# Tasman District Council
# DRAFT
# Treasury Management Policy

Incorporating the Borrowing Management Policy and Investment Policy

(19 November 2008)

# Contents

# 1. Introduction

Tasman District Council ("the Council") undertakes borrowing, investment and risk management activity (in total referred to in this document as treasury activity). The Council's treasury activities are carried out within the requirements of the Local Government Act 2002 which defines the operating environment for local authorities in relation to borrowing, investment and risk management activity.

This treasury policy document provides the policy framework for all of the Council's treasury activities and defines the financial stewardship and key responsibilities and the operating parameters within which borrowing, investment and risk management activity is to be carried out. This treasury policy document will be reviewed and updated on an triennial basis.

## *1.1 Objective*

*To implement policy and financial management that will yield advantage to the people of the Tasman District.*

Council's goals to achieving this objective are:

- accurate, transparent accounting and cash flow reporting
- to provide timely and accurate information to Council operating committees
- to act in accordance with Council delegated responsibility for all financial matters
- ensure that Council investment expenditure is justified by a pre-determined recovery of capital, or a return on investment at an established rate in either cash or public good
- the value of Council owned assets to be costed into annual operating expenses of each activity
- to manage Council investment portfolio and advise on the use of those revenues generated
- to ensure Council compliance with statutory obligations
- to advise Council on risk management obligations in the protection of its ratepayers assets
- to ensure that financial planning will not impose unnecessary burdens on future ratepayers of Tasman District

## *1.2 Borrowing*

The Council's borrowing activity is largely driven by its capital works programme.

Council's primary objective behind its borrowing activity is:

- to ensure that appropriate funding is in place to meet current and ongoing commitments of the Council
- that borrowings provide a basis to achieve intergenerational equity by aligning long term assets with long term funding sources.
- to ensure that borrowings are undertaken efficiently and in accordance with the council's Liability Management Policy

The Council's borrowing policy is discussed in Section 3 of this document.

## *1.3 Investments*

The Council manages a significant portfolio of investments comprising equity investments, forestry, property and special funds.

Council's primary purpose in retaining an investment portfolio is:

- strategic assets are to be held by the Council, for public good
- to earn from strategic investments a cash flow for investment in community wellbeing
- prudently manage cash flows within annual budget parameters
- to support short term cash requirements

The Council's investment policy is discussed in Section 4 of this document.

## *1.4 Philosophy*

The Council acknowledges that there are various financial risks such as interest rate risk, liquidity risk, funding risk and credit risk arising from its borrowing and investment activities. The Council is a risk-averse entity and does not wish to incur unnecessary risk from its treasury activities.

The strategies to achieve this are as follows:

- adherence to the principles stated within the Liability Management Policy and Investment Policy
- principle of investments - minimisation of risk
- protection of real value of assets
- investments to yield a return equal to the weighted average annual cost of capital (or better) over time.

*The Council's treasury function (refer below) is a risk management function focused on protecting the Council's budgeted interest cost and stabilising the Council's cash flows. The Council will not undertake any treasury activity which is unrelated to its underlying cash flows or is speculative in nature.*

### 1.5 Policy Setting and Management

The Council approves policy parameters in relation to its treasury activities.

The Council's Chief Executive has overall financial management responsibility for the Council's borrowing and investments.

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

Operational management of the Council's forestry investment is provided by P F Olsen & Co Ltd.

Council is joint (50:50) shareholder of Port Nelson Ltd, Nelson Airport Ltd and Tourism Nelson Tasman Ltd, together with Nelson City Council.

### 1.6 Treasury (internal) function

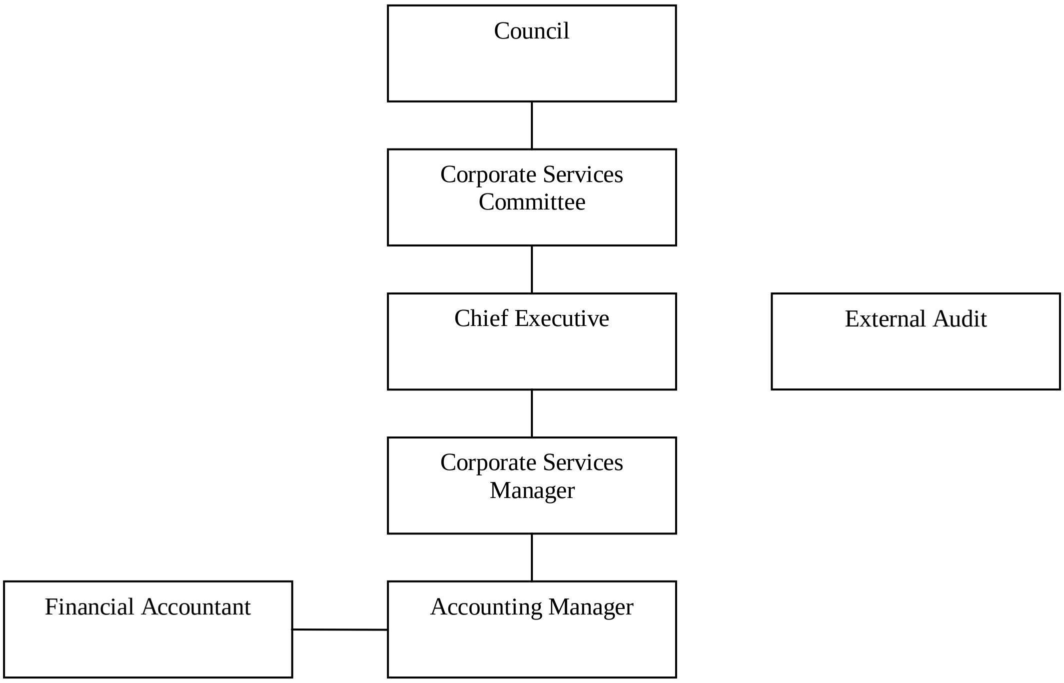
The Council's borrowing, investments (other than those mentioned above) and cash management activities are managed centrally through its treasury function. The treasury function is broadly charged with the following responsibilities to:

- raise funds as required in terms of both maturity and interest rate and manage the Council's borrowing programme to ensure funds are readily available at margins and costs favourable to the Council;
- maintain liquidity levels and manage the overall cash position of Council's operations to meet known and reasonable unforeseen funding requirements;
- minimise Council's exposure to adverse interest rate movements;
- develop and maintain professional relationships with financial markets in general and the Council's bankers in particular;
- manage the Council's investments within its strategic objectives and ensure that surplus cash is invested in liquid and credit worthy instruments;
- avoid adverse interest rate related increases on ratepayer charges and maintain overall interest cost within budgeted parameters;
- realise the economies of scale from operating as a centralised function on behalf of Council's operating divisions and business units;
- effectively charge costs of Council's internal debt to specifically defined operating activities of Council, on a monthly basis;
- borrow and invest funds, and transact risk management instruments within an environment of control and compliance under this Policy to protect the Council's financial assets and costs;
- provide timely and accurate reporting of treasury activity and performance;
- monitor return on investments and achieve performance budgets/targets;
- monitor and report on financing/borrowing covenants and ratios under the obligations of the Council's lending/security arrangements;
- ensure that the relevant Council staff are aware of the latest treasury products, methodologies and accounting treatments through training and in-house presentations

# 2. Management Structure & Responsibilities

## *2.1 Organisation Structure*

The organisation chart for treasury activity is as follows:-




## *2.2 Treasury Responsibilities*

The key responsibilities of the above positions are as follows:

a) Council

- Approve and adopt the Investment and Liability Management Policy document (the Treasury Management Policy)
- Approve actions outside of policy

b) Corporate Services Committee – under Delegation from Council

- Evaluate and approve amendments to policy
- Approve annual borrowing programme contained in the Annual Plan or LTCCP
- Review treasury activity through monthly reporting, supplemented by exception reporting
- Approve interest rate risk management instruments contained in Appendix II and all subsequent additions/deletions

c) Chief Executive

- Overall responsibility for treasury function
- In conjunction with the Corporate Services Manager, approve the opening/closing of bank accounts and new banking facilities
- Manage Council's interest rate profile within prescribed limits (see Section 3.2)
- In conjunction unless delegated to the Corporate Services Manager, approve register of cheque and electronic banking signatories
- Also includes Corporate Services Manager's delegations

d) Corporate Services Manager

- Treasury function responsibilities under delegation from Chief Executive
- Responsibility for managing relationships with financial institutions
- Negotiate borrowing facilities
- Arrange new borrowing undertaken in line with Council resolution and approved borrowing strategy
- Authorise the use of Council approved interest rate risk management instruments within discretionary authority
- Recommend policy changes to Corporate Services Committee for approval
- Peruse market quotes for all treasury transactions (except cash management transactions) prior to execution
- Also includes the Accounting Manager's delegations

e) Accounting Manager

- Day to day responsibility for treasury function

- Secondary responsibility for executing treasury management transactions in the absence of the Corporate Services Manager
- Review month end variance analysis to ensure reasonableness of treasury accounts
- Responsible for maintaining operational and accounting systems to record and report treasury activity
- Review and approve treasury system/spread sheet reconciliation to general ledger
- Also includes Financial Accountant's delegations

f) Financial Accountant
- Report treasury activity to the Corporate Services Manager and to the Accounting Manager
- Prepare cash flow forecasts within policy guidelines
- Execute approved borrowing, investment and interest rate risk management strategies
- Update treasury system/spread sheets for all new, re-negotiated or maturing transactions
- Reconcile treasury system/spread sheets to general ledger

g) External Audit
- Verify accuracy of outstanding treasury transactions by undertaking independent confirmation checks
- Ongoing review of treasury procedures and controls
- To provide an opinion as to whether the Annual Report fairly reflects Council's financial and non financial information
- To provide an opinion as to whether compliance with significant legislative requirements have been met

# 3. Liability Management Policy

### *3.1 General Policy*

The Council borrows as it considers prudent and appropriate and exercises its flexible and diversified funding powers pursuant to the Local Government Act 2002. The Council approves, by resolution, the borrowing requirement for each financial year during the Annual and Long Term Council Community Planning process. The arrangement of precise terms and conditions of borrowing is delegated to the Corporate Services Manager.

*The Council has significant infrastructural assets with long economic lives yielding long term benefits. The Council also has a significant strategic investment holding. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to the Council's assets and investments. Debt in the context of this policy refers to the Council's net external public debt, which is derived from the Council's gross external public debt adjusted for reserves as recorded in the Council's general ledger.*

Generally, the Council's capital expenditure projects with their long-term benefits are debt-funded. The Council's other District responsibilities have policy and social objectives and are generally revenue funded.

The Council raises debt for the following primary purposes:
- Capital to fund development of infrastructural assets
- Short-term debt to manage timing differences between cash inflows and outflows and to maintain the Council's liquidity
- Debt associated with specific projects as approved in the Annual Plan or LTCCP. The specific debt can also result from finance, which has been packaged into a particular project
- In approving new debt, the Council considers the impact on its borrowing limits (refer Section 3.2) as well as the size and the economic life of the asset that is being funded and its consistency with Council's long term financial strategy

### *3.2 Borrowing Limits*

In managing debts, the Council will adhere to the following limit (based on the Council's latest financial statements).

| | |
|---|---|
| Net External Debt (2) not to exceed | 20% of Equity |
| Net External Debt not to exceed | 250% of<br>Total Operating Revenues (1) |
| Net interest expense on external debt as a percentage of total revenue (debt secured) to be less than | 20% |
| Net interest expense on external debt as a percentage of total annual rates income (debt secured) to be less than | 30% |
| Liquidity (Term debt + committed loan facilities + cash or cash equivalents) over projected peak net debt levels over the next 12 months, to be at least | 110% |

1. Operating revenue is defined as earnings from rates, government grants and subsidies, user charges, levies, interest, dividends, financial and other revenue

2. Net External Debt = Gross External Debt (aggregate borrowings of the council, including any capitalised finance leases, and financial guarantees provided to third parties) less any cash or near cash treasury investments held from time to time. Net external debt is defined as loan funds raised to meet Council activities, but does not include debt of Council's associate organisations or equity investments.

### *3.3 Borrowing Mechanisms*

*The Council will be able to borrow through a variety of market mechanisms including issuing, commercial paper, stock and debentures, direct bank borrowing. Council accesses the short and long-term wholesale and retail debt capital markets directly and indirectly.*

Finance leases are evaluated with financial analysis in conjunction with traditional on balance sheet financing. The evaluation should take into consideration, ownership, redemption value and effective cost of funds.

In evaluating strategy for new borrowing (in relation to source, term, size and pricing) the Corporate Services Manager takes into account the following:

- Available terms from banks, debt capital markets and loan stock issuance
- The Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/roll over time
- Prevailing interest rates and margins relative to term for; loan stock issuance, capital markets and bank borrowing
- The market's outlook on future interest rates, as well as its own
- For internal funded projects, to ensure that finance terms for those funded projects are at least equitable with those terms that could be obtained externally
- Legal documentation and financial covenants

The Council uses a mixture of short-term facilities (which generally have lower credit margins) as well as longer term facilities to achieve an effective borrowing mix, balancing the requirements of liquidity and cost.

### *3.4 Liquidity/Funding Risk Management*

Cash flow deficits in various future periods based on long term financial forecasts are reliant on the maturity structure of loans and facilities. Liquidity risk management focuses on the ability to borrow at that future time to fund the gaps without incurring penalty costs. The main requirement of this policy, in terms of liquidity, is for there to be sufficient funds available at any time to meet cash obligations as they fall due. Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and borrowing margins) and maturity terms of existing facilities.

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

Where possible, Council seeks a diversified pool of borrowing and ensures that bank borrowings are only sought from strongly rated New Zealand registered banks.

To ensure funds are available when needed Council ensures that:

- There is sufficient available operating cash flow, liquid investments and committed bank facilities to meet cash flow requirements between rates instalments as determined by the Chief Executive and Corporate Services Manager. Cash flow management will be used to identify and manage maturity mismatches between external borrowings, internal loans and liquid investments
- Term debt and a liquidity buffer are maintained at an amount over 110% of projected peak net debt levels over the next 12 months
- The liquidity buffer is maintained from either available committed bank facilities and/or liquid negotiable financial investments. Liquid investments have a maturity of no more than 3 months
- The Chief Executive and Corporate Services Manager have the discretionary authority to re-finance existing debt on more favourable terms. Such action is to be ratified and approved by the Council at the earliest opportunity

The Council does not hold its reserves in cash. While reserves are not funded, the Council anticipates and plans for draw-downs against reserves (refer section 3.9)

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

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high for reasons within or beyond Council's control, delegated debt maturities are generally spread widely over a band of maturities. Specifically, total committed funding in respect to all loans and committed bank facilities is controlled by the following system:

| Period | Minimum | Maximum |
|---|---|---|
| 0 to 3 years | 20% | 60% |
| 3 to 5 years | 20% | 60% |
| 5 years plus | 10% | 60% |

A maturity schedule outside these limits requires specific Council approval.

### *3.5 Interest Rate Risk Management*

Interest rate risk refers to the impact that movements in interest rates can have on the Council's cash flows. The Council's borrowing gives rise to direct exposure to wholesale interest rate movements. Generally, given:

- the Council's desire to have predictable, certain, interest costs
- the need to avoid large adverse impacts on general and special rates arising from interest rate related rises
- the long term nature of the Council's assets and intergenerational factors

Council's debt/borrowings are maintained within the following fixed/floating interest rate risk control limit:

| Master Fixed/Floating Risk Control Limit | |
|---|---|
| Minimum Fixed Rate | Maximum Fixed Rate |
| 55% | 95% |

"Fixed Rate" is defined as an interest rate repricing date beyond 12 months forward on a continuous rolling basis.

"Floating Rate" is defined as an interest rate repricing within 12 months.

The percentages are calculated on the rolling 12 month projected net debt level calculated by management (signed off by the Chief Executive). Net external debt is the amount of total debt net of cash or cash equivalents. This allows for pre-hedging in advance of projected physical drawdowns of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to comply with the policy minimums and maximums.

The fixed rate amount at any point in time must be within the following maturity bands:

| Fixed Rate Maturity Profile Limit | | |
|---|---|---|
| Period | Minimum Cover | Maximum Cover |
| 1 to 3 years | 20% | 60% |
| 3 to 5 years | 20% | 60% |
| 5 to 10 years | 10% | 60% |

- Floating rate debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months.

Overall, the Corporate Services Manager sets interest rate risk management strategy by monitoring the interest rate markets on a regular basis and evaluating the outlook for short-term and long-term interest rates in comparison to the rates payable on its fixed rate borrowing. Interest rate risk management must be administered with regard to the hedging parameters within the above limits. Council approval will be sought if the Corporate Services Manager believes that hedging outside of these parameters is warranted.

Interest rate risk strategy is managed through the use of interest rate risk management instruments (see Appendix II) to convert fixed rate borrowing into floating rate or hedged borrowing and floating rate borrowing into fixed or hedged borrowing

A current list of approved interest rate risk management instruments with appropriate definitions is included in the Risk Management Tool Kit in Appendix II of the Treasury Management Policy. Additions to, and deletions from, this list are recommended by the Corporate Services Manager and approved by the Council. The Corporate Services Manager is authorised to use Council approved interest rate risk management instruments on a case by case basis.

### *3.6 Security*

In general, Council will secure its borrowings against its rates revenue as per section 115 of the Local Government Act 2002. The Council has a Deed Sharing Arrangement presently (which is likely to change to a Debenture Trust Deed arrangement) which is offered to lenders/investors and providers of incidental arrangements as security. Other forms of security may be considered if they can lower the cost of borrowing.

Security may be offered over specific assets with prior Council approval. Council will offer security on infrastructure assets where special rating provisions apply.

A register of charges will be maintained by the Council and will be available for inspection.

### *3.7 Repayment*

The Council repays borrowings from rates, surplus funds or proceeds from the sale of investments and assets.

Rates are defined as charges levied under the Local Government (Rating) Act 2002, subjected to Council's Annual Plan or LTCCP process and duly advertised and levied on rating instalment notices.

Surplus funds and proceeds from the sale of investments and assets will be used to repay borrowing unless the Council determines otherwise.

Council policy where it is to the advantage of ratepayers is to repay net external debt to a minimum level of $4,000,000 per year.

### *3.8 Internal Debt Management*

The treasury function is responsible for administering the Council's internal debt portfolio. Loans are set up within the internal debt portfolio based on planned loan funded capital expenditure, and allocated to the department or project incurring the capital expenditure. The following operational parameters apply to the management of the Council's internal debt portfolio:

- Capital expenditure details are extracted by the Accounting Manager at month end
- A notional internal loan is set up for all new capital expenditure and allocated in the internal portfolio to the department incurring the expenditure
- Interest is charged by treasury to departments on month end loan balances at average monthly funding costs incurred by Council
- Treasury uses the internal debt portfolio as an input into determining its external debt requirements. Where possible, the Council's reserves are used to reduce external debt, effectively reducing the Council's net interest cost

### *3.9 Reserves*

The Council has a number of reserves that have been created for specific purposes. Such reserves are used to reduce external borrowings in order to avoid the negative spread on interest rates between borrowed and invested money.

Reserve funds must be available subject to reasonable notice, to the respective committees of Council for specific use.

*Council reserves are utilised for the internal funding of asset investments. They are not necessarily held as liquid assets. The Council maintains committed lines sufficient to cover the sum of the Council's contingency reserves.*

### *3.10 Counterparty Credit Risk*

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

Credit risk will be regularly reviewed by Council. Exposures should be spread amongst a number of counterparties to avoid concentrations of credit exposure. Counterparty limits and credit exposure measurement criteria are set out in Section 7.

# 4. Investment Policy

### *4.1 Investment Mix*

The Council has a significant portfolio of investments comprising:

- equity investments (covered in Section 4.3)
- asset investments (covered in Section 4.4)
- associated organisations (covered in Section 4.5)

### *4.2 General Policy*

Council's philosophy is to ensure that the return on investments in cash, realisable capital growth and/or public good over time is equal to or greater than the average cost of councils borrowings.

The Council will not hold cash investments other than those involving special funds and cash management investments. In its cash investment activity, the Council's primary objective when investing is the protection of its investment. Accordingly, any credit worthy counterparties will be acceptable. The Council's policy on managing credit risk is contained in Section 7 of the Treasury Management Policy.

Council's policy is to invest into banks with short term rating minimum of A-1+ and long term AA-, by Standard and Poor's Rating (or equivalent rating) (see section 7).

Within the above credit constraints, Council also seeks to:

- Ensure investments are negotiable and liquid
- Manage potential capital losses
- Maximise investment return

### *4.3 Equity Investments*

#### *4.3.1 Port Nelson Limited*

*Nature of Investment and Rationale for Holding.*

Council is a 50% shareholder in this Company, with Nelson City Council holding the other 50% shareholding. Future investments in the port will be measured on their ability to return current market rates of return to the shareholders.

*Disposition of Revenue*

The current Directors policy is that a dividend equal to 50% of net profit after tax will be returned to shareholders annually.

*Risk Management*

Risks associated with Council's investment in Port Nelson Ltd are limited.

*Management/Reporting Procedures*

Quarterly reports are received and reviewed by Council. Election of Directors takes place at the Company's annual general meeting

*Specific Policy*

To retain 50% investment in Port Nelson Ltd. This Company is regarded by Council as a strategic investment and is noted for its efficient and flexible operations.

#### *4.3.2 Nelson Airport Limited*

*Nature of Investment*

Council is a 50% shareholder in this Company, with Nelson City Council holding the other 50% shareholding. Future investments in the company will be measured on their ability to return current market rates of return to the shareholders.

Council's investment is represented by 1.2 million ordinary one dollar shares.

*Rationale for Holding Investment*

Council intends to maintain its 50% investment in Nelson Airport Ltd and aims with Nelson City Council to retain effective local body control of this strategic investment.

*Disposition of Revenue*

This Company has resolved to pay an annual dividend detailed in its Statement of Intent and adopted by the shareholders for each of the next three years.

*Risk Management*

Nelson Airport Ltd is an autonomous entity, with Directors appointed by the two local authorities. Directors are required to manage the Company on behalf of the shareholders, in accordance with the requirements of the Companies Act 1993.

### *4.3.3 Tourism Nelson Tasman Ltd*

*Nature of Investment*

This Company was established on 1 July 1994 with a view to promoting and marketing tourism activities of the District, to the potential tourism market throughout New Zealand, the Pacific basin and ultimately the rest of the world.

Tasman District Council and Nelson City Council each hold a 50% share in this Company.

*Disposition of Revenue*

Council is not planning to receive a dividend from the shares in Tourism Nelson Tasman Ltd.

*Risk Management*

Risks associated with Council's investment in Tourism Nelson Tasman Ltd are limited.

*Management/Reporting Policies*

To retain and utilise strategic benefits of investment in this Company.

## *4.4 Asset Investments*

### *4.4.1 Forestry*

*Nature of Investment*

The Council and its predecessor organisations have been involved in forestry for many years. Council's current forestry policy is that it will operate and maintain up to 3,000 planted hectares.

*Rationale for Holding Investment*

Forestry is a flexible investment – the resource can be manipulated to suit cash flow requirements and market conditions. Council has achieved economies of scale with 3,000 hectares. This provides a marketing advantage and cost savings in operations.

*Disposition of Revenue*

Current policy is to provide a fixed sum from net forestry revenue towards subsidising general rate in each financial year. Current statute requires that 10% of net forestry revenues be used for maintenance of Rabbit Island each year. Council's Enterprise Subcommittee currently contributes $140,000 from forestry revenues to the maintenance of Rabbit Island each year. This figure is currently in excess of 10%. The forestry activity will from time to time contribute to Council's general rate – annual contributions are detailed in the 10-year Activity Management Report.

*Risk Management*

Council's forests are currently managed under contract by consultants P F Olsen & Co Ltd. Forestry activities are reviewed quarterly by Council's Enterprise Subcommittee.

Significant risk management strategies include diversity of forest age classes, insurance against fire, mix of species, geographic spread of forests and controlled access.

*Policies for Forestry*

Retention of forestry investment is reviewable annually.

### *4.4.2 Property Investments*

*Nature of Investment*

Council currently has a range of Investment property holdings defined within categories of:

- ready saleable assets
- strategically placed land, precluding the sale of operational properties
- assets saleable after a specific process (often subdivision)
- land with high community value

Property investments do not include properties for operational purposes

*Rationale for Holding Investment*

Council's current property holding, management and operational philosophies are contained within the Property Asset Management Plan. This policy clearly defines Council's statutory obligation, levels of service, tenancy requirements, maintenance scheduling, return on investments and any other pertinent property related matters.

*Disposition of Revenue*

Council policy requires that surplus funds generated from Council's property activities are utilised as a contribution against annual general rate.

Revenues are generated both from commercial property sources at negotiated market rentals and internally assessed occupational costs.

*Risk Management*
Council's property activities are managed by a Property Manager and specifically assigned staff.

Council has a delegated Enterprises Subcommittee which is regularly briefed on property related matters, considers all proposed property acquisition, property disposals and utilisation of revenues generated from Council's properties.

#### *4.4.3 Community Housing*

*Nature of Investment*
Council currently has 97 community houses available for rental, generally to elderly or disabled persons. These houses are located in:

| | |
|---|---|
| Croucher Street, Richmond | 10 |
| Vosper Street, Motueka | 27 |
| Hill Street, Richmond | 20 |
| Mears Haven, Motueka | 18 |
| Starveall Street, Brightwater | 7 |
| Commercial Street, Takaka | 4 |
| Edward Street, Wakefield | 7 |
| Fairfax Street, Murchison | 4 |

*Rationale for Holding Investment*
Council continues to retain community housing to meet its considered obligation for the provision of rental accommodation, primarily for the elderly or people with disabilities.
Council's philosophies include ensuring that rental charges cover cost (excluding depreciation) and to continue to maintain the housing at its current high standard. There is no required rate of return on this investment.

*Disposition of Revenue*
Council operates its community housing activity in the nature of a ‚"closed account" whereby revenues generated are utilised for debt repayment on loans outstanding on this asset and for meeting the annual maintenance schedules. A small dividend is returned to Council's Community Services Committee annually from this account.

*Risk Management*
Council's community housing activities are managed by staff in the Community Services Department.
Council's Community Services Committee regularly reviews Council's involvement in community housing, including assessment of the need for this asset within the community.

#### *4.4.4 Camping Grounds*

*Nature of Investment*
Council owns four camping grounds within its District (Collingwood, Pohara, Motueka and Murchison) that are leased to private individuals.

*Rationale for Holding Investment*
Council's camping grounds are retained for the enjoyment of visitors to and residents of the District.

*Disposition of Revenue*
Council receives net revenue from these assets which it uses to subsidise general rating activities performed by its Parks and Reserves Department.

*Risk Management*
Council's Community Services Committee receives regular reports on the nature and activity of its camping grounds. Evaluation of these reports includes continued ownership which is evaluated on an ongoing basis as and when leases become available for renewal.

### ***4.5 Associated Organisations***

#### *4.5.1 Nelson Regional Sewerage Business Unit*

*Nature of Investment*
Tasman District Council and Nelson City Council equally share in ownership of this asset. Tasman District Council provides treasury advice and Nelson City Council provides some engineering and administrative services to the Business Unit, which has committee representation from both Councils.

*Rationale for Holding Investment*
To ensure continuity of wastewater services for the residents and ratepayers of both Tasman District and Nelson City.

*Disposition of Revenue*
Council does not receive any financial return from this Business Unit. Council's cash commitment to the Business Unit for the 2009/2010 financial year will be $2.0 million.

*Risk Management*
The Business Unit is managed by a committee, with representatives from both Councils plus one external representative. This Committee is required to regularly report to the Councils.

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## 5. Cash Management

The treasury function is responsible for managing the Council's cash surpluses and/or deficits.

The Council maintains rolling daily, monthly and annual cash flow projections which form the basis of its cash management activity. The Council maintains one main bank account for its operating cash flows as well as other bank accounts for specialist activities such as borrowing requirements. Individual business units within the Council do not maintain separate bank accounts. Full details of the Council's bank accounts are listed in Appendix VI of the Treasury Management Policy.

The Council manages its working capital balances by matching expenditure closely to its revenue streams, and managing cash flow timing differences to its favour. Daily bank balances are extracted by the Financial Accountant..

Generally cash flow surpluses from timing differences are available for periods less than 90 days.

Cash management activities must be undertaken within the following parameters:
- Cash flow surpluses will be placed in bank call deposits, registered certificates of deposit or bank bills for a term of up to 3 months. Amounts invested must be within limits specified in Section 7 of the Treasury Management Policy
- An optimal daily range of -$500,000 to +$500,000 is targeted for in the Council's main bank account, with amounts drawn from the Council's money market lines, if required
- The Council will maintain a committed bank overdraft facility of not more than $3 million
- The use of interest rate risk management on cash management balances is not permitted
- The Council will maintain committed funding lines consistent with section 3.4.

## 6. Foreign Exchange Management

Council will not borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency, without the resolution of full Council.

## 7. Treasury Counterparty Exposure Limits

The Council ensures that all shorterm investments of cash, interest rate risk management, as well as any foreign exchange activity is undertaken with institutions that are of a high quality credit standing to ensure amounts owing to the Council are paid fully and on due date.

More specifically, the Council minimises its credit exposure by:
- Ensuring all investment, cash management, interest rate risk management and any foreign transactions are undertaken with entities that have a Standard and Poor's (S&P) credit rating (or equivalent) no worse than the minimum levels stated in the table below
- Limiting total exposure to prescribed amounts
- Rigorously monitoring compliance against set limits

| Institution | Minimum S&P short term issuer credit rating | Minimum S&P long term credit rating | Total exposure limit for each counterparty |
|---|---|---|---|
| **Government** | **N/A** | **N/A** | **Unlimited** |
| **Registered Bank** | **A-1+** | **AA-** | **$30 million** |

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. Exceptions are reported to the Chief Executive and reported to Council. A current list of S&P rated issuers is included in Appendix V.

Exposures to each counterparty are computed as follows:

- On-balance Sheet
  Total amounts invested with that counterparty

- Risk Management Instruments

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

- *Interest Rate Risk Management (e.g. swaps, FRAs): Transaction Notional × Maturity (years) × 3%*

Netting Arrangements

Exposures computed above can be netted where there is a right to set-off which is enforceable by law, e.g. transactions entered into under a single master agreement.

## 8. Banking relationships

As in other parts of its activities, the Council's preference in the treasury management area is to deal with preferred suppliers. The Council's choice of relationship banks is determined by its desire to benefit from long term relationships rather than seeking the best returns in the short term.

Each financial institution must be capable of providing the Council with:

- comprehensive treasury services in NZD products. In this regard whilst day to day transactional requirements are important, it is the Council's borrowing requirements that are likely to drive key relationships
- proven expertise and a track record in arranging local capital markets facilities
- a desire to accommodate Council funding without additional security requirements

The Council's cash management and interest rate risk management activities are undertaken with its relationship bank(s).

The Council's banking relationships will be reviewed at least every three years.

# 9. Reports and Meetings

## *9.1 Reports*

The following reports will be produced:

| **Report Name** | **Frequency** | **Prepared by** | **Reviewed by** | **Recipient** |
|---|---|---|---|---|
| Daily Cash Position | Daily | Financial Accountant | Accounting Manager | Corporate Services Manager |
| Treasury Report<br>- funding facility;<br>- cost of funds vs. budget<br>-income vs. budget<br>- new treasury transactions | Monthly | Accounting Manager | Corporate Services Manager | Corporate Services Committee<br>Chief Executive |
| Limits Report<br>- policy limit compliance;<br>- borrowing limits/ratios<br>- counterparty credit<br>- liquidity risk | Monthly | Accounting Manager | Corporate Services Manager | Corporate Services Committee<br>Chief Executive |
| Debt Maturity Profile<br>- funding and interest rate position | Monthly | Financial Accountant | Corporate Services Manager | Corporate Services Committee<br>Chief Executive |
| Revaluation of financial instruments | Quarterly | Accounting Manager | Corporate Services Manager | Corporate Services Committee<br>Chief Executive |

# 10. Delegated Authorities

Pursuant to clause 32 (2), schedule 7, of the Local Government Act 2002, Council may make delegations to officers of Council to allow for the efficient conduct of Council business. Clause 32 (3), schedule 7 of this Act allows officers to delegate those powers to other officers.

Notwithstanding clause 32 (1) (c), schedule 7 the power to borrow money, or purchase or dispose of assets, other than in accordance with the LTCCP remains the sole responsibility of Council. This responsibility cannot be delegated.

Approved delegations to Officers are contained within the Council's register. All delegations are approved by Council resolution. The Treasury Management Policy related delegations are outlined below.

| **Activity** | **Delegated to** |
|---|---|
| Approved policy document | Council |
| Alter policy document | Council |
| Open/close bank accounts | Council/Mayor |
| Acquire and dispose of investments other than financial investments | Council |
| Approve borrowing programme for the year | Council |
| Approve charging assets as security over borrowing | Council |
| Approve new loans in accordance with Council resolution | Corporate Services Manager |
| Refinancing existing debt | Corporate Services Manager |
| Negotiate debt in relation to pricing,, term and maturity date | Corporate Services Manager |
| Approve signatories | Chief Executive |
| Approve funds transfer signatories | As per register approved by Chief Executive |
| Manage borrowing, interest rate strategy | Corporate Services Manager/Accounting Manager |
| Maximum daily transaction amount (borrowing, investing, interest rate risk management and cash management) excludes roll-overs on debt facilities | Council (unlimited)<br>Chief Executive ($50m)<br>Corporate Services Manager ($20m)<br>Accounting Manager ($5m) |
| Approve interest rate risk management instruments contained in the Risk Management Tool Kit in Appendix III and subsequent additions and deletions | Council |

| | |
|---|---|
| Authorise use of Council approved interest rate risk management instruments | Corporate Services Manager |
| Manage Council cash requirements | Accounting Manager |
| Ensure policy compliance | Corporate Services Manager |
| Triennial review of policy | Corporate Services Manager |

*Note: In the case of absence of Council officers, cross delegations as incorporated in 2.1 Treasury responsibilities will apply.*

# 11. Key Internal Controls

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

- adequate segregation of duties among the core treasury functions of deal execution, confirmation, settling and accounting/reporting. There are a small number of people involved in treasury activity. Accordingly strict segregation of duties is not always achievable. Refer to Section 2.2 for more detailed treasury responsibilities. The risk from this will be minimised by the following processes:
  - a documented discretionary approval process for treasury activity
  - regular management reporting
  - regular operational risk control reviews by the independent audit function

Organisational, systems, procedural and reconciliation controls to ensure:

- All treasury activity is bona fide and properly authorised
- Checks are in place to ensure the Council's accounts and records are updated promptly, accurately and completely
- All outstanding transactions are re-valued regularly and independently of the execution functions to ensure accurate reporting and accounting of outstanding exposures and hedging activity

More specifically, key internal controls are as follows:

## *11.1 General*

*Organisational Controls*

- The Corporate Services Manager has responsibility for establishing appropriate structures, procedures and controls to support treasury activity. Detailed procedures supporting the key controls contained in this document are contained in the Council's Treasury Procedures Manual
- All borrowing, investment, cash management and risk management activity is undertaken in accordance with approved delegations authorised by the Council
- Personnel with dealing responsibilities cannot perform bank reconciliations or act as a cheque signatory

*Cheque/Electronic Banking Signatories*

- Positions approved by the Council as per register
- Dual signatures are required for all cheques and electronic transfers

*Authorised Personnel*

- All counterparties are provided with a list of personnel approved to undertake transactions, standard settlement instructions and details of personnel able to receive confirmations

*Confirmations*

- Same day faxed confirmations are requested from banks and checked by the Financial Accountant
- All inward letter confirmations including registry confirmations are received and checked by the Corporate Services Manager against completed deal tickets and summary spread sheet records to ensure accuracy

*Reconciliations*

- Bank reconciliations are performed regularly by the Accounts Administrator and checked by the Accounting Manager. Any unresolved unreconciled items arising during bank statement reconciliation which require amendment to the Council's records are signed off by the Corporate Services Manager

- › A monthly reconciliation of the treasury system/spread sheets to the general ledger is carried out by the Financial Accountant and approved by the Corporate Services Manager

### *11.2 Borrowing*

In addition to the controls listed under Section 11.1, the following controls apply to borrowing:

- › Borrowing activity is undertaken within borrowing limits specified in Section 3 of this policy
- › All borrowing is undertaken by using competitive bidding processes. Detailed procedures for issuing securities and bank borrowing are included in the Treasury Procedures Manual

### *11.3 Investments*

In addition to the controls listed in Section 11.1, the following controls apply to investments:

- › Investment activity is undertaken within limits specified in Section 4 and Section 7 of this policy
- › All deliverable certificates of investments (for example, bank bills) are held in safe custody in Council's safe or with the originating bank

### *11.4 Incidental Arrangements*

In addition to the controls listed under Section 11.1, the following controls apply to incidental arrangements:

- › The use of incidental arrangements is confined to managing interest rate risk of Council borrowings and is to be within the confines of the parameters and instruments specified in Section 3 of this policy
- › The use of incidental arrangements requires formal prior approval of the Corporate Services Manager
- › Standard master agreements for incidental arrangements are completed by the Council with its relationship banks

## 12. Legal Risk

Legal and regulatory risks relate to the unenforceability of a transaction due to an organisation not having the legal capacity or power to enter into the transaction usually because of prohibitions contained in legislation. While legal risks are more relevant for banks, Council may be exposed to such risks. In the event that Council is unable to enforce it's rights due to deficient or inaccurate documentation.

Council will seek to minimise this risk by adopting policy regarding:

- The use of standing dealing and settlement instructions (including bank accounts, authorised persons, standard deal confirmations, contacts for disputed transactions) to be sent to counterparties
- The matching of third party confirmations and the immediate follow-up of anomalies
- The use of expert advice for any non-standardised transactions

### *12.1 Agreements*

- Financial instruments can only be entered into with banks that have in place an executed ISDA Master Agreement with Council. All ISDA Master Agreements for financial instruments must be signed under seal by the Council
- Council's appointed legal counsel must sign off on all documentation for new loan borrowings, re-financings and investment structures

### *12.2 Financial Covenants and Other Obligations*

- Council must not enter into any transactions where it would cause a breach of financial covenants under existing contractual arrangements
- Council must comply with all obligations and reporting requirements under existing funding facilities and legislative requirements

## 13. Accounting Treatment of Financial Instruments

Council uses financial market instruments for the primary purpose of reducing its exposure to fluctuations in interest rates.

The accounting treatment for such financial instruments is to follow IFRS accounting standards.

Valuation of treasury instruments

All treasury financial instruments must be revalued (marked-to-market) every three months for risk management purposes. This includes those instruments that are used only for hedging purposes.

Underlying rates to be used to value treasury instruments are as follows:

- Official daily settlement prices for established markets
- Official daily market rates for short term treasury instruments (e.g. FRA settlement rates calculated by Reuters from price maker quotations as displayed on the BKBM page)
- Relevant market mid-rates provided by Council's bankers at the end of the business day (5.00pm) for other over-the-counter treasury instruments

- For markets that are illiquid, or where market prices are not readily available, rates calculated in accordance with procedures approved by the Corporate Services Manager

## 14. Policy Review

This Treasury Management Policy is to be formally reviewed on a triennial basis.
The Corporate Services Manager has the responsibility to prepare a review report (following the preparation of annual financial statements) that is presented to the Chief Executive. The report will include:

- Recommendation as to changes, deletions and additions to the policy
- Overview of the treasury management function in achieving the stated treasury objectives, including performance trends in actual interest cost against budget (multi-year comparisons)
- Summary of breaches of policy and one-off approvals outside policy to highlight areas of policy tension
- Analysis of bank and lender service provision, share of financial instrument transactions etc.
- Comments and recommendations from Council's external auditors on the treasury function, particularly internal controls, accounting treatment and reporting
- An annual audit of the treasury spreadsheet and procedures should be undertaken
- Borrowing limits should not exceed limits specified in the covenants of lenders to Council

Council receives the report, approves policy changes and/or rejects recommendations for policy changes.

The policy review should be completed and presented to the Council within five months of the financial year-end

## 15. Content of Appendices

- **Appendix I**
  Borrowing Instruments Definitions
- **Appendix II**
  The Risk Management Tool Kit
- **Appendix III**
  List of Council approved Financial Institutions and their date of registration
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  Approved Financial Investment Instruments
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  Standard and Poor's Ratings
- **Appendix VI**
  Tasman District Council Bank Accounts
- **Appendix VII**
  Specified Reserve Accounts

# Appendix I

*Borrowing Instruments Definitions*

## 1. Bank Sourced Borrowing

### *1.1 Bank Bill Facilities*

Commercial Bills cover all types of bills of exchange which are defined under the Bills of Exchange Act 1908 as:

*"An unconditional order in writing, addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at fixed or determinable future time, a sum certain in money to, or to the order of a specified person, or to bearer."*

Bank bill facilities are normally for a term of up to three years, but may be for as long as five years. Bank Bills are bills of exchange, drawn or issued usually by the original borrower and accepted or endorsed by a bank.

For a Bank Accepted Bill, the bank makes the payment of the face value of the bill on maturity. Most bank bills traded in the New Zealand market are Bank Accepted Bills.

Bank Endorsed Bills have been endorsed by a bank with another party as acceptor. In the event of default of the original acceptor, payment can be sought through the chain of endorsers to the bill.

An investor in bank bills can sell the bills prior to maturity date and receive the cash. Bank bills are a longer term borrowing instrument than cash loans. Bills are normally drawn for terms of 30, 60 or 90 days, with a few being drawn for 180 days. The 90 day bank bill is the underlying traded bench mark instrument for the short end of the market.

Costs

The principal costs to the borrower are the discounting bank's yield at which it discounts the bill at the time of draw down, an arrangement fee, an acceptance fee and line fee (expressed in basis points or percentage per annum) and margin. Acceptance fees, arranger fees, line fees and margins in aggregate normally range between 35 – 300 basis points (i.e. 0.35% – 3.00%), depending on the credit worthiness of the borrower.

### *1.2 Revolving Credit Facilities*
### *(Variable Amount Term Loans)*

Revolving credit facilities are similar from a borrower's perspective, except interest is paid in arrears rather than upfront as in the case of bank bills. Revolving credit facilities are usually for a term of up to three years but may be for as long as five years and like bank bills, drawings under the facility are priced off the bank bill buy rate. Most facilities allow for the borrower to draw up to the facility amount in various tranches of debt and for various terms out to a maximum term of the maturity date of the facility. Like bank bills, most borrowers use these facilities to borrow on a 90 day basis.

Costs

The principal costs are the same as with bank bills, the lending banks yield which sets the base rate at the time of lending, an arrangement fee, an acceptance fee and a line fee (expressed in basis points or percentage per annum) and the margin. Acceptance fees, arranger fees, lines fees and margins in aggregate normally range between 35 - 300 basis points (i.e. 0.35% - 3.00%), depending on the credit worthiness of the borrower.

### *1.3 Short Term Money Market Lines*

Short-term money market loans or cash loans can be Committed or Uncommitted. A customer pays for a guarantee of the availability of the funds in a Committed Loan. In an Uncommitted Loan, funds are provided on a best endeavours basis and no line/commitment fee is payable. In addition to a line fee, a margin may be charged on any line usage.

The main usage of cash loans is to cover day-to-day shortfalls in funds. The interest rate is governed by the term of the borrowing and the implied or implicit credit rating of the borrower. Cash loans are short term only and are normally drawn for a term of one (overnight) to seven days. Interest collection can be daily.

# Appendix II

*The Risk Management Tool Kit*

## *1. Approved Interest Rate Risk Management Instruments*

a) Interest rate risk management instruments approved for use, consistent with the policy contained in Section 3.5 are:

- Fixing through physical borrowing instruments - loan stock, debentures, medium term notes, bank term loan
- Floating through physical borrowing instruments - short term revolving stock, bank borrowing, promissory note programme

b) The following interest rate risk management instruments are available for interest rate risk management activity, but are to be specifically approved by the Council (refer glossary of terms):

Forward rate agreements ("FRAs") on:

- Bank bills
- Government bonds

Interest rate swaps including:

- Forward start swaps
- Amortising swaps (whereby notional principal amount reduces)
- Swap extensions and shortenings

Interest rate options on:

- Bank bills (purchased caps and one for one collars)
- Interest rate swaps (purchased swaptions and one for one collars)
- Government bonds

Any other financial instrument must be specifically approved by Council on a case-by-case basis and only be applied to the one singular transaction being approved. Credit exposure on these financial instruments is restricted by specified counterparty credit limits.

- Interest rate options must not be sold outright. However, 1:1 collar option structures are allowable whereby the sold option is matched precisely by amount and maturity to the simultaneously purchased option. During the term of the option, the sold option can be closed out by itself (i.e. repurchased). The sold option leg of the collar structure must not have a strike rate "in-the-money".

- Purchased borrower swaptions mature within 18 months.

- Forward start period on swaps and collar strategies to be no more than 24 months, and the underlying cap or swap starts within this period.

- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 1.00% above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation.

- Buying and selling of financial futures is not permitted, primarily due to the administrative burden and the ready availability of other more tailored risk management products.

- Structured or leveraged interest rate option strategies where there is any possibility of the Council's total interest expense increasing in a declining interest rate market or where the Council's total interest cost is increasing faster than the general market rate.

## *2. Glossary of Terms*

- Amortising Swap; An interest rate swap contract that has a reducing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an amortising swap is the weighted average maturity, not the final maturity date.

- Accreting Swap; An interest rate swap contract that has an increasing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an accreting swap is the weighted average maturity, not the final maturity date.

- Bank Bill; A "bill of exchange" security document issued by a corporate borrower, but guaranteed by a bank, who then in turn sells the security into the bank/investor market to re-liquefy itself with cash. Normally for terms of 30, 60, 90 or 180 days.

- Base rate; Normally a lending bank's cost of funds/interest rate for a particular funding period. The base or "prime" rate will be changed by the bank from time to time, but not every day like market rates.

- Basis Point(s); In financial markets it is normal market practice to quote interest rates to two decimal places e.g. 6.25% - one basis point is the change from 6.25% to 6.26%, one hundred basis points is the change from 6.25% to 7.25%.

- Basis Risk; The risk that the interest rate difference between the current physical debt instrument (say, a bank bill) market interest rate and the interest rate quoted for that debt instrument's future price (say, a bank bill futures price) changes over the period to the date of the future price.
- Benchmark; An agreed market related yardstick that investor returns, funding costs or average exchange rate achieved are compared against for performance measurement purposes.
- Bid–Offer Spread; The exchange points (FX) or basis points (interest rates) difference between the bid and offer rate when quoted by a bank is known as the "bid-offer spread". Banks make their profits from dealing at their own bid and offer prices, thus earning the spread.
- Bid Rate; Exchange rates and interest rate securities/ instruments that are traded between banks are always quoted as a two-way price. One rate is where the quoting bank will buy – the bid rate, the second rate or price where the bank will sell at – the offer rate.
- Bond; The security instrument that is issued by a borrower whereby they promise to repay the principal and interest on the due dates. A bond's interest rate is always fixed.
- Bond FRA; A tailored contract to buy or sell a bond (Government or Corporate) at a fixed interest rate at some specified future date. The Bond FRA contract rate will differ from the current physical market bond yield, depending on the slope of the interest rate yield curve.
- Bond Option; The right, but not the obligation by the owner/holder of the option to buy or sell bonds (Government or Corporate) at a predetermined interest rate at a specified future date. The buyer pays a "premium" in cash up-front to reduce risk and have insurance-type protection, the seller or grantor of the bond option receiving the premium for assuming the risk.
- Call Option; The owner or buyer of a call option has the right, but not the obligation, to buy the underlying debt security/currency/commodity at the price stated in the option "contract.
- Cap; A series or string of bought interest rate put options whereby a borrower can have protection against rising short term interest rates, but participate in the lower rates if market rates remain below the "capped rate." A cap is normally for more than one 90-day funding period.
- Certificate of Deposit "CD"; A debt instrument (normally short term) issued by a bank to borrow funds from other banks/investors.
- Closing-Out; The cancellation/termination of a financial instrument or contract before its maturity date, resulting in a realised gain/loss as the current market rate differs from the contract rate.
- Collar Two; option contracts linked together into the one transaction or contract. A borrower's collar is normally a bought "cap" above current market rates and a sold "floor" below current rates. Over the term of the collar contract, if rates go above the cap the borrower is protected and pays an interest cost no more than the cap rate. Likewise, if market rates fall below the floor, the borrower pays the floor rate and does not participate in the lower market rates. Also called a "cylinder".
- Collateral; A legal term means "security".
- Commercial Paper; The debt security instrument issued by a prime (and normally credit-rated) borrower to raise short-term funds (30, 60, 90 or 180 days). Also called "one-name paper"} and "promissory notes" issued by competitive public tender to investors or by private treaty to one investor.
- Commoditised; When a financial market or instrument becomes so popular and "plain vanilla" that there is no longer any difference in the prices quoted by participants in the market.
- Convexity; A measure of the degree of curve or slope in an interest rate yield curve.
- Coupon; The interest rate and amount that will be paid on the interest due dates of a bond. The coupon will normally differ from the purchase or issue yield/interest rate on a bond instrument.
- Counter party; The contracting party to a financial transaction or financial instrument.
- Covenants; Special conditions and financial ratios required to be met or maintained by a borrower for a lender under the legal security documents.
- Cover; A term used to describe any action of entering financial instruments that reduces risk or puts protection in place against adverse future price movements.
- Credit Risk or Exposure; The risk that the other party to a financial transaction (bank deposit, interest rate swap contract) will default on or before the maturity date and not be able to fulfil their contractual obligations.
- Credit Spread; The interest rate difference (expressed as basis points) between two types of debt securities. The credit spread being a reflection of the difference in credit quality, size, and liquidity between the two securities e.g. five year corporate bonds may be at a credit spread of 200 basis points above Government bonds.
- CSFB NZGS Index; Credit Suisse First Boston NZ Government Stock Index.
- Current Ratio; A liquidity measure to determine how quickly Council can generate cash. Current assets are divided by current liabilities.
- Debenture; A debt instrument similar to a bond whereby a borrower (normally a finance company) borrows for a longer term at a fixed rate. Also a legal instrument provided as security to a lender.

- Delta; “Greek” letter that measures how the price of an option (premium) changes given a movement in the price of the underlying asset/instrument.

- Derivative(s); A “paper” contract whose value depends on the value of some “underlying” referenced asset e.g. share market stocks, bank bills, bonds or foreign currency. Also called a “synthetic.” The value of the assets will change as its market price changes; the derivative instrument will correspondingly change its value.

- Digital Option; An option contract that provides a predetermined payout based on an agreed and contracted market price path.

- Discount; A bond or bank bill is discounted when the interest rate is applied to the face value of the security and the net proceeds after deducting the interest is paid out to the borrower. Investors pay for the discounted (NPV) value at the commencement of the investment and receive the interest coupon payments along the way and the full face value at the maturity date.

- Duration; Not the simple average maturity term of a debt or investment portfolio, but a measure of the interest rate risk in a portfolio at a particular point in time. The duration of a portfolio is the term (measured in years and months) if the total portfolio of bonds/fixed interest investments was revalued at market rates and expressed as one single bond. The profit/loss on revaluation of a one basis point movement being the same in both cases.

- Embedded Option; An option arrangement that may be exercised by a borrower at a future date, but the determining conditions are buried or “embedded” in a separate debt or financial instrument.

- Eurodollar; The borrowing and depositing of a currency outside its domestic financial markets.

- Event Risk; The risk of a major/unforeseen catastrophe e.g. earthquake, year 2000, political elections, adversely affecting a Council’s financial position or performance.

- Exchange Traded; A currency, debt or financial instrument that is quoted and traded on a formal exchange with standardised terms, amounts and dates.

- Exercise Date/Price; The day and fixed price that an option contract is enforced/actioned or “exercised” because it is in the interests of one of the parties to the contract to do so.

- Fair Value; The current market value of an off-balance sheet financial instrument should it be sold or closed-out on the market rates ruling at the balance date.

- Federal Reserve; The US Government’s central bank and/or monetary authority.

- Fixed Rate; The interest rate on a debt of financial instrument is fixed and does not change from the commencement date to the maturity date. Fixed is defined as an interest rate that does not change in the next 12 months.

- Floating Rate; The interest rate on a loan or debt instrument is re-set at the ruling market interest rates on the maturity date of the stipulated funding period (usually 90-days). Floating is defined as an interest rate that changes in the next 12 months.

- Floor; The opposite of a “cap.” An investor will buy a floor, or a series/string of call options (the right to buy) to protect against falling interest rates, but be able to invest at higher interest rates if rates move upwards. A borrower may sell a floor as part of a collar structure to generate premium to pay for the “linked” bought cap.

- Forward Rate Agreement; A contract (“FRA”) whereby a borrower or investor in Bank Bills or Government Bonds agrees to borrow or I invest for an agreed term (normally 90-days) at a fixed rate at some specified future date. A FRA is an “over-the-counter” contract as the amount and maturity date is tailored by the bank to the specific requirements of the borrower/investor.

- Forward Start Swap; An interest rate swap contract that commences at a future specified date. The rate for the forward starting swap will differ from the current market rate for swaps by the shape and slope of the yield curve.

- Funding Risk; The risk that a borrower cannot re-finance its debt at equal or better terms at some date in the future, in terms of lending margin, bank fees and funding time commitment. Funding risk may increase due the Council’s own credit worthiness, industry trends or banking market conditions.

- Futures; Exchange-traded financial and commodity markets which provide forward prices for the underlying asset, instrument or commodity. Futures contracts are standardised in amount, term and specifications. Futures markets are cash-based, transacting parties do not take any counter party credit risk on each other. Deposits and margin-calls are critical requirements of all futures markets.

- Gamma; “Greek” letter used in option pricing that measures how rapidly the delta of an option changes given a change in the price of the underlying asset/instrument.

- Hedging; The action of reducing the likelihood of financial loss by entering forward and derivative contracts that neutralise the price risk on underlying financial exposures or risks. The gain or loss due to future price movements on the underlying exposure is offset by the equal and opposite loss and gain on the hedge instrument.

- High-Yield Bonds; Corporate bonds issued by borrowing companies that are non-prime i.e. have a low or no credit rating. The margin or credit spread above Government bond yields is high (>300 basis points) to compensate the investor into the bond for the higher credit and liquidity risk.

- Implied Volatility; Used in option pricing. To estimate the future volatility of the underlying asset or instrument, the option pricing models use historical volatility (expressed as percentage) as a key variable to calculate the option premium amount. The movement in option prices is therefore a good indicator of future market volatility, as volatility is "implied" in the option price.

- Index Linked Bonds; Debt instruments that pay an interest coupon or return that is wholly or partially governed by the performance of another separate index e.g. a share market index, or the gold price.

- ISDA; International Security Dealers Association: a governing body that determines legal documentation/standards for over-the-counter swaps/options/FRAs and other derivative instruments for interest rates, currencies, commodities etc. Corporate users of such instruments sign an ISDA Master Agreement with banking counter parties that covers all transactions.

- Incidental Arrangements; The term used in the Local Government Act for interest rate risk management instruments or derivatives.

- Interest Rate Swaps; A binding, paper contract where one party exchanges, or swaps, its interest payment obligations from fixed to floating basis, or floating to fixed basis. The interest payments and receipts under the swap contract being offsetting, equal and opposite to the underlying physical debt.

- "In-the-Money" Option; An option contract that has a strike price/rate that is more favourable or valuable than the current market spot or forward rate for the underlying currency/instrument.

- Inverse Yield Curve; The slope of the interest rate yield curve (90-days to years) is "inverse" when the short-term rates are higher than the long-term rates. The opposite, when short-term rates are lower than long-term interest rates is a normal curve or "upward sloping." In theory, a normal curve reflects the fact that there is more time, therefore more time for risk to occur in long term rates; hence they are higher to build in this extra risk premium.

- Liability Management; The policy, strategy and process of pro-actively managing the treasury exposures arising from a portfolio of debt.

- LIBOR; London Inter-bank Offered Rate, the average of five to six banks quote for Eurodollar deposits in London at 11:00am each day. The accepted interest rate-fixing benchmark for most offshore loans.

- Limit(s); The maximum or minimum amount or percentage a price or exposure may move to before some action or limitation is instigated. Also called "risk control limits".

- Liquidity Risk; The risk that Council cannot obtain cash/funds from liquid resources or bank facilities to meet foreseen and unforeseen cash requirements. The management of liquidity risk involves working capital management and external bank/credit facilities.

- "Long" Position; Holding an asset or purchased financial instrument in anticipation that the price will increase to sell later at a profit.

- Look-back Option; An option structure where the strike price is selected and the premium paid at the end of the option period.

- Marked-to-Market; Financial instruments and forward contracts are revalued at current market rates, producing an unrealised gain or loss compared to the book or carrying value.

- Margin; The lending bank or institution's interest margin added to the market base rate, normally expressed as a number of basis points.

- Medium Term Notes; A continuous program whereby a prime corporate borrower has issuance documentation permanently in place and can issue fixed rate bonds at short notice under standard terms.

- Moody's; A rating agency similar to Standard & Poor's.

- Netting; Method of subtracting currency receivables from currency payables (and vice versa) over the same time period to arrive at a net exposure position.

- Open Position; Where a Council has purchased or sold an asset, currency, financial security or instrument unrelated to any physical exposure, and adverse/favourable future price movements will cause direct financial loss/gain.

- Option Premium; The value of an option, normally paid in cash at the commencement of the option contract, similar to an insurance premium.

- Order; The placement of an instruction to a bank to buy or sell a currency or financial instrument at a preset and pre-determined level and to transact the deal if and when the market rates reach this level. Orders are normally placed for a specific time period, or "good till cancelled." The bank must deal at the first price available to them once the market level is reached. Some banks will only take orders above a minimum dollar amount.

- "Out-of-the-Money"; An option contract which has a strike price/rate that is unfavourable or has less value than the underlying current spot market rate for the instrument.

- Over-the-Counter; Financial and derivative instruments that are tailored and packaged by the bank to meet the very specific needs of the corporate client in terms of amount, term, price and structure. Such financial products are non-standard and not traded on official exchanges.

- Perpetual Issue; A loan or bond that has no final maturity date.

- Pre-hedging; Entering forward or option contracts in advance of an exposure being officially recognised or booked in the records of the Council.

- Primary Market; The market for new issues of bonds or MTNs.
- Proxy Hedge; Where there is no forward or derivative market to hedge the price risk of a particular currency, instrument or commodity. A proxy instrument or currency is selected and used as the hedging method as a surrogate. There needs to be a high correlation of price movements between the two underlying prices to justify using a proxy hedge.
- Put Option; The right, but not the obligation to sell a debt security/currency/commodity at the contract price in the option agreement.
- Revaluation; The re-stating of financial instruments and option/forward contracts at current market values, different from historical book or carrying values. If the contracts were sold/ bought back (closed-out) with the counter party at current market rates, a realised gain or loss is made. A revaluation merely brings the contract/instrument to current market value.
- Roll-over; The maturity date for a funding period, where a new interest rate is reset and the debt re-advanced for another funding period.
- Secondary Market; The market for securities or financial instruments that develops after the period of the new issue.
- "Short" Position; Selling of an asset or financial instrument in anticipation that the price will decrease or fall in value to buy later at a profit.
- Spot Rate; The current market rate for currencies, interest rates for immediate delivery/settlement, and normally two business days after the transaction is agreed.
- Standard & Poor's; A credit rating agency that measures the ability of an organisation to repay its financial obligations.
- Stop Loss; Bank traders use a "stop-loss order" placed in the market to automatically closeout an open position at a pre-determined maximum loss.
- Strike Price; The rate or price that is selected and agreed as the rate at which an option is exercised.
- Strip; A series of short-term interest rate FRAs for a one or two year period, normally expressed as one average rate.
- Structured Options; An option instrument where the relationship/profile to the underlying referenced asset or liability is not linear i.e.1:1
- Swap Spread; The interest rate margin (in basis points) that interest rate swap rates trade above Government bond yields.
- Station; An option on an interest rate swap that if exercised the swap contract is written between the parties. The option is priced and premium paid similar to bank bill and bond interest rate options.
- Time Value; Option contracts taken for longer-term periods may still have some time value left even though the market rate is a long way from the strike rate of the option and the option is unlikely to be exercised.
- Tranches; A loan may be borrowed in a series of partial drawdowns from the facility, each part borrowing is called a tranche.
- Treasury; Generic term to describe the activities of the financial function within Council that is responsible for managing the cash resources, financial investments, debt, and interest rate risk.
- Treasury Bill; A short term (<12 months) financing instrument/security issued by a Government as part of its debt funding program.
- Vega; Another "Greek" letter that is the name given to the measure of the sensitivity of the change in option prices to small changes in the implied volatility of the underlying asset or instrument price.
- Volatility; The degree of movement or fluctuation (expressed as a percentage) of an asset, currency, commodity or financial instrument price over time. The percentage is calculated using mean and standard deviation mathematical techniques.
- Yield; Read-interest rate, always expressed as a percentage.
- Yield Curve; The plotting of market interest rate levels from short term (90-days) to long term on a graph i.e. the difference in market interest rates from one term (maturity) to another.
- Zero Coupon Bond; A bond that is issued with the coupon interest rate being zero i.e. no cash payments of interest made during the term of the bond, all interest paid on the final maturity date. In effect the borrower accrues interest on interest during the term, increasing the total interest cost compared to a normal bond of paying interest quarterly, half-yearly or annually.

## Appendix III

List of Council approved Financial Institutions and their date of registration.

| | | Standard & Poor's | | Moodys | | Fitch | |
|---|---|---|---|---|---|---|---|
| **Registered Banks** | **Date of RBNZ registration** | Short | Long | Short | Long | Short | Long |
| ANZ Banking Group (NZ) Ltd | 1 April 1987 | A-1+ | AA | P-1 | Aa1 | F1+ | AA- |
| ASB Bank Ltd | 11 May 1989 | A-1+ | AA | P-1 | Aa2 | F1+ | AA |
| Bank of New Zealand | 1 April 1987 | A-1+ | AA | P-1 | Aa2 | F1+ | AA |
| Rabobank Nederland | 1 April 1996 | A-1+ | AAA | P-1 | Aaa | F1+ | AA+ |
| Kiwi Bank | 29 November 2001 | A-1+ | AA- | - | - | - | - |
| The National Bank of New Zealand Ltd | 1 April 1987 | A-1+ | AA | P-1 | Aa1 | F1+ | AA- |
| TSB Bank Ltd | 8 June 1989 | A-2 | BBB+ | - | - | - | - |
| Westpac Banking Corporation | 1 April 1987 | A-1+ | AA | P-1 | Aa2 | F1+ | AA- |

## Appendix IV

Approved Financial Investment Instruments

Investment instruments available in the market (excluding equities and property) can generally be discussed under four broad categories relating to the issuer of these instruments.

***1. New Zealand Government***

Treasury bills are registered securities issued by the Reserve Bank of New Zealand (RBNZ) on behalf of the Government. They are usually available for terms up to a year but generally preferred by investors for 90 day or 180 day terms. They are discounted instruments, and are readily negotiable in the secondary market.

Government stock is registered securities issued by the RBNZ on behalf of the Government. They are available for terms ranging from one year to twelve year maturities. Government stock has fixed coupon payments payable by the RBNZ every six months. They are priced on a semi annual yield basis and are issued at a discount to face value. They are readily negotiable in the secondary market.

***2. Local Authorities***

Local Authority stock are registered securities issued by a wide range of local government bodies. They are usually available for maturities ranging from one to ten years. A fixed or floating coupon payment is made semi annually and quarterly respectively to the holder of the security. They are negotiable and usually can be bought and sold in the secondary market, but liquidity can be patchy. Both credit rated and unrated local authorities also issue commercial paper similar to that described in the corporate section below.

***3. Registered Banks***

Call and term deposits are funds accepted by the bank on an overnight basis (on call) or for a fixed term. Interest is usually calculated on a simple interest formula. Term deposits are for a fixed term and are expected to be held to maturity. Term deposits are not negotiable instruments. Termination prior to maturity date can often involve penalty costs.

Certificates of deposits are securities issued by banks for their borrowing needs or to meet investor demand. Registered certificates of deposit (RCDs) are non-bearer securities in that the name of the investor, face value and maturity date are recorded at the Reserve Bank and settled through Austraclear. They are paperless securities and are able to be transferred by registered transfer only. RCDs are priced on a yield rate basis and issued at a discount to face value. They are generally preferred over term deposits because investors can sell them prior to maturity.

Bank bills are bills of exchange drawn or issued, usually by a corporate borrower and accepted or endorsed by a bank. The investor is exposed to bank credit risk when investing in such instruments. Bank bills are readily available for any maturity up to 180 days, although 30 to 90 day terms are more common. They are priced on a yield basis and issued at a discount to face value. Investors in bank bills can sell the bills prior to maturity date.

***4. Corporate***

Corporate bonds are generally issued by companies with good credit ratings. These bonds can be registered securities or bearer instruments. A fixed coupon payment is made semi annually to the holder of the security (MTN). They are priced on a semi annual yield basis and are issued at a discount to face value. Corporate bonds are negotiable and can be bought and sold in the secondary market.

Promissory notes or commercial paper are issued by borrowers who usually have a credit rating and standing in the market that is sufficient to enable the notes to be issued without endorsement or acceptance by a bank. The notes are usually underwritten by financial institutions to ensure that the borrower obtains the desired amount of funds. Promissory notes are issued with maturities ranging from seven days to over one year. The common maturities are for 30 and 90 days. The face value of the note is repaid in full to the bearer on maturity.

# Appendix V
*S & P Ratings*

S & P Australian Ratings Rating Code

AAA rated corporations, financial institutions, governments or asset-backed financing structures (entities) have an extremely strong capacity to pay interest and repay principal in a timely manner.

AA rated entities have a very strong capacity to pay interest and repay principal in a timely manner and differ from the highest rated entities only in a small degree.

A rated entities have a strong capacity to pay interest and repay principal in a timely manner, although they may be somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than those in higher rating categories.

BBB rated entities have a satisfactory or adequate capacity to pay interest and repay principal in a timely manner. Protection levels are more likely to be weakened by adverse changes in circumstances and economic conditions than for borrowers in higher rating categories.

BB rated entities face ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to a less adequate capacity to meet timely debt service commitments.
B rated entities are more vulnerable to adverse business, financial or economic conditions than entities in higher rating categories. This vulnerability is likely to impair the borrower‘s capacity or willingness to meet timely debt service commitments.

CCC rated entities have a currently identifiable vulnerability to default and are dependent upon favourable business, financial and economic conditions to meet timely debt service commitments. In the event of adverse business, financial or economic conditions, they are not likely to have the capacity to pay interest and repay principal.

CC is typically applied to debt subordinated to senior debt that is assigned an actual or implied “CCC” rating.

C rated entities have high risk of default or are reliant on arrangements with third parties to prevent defaults.

D rated entities are in default. The rating is assigned when interest payments or principal payments are not made on the date due, even if the applicable grace period has not expired. The “D” rating is also used upon the filing of insolvency petition or a request to appoint a receiver if debt service payments are jeopardised.

Entities rated “BB”, “B”, “CC” and “C” are regarded as having predominantly speculative characteristics with respect to the capacity to pay interest and repay principal. “BB” indicates the least degree of speculation and “C” the highest. While such entities will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major exposures to adverse conditions.

The ratings from “AA” to “CCC” may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

Credit Watch highlights an emerging situation which may materially affect the profile of a rated corporation.

Short Term Ratings Including Commercial Paper (up to 12 months).

A1 rated entities possess a strong degree of safety regarding timely payment. Those entities determined to possess extremely strong safety characteristics are denoted with an “A1+” designation.

A2 rated entities have a satisfactory capacity for timely payment. However the relative degree of safety is not as high as for those rated “A1”

A3 rated entities have an adequate capacity for timely repayment. They are more vulnerable to the adverse effects of changes in circumstances than obligations carrying the higher designations.

Entities receiving a “B” rating have only a speculative capacity for timely payment. Those with “B1” have a greater capacity to meet obligations and are somewhat less likely to be weakened by adverse changes in the environment and economic conditions than those rated “B2”.

C1 rated entities possess a doubtful capacity for payment.

D1 rated entities are in default.

Ratings of BBB- (long term) or A3 (short term) and above are investment grade.

## Appendix VI

Tasman District Council Bank Accounts

- General Fund Account
- Loan Account
- Direct Credit Account
- Takaka Imprest Account
- Motueka Imprest Account
- General Disaster Relief Fund
- Rivers Relief Fund
- Self Insurance Fund

## Appendix VII

Specified Reserve Accounts

Tasman District Council will maintain separate bank accounts for the following specified reserve accounts:

- Pinegrove Trust
- Port Dividend Fund
- General Disaster Relief Fund
- Rivers Relief Fund
- Self Insurance Fund