Liability Management Policy

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1. Introduction

1.1. This Liability Management Policy provides appropriate parameters for Council to prudently manage its borrowing activities and external liabilities.

1.2. Council is a risk-adverse entity that seeks to manage the risks associated with its borrowing activities. Interest rates, liquidity and credit risks will be managed but not speculated on.

2. General

2.1. The use of debt is seen as an appropriate and efficient mechanism for promoting inter-generational equity between current and future ratepayers, in relation to funding assets that have long economic lives and/or long-term benefits. Sometimes short-term debt is required to maintain Council's liquidity.

2.2. Council will borrow to:

- fund specific capital works on long-term assets
- fund non treasury investments
- manage short-term deficits through overdraft facilities
- fund hire purchase, credit, credit cards, deferred payment or lease arrangements in the ordinary course of Council's business.

2.3. The Local Government Act 2002 prohibits Council from entering into borrowing arrangements denominated in any foreign currency.

3. Borrowing Mechanisms

3.1. Council is able to borrow through a variety of market mechanisms, which include:

- debt borrowing from the Local Government Funding Agency (LGFA)
- issuing of loan stocks and debentures
- facilities with banks
- community bonds
- overdraft facilities
- credit contracts, leasing arrangements, credit cards and trade creditors
- internal borrowing from the treasury fund.

3.2. Before accessing any borrowing facilities, the size and nature of the project, cost of borrowing, Council's debt maturity portfolio, terms and covenants, must be taken into account to determine the most appropriate source of funds.

3.3. Council's primary source of borrowing will be from the Local Government Funding Agency (LGFA). This supports Council investment in the company as a shareholder and guarantor.

4. Security

4.1. Many of Council's assets are not readily saleable so will be less attractive as security items. Council will offer security by way of a charge over our ability to levy rates, through a debenture trust deed.

4.2. As a matter of course, Council will not secure other assets unless circumstances show it to be appropriate (e.g. leased assets).

5. Management of Risks

5.1. Borrowing Limits

5.1.1. A number of industry benchmarks exist that give an indication of acceptable borrowing limits. For Council there is a trade-off between the strict application of these borrowing limits and the community's desire for projects to proceed, particularly those of an urgent nature and for which the community is willing to pay. Council's borrowing levels will be managed through a process of careful planning, constant review and these will be disclosed during the annual planning and reporting processes.

5.1.2. In managing debt, Council will adhere to the following limits:

- Net interest must not exceed 20 percent of total revenue
- Net interest must not exceed 25 percent of annual rates income
- Net debt must not exceed 175 percent of total revenue
- Available financial accommodation (Liquidity) must be greater than 110 percent of external indebtedness

5.1.3. These limits are the same as the covenants used by the LGFA, Council's prime source of debt. The terms used in the limits above are defined in the appendix.

5.2. Interest Rate Exposure

5.2.1. The 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 relationships with bankers and other financial institutions.

5.2.2. Council's borrowing gives rise to direct exposure to interest rate movements in the market. Interest rate exposure can be managed by spreading the maturity dates of its floating and fixed rate borrowings to ensure that not all of its borrowings become exposed to the interest rate market at any one time.

5.2.3. Council may use the following interest rate risk management instruments to manage interest rate exposure risk:

- Fixed interest rate swaps, including forward starting swaps.
- Interest rate options – includes caps, swaptions and collars. For a collar, the amount of the sold option must match the amount of the purchased option.
- Fixed rate Bonds.

- Fixed Rate Term Loans.

Options that hedge floating rate debt with an exercise rate greater than 1.50%, above the equivalent period fixed interest rate at the time of inception cannot be included as part of the fixed rate cover percentage calculation.
For example, a two year cap at 2.00% would only count as a fixed rate hedge if the underlying two year swap rate at the time of inception was higher than 0.50%.

5.2.4. **Council will use the following fixed/floating rate bands to manage the interest rate risk:**

Fixed Rate Policy Bands		
	Minimum	Maximum
0 - 2 years	40%	100%
2 - 4 years	20%	80%
4 - 13 years	0%	60%

5.2.5. The interest on internal borrowings will be charged quarterly and will be based on the Council's internal borrowing rate agreed in its Long Term Plan.

5.3. Liquidity and Credit Risk

5.3.1. Council's liquidity and credit risk exposure is primarily our ability to pay borrowings as loans fall due. Council will only transact business with reputable creditworthy counter parties.

5.3.2. To manage liquidity risk, Council will adhere to the following limit:

5.3.3. **Council shall maintai**n the **liquidity** ratio at a minimum of 1:1

5.4. Funding Risk (Debt Repayment Risk)

External funding

5.4.1. Funding risk management centre on the ongoing ability to re-finance or raise new debt at a future time, at the same or more favourable pricing (fees and borrowing margins) and terms of current facilities. A key factor in funding risk management is to spread and control the risk by managing the quantum of debt that matures in any 12mth period. Council has a number of borrowing mechanisms available to it. These range from a table loan style where interest and principal are paid at the same time, to fixed/floating rate bonds where interest only is paid through the term of the debt and principal is only repaid at the end of the loan term.

5.4.2. No more than 40% of Council's net debt shall be subject to refinancing in any rolling 12 month period without prearranged facilities being in place. This requirement shall not apply if debt is less than $20.0 million.

Internal Funding

5.4.3. In respect to internal borrowing, revenue will be applied each year to repay the principal outstanding over the life of the loan.

5.4.4. The maximum term of any borrowings will be the expected life of the asset that is being acquired or constructed or thirty years, whatever is the least.

5.4.5. Loan repayments and borrowing charges are applied to the activity, which received the benefit of the borrowing.

6. Contingent Liabilities

6.1. From time to time, the Council may be asked to provide financial guarantees to community, sporting and non-profit organisations. Applications for guarantee support will be considered by Council if:

- the organisation will provide benefit to the Manawatu District
- the organisation furthers the strategic objectives of Council, and
- there are satisfactory projections of the financial strength and long-term viability of the organisation.

6.2. The Council must pass a resolution to approve all financial guarantees. Management will monitor the guaranteed organisation's ongoing performance through regular communications and by assessing their financial statements (at least annually).

6.3. Should it become apparent that a guarantee is at risk of being called on, the Council will take immediate action to minimise this risk. Should a guarantee be called, Council will take action to recover any monies called on.

6.4. In addition to the guarantees mentioned above, in connection with its borrowing from the LGFA, Council may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required.

7. Approval of Borrowing

7.1. The Council will approve borrowings. This will normally be done for the borrowing requirement for each financial year during the annual planning process or by later resolution during the year.

7.2. A resolution of Council is not required for hire purchase and normal credit activities if:

- the period of indebtedness is less than 91 days or
- the goods or services are obtained in the ordinary course of operations, on normal terms, for amounts not exceeding in aggregate $100,000.

8. Management and Reporting

8.1. Internal and external borrowings will be managed by the Chief Financial Officer under delegated authority. Borrowings will be included in the quarterly report to Council following review and approval by the Executive Team.

Appendix 1 – Definitions

Annual rates income - Total revenue from funding mechanism authorised by the Local Government (Rating) Act 2002 (includes water by meter but not volumetric sewerage charges) plus any revenue from services provided to another Local Authority (includes revenue received from Rangitikei District Council for shared services).

Available financial accommodation - External indebtedness plus committed but undrawn financial accommodation available plus liquid investments.

External indebtedness - The total amount of indebtedness to any person in respect of money borrowed or raised or any other financial accommodations having a similar economic effect to borrowing or raising money, as shown in the Financial Statements. This excluded internal indebtedness, contingent liabilities and indebtedness resulting from unrealised losses on hedging instruments.

Financial statements - The audited Financial statements

Liquid investments - Cash plus securities or guaranteed investment issued by the NZ Government plus commercial paper or other debt securities including deposits with a registered bank..

Liquidity ratio - Current assets, excluding the current portion of assets held for sale divided by current liabilities, excluding current portion of term borrowings

Net debt - Total of all financial liabilities less liquid investment (as shown in the Financial Statements)

Net interest -Annual interest and financing costs incurred less interest income (as shown in the Financial Statements)

Total revenue -The total operating revenue for the financial year (as shown in the Financial Statements) but not including non-Government capital contributions such as developers contributions and vested assets.

Fixed interest rate swaps

Forward swaps

Caps

Swaptions

Collars

FRN – Floating rate note

FRB - Fixed rate bond