. Accordingly, only creditworthy counterparties are acceptable. Creditworthy counterparties are selected on the basis of their Standard and Poor's (S&P) rating except for unrated Local Authorities secured by charge over rates, which are governed by individual counterparty limits.

More specifically, Council minimises its credit exposure by:

- Ensuring all investment, cash management, interest rate risk management and any foreign exchange transactions are undertaken with entities (excluding Government) that have a Standard and Poor's (S&P) credit rating of at least A2 for short term and A- for long term except for unrated Local Authorities secured by charge over rates, which are governed by individual counterparty limits and State Owned Enterprises which must have minimum credit ratings of A2 and BBB respectively.
- Limiting total exposure to prescribed amounts and portfolio limits.
- Rigorous monitoring of compliance against set limits.

Council approval is required to add to or delete from the counterparty exposure limits. The following table summarises credit requirements and limits:

Institution	Minimum S&P Short Term Credit Rating [1]	Minimum S&P Long Term Credit Rating [2]	Total Exposure Limit for Each Counterparty	Portfolio Limit (% of Total Portfolio)
Government	N/A	N/A	Unlimited	100%
New Zealand Registered Banks				
➢ On balance sheet exposures	A2	AA-	$35 million	80%
➢ Off balance sheet exposures	A2	AA-	$10 million	N/A
Strongly Rated Corporates, SOEs (on balance sheet exposures only), Local Authorities with rates as security (on balance sheet exposures only)	A2 (N/A for Local Authorities)	A- (BBB for SOEs, N/A for Local Authorities)	$5 million [Face Value]	50%

1. Short term refers to securities with a remaining maturity of 12 months or less.
2. Long term refers to securities with a remaining maturity of more than 12 months.

If any counterparty's credit rating falls below the minimum specified in the above table then all practical steps are taken to reduce the credit exposure to that counterparty to zero as soon as possible or in any case within three months of the downgrade being notified. Exposures to each counter party are computed as follows:

On-Balance Sheet

- Total principal invested with that counterparty.
- International equities currency exposure on foreign currency hedging converted on the day at the spot rate.

Off-Balance Sheet

Credit exposure on interest rate contracts computed by multiplying face value of outstanding transactions by an interest rate movement factor of 5%, per calendar year or part thereof of the life of the instrument.

Interest Rate Risk

Interest rate risk refers to the impact that movements in interest rates can have on Council's cash flows. Council's financial investments give rise to direct exposure to interest rate movements. Interest rate risk is managed by Council as part of its overall investment strategy.

The following interest rate risk management instruments are approved by Council:

- Interest Rate Swaps.
- Forward Rate Agreements.
- Interest Rate Options on approved underlying instruments, eg on Interest Rate Swaps or bonds.
- Interest Rate Collar Strategy, but only where the ratio of the face value and interest rate exposure on bought to sold legs is 1:1.

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

Liquidity Risk

Liquidity risk management refers to the timely availability of funds to Council when needed, without incurring penalty costs.

Because of Council's credit rating criteria, all investments would be readily saleable in the secondary market, which addresses Council's liquidity requirements, even though there may be a pricing risk if there was a forced sale in adverse market conditions. Nevertheless, at least 25% of financial investments must mature within the ensuing 12 months.

The average duration* of the total investment portfolio would normally be between two and three years.

* *Duration is a mathematically calculated term representing the average of the time weighted cash flows of the investment, discounted at current yields.*

Property Investments

Council's property investments include:

- Property owned by Council either for the development needs of the district or for investment purposes which could include land, buildings and ground leases.

Council's primary objective for property owned for development needs or for investment purposes is that it is important for the economic, physical and social development of the Invercargill district and to achieve an acceptable rate of return. Council generally follows a similar assessment criteria in relation to the acquisition of new property investments.

Acquisition/Disposition and Revenue

Prior to acquisition of property for the development needs of the district or for investment purposes the property will be assessed as follows:

- Property for the development needs of the district – a financial and non financial assessment of economic, physical and social benefit to the district, the cost of owning the property and the cost of ownership and assessment.
- Investment property – a financial assessment including a calculation and assessment of the total cost of ownership, and the likely returns to be generated from that ownership.

Proceeds from the disposition of property investments are used for retirement of debt relating to such property, or allocated to general funds, endowment funds or special funds. All income from property investments is shown in the Statement of Comprehensive Revenue and Expenses and forms part of general funds.

Management Reporting and Procedures
Council reviews the performance of its property investments on at least a six monthly basis, and ensures that the benefits of continued ownership are consistent with its stated objectives.

Investment Risks
Insurance cover is held for all property investments. A risk assessment is carried out prior to acquisition of a property investment.

Cash and Working Capital Management

Cash management deals with the net balance in Council's main bank accounts. The treasury function is responsible for managing Council's cash surpluses and/or deficits.

Council maintains a Daily Balancing Report (bank reconciliation) and short term and long term cash flow projections which are updated weekly and which form the basis of its cash management activity. Generally cash management surpluses are available for periods less than 90 days.

Cash management instruments are limited to:

- Call deposits with New Zealand Registered Banks.
- Corporate Commercial Paper with a maturity less than three months.
- Term deposits (less than three months) with registered banks.
- The use of interest rate risk management instruments on cash management balances is not permitted.

Cash and the counterparties on cash management instruments may only be invested with approved counterparties within the limits detailed.

Monitoring and Auditing

The Risk and Assurance Committee will monitor the application of this Policy via reports from Executive staff.

Revision History:	21 November 2017 (A804694)
Reference Number:	**A3420180**
Effective Date:	9 June 2021
Review Period:	This Policy will be reviewed every six (6) years, unless earlier review is required due to legislative changes, or is warranted by another reason requested by Council.
Supersedes:	2017 Investment Policy
New Review Date:	June 2027
Associated Documents/References:	
Policy Owner:	Invercargill City Council

Appendix 1

Approved Risk Management Instruments

Examples of the Use of Derivative Products

Forward Rate Agreement

An agreement between Council and 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 contained on 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 three month period, starting at some point within the next 12 months.

Example

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

Outcome

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

Interest Rate Swap

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

Objective

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

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

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

Interest Rate Collar

The combined purchase (or sale) of a cap or a floor with the sale (or purchase) of another floor or cap. Unlike an outright option purchase there is no premium payable but conversely participation in favourable movements is limited.

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

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

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