LIABILITY MANAGEMENT POLICY

Effective from 9 June 2021

Purpose

Council borrows for the following primary purposes:

- General debt to fund Council's capital works primarily on infrastructure assets. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to Council's assets and investments.
- Short term debt to manage timing differences between cash inflows and outflows, and to maintain Council's liquidity.
- Specific debt associated with significant "one-off" projects and non-financial investments from time to time.
- Borrowing through hire purchase, credit, deferred payment or lease arrangements in the ordinary course of Council business.

Scope

Local Government Act 2002 Requirements

Section 104 of the Local Government Act 2002 provides that the Liability Management Policy required to be adopted under Section 102(1) must state the local authority policies in respect of liability management, including:

(a) Interest rate exposure

(b) Credit exposure

(c) Liquidity

(d) Debt repayment

Objectives

The objectives of the Liability Management Policy are consistent with market best practice and will take into account Council's 10 year plans as set out in the Long-Term Plan. The key Liability Management objectives in relation to borrowings are to:

- Prudently manage Council's borrowing activities to ensure the ongoing funding of Council.
- Borrow only under Council approved facilities and as permitted by this policy.
- Minimise borrowing costs within prudent risk management control limits.

- Manage exposure to adverse interest rate movements.
- Ensure operational controls and procedures to protect Council against financial loss, opportunity cost and other inefficiencies are maintained.

Borrowing Management and Internal Controls

Council approves policy parameters in relation to borrowing activities.

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

Council considers the impact on its borrowing limits as well as the size and the economic life of the asset that is being funded and its consistency with Council's Long-Term Plan.

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

- The period of indebtedness is less than 365 days; or
- The goods or services are obtained in the ordinary course of operations on normal commercial terms for amounts not exceeding in aggregate $50,000.

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

The Group Manager of Finance and Assurance reviews regular treasury reports to ensure compliance with policies, procedures and risk limits and has overall responsibility for setting risk management strategies in relation to the implementation of this treasury policy. The Group Manager will also oversee the management of Council's relationship with financial institutions and the negotiation of borrowing facilities with bankers, the appointment of brokers/arrangers/managers.

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

- Manage Council's borrowing programme to ensure funds are readily available at margins and costs favourable to Council.
- Raise authorised and appropriate borrowing, in terms of both maturity and interest rate strategies.
- Manage the impact of market risks such as interest rate risk and liquidity on Council's borrowing by undertaking appropriate hedging activity in the financial markets.
- Minimise adverse interest rate related increases on ratepayer charges and maintain overall interest costs within budgeted parameters.
- Provide timely and accurate reporting of treasury activity and performance.

Council is prohibited from borrowing in a foreign currency by Section 113 of the Local Government Act 2002.

Interest Rate Exposure

Interest rate risk management refers to managing the impact that movements in interest rates can have on Council's cash flows. This impact can be both favourable and unfavourable. Council's ongoing borrowing requirement gives rise to direct exposure to interest rate movements.

Fixed / Floating Profile

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

A balance is achieved through having variable terms with regard to interest rate resets.

The Council manages its interest rate exposures by defining minimum and maximum hedging percentages within various time buckets. These parameters are reviewed annually by the Group Manager of Finance and Assurance. Any changes recommended must be approved by the full Council before inception. The table below shows an example of how minimum and maximum hedged or fixed rate exposure requirements within various time buckets are detailed in operational procedure and reporting documentation.

Interest Rate Maturity Profile Limit		
	Minimum Fixed Rate	**Maximum Fixed Rate**
Zero to two years	40%	100%
Two to five years	25%	80%
Five to ten years	0%	60%

Any hedging outside the determined parameters or for longer than 10 years must be approved by the Council, before initiation.

When managing the interest rate risk of the Council the hedging percentages relate to total core debt. Core debt cannot exceed borrowing projections as per the Long-Term Plan or Annual Plan or as approved by the Council.

Interest Rate Risk Management Contracts

Interest rate risk can be managed by using interest rate risk management contracts that allow the re-profiling of the portfolios including the:

- Hedging of up to 100% of repricing risk on existing fixed rate debt and issue yield risk on planned new debt within the next 12 month period.
- Converting fixed rate borrowing into floating rate or hedged borrowing and floating rate borrowing into fixed or hedged borrowing within the overall parameters of this policy.

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

- Interest Rate Swaps
- Forward Rate Agreements
- Interest Rate Options on approved underlying instruments, e.g. 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.

Credit Exposure

Council hedging can only be undertaken with approved New Zealand Registered Banks.

Liquidity and Funding Risk

Liquidity management refers to the timely availability of funds to Council when needed, without incurring penalty costs. 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 terms of existing facilities. A key factor of funding risk management is to reduce the concentration of risk at any one point in time so that if one-off internal or external negative credit events occur, the overall interest cost is not unnecessarily increased.

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

- Cash flow forecasts will be produced to assist in the matching of operational and capital expenditure to revenue streams and borrowing requirements.
- Council will maintain its financial investments in liquid instruments.
- Council will ensure that, where sinking funds or Council created investments are maintained to repay borrowing, these investments are held for maturities not exceeding the relevant borrowing repayment date.
- To minimise the impact of unexpected cash surpluses, the Council will take advantage of the efficiencies of any floating rate loan facility.

The following guidelines have been established to control funding risk:

- To avoid concentration of debt maturity dates no more than 50% or $25 million (whichever is the highest) of total debt can be subject to refinancing on a rolling 12 month basis. Total debt is defined as total existing external debt.

Debt Repayment

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

- Affordability of debt servicing costs.
- Intergenerational equity principles (debt will be repaid over the life of the asset or an appropriate period of time determined by the asset involved, whichever is the lesser).
- Maintenance of prudent debt levels and borrowing limits.

- Council repays borrowings from general, special funds, the existing specific sinking fund, or operating surpluses allocated to that borrowing.
- Where a loan is raised for a specific purpose and the funds are no longer required, the funds will be used to repay existing debt or held in a special fund until the funds can be applied against a future borrowing.

Borrowing Mechanisms

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

- Available and Council approved sources, terms and types of borrowing.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates, margins and total cost relative to term and nature of the borrowing.
- The market's outlook on future interest rate movements as well as Council's own.
- Legal documentation and financial covenants.

Guarantees

Council provides guarantees for banks for loans between the bank and non-profit bodies where Council considers the guarantee to be beneficial to the community and in accordance with the following parameters:

- The loan must be in the name of a legally constituted body.
- To qualify for a guarantee, the proposed works should be such as are not available for normal security when situated on Council reserve.
- The guarantee must be required by the lender.

The organisation must provide the Council with satisfactory evidence of its ability to repay the loan, on the terms specified for the loan. To that end the organisation shall supply the latest annual accounts and such other information as may be available in support of its application. A three-year projection of the organisation's financial ability to meet loan repayments should be included.

- Where the loan is for an insurable asset, such as a building, it shall be insured in the joint names of the Invercargill City Council and the applicant organisation for full replacement value (not the indemnity value).
- The loan shall be subject to personal guarantees, by way of a legal document, from persons acceptable by the Council. Such personal guarantees shall remain in force until the loan is fully paid off and shall not reduce proportionality to repayments.
- In consideration of the guarantee, the organisation which will benefit shall pay an annual charge of 1/2% of the amount guaranteed either to form a fund from which any liability of the Council could be met, or for administration purposes. Such a percentage, together with the personal guarantees suggested, will tend to make an application for guarantees more realistic.
- In the event of the Council being required to meet a guarantee all the assets of the organisation revert to the Council. To ensure that these assets are kept in good repair the Council shall have the right to inspect assets and request any action necessary to maintain them in good repair.

- Guarantees require the approval by way of Council resolution.

Leases

Council utilises finance leases (as opposed to an operational lease ie renting) as a means of financing some office equipment.

Approved Risk Management Instruments

Interest Rate Swap ("IRS")

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 cash flows would be netted off if the swap and the underlying borrowing facility were with the same bank.

Monitoring and Auditing

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

Reference Number:	A3411478
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 Liability Management Policy
New Review Date:	June 2027
Associated Documents/References:	Nil.
Policy Owner:	GM - Finance and Assurance, Invercargill City Council