Auckland Council
Treasury Management Policy

Context

The Local Government Act 2002 requires local authorities to adopt a liability management policy and an investment policy.

The liability management policy must state the council's policies on how it will manage its borrowings and other liabilities, including interest rate exposure, liquidity, credit exposure and debt repayment.

The investment policy must set out the council's policies on investments including the mix of investments, acquiring new investments, management and reporting procedures, and risk management.

Together these policies make up Auckland Council's treasury management policy providing the framework under which council operates all borrowing and investment activities. This policy should be read in the context of the council's financial strategy, which contains the council's overarching financial policy statements and objectives.

The policy applies to the Auckland Council parent and all 100 per cent owned Council Controlled Organisations (CCO)'s (excluding Ports of Auckland Limited (POAL)). All references to council refer to Auckland Council parent and all 100 per cent owned CCOs except where explicitly excluded.

The Governing Body[1] will review and approve any changes to the treasury management policy. The council will consider whether or not to consult before making any changes to this policy – the council will consult where the proposed changes are significant. The council will review treasury outcomes against the strategic risk limits and performance benchmarks on a quarterly basis.

A treasury management steering group (TMSG) reviews and approves strategic risk limits conforming to this treasury management policy. The TMSG also monitors compliance with these limits and the performance of treasury activities against agreed benchmarks on a monthly basis. The TMSG is made up of senior council parent officers, the CFO of Watercare (or their designate), the CFO of Auckland Transport (or their designate), other CCO CFO's (as appropriate) and one or more external appointees.

Auckland Council Parent treasury staff carry out the council's treasury activities in accordance with this policy. Internal treasury policies are developed with each individual CCO. Individual CCOs will be consulted on matters of material significance to that CCO.

Under the Local Government (Rating) Act 2002, the council parent has the flexible powers to set, access and collect rates to fund local government activities. This allows council parent to provide its rating powers as security for borrowing purposes in the form of a Debenture Trust Deed. This is a strong security position and is reflected in the credit quality of the council. The borrowing and liquidity ratios included in this policy both support the credit quality and provide assurance to council's external lenders.

Liability management policy

The following is a general description of the council's policies with respect to borrowing and liability management.

Objectives

The council's key liability management objectives in relation to borrowings (to be considered collectively) are to:

- minimise borrowing costs within approved risk parameters
- prudently manage the council's exposure to interest rate changes
- prudently manage the council's borrowing to ensure the avoidance of maturity and interest rate re-pricing concentrations

[1] Reference to the Governing Body in this document refers to the Governing Body or a committee of the whole.

- maintain accurate cash flow forecasts to ensure sufficient levels of liquidity to meet both planned and unforeseen cash requirements, and to assist borrowing decisions
- prudently manage the council's credit exposures, which are to be with approved counterparties within predetermined limits
- maintain market confidence in the creditworthiness and integrity of the council as a borrower, through positive ongoing relationships with lenders, investors, registrar and paying agent, trustee, and credit rating agencies
- monitor and report on the risk and the performance of debt portfolios against predetermined limits and benchmarks
- maintain a credit rating of at least "A+" from Standard & Poor's (or an equivalent rating agency).

Management of borrowings

The Governing Body considers and approves its forecast borrowing requirements by approving financial projections in its 10-year plan and each annual plan.

The council manages financial assets and debt on a net portfolio basis (borrowings less cash instruments). A centralised approach to debt management is applied. The key factors considered in this approach are the council's liquidity profile, contractual terms, debt levels, operating surpluses and sustainable funding needs.

Funding may be sourced from domestic and foreign investors in local and foreign currency[2] and from the New Zealand Local Government Funding Agency ("LGFA"). The council enters into offsetting derivative contracts with approved counterparties to eliminate foreign currency exposure on its foreign currency borrowings.

Borrowings to fund CCO's will be passed through to CCOs in the most efficient manner after taking into account any accounting, tax or legal compliance issues. There is no prescribed maximum limit for CCO borrowings. These borrowings are agreed by the Governing Body when approving the subsidiary's statements of intent and funding plans.

Any other council liabilities are managed in the course of the council's day-to-day operations.

Debt repayments

Debt repayment decisions are driven by the council's liquidity profile, contractual terms, debt levels and sustainable funding needs. Debt repayments (both interest and principal) are governed by:

- the council's policy of maintaining forecast prudential ratios within specified limits
- the council's projected liquidity profile
- spreading the council's borrowings over a range of maturities to reduce the concentration of debt repayments at any one point in time
- contractual terms and conditions of borrowing (funds must be available to repay debt as and when it falls due)
- the need to preserve borrowing flexibility.

The council sets, on a case-by-case basis, the appropriate terms for repaying debt for transitional project financing and for non-routine capital expenditure.

[2] The council can borrow and enter into incidental arrangements in foreign currencies: see s107 Local Government (Auckland Council) Act 2009.

Borrowing and liquidity limits

The council's prudential limits[3] are:

Debt as a percentage of revenue	< 270%
Interest as a percentage of revenue	< 15%
Interest as a percentage of rates income	< 25%
Liquidity (cash and liquid investments plus headroom under committed funding facilities to equal a minimum period of forecast net cash outflow including maturing debt on a rolling basis)	6 months at least

Council must also comply with all relevant financial covenants/ratios (for example those imposed by the Local Government Funding Agency).

Liquidity

Liquidity management is the management of liquid assets and funding sources to meet both short and long-term commitments as and when they fall due. Where the council has a long-term or ongoing need for core borrowings, lengthy borrowing terms are attractive as they eliminate short-term liquidity risk (the risk of not being able to roll over short-term debt as it matures).

To ensure the council maintains a sufficient level of liquidity at all times, the TMSG determines at least annually (when approving the council's strategic risk limits):

- the minimum amount by which the total of the council's unutilised short-term funding facilities and its liquid investments must exceed forecast net cash outflow
- the period of time over which the forecast net cash outflow must be measured.

Council's borrowings are spread over a range of maturities to minimise the risk that the council is not able to raise new borrowings or refinance existing borrowings at acceptable credit margins. The TMSG establishes the maximum value of outstanding borrowings that may mature over any twelve-month period when approving the council's strategic risk limits.

Interest rate exposure policy

Interest rate risk refers to the impact that movements in interest rates can have on an organisation's financial performance. The council prefers predictable interest income and expense to minimise the risk of adverse movements impacting the operating surplus.

The primary objective of interest rate risk management is to reduce uncertainty about net interest income or expense as interest rates change. Mechanisms used include matching the interest rate re-pricing profile of the council financial investments and financial liabilities and, within risk limits, fixing rates through fixed-rate borrowings and by using interest rate hedging instruments. The council manages interest rate risk on its debt on a portfolio basis.

Credit exposure policy

Prudent credit management can reduce the council's risk of loss from a counterparty failing to meet its obligations. Credit exposure for borrowings is relevant for the undrawn portion of any committed, standby or bank facility, where the counterparty has a contractual obligation to provide funds to the council. For these facilities, the counterparty's minimum credit rating must be A- (long term) as rated by Standard & Poor's, or equivalent credit ratings from another internationally recognised rating agency (such as Moody's or Fitch Ratings).

Security for debt

As borrowing facilities are usually established for broad funding purposes, the council generally provides rates revenue as security for its borrowings. However, in specific cases, the council may consider whether

[3] The calculation of these limits will be consistent with methodology and definitions used by Standard and Poor's.

alternative security is appropriate, for example security over property that is specifically connected with the borrowing.

Investment policy

Objectives

The council seeks to minimise the risks associated with its investments to avoid placing the capital value of individual investments at risk. The council does not undertake any unnecessary or speculative investment activity.

Key investment policy objectives are to:

- prudently manage the council's financial investments by seeking to maximise investment income within acceptable investment risk parameters
- practise an ethical investment approach[4]
- invest only in approved securities and asset classes
- maintain an appropriate level of diversity across asset classes
- support the council's liquidity requirements
- monitor and report on risk and performance against predetermined limits and benchmarks
- maintain operational controls and procedures that protect the council against financial loss, opportunity cost and other inefficiencies.

Where appropriate, council favours investment in New Zealand entities which meet the following conditions:

- the proposed investment is within the constraints of the council's financial position and the long-term plan
- the effect of the proposed investment on the expected risk and return characteristics of the council's total investment portfolio is considered
- the expected risk and return characteristics of the proposed domestic investment are not inferior to currently available and comparable foreign investment opportunities.

Investment mix

The council has investments in equity, property, and debt securities. The council's equity investments include holdings in subsidiaries (direct or indirect) and other entities, where there is a specific strategic objective for holding the investment or the investment is required to comply with legislation. Council has invested in shares and other financial instruments of the LGFA. If required in connection with this investment, the council may also subscribe for uncalled capital in the LGFA.

The council's debt investments include treasury assets, such as cash and short-term money market instruments, which are used to manage the council's day-to-day and longer-term cash flow and liquidity requirements. The council also holds other debt investments in various investment portfolios, each tagged for specific purposes. The council's debt investments may include loans to subsidiaries.

Acquisition of new investments

The acquisition of fixed-interest investments are made in accordance with strategic risk limits approved by the TMSG.

New equity investments, other than those purchased as a part of a perpetual or externally managed investment portfolio, are approved by the council acting on the recommendation of the appropriate council committee. In general, it is not the council's policy to acquire equities solely for investment purposes, except where those equities form part of a perpetual or externally managed investment portfolio, or where arrangements are entered into that mitigate financial risks associated with the investment.

[4] Council's ethical investment approach is outlined in the Responsible Investment Policy.

Managing and reporting on investments

Details on the performance of investments are reported to the council, quarterly. Monthly management reports covering treasury assets and fixed-interest securities are reviewed by the TMSG, including liquidity details, interest rate exposure and credit exposure.

Risk management

In the normal course of its treasury investment operations, the council has exposure to credit risk, interest rate risk and liquidity risk.

Credit risk is managed by the council limiting its credit exposure to any single counterparty. This is done by weighting exposures towards counterparties with higher credit ratings, as determined by an international credit rating agency, e.g. parties that are rated A- or better by Standard & Poor's. To safeguard against loss through poor credit quality, limits are applied to the council's aggregate exposure to each counterparty (and groups of counterparties) within specified credit rating bands. The only unrated counterparties that the council may invest in are other local government bodies. The TMSG reviews and approves strategic credit risk limits annually.

The main objective of interest rate risk management is to reduce uncertainty around net interest income or expense as interest rates change. Mechanisms used include matching the interest rate re-pricing profile of the council's financial investments and financial liabilities and, where appropriate, fixing rates through fixed rate borrowings and the use of interest rate hedging instruments.

Interest rate risk is the risk that interest income will (due to adverse movements in market interest rates) materially under-perform the interest income projections in the council's annual plans and 10-year plan, negatively affecting the council's financial performance and position.

The council manages interest rate risk on investments on a portfolio basis.

Liquidity risk is managed by investing only in financial assets that can be liquidated through a readily available secondary market or have a short time period before maturity.