SOUTH WAIRARAPA DISTRICT COUNCIL

25 OCTOBER 2017

AGENDA ITEM C1

INVESTMENT POLICY AND LIABILITY MANAGEMENT POLICY REVIEW REPORT

Purpose of Report

To inform Councillors of the proposed amendments to the Investment Policy M200 and Liability Management Policy M300.

Recommendations

Officers recommend that the Council:

1. *Receive the Investment Policy and Liability Management Policy Review Report.*
2. *Approve the changes to the Investment Policy M200.*
3. *Approve the changes to the Liability Management Policy M300.*
4. *Agree the next review date for both policies should be June 2021.*

1. Executive Summary

A number of core policies need to be reviewed at least every three years by Council as part of the Long Term Plan (LTP) process. A number of these policies form part of the LTP document. Two of these policies, the Investment Policy (M200) and Liability Management Policy (M300) have been reviewed and are now brought to Council for approval.

2. Background

As part of the Long Term Plan (LTP) process, a number of core policies need to be reviewed at least every three years by Council.

Eight of these policies form part of the LTP Document.

These policies are as follows:

- Significance and Engagement Policy
- Revenue and Financing Policy
- Liability Management Policy
- Investment Policy
- Development Contributions/Financial Contributions Policy

- Remission and Postponement of Rates on Maori Freehold Land Policy
- Remission of Rates Policy
- Postponement of Rates Policy

Council approved amendments to the Remission of Rates Policy at the September Council meeting.

The next two policies have now been reviewed and amendments agreed by the Audit and Risk working party (A&R) and are now presented to Council for their approval.

Some additional changes have been made since the A&R review, including proposing the next review date be June 2021 in line with the next LTP approval deadline.

2.1 Amendments to Investment Policy M200

The amended Investment Policy M200 is attached as Appendix 1 with tracked changes to show wording changes.

These changes include:

a. Updating the name of Civic Financial Services Limited (formerly New Zealand Local Government Insurance Corporation Limited). This name change occurred in March 2017 as a result of changes within the company. Civic Financial Services has provided insurance services to SWDC over a number of years.

b. To add additional information regarding the Local Government Funding Agency (LGFA) borrower notes. Borrowers are required to be hold borrower notes equal to 1.6% of their LGFA borrowings as part of the contract with LGFA.

c. To update Councils policy on Investment properties. Previously the policy indicated Council would not hold real estate for investment purposes. The policy has been amended to allow that this is a valid investment for Council.

d. To remove references to sinking funds as these are no longer used by SWDC.

e. Clarification of the intended use of proceeds from sale of investments. Primarily these proceeds would be used for capital investments or the retirement of debt. The policy clarifies that the proceeds may be used for operational expenditure but only by resolution by Council.

f. Amending the reporting requirements regarding the percentage of term deposit investments held with different banks to ensure that monthly reports are provided to A&R and any exceedances of the 30% per banking institution are noted in the A&R minutes. This ensures that in months where monthly financial statements are not produced due to other work priorities (e.g. Annual report, Annual plan etc), the percentage split of investments is still reviewed and noted by the appropriate working party.

2.2 Amendments to Liability Management Policy M300

The amended Liability Management Policy M300 is attached as Appendix 2 with tracked changes to show wording changes.

These changes include:

a. Updating the debt repayment wording to recognise that Council currently holds all of its debt as interest only loans with LGFA but to enable Council to enter into interest and principal loans in the future if this is the preferable option.

b. To extend the length of time Council may repay its loans over to reflect lending for longer term, intergenerational assets such as the current projects to dispose of wastewater to land which have a 35 year time span in line with their resource consents.

c. To record a policy of building up cash reserves in order to meet future repayment of Councils interest only loans.

d. To removing references to sinking funds as these are no longer used by SWDC.

3. Conclusion

The two policies attached in the Appendices have been reviewed by Officers and the A&R working party and are now submitted to Council for approval of amendments including the next review date of June 2021 in line with the next LTP approval deadline.

The remaining policies required to be reviewed and included in the LTP will be reviewed and submitted for approval in coming months.

4. Appendices

Appendix 1 – Investment Policy M200

Appendix 2 – Liability Management Policy M300

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Appendix 1 – Investment Policy M200

INVESTMENT POLICY

1. General Policy

The investment policy will be consistent with Council's overall objectives and plans. Council acknowledges that there are financial risks associated with its investment activities but is risk averse. The treasury function is based on managing risk and protecting investments. There is no involvement in speculative transactions.

The management of trusts, ~~and~~ special funds and reserves will be reviewed on a regular basis. This will ensure that their holding complies with any statutory or other special requirements and that their use is consistent with ~~these~~ these requirements and with Council policy at the time.

Investments generally will be made having regard to the following objectives:

- To manage short term cash flows in an efficient and prudent manner providing cash for approved expenditure needs and in the event of urgent requirements.
- To provide cash for the future retirement of debt on maturity.
- To maximise interest income and minimise risk to the capital invested.

2. Treasury Investments

Council's treasury investments comprise sums reserved for special purposes and funds held for working capital requirements. These funds are managed using the following guidelines:

- Funds are invested only with institutions which offer an excellent degree of security. These include the New Zealand Government, State Owned Enterprises, Local Authorities (including itself) and New Zealand registered banks.
- The maximum amount to be invested with any one approved institution is 30% ~~(occasional and short term exceedances of the 30% rule are allowed, such exceedances are to be reported to the Audit and Risk Working Party)~~ of Council's total investments except for the Wairarapa Building Society which shall be 10%.
- Occasional and short term exceedances of the 30% rule are allowed, such exceedances are to be reported to the Audit and Risk Working Party.

3. Equity Investments

Council has small shareholdings in the following organisations:

- ~~New Zealand Local Government Insurance Corporation~~Civic Financial Services Limited~~.~~
- AIRTEL Limited~~.~~
- Farmlands Trading Society Limited~~.~~

A Council resolution is required to dispose of these shares.

Council is risk averse and does not wish to expose itself to the risks associated with equity investments. It will not as a general rule seek to acquire further equity investments.

4. Emissions trading scheme

Council has a number of "New Zealand Emissions Units" that were issued as a result of the introduction of the emissions trading scheme.

A Council resolution is required to transact these units.

5. Local Government Funding ~~Authority~~Agency

Council may~~,~~ borrow funds from the Local Government Funding ~~Authority~~Agency (LGFA).

Council holds Borrower Notes with the LGFA. Borrower notes are subordinated debt instruments which are required to be held by each local authority that borrows from LGFA in an amount equal to 1.6% of the aggregate borrowings by that local authority.

Under certain very limited circumstances, the borrower notes can convert to shares.

If this were to occur, ~~A~~a Council resolution will be required to manage these shares.

6. Property

Council ~~does not~~ holds a limited amount of real property for investment purposes. It may and does purchase property from time to time to assist in the provision of its core services to the community. Surplus properties will be disposed of wherever possible. Council will review its property holdings on a regular basis.

6.1 Mix of Investments

The mix of investments will be determined having regard to the overall funding needs of Council. Investment mix is also influenced by risk management considerations. Council will maintain sufficient general funds for day to day operational needs.

Council may establish, alter or dissolve a fund for a particular purpose by ordinary resolution.

6.2 Acquisition of New Investments

Treasury investments are acquired under delegated authority to the Chief Executive.[1]

It is unlikely that Council will invest in shares ~~or investment properties~~ in the foreseeable future. Any such acquisitions would require a resolution by Council.

When acquiring treasury investments Council seeks to:

- Optimise return on investments.
- Ensure investments are secure.
- Manage potential interest rate movement losses.

~~6.4~~6.3 Disposition of Revenue from Investments

All dividends, interest and other income from investments will be available for Council's general use except ~~:~~

~~W~~where Council has resolved that interest earned on funds invested in an account shall be reinvested in that account. These accounts shall be subject to review each year.

- ~~Interest earned on sinking funds which shall remain in the sinking funds.~~

~~6.6~~6.4 Disposition of Proceeds of Sale of Investments

Equity and property investments may be disposed of by resolution of Council. In general terms, ~~and~~ these proceeds will not be available for operational purposes ~~Council's general use~~ unless Council~~it~~ resolves otherwise. These proceeds will normally~~may~~ ~~only~~ be used for capital investments or the retirement of debt.

On maturity, treasury investments may be realised for Council's general use or reinvested under delegated authority by the Chief Executive.

[1] ~~Means t~~The Chief Executive and/or other officers to whom the Chief Executive may delegate from time to time.

~~6.7~~6.5 Procedures

Equity and property investments will be reviewed by Council ~~before the end of March~~ each year.

Treasury investments will be managed under delegated authority by the Chief Executive. All realisations, transfers and reinvestments will comply with this policy. ~~All treasury transactions are required to be validated by way of a deal ticket (as contained in Council's Treasury Policy).~~

~~Council~~ The Audit and Risk working party will receive a schedule of all treasury investments for each month. A schedule of investments will be provided to Council on a regular basis ~~-~~as part of the financial statements included in the Chief Executive Officer's report.

~~6.8~~6.6 Investment Risk Assessment and Management

Council has no investment properties and only one equity investment.[2] [Council does hold shares in Airtel Ltd and Farmlands Trading Society Limited, however these are not held for investment purposes]. The exposure to risk in these areas is minimal.

Council's primary objective in respect of treasury investments is the protection of those investments. Only credit worthy counter parties are acceptable. Council will manage its exposure to credit risk by maintaining a diverse investment portfolio with prescribed limits for each counter party. The exposure to interest rate risk will be managed by a mix of terms and staggered maturity dates to mitigate the effect of market fluctuations.

~~6.9~~6.7 Objectives for holding and managing financial investments and equity securities

The objectives of holding financial investments are:

- To maintain sufficient cashflow to meet current and future needs.
- To ensure sufficient funding is available to meet future loan repayments as they fall due ~~through the maintenance of sinking fund accounts~~.

The objectives of holding equity investments are:

- Equity investments are held solely for strategic purposes and are not held for financial return.

[2] ~~New Zealand Local Government Insurance Corporation~~Civic Financial Services Ltd ~~26,965~~53,390 shares.

- Equity investments will only be made to support companies that provide a service that may not otherwise be provided, for the benefit of either the three Wairarapa local authorities, or a wider base of local authorities.

~~6.10~~6.8 Targets for returns on financial investments and equity investments

The targets for returns on financial investments are:

- The key rationale of the holdings of financial investments is risk minimisation. Due to the levels of cash holdings these are managed solely for cashflow purposes. Council policy limits investment to very low risk investment, which by its nature provides modest returns.

The objectives of holding equity investments are:

- Equity investments are held solely for strategic purposes and are not held for financial return.
- There is no quantified target for equity investments for the reasons outlined above.

Appendix 2 – Liability Management Policy M300

LIABILITY MANAGEMENT POLICY

1. General policy

The borrowing management policy will be consistent with Council's overall objectives and plans. The amount of borrowing is driven on a project by project basis. Council approves borrowing by resolution as part of the Annual and Long Term Planning processes.

Council may borrow from itself, any registered bank or wholesale investor by the issue of local authority stock, or the Local Government Funding Agency or in any other manner which it considers appropriate.

2. Interest rate exposure

Council's borrowing gives rise to direct exposure to interest rate movements. Given the long term nature of Council's assets, projects and intergenerational factors, Council's policy is to have a high percentage of fixed rate borrowing, however in certain circumstances it may be prudent to consider a more even balance between floating and fixed rate instruments. Interest rate risk is managed by adjusting the maturity of borrowings to avoid a concentration of debt reissues or rollovers in line with interest rate predictions.

All matters concerning borrowing which can be lawfully delegated are delegated to the Chief Executive.

The use of hedging instruments for risk management on Council's borrowing is not appropriate. Should Council wish to use hedging instruments an ordinary resolution approving their use will be adopted by Council.

3. Liquidity

Liquidity refers to the availability of cash resources to meet all obligations as they arise.

Short term liquidity management is monitored and controlled through daily cash management activities with long term liquidity being monitored and controlled through the Annual Plan and Long Term Financial Strategy processes.

Council ensures debt maturity is spread widely to minimise the risk of large concentrations of debt maturing at any one time. Council may maintain an overdraft facility to meet short term cash requirements as and when necessary.

4. Credit exposure

Council is readily able to attract cost effective borrowing because of the strength of security offered by its powers to rate, and the very low historical incidence of default by local authorities.

5. Debt repayment

Council ~~has at present~~has traditionally entered into two types of loans. These comprise reducing balance and interest only loans. Reducing balance (table mortgage) loans are repaid from operational funds over the life of the loan. Council can liquidate these loans at any point of time if allowed under the terms of the loan agreement. Interest only loans are taken out over the life of the project and refinanced at three to five year intervals.

~~Council has established sinking funds in respect of all interest only loans.~~ Council has not forecast to make any repayments of principal on ~~the~~interest only loans~~ it has sinking funds for~~, as the loans are intended to be for the same length of time as the asset life ~~and the sinking fund repayment schedules are calculated based on the same~~. Most of the loans are for assets that have a life of ~~either 10 or 20~~between 7 years and 35 years and as a result ~~– none~~some of these mature within the period of th~~is~~e current Long Term Plan (LTP).

~~This~~Council's goal is to spread~~s~~ the principal and interest costs related to ~~the~~ asset purchases evenly over the period of the assets life, and therefore achieve~~s~~ inter-generational equity for ~~the~~ ratepayers. While the loan principal is not paid off progressively, ~~the sinking fund~~ Council sets aside deposits to accumulate progressively to prepare for repayment of the loans. ~~and therefore accumulate more interest earned. Sinking funds may be converted to "table" loans should it be prudent to do so.~~

Council has introduced a policy of building up its cash reserves in order to meet future renewals of its assets and repayment of its interest only loans.

~~Council is under no obligation to establish sinking funds for new borrowings but must consider and record how it intends to effect repayment.~~

Terms of repayment should be determined after consideration of the cost of finance and any intergenerational benefits of the assets being financed.

The maximum period over which borrowings are to be repaid is the lesser of 3~~0~~5 years or the life of the project, unless otherwise resolved by Council.

6. Specific borrowing limits

The gross interest expense of all borrowings will not exceed 12% of rates income.

7. Security

Council does not offer assets as security for borrowings.