



# Treasury Risk and Liability Management and Investment Policies

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## 1. Introduction

### 1.1 Policy purpose

The Treasury Risk Management Policy ("Policy") guides the way the Selwyn District Council ("SDC") manages and controls its borrowing and investment activities. The aim of the Policy is to enable treasury risks to be managed prudently with an appropriate balance of risk and return. The Policy links to the Revenue and Financing Policy (that determines how individual activities are funded) and the Financial Strategy (that sets out how SDC manages its finances as a whole). This Policy can be amended at any time by Council resolution and will be reviewed at least every three years.

Periodic reviews will be conducted to test the Policy against the following criteria:

- Treasury "best practices" for a Council the size and type of SDC.
- The risk bearing ability and tolerance levels of the Council and its underlying revenue and expenditure.
- The effectiveness and efficiency of the Policy and treasury management function to recognise, measure, control, manage and report on SDC's financial exposure to market interest rate risks, funding risk, liquidity, investment risks, counterparty credit risks and other associated risks.
- The operations of a pro-active treasury function in an environment of control and compliance.
- The robustness of the Policy's risk control limits and risk spreading mechanisms against normal and abnormal interest rate market movements and conditions.

- Assistance to SDC in achieving strategic objectives relating to ratepayers.

It is intended that the Policy be distributed to all personnel involved in any aspect of the SDC's financial management. In this respect, all staff must be completely familiar with their responsibilities under the Policy at all times.

## 2. Scope and Objectives

### Policy purpose

- This document identifies the policy of SDC in respect of treasury management activities.
- The Policy has not been prepared to cover other aspects of SDC's operations, particularly transactional banking management, systems of internal control and financial management. Other policies and procedures of SDC cover these matters.

### Treasury management objectives

The objective of this Policy is to control and manage costs and investment returns that can influence operational budgets and public equity and set debt levels. Specifically:

#### Statutory objectives

- All borrowing, investments and incidental financial arrangements (e.g., use of interest rate hedging financial instruments) will meet requirements of the Local Government Act 2002 and incorporate the Liability Management Policy and Investment Policy.
- SDC is governed by the following relevant legislation:
  - Local Government Act 2002, in particular

Part 6 including sections 101, 102, 104, 105, 112 and 116.

- Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.
- Trusts Act 2019 (effective 30 January 2021). When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others. Details of relevant sections can be found in the Trustee Act 2019 Part 4 Investments.
- All projected borrowings are to be approved by Council as part of the Annual Plan and Long-Term Planning (LTP) process, or resolution of Council before the borrowing is affected.
- All legal documentation in respect to borrowing and financial instruments will be approved by Council's solicitors prior to the transaction being executed. This includes but is not limited to underlying International Security Dealers Association (ISDA) swap documentation, Loan agreements, Local Government Funding Agency (LGFA) supporting bond and note issuance agreements, but does not include draw down notices, individual swap confirmations or deposits.
- Council will not enter into any borrowings denominated in a foreign currency.
- Council will not lend to any Council Controlled Trading Organisation (CCTO) on terms more favourable than those achievable by Council itself.

The statutory requirements for the Liability Management Policy and Investment Policy are met by the following liability management and investment sections of this policy.

## General objectives

- Safeguard the council's assets/capital.
- Manage investments to optimise returns in the long term whilst balancing risk and return considerations.
- Have a diverse investment portfolio (to manage the risk).
- Focus on economic benefits / economic wellbeing from investments in projects or activities.
- Monitor Council's return on investments.
- Minimise Council's costs and risks in the management of its borrowings.
- Minimise Council's exposure to adverse interest rate movements.
- Monitor, evaluate and report on treasury performance.
- Borrow funds and transact risk management instruments within an environment of control and compliance under the Council approved Policy so as to protect Council's financial assets and manage costs.
- Arrange and structure long term funding for Council at a favourable margin and cost from debt lenders. Optimise flexibility and spread of debt maturity terms within the funding risk limits established by this Policy statement.
- Monitor and report on financing/borrowing covenants and ratios under the obligations of Council's lending/security arrangements.
- Comply with financial ratios and limits stated within this Policy.

- Ensure the Council, management and relevant staff are kept abreast of the latest treasury products, methodologies, and accounting treatments through training and in-house presentations.
- Maintain appropriate liquidity levels and manage cash flows within Council to meet known and reasonable unforeseen funding requirements.
- Minimise exposure to credit risk by dealing with and investing in credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- Ensure that financial planning will not impose an inequitable spread of costs/benefits over current and future ratepayers.
- Ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, LGFA, investors and investment counterparties.
- Maintain a credit rating of "AA" from Fitch Ratings (or an equivalent rating agency).

## 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 (CCO/ CCTO), through the process of approving the Constitutions, Statements of Intent, and the appointment of Directors/ Trustees of these companies.





### 3. Governance and management responsibilities

#### 3.1 Overview of management structure

The following diagram illustrates those individuals and bodies who have treasury responsibilities. Authority levels, reporting lines and treasury duties and responsibilities are outlined in the following section:



#### 3.2 Council

The Council has ultimate responsibility for ensuring that there is an effective policy for the management of its risks. In this respect the Council decides the level and nature of risks that are acceptable, given the underlying objectives of SDC.

The Council is responsible for approving the Policy. While the Policy can be reviewed and changes recommended by other persons, the authority to make or change Policy cannot be delegated.

In this respect, the Council has responsibility for:

- Approving the long-term financial position of SDC through the Long-Term Plan (LTP) and the adopted Annual Plan.
- Approving new debt in accordance with adoption of the LTP, Annual Plan, specific Council resolution and approval of this Policy
- Approving and adopting the Liability Management and Investment Policies.
- Approving the Policy following recommendation by the Audit & Risk Committee, incorporating the following delegated authorities:
  - Borrowing, investment and dealing limits and the respective authority levels delegated to the Chief Executive (CE), Group Executive Director Enabling Services (EDES) and other management.
  - Counterparties and credit limits.
  - Risk management methodologies and benchmarks.
  - Guidelines for the use of financial instruments.
  - Receive a triennial review report on the Policy.
  - Approval for one-off transactions falling outside Policy.

#### 3.3 Audit and Risk Sub-Committee (ARC)

Under delegation from Council:

- Receiving and reviewing quarterly treasury report.

- Recommending the Treasury Management Policy (or changes to existing policy) to the Council.
- Receiving recommendations from the Executive Director Enabling Services and make submissions to the Council on all treasury matters requiring Council approval.
- Recommending performance measurement criteria for all treasury activity.
- Monitoring performance against benchmarks at least quarterly.

#### 3.4 Chief Executive (CE)

While the Council has final responsibility for the Policy governing the management of Council's risks, it delegates overall responsibility for the day-to-day management of such risks to the Chief Executive.

In respect of treasury management activities, the Chief Executive's responsibilities include:

- Ensuring the policies comply with existing and new legislation.
- Approving the register of authorised signatories.
- Approving new counterparties and counterparty limits.
- Approving new borrowing undertaken in line with the LTP, Annual Plan and Council resolution.
- In conjunction with the Group Manager Organisational Performance (EDES), approving the opening and closing of bank accounts.
- Receiving advice of non-compliance of Policy and significant treasury events from the EDES.



### 3.5 Executive Director Enabling Services (EDES)

The EDES's responsibilities are as follows:

- Management responsibility for borrowing and investment activities as delegated by the CE.
- Recommending Policy changes to the Audit & Risk Committee for approval.
- Ongoing risk assessment of borrowing and investment activity including procedures and controls.
- Approving treasury transactions in accordance with delegated authority.
- Authorising the use of approved interest rate management instruments within discretionary authority.
- Recommending authorised signatories and delegated authorities in respect of all treasury activities.
- Proposing new funding requirements to the CE, and if required submission to the Audit & Risk Committee.
- Reviewing and making recommendations on all aspects of the Policy to the CE, including dealing limits, approved instruments, counterparties, and general guidelines for the use of financial instruments.
- Conducting a review, at least triennially, of the Policy, treasury procedures and counterparty limits.
- Managing the long-term financial position of Council as outlined in the LTP.
- Monitoring and reviewing the performance of the treasury function in terms of achieving the objectives.
- Authorising borrowing, investing, interest rate,

cash management transactions with bank counterparties.

- Approving all amendments to Council records arising from checks to counterparty confirmations.
- Reviewing and approving treasury spreadsheet reconciliation to internal records.
- The EDES has oversight, and approves actions undertaken by the Head of Finance per delegated authority.

### 3.6 Head of Finance (HF)

The AM's responsibilities are as follows:

- Day-to-day responsibility for the treasury function as delegated by the EDES.
- Execute borrowing, investment, and interest rate management transactions in accordance with set limits. Investigate financing alternatives to minimise borrowing costs, margins and interest rates, making recommendations to the EDES as appropriate.
- Monitoring treasury exposure on a regular basis, including current and forecast cash position, interest rate exposures and borrowings.
- Account for all treasury transactions in accordance with legislation and generally accepted accounting principles, Council's accounting and funding and financial policies.
- Ensuring management procedures and policies are implemented in accordance with this Policy.
- Ensuring all financial instruments are valued and accounted for correctly in accordance with current best practice standards.



- Update treasury spreadsheets and 'Hedgebook' for all new, re-negotiated and maturing transactions (Hedgebook is the Council's software system for recording and valuing borrowing and interest rate swap transactions).
- Monitor and update credit ratings of approved counterparties.
- Handle all administrative aspects of bank counterparty agreements and documentation such as loan agreements and ISDA documents.
- Review and approve monthly bank reconciliations.
- Prepare treasury reports.
- Check compliance against limits and report potential/actual breaches to the EDES.

### 3.7 Finance Team

- Including all finance team members reporting to the EDES for segregation purposes.
- Settlement of borrowing, investment, cash management, and interest rate management transactions.
- Check all treasury deal confirmations against the treasury spreadsheet and report any irregularities immediately to the EDES.
- Complete monthly bank reconciliations.
- Complete general ledger reconciliations to treasury spreadsheet.
- Co-ordinate the compilation of cash flow forecasts and day-to-day cash management responsibilities.
- Reconcile monthly summaries of outstanding financial contracts from bank counterparties to internal records.

### 3.8 Delegation of authority and authority limits

Treasury transactions entered into without the proper authority are difficult to cancel given the legal doctrine of "apparent authority". Also, insufficient authorities for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays). To prevent these types of situations, the following procedures must be complied with:

- All delegated authorities and signatories must be reviewed at least annually to ensure that they are still appropriate and current (the review to be completed by the Audit and Risk Sub Committee)
- A comprehensive letter must be sent to all bank counterparties at least annually to confirm details of all relevant current delegated authorities empowered to bind Council.

Whenever a person with delegated authority on any account or facility leaves Council, all relevant banks and other counterparties must be advised in writing in a timely manner to ensure that no unauthorised instructions are to be accepted from such persons.



Council has the following responsibilities, either directly itself, or via the following stated delegated authorities:

Activity	Delegated Authority	Limit
Approving and changing policy	Council	Unlimited
Approve borrowing for year as set out in the AP/LTP	Council	Unlimited (subject to legislative and other regulatory limitations)
Acquisition and disposition of investments other than financial investments	Council	Unlimited
Approval for charging assets as security over borrowing	Council	Unlimited
Approve new and re-financed bank facilities	CE (delegated by Council)	Subject to Policy
Approving transactions outside Policy	Council	Unlimited
Overall day-to-day treasury management	CE (delegated by Council) EDES (delegated by CE) HF (delegated by EDES)	Subject to Policy
Re-financing existing debt	CE (delegated by Council) EDES (delegated by CE)	Subject to Policy
Existing Debt and Swap roll overs	EDES HF	Subject to Policy
Approve new borrowing in accordance with Council resolution or through the adoption of the AP/LTP	EDES (delegated by CE)	Per Council approved AP/LTP
Negotiate bank facilities	EDES	N/A
Manage borrowing and interest rate strategy	EDES	N/A
Adjust interest rate risk profile	EDES	Per risk control limits
Managing funding and investment maturities	EDES	Per risk control limits
Maximum daily transaction amount (borrowing, investing, interest rate risk management and cash management) excludes roll-overs on debt and interest rate swaps.	Council CE EDES HF	Unlimited \$60M \$50M \$20M
Manage cash/liquidity requirements	HF	Per risk control limits
Authorising list of signatories	CE	Unlimited
Opening/closing bank accounts	CE	Unlimited
Triennial review of Policy	EDES	N/A
Ensuring compliance with Policy	EDES	N/A
Approving new and refinanced lending activity with CCO/CCTOs	Council	Unlimited (subject to legislative and other regulatory limitations)
Negotiation and ongoing management of lending arrangements to CCO/CCTOs	EDES	Per approval/per risk control limits



## 4. Liability management policy

### 4.1 Introduction

In broad terms, the Council manages both current and term liabilities and the purpose of this policy is to set the Council's overall approach to managing these liabilities.

This policy includes a number of policy limits that are applied to the management of term liabilities (borrowing) and committed access to funds (liquidity).

### 4.2 Objectives

The Council's liability management objectives, in order of priority, are;

- To limit the Council's exposure to risk.
- To maintain a prudent level of liquidity to meet both planned and unforeseen cash requirements.
- To minimise the cost of borrowing.
- To ensure that all statutory requirements of a financial nature are adhered to.
- To ensure the treasury function operates in an environment of control and compliance.

### 4.3 Use of Borrowing

The Council primarily borrows to pay for the upgrading of existing assets or the construction/purchase of new assets, including land and property development. These assets generally provide new or enhanced benefits to SDC for many years. Borrowing is therefore considered the most cost effective and equitable way to fund these assets as it spreads the cost of the asset over the future generations of ratepayers who will benefit from the use of the asset. Accordingly, borrowings have a strategic benefit of making the cost of the asset investment affordable to today's ratepayers.

Generally, borrowing will be managed on a portfolio basis whereby loans are taken out to meet the Council's overall funding requirements rather than specific loans being taken out to fund specific projects. Financing costs will be allocated to projects based on the average cost for the debt portfolio.

Borrowing terms will be managed on a case-by-case basis taking into consideration, available term, debt maturity profile, prevailing interest rates and credit margins, legal documentation and financial covenants.

Borrowings are maintained at a prudent level and will be managed within the following limits:

Item	Borrowing Limit	LGFA Lending Covenants
Net borrowing as a percentage of total revenue	<220%	<295%*
Net interest as a percentage of total revenue	<15%	<20%
Net interest as a percentage of rates revenue	<25%	<30%
Liquidity (External, borrowing + unutilised committed debt facilities + available liquid investments as a percentage of existing external debt)	>110%	>110%
Payback ratio (net borrowing/operating balance)	<9 years	

\*For the financial years ending 30 June 2023, 295% will apply; and for each of the next three financial years, a decrease of 5% until 280% will apply for and from the financial year ending 30 June 2026. Total Revenue is defined as cash earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non-government capital contributions (e.g. developer contributions and vested assets).

- Net Borrowing is defined as total debt less unencumbered financial assets and investments with a maturity of less than 1 year.
- Liquidity is defined as external term debt plus unutilised committed debt facilities plus liquid investments divided by current external debt. Liquid investments are unencumbered assets defined as being:
  - Overnight Bank cash deposits
  - Wholesale/retail bank term deposits no greater than 30 days.
  - Bank issued RCD's less than 181 days
  - External debt funding and associated investment activity relating to pre funding is excluded from the liquidity ratio calculation
- Net Interest is defined as the amount equal to all interest and financing costs less interest income for the relevant period.
- Annual Rates Revenue is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 together with any revenue received from other local authorities for services provided (and for which the other local authorities rate).
- Financial covenants are measured on Council only not consolidated group.
- Disaster recovery requirements are to be met through the liquidity ratio and special funds.
- Operating balance is defined as surplus of operating funding taken from the Funding Impact Statement, excluding financing costs and interest revenue

Additionally, the Council will take account of the Local Government (Financial Reporting and Prudence) Regulations 2014 that set a 'debt

servicing benchmark' that borrowing costs are less than 15% of revenue for a high growth local authority, or 10% of revenue for other local authorities (revenue is defined as above.)

#### 4.4 Borrowing mechanisms and credit exposure

Council is able to borrow through a variety of market mechanisms including issuing stock/bonds, commercial paper (CP) and debentures, direct bank borrowing, LGFA, accessing the short and long-term wholesale/retail debt capital markets directly or indirectly, or internal borrowing of reserve and special funds. The Council will only transact treasury instruments and borrow with creditworthy parties. Borrowings are managed to ensure that the Council is not exposed to material concentrations of counterparty risk and therefore spread amongst a number of institutions to avoid concentrations of credit reliance. In evaluating strategies for new borrowing (in relation to source, term, size and pricing) the following is taken into account:

- Available terms from banks, LGFA, debt capital markets and loan stock issuance.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and margins relative to term for loan stock issuance, LGFA, debt capital markets and bank borrowing.
- The market's outlook on future credit margin and interest rate movements as well as its own.
- Legal documentation and financial covenants considerations.
- For internally funded projects, to ensure that finance terms for those projects are at least as equitable with those terms from external borrowing.

- Alternative funding mechanisms such as leasing should be evaluated with financial analysis in conjunction with traditional funding. The evaluation should take into consideration, ownership, redemption value and effective cost of funds.

Council's ability to readily attract cost effective borrowing is largely driven by its ability to rate, maintain a strong financial standing and manage its relationships with its investors, LGFA, and financial institutions/brokers.

#### 4.5 Security

Council's external borrowings and interest rate management instruments will generally be secured by way of a charge over rates and rates revenue offered through a Debenture Trust Deed. Under a Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Rating Act. The security offered by Council ranks equally or pari passu with other lenders.

From time to time, and with Council approval, security may be offered by providing a charge over one or more of Council's assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds (e.g. project finance).
- Council considers a charge over physical assets to be appropriate.
- Any pledging of physical assets must comply with the terms and conditions contained within the security arrangement.



#### 4.6 Debt repayment

The funds from all asset sales, operating surpluses, grants and subsidies will be applied to specific projects or the reduction of debt and/or a reduction in borrowing requirements, unless the Council specifically directs that the funds will be put to another use.

Debt will be repaid as it falls due in accordance with the applicable borrowing arrangement. Subject to the appropriate approval and debt limits, a loan may be rolled over or re-negotiated as and when appropriate.

Council will manage debt on a net portfolio basis and will only externally borrow when it is commercially prudent to do so.

#### 4.7 Guarantees/contingent liabilities and other financial arrangements

Council may act as guarantor to financial institutions on loans or enter into incidental arrangements for organisations, clubs and Trusts when the purposes of the loan are in line with Council's strategic objectives.

Council is not allowed to guarantee loans to Council-controlled trading organisations under Section 62 of the Local Government Act. Council will ensure that sufficient funds or lines of credit exist to meet amounts guaranteed. Guarantees given will not exceed NZ\$0.5 million in aggregate.

- Conditions to financial arrangements, such as loan advances, are specified in section 5.5.7.

#### 4.8 Borrowing mechanisms for council controlled organisations

and council controlled trading organisations  
To better achieve its strategic and commercial objectives, Council may provide financial support in the form of debt funding directly or indirectly to CCO/CCTOs.

Guarantees of financial indebtedness to CCTOs are prohibited, but financial support may be provided by subscribing for shares as called or uncalled capital. Any lending arrangement to a CCO or CCTO must be approved by Council. In recommending an arrangement for approval the Chief Executive considers the following:

- Credit risk profile of the borrowing entity, and the ability to repay interest and principal amount outstanding on due date.
- Impact on Council's credit standing, debt cap amount (where applied), lending covenants with the LGFA and other lenders and Council's future borrowing capacity.
- The form and quality of security arrangements provided.
- The lending rate given factors such as; CCO or CCTO credit profile, external Council borrowing rates, borrower note and liquidity buffer requirements, term etc.
- Lending arrangements to CCTO must be documented on a commercial arm's length basis. A term sheet, including matters such as borrowing costs, interest payment dates, principal payment dates, security and expiry date is agreed between the parties.
- Accounting and taxation impact of on-lending arrangement.

- All lending arrangements must be executed under legal documentation (e.g. loan, guarantee) reviewed and approved by Council's independent legal counsel.

#### 4.9 Internal borrowing

Council uses its reserves and external borrowing to internally fund both capital expenditure and working capital. The Council approves overall borrowing during the annual planning and/or LTP process. The finance function is responsible for administering Council's internal loan portfolio.

The primary objective in funding internally is to use reserves and external borrowing effectively, by establishing a portfolio that provides funding to internal activity centres. This creates operational efficiencies, as savings are created by eliminating the margin that would be paid through Council separately investing and borrowing externally. In addition to external borrowing mechanisms all reserve accounts are used for internal borrowing purposes.

The following operational parameters apply in relation to the management of Council's internal loan portfolio:

- All internal borrowing activities are consistent with the principles and parameters, outlined throughout this policy.
- Council seeks to firstly utilise reserve funds and if insufficient reserves are available, utilises external borrowing mechanisms.

Specific operating parameters are:

- Internal loans may be set up as:
  - Interest only

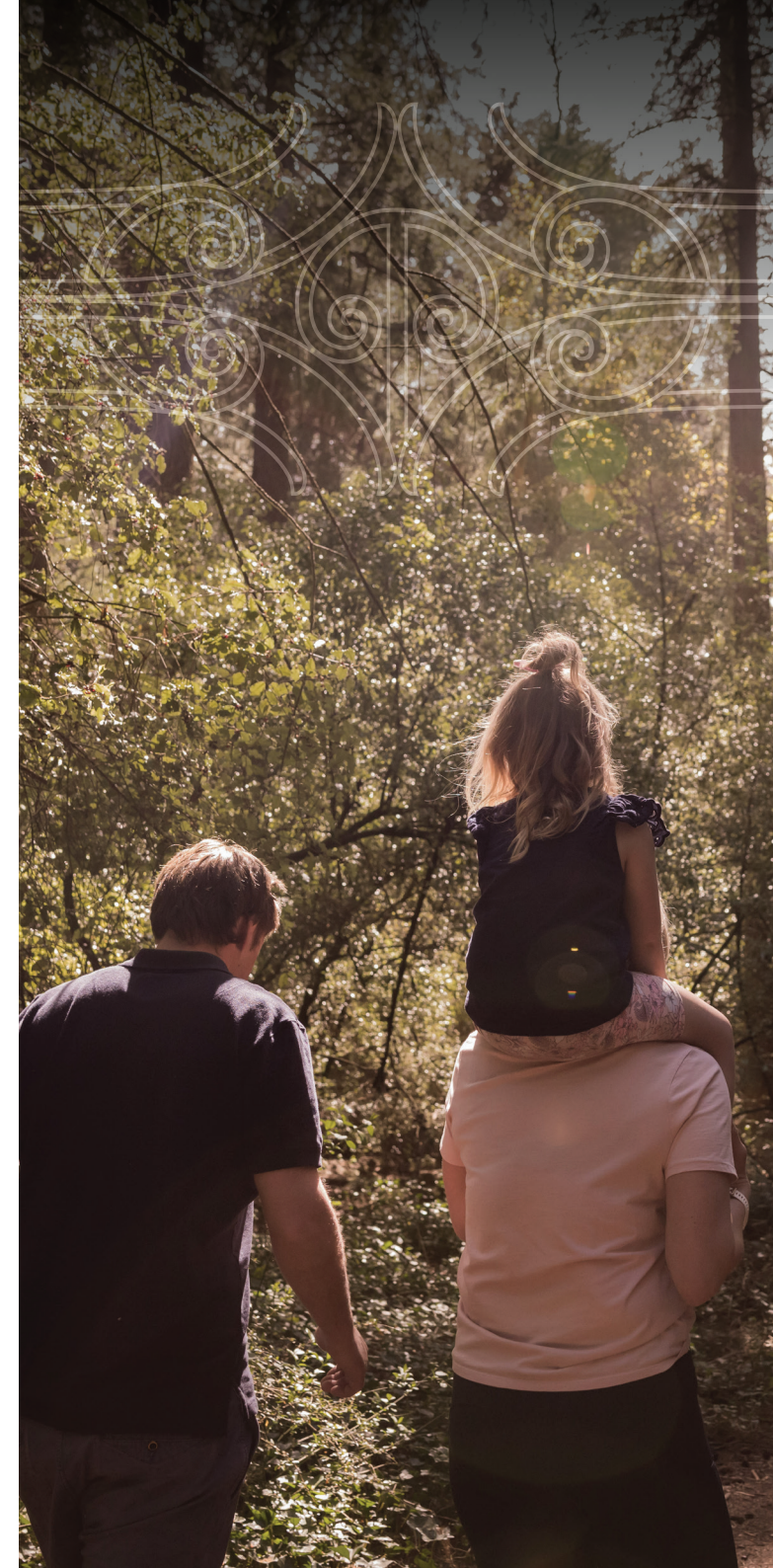
- A Non-table (reducing balance) loan
- A Table loan - (Payments are kept the same over the loan period)
- An internal loan may be set up for new capital expenditure and significant renewal expenditure not covered by accumulated reserves. The loan is allocated to the scheme incurring the expenditure.
- Internal Loans may be consolidated where that course of action is not inconsistent with the borrowing principles included within this document.
- Interest is set annually on all internal loans at the 1 year bank borrowing rate (including credit margin and other related costs).
- Interest on special funds (reserve) balances is set annually at the 1 year bank deposit rate. No adjustment is included for treasury related operational costs.
- Council may determine not to pay interest on specific reserve balances or to pay interest at a reduced rate.
- If required Council has the ability to reset interest rates monthly.
- Interest is charged on the opening loan balance. Interest may be notionally received and allocated to the specific reserve account providing the funds or through the related cost centres income/expenditure accounts.
- The term of the loan is the lesser of either:
  - the economic life of the asset
  - normally a maximum of 20 years but up to 40 years for long life assets.
- Principal repayment instalments are charged to the cost centre. Instalment amounts are agreed

upon commencement of the loan. Instalments are paid annually.

#### 4.10 New Zealand Local Government Funding Agency (LGFA) Limited Investment

Despite anything earlier in this Policy, the Council may borrow from the New Zealand Local Government Funding Agency Limited (LGFA) and, in connection with that borrowing, 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. For example borrower notes.
- 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;
- Secure its borrowing from the LGFA and the performance of other obligations to the LGFA or its creditors with a charge over the Council's rates and rates revenue.
- Subscribe for shares and uncalled capital in the LGFA.





## 5. Investment policy

### 5.1 Introduction

Council generally holds investments for strategic reasons where there is some community, social, physical or economic benefit accruing from the investment activity. Generating a commercial return on strategic investments is also an objective. Investments and associated risks are monitored and managed, and regularly reported to Council. Specific purposes for maintaining investments include:

- For strategic purposes consistent with Council's LTP.
- To reduce the current ratepayer burden.
- The retention of vested land.
- Holding short term investments for working capital requirements.
- Holding investments that are necessary to carry out Council operations consistent with Annual Plans, to implement strategic initiatives, or to support inter-generational allocations.
- Holding assets (such as property) for commercial returns.
- Providing ready cash in the event of a natural disaster. The use of which is intended to bridge the gap between the disaster and the reinstatement of normal income streams and assets.
- Investment of amounts allocated to general funds and reserves.
- Investment of proceeds from the sale of assets.

Council recognises that as a responsible public authority all investments held should provide an

appropriate return in relation to risk. Generally, Council will invest in low risk investments and recognises that such investments generally mean lower returns. It will consider other than low risk investments where there are broader social and/or economic benefits associated with the investment. Council can internally borrow from reserve funds in the first instance to meet future capital expenditure requirements, unless there is a compelling reason for establishing external debt.

### 5.2 Objectives

In its financial investment activity, Council's primary objective when investing is the protection of its investment capital and that an appropriate approach to risk/return is always applied within the confines of this policy. Accordingly, only Council approved counterparties are acceptable. The Council will act effectively and appropriately to:

- Protect the Council's investments.
- Ensure the investments benefit the Council's ratepayers.
- Maintain a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements.
- Ensure the Council has appropriate working capital funds available to carry out its strategic plans as outlined in the Annual Plan/Long-Term Plan.
- Ensure that adequate funds are immediately accessible in the event of a disaster or unexpected failure of infrastructure.
- Ensure that legally restricted funds are appropriately accounted for and invested so as to earn reasonable income towards their purposes. (Legally restricted funds include trust

funds, and bonds/deposits etc).

- Ensure that where the Council has resolved to set aside investments for particular purposes, these funds earn interest towards those purposes and are readily available when called upon. (It should be recognised that these funds are by policy of the Council only and have no enduring legal status that would bind a future Council).
- Ensure that all statutory requirements are met.

### 5.3 Policy

The Council's general policy on investments is that the Council:

- May hold financial, property, forestry, and equity investments if there are strategic, commercial, economic or other valid reasons (e.g. where it is the most appropriate way to administer a Council function).
- May realise investments to repay debt or make internal loans (to reduce external risk exposures).
- May purchase appropriate land and buildings.
- May purchase financial instruments, risk or near risk-free, diversified in term and institution.
- Will keep under review its approach to all major investments and the credit rating of approved financial institutions.
- Will review its policies on holding investments at least once every three years.

### 5.4 Acquisition of new investments

With the exception of financial investments, new investments are acquired if an opportunity arises

and approval is given by Council, based on advice and recommendations from Council officers. Before approving any new investments, Council gives due consideration to the contribution the investment will make in fulfilling Council's objectives, and the financial risks of owning the investment. The authority to acquire financial investments is delegated to the EDES.

## **5.5 Investment mix**

Council maintains the following mix of investments.

### **5.5.1 Equity Investments including Trusts**

Equity investments, including investments held in CCO/CCTO and other shareholdings.

Council maintains equity investments and other minor shareholdings. Council's equity investments fulfil various strategic, economic development and financial objectives. Equity investments may be held where Council considers there to be strategic community value.

Council seeks to achieve an acceptable rate of return on all its equity investments consistent with the nature of the investment and their stated philosophy on investments.

All requests for the Council to approve the acquisition of equity investments must be fully supported by an appropriate analysis. The overriding concern to the Council by approving any equity investment will be that the economic value of its investment is being increased.

Dividends received from CCO's/CCTO's and unlisted companies not controlled by Council are used to support the general rate requirement. Any purchase or disposal of equity investments requires Council approval.

Any dividends received, and/or profit or loss arising from the sale of these investments must be recorded in accordance with appropriate accounting standards. Council may also acquire shares that are gifted or are a result of restructuring.

Decisions to dispose of equities must be fully supported by generally accepted financial analysis. Any disposal must be in the best interests of the community. The inability of the Council to add economic value to its equity investments will be the key driver in any equity disposal. Unless otherwise directed by Council, the proceeds from the disposition of equity investments will be used firstly to repay any debt relating to the investment and then included in general funds. Council recognises that there are risks associated with holding equity investments and to minimise these risks Council, through the Audit & Risk Committee monitors the performance of its equity investments on a quarterly basis to ensure that the stated objectives are being achieved. Council seeks professional advice regarding its equity investments when it considers this appropriate.

Details of the Council's equity investments and interest in Trusts are set out in the appendix to this document.

### **5.5.2 Property Investments.**

Council owns property investments for strategic and commercial purposes. Council reviews ownership through assessing the benefits including financial returns and reviews the performance of its property investments on a regular basis, in comparison to other arrangements that could deliver the similar results.

Surpluses generated from commercial and semi commercial property investments are treated

as an internal dividend to Council, with use of the dividend to be determined by the Council. Other surpluses from property are treated as income in the related Council activity.

Property disposals are managed to ensure compliance with statutory requirements and where appropriate consultation with Community Boards and Committees.

Property purchases are supported by registered valuations and where appropriate a full business case analysis. Council will not purchase properties on a speculative basis.

Council will seek to establish a portfolio of commercial properties that provides appropriate market returns. Any commercial property strategy sits outside this Treasury Risk Management Policy.

### **5.5.3 Financial Investments.**

#### **Objectives**

Council's primary objectives when investing is the protection of its investment capital. Accordingly, Council may only invest in approved counterparties. Creditworthy counterparties and investment restrictions are covered in section 6.5. Credit ratings are monitored and reported quarterly to Council.

Council may invest in approved financial instruments as set out in section 6.3. These investments are aligned with Council's objective of investing in high credit quality and highly liquid assets.

Council's investment portfolio will be arranged to provide sufficient funds for planned expenditures and allow for the payment of obligations as they fall due.

Council prudently manages liquid financial investments as follows:

- Any liquid investments must be restricted to a term that meets future cash flow and capital expenditure projections.
- Interest income from financial investments is credited to general funds, except for income from investments that are specifically attached to special funds, reserve funds and other funds where interest may be credited to the particular fund.
- Council may choose to hold specific reserves in cash and direct what happens to that investment income. In effect the income from financial investments will be an interest income stream into the finance activity. The finance activity 'pays' internal interest on internal reserves by way of account transfers.
- Internal borrowing will be used wherever possible to avoid external borrowing.
- Financial investments do not include shares.

## Cash investments

- Financial investments for cash/liquidity management purposes involve the Council acquiring financial products such as bank call and term deposits, bank registered certificates of deposits (RCD), and bank bills of terms no greater than 12 months. General investments are normally held to maturity date. Where investments are liquidated prior to maturity, approval is obtained from the CE.
- The investment maturity profile will be managed within the parameters outlined in section 6.2.1.

## Long-term core investments

Long-term core financial investments are held for the purposes of generating a return. Council will maximise the total return that can be provided by the investments over the long term, subject to conservative risk management. Council's objective is to maintain the real value (as opposed to face value) of the capital of the long term investment fund with regard to inflation. Any disposal of the long-term investment fund will require Council and ratepayer approval.

The investment maturity profile will be managed within the parameters outlined in section 6.2.2.

## Special funds and reserve funds

Liquid assets are not required to be held against special funds and reserve funds. Instead Council will internally borrow or utilise these funds wherever possible.

## Trust funds

Where Council hold funds as a trustee, or manages funds for a Trust then such funds must be invested on the terms provided within the Trust. If the Trust's investment policy is not specified then this policy should apply.





### 5.5.4 Loan Advances

Council may provide advances to CCOs, CCTOs, charitable trusts and community and other organisations for strategic and commercial purposes. New loan advances are by Council resolution only. Council does not lend money, or provide any other financial accommodation, to a CCO or CCTO on terms and conditions that are more favourable to the CCO or CCTO than those that would apply if Council were borrowing the money or obtaining the financial accommodation. Council does not lend on more favourable terms than what it can achieve itself, without charging any rate or rate revenue as security.

Council will consider applications for loans from charitable trusts and community organisations on a case by case basis. Loans are not the Council's preferred approach to supporting such organisations, with grants, guarantees or other forms of support preferred.

Advances to charitable trusts, and community organisations do not have to be on a fully commercial basis.

Council reviews performance of its loan advances on a regular basis to ensure strategic and economic objectives are being achieved.

### 5.6 Departures from normal Policy

The Council may, in its discretion, depart from the Investment Policy where it considers that the departure would advance its broader social or other policy objectives. Any resolution authorising an investment under this provision shall note that it departs from the Council's ordinary policy and the reasons justifying that departure.

### 5.7 Investment management and reporting procedures

Council's cash investments are managed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed through the Daily Cash Position Report, and long-term cashflow through the annual Cashflow Forecast. To maintain liquidity, Council's short and long-term investment maturities are matched with Council's known cashflow requirements.

The performance of Council investments is regularly reviewed to ensure Council's objectives are being met. Both performance and policy compliance are reviewed through quarterly reporting to the Audit and Risk Sub-Committee.

## 6. Risk recognition/identification management

The definition and recognition of liquidity, funding, interest rate, counterparty credit, operational and legal risk of Council is detailed below and applies to both the Liability Management Policy and Investment Policy.

### 6.1 Interest rate risk

#### 6.1.1 Risk Recognition

Interest rate risk is the risk that funding costs (due to adverse movements in market wholesale interest rates) will materially exceed or fall short of projections included in the LTP and Annual Plan so as to adversely impact revenue projections, cost control and capital investment decisions/returns/feasibilities.

The primary objective of interest rate risk management is to reduce uncertainty relating to

interest rate movements through fixing/hedging of interest costs. Certainty around interest costs is to be achieved through the active management of underlying interest rate exposures.

#### 6.1.2 Interest rate risk control limits

Exposure to interest rate risk is managed and mitigated through the risk control limits below. Council's forecast gross external debt should be within the following fixed/floating interest rate risk control limit.

The EDES can consider alternative debt forecast scenarios that make assumptions around such matters as, the delivery and timing of the capital expenditure programme when designing the interest rate strategy.

Debt Interest Rate Policy  
Parameters (calculated on  
rolling monthly basis)

Rolling Period	Minimum Fixed Rate	Maximum Fixed Rate
0 - 1 Year	40%	90%
1 - 2 Years	35%	85%
2 - 3 Years	30%	80%
3 - 4 Years	20%	75%
4 - 5 Years	10%	70%
5 - 6 Years	0%	65%
6 - 7 Years	0%	60%
7 - 8 Years	0%	55%
8 - 9 Years	0%	50%
9 - 10 Years	0%	45%
10 - 11 Years	0%	40%
11 - 12 Years	0%	35%
12 Years +	0%	30%

**“Fixed Rate”** is defined as all known interest rate obligations on gross forecast external debt, including where hedging instruments have fixed movements in the applicable reset rate.

**“Floating Rate”** is defined as any interest rate obligation subject to movements in the applicable reset rate.

- Fixed interest rate percentages are calculated based on the average amount of fixed interest rate obligations relative to the average gross forecast external debt amounts for the given period (as defined in the table above).

This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to ensure compliance with the Policy minimums and maximums. Term investments that are an economic match to debt instruments may be used to net external debt as defined in section 6.2.2.

- The EDES in conjunction with Council’s treasury advisors set interest rate risk management strategy. The EDES approves the strategy.
- Floating rate debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months.
- A fixed rate maturity profile that is outside the above limits, but self corrects within 90-days is not in breach of this Policy. However, maintaining a maturity profile beyond 90-days requires specific approval by Council.
- Interest rate options must not be sold outright. However, one for one 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, only the sold side of the collar can be closed out (i.e. repurchased) otherwise, both sides must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate “in-the-money”.

- Purchased borrower swaptions mature within 36 months.
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00% above the appropriate swap rate, cannot be counted as part of the fixed rate hedge percentage calculation.
- Any interest rate derivatives with a maturity beyond the maximum LGFA bond maturity must be approved by Council through a specific approval. Hedging outside the above risk parameters must be approved by Council.

**6.2 Financial investment portfolio**

**6.2.1 Cash investment risk control limits (less than 12 months)**

The following controls are designed to manage maturity risk on the cash investment portfolio. The primary objective of the cash investment portfolio is to match the portfolio’s maturity term to planned expenditure thereby ensuring that investments are available when required. There is no separate management of interest rate risk.

To ensure the matching of treasury investments to expenditure, investment terms are no more than 12 months.

The control limits are as follows:

Maturity Profile Limit		
Period	Minimum %	Maximum %
0 - 3 Months	50%	100%
3 - 12 Months	0%	50%

Approved instruments are listed in 6.3.

**6.2.2 Term investment risk control limits**

Financial investments should be restricted to a term that meets future cash flow projections and be mindful of forecast debt associated with future capital expenditure programs as outlined within the LTP Financial investments that economically match off against existing external debt in terms of interest rate risk and duration (gap risk) may be excluded from this portfolio and used to economically net off external debt within section 6.1.2.

The following interest rate re-pricing percentages are calculated on the projected 12-month rolling Term Investment portfolio. This allows for adjustments in advance of materially changing forecasts. When cash flow projections are changed, the interest rate re-pricing risk profile may have to be adjusted to comply with the Policy limits.

Maturity Profile Limit		
Period	Minimum %	Maximum %
0 - 1 Years	40%	100%
1 - 3 Years	0%	60%
3 - 5 Years	0%	40%
5 - 10 Years	0%	20%

To ensure maximum liquidity any interest rate position beyond 5 years must be made with acceptable financial instruments such as investor swaps.

The re-pricing risk mix can be changed, within the above limits through sale/purchase of fixed income investments and/or using approved financial instruments such as swaps.

### 6.3 Approved financial instruments.

Approved financial instruments (which do not include shares or equities) are as follows:

Category	Instrument
Cash management and borrowing	<ul style="list-style-type: none"> <li>• Bank overdraft</li> <li>• Committed cash advance and debt facilities (short term and long term debt facilities)</li> <li>• Committed standby facilities from the LGFA</li> <li>• Forward starting committed term debt with the LGFA</li> <li>• Loan stock /bond issuance</li> <li>• Floating Rate Note (FRN)</li> <li>• Fixed Rate Note (MTN)</li> <li>• Commercial paper (CP)/Promissory notes</li> </ul>
Investments (cash portfolio, term <365 days)	<ul style="list-style-type: none"> <li>• Short term bank deposits</li> <li>• Bank certificates of deposit (RCDs)</li> <li>• Commercial paper (CP)/Promissory notes</li> </ul>
Investments (core portfolio)	<ul style="list-style-type: none"> <li>• Term bank deposits</li> <li>• Bank certificates of deposit (CDs)</li> <li>• Government Bonds</li> <li>• LGFA bonds/FRNs</li> <li>• Local Authority stock or State-Owned Enterprise (SOE) bonds and FRNs (senior)</li> <li>• Corporate bonds (senior)</li> <li>• Floating Rate Notes (senior)</li> </ul>
Investments (other)	<ul style="list-style-type: none"> <li>• LGFA borrower notes</li> </ul>
Interest rate risk management	<ul style="list-style-type: none"> <li>• Forward rate agreements ("FRAs") on:</li> <li>• Bank bills</li> <li>• Interest rate swaps/collars including:</li> <li>• Forward start swaps/collars. Start date &lt;36 months, unless linked to existing maturing fixed</li> <li>• interest rate instrument (i.e. either derivative or fixed rate borrowings)</li> <li>• Swap extensions and shortenings</li> <li>• Interest rate options on:</li> <li>• Bank bills (purchased caps and one for one collars)</li> <li>• Interest rate swaptions (purchased swaptions and one for one collars only)</li> </ul>



Any other financial instrument must be specifically approved by the Council on a case-by-case basis and only be applied to the one singular transaction being approved.

All unsecured investment securities must be senior in ranking. The following types of investment instruments are expressly excluded;

- Structured debt where issuing entities are not a primary borrower/ issuer
- Subordinated debt (other than Borrower Notes subscribed from the LGFA), junior debt, perpetual notes and debt/equity hybrid notes such as convertibles.

6.4 Liquidity risk/funding risk

6.4.1 Risk recognition

Cash flow deficits in various future periods based on long term financial forecasts are reliant on the maturity structure of cash, short-term financial investments, loans and bank facilities. Liquidity risk management focuses on the ability to access committed funding at that future time to fund the gaps. 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 loans and facilities.

The management of Council’s funding risks is important as several risk factors can arise to cause an adverse movement in borrowing margins, term availability and general flexibility including:

- Local Government risk is priced to a higher fee and margin level.

- Council’s own credit standing or financial strength as a borrower deteriorates due to financial, regulatory or other reasons.
- A large individual lender to Council experiences its own financial/exposure difficulties resulting in Council not being able to manage their debt portfolio as optimally as desired.
- New Zealand investment community experiences a substantial “over supply” of Council investment assets.
- Financial market shocks from domestic or global events.

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.

6.4.2 Liquidity/funding risk control limits

- External term loans and unutilised committed debt facilities together with available liquid investments (as defined in the Borrowing Limits section of this policy) must be maintained at an amount of 110% over existing external debt.
- Council can pre-fund up to 18-months forecast debt requirements including re-financings. Debt refinancing that have been pre-funded, will remain included within the funding maturity profile until their maturity date.
- The EDES has the discretionary authority to re-finance existing debt on more acceptable terms. Such action is to be reported to the CE at the earliest opportunity.

- The maturity profile of the total committed funding in respect to all external debt/

loans and committed debt facilities, is to be controlled by the following system:

Period	Minimum %	Maximum %
0 - 3 Years	15%	60%
3 - 7 Years	25%	85%
7 Years +	0%	60%

- A funding maturity profile that is outside the above limits but self corrects within 90 days is not in breach of this Policy. However, maintaining a maturity profile outside these policy limits beyond 90 days requires specific approval by Council.
- Once debt has been refinanced with a contracted term deposit (pre-funded), the term deposit amount will net off the maturing debt instrument from the funding maturity profile percentage calculation.
- To minimise concentration risk the LGFA require that no more than the greater of NZD 100 million or 33% of a Councils borrowings from the LGFA will mature in any 12 month period.
- A maturity schedule outside these limits will require specific Council approval.

## 6.5 Counterparty credit risk

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

Credit risk will be regularly reviewed by the Audit & Risk Committee. Treasury related transactions would only be entered into with organisations that meet policy parameters.

Counterparties and limits can only be approved on the basis of long-term Standard & Poor's, (S&P) credit ratings (or equivalent Fitch or Moody's rating) being A and above and/or short term rating of A-1 or above.

Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

The following matrix guide will determine limits:

Counterparty/ Issuer	Minimum S&P Long Term/ Short Term Credit Rating	Investment Maximum per Counterparty (% of Portfolio)	Total Maximum per Counterparty (\$m)
NZ Government	N/A	100%	Unlimited
Local Government Funding Agency	AA+	100%	Unlimited
NZ Registered Bank	A / A-1	100%	50.0
State Owned Enterprises	A / A-1	25%	5.0
NZ Corporate	A / A-1	25%	2.0
Rated Local Government	N/A	100%	10.0
Unrated Local Government	N/A	100%	5.0

Only senior/unsubordinated or secured investments are permissible i.e. subordinated issues are excluded. In determining the usage of the above gross limits, the following product weightings will be used:

- Investments (e.g. Bank Deposits) – Transaction Principal × Weighting 100% (unless a legal right of set-off exists).
- Interest Rate Risk Management (e.g. swaps, FRAs) – Transaction Notional × Maturity (years) × 3%.
- Foreign Exchange/Carbon credit – Transactional face value amount x the square root of the Maturity (years) x 15%.
- Each transaction should be entered into a treasury spreadsheet and a quarterly report prepared to show assessed counterparty actual exposure versus limits.

Individual counterparty limits are kept in a spreadsheet by management and updated on a day to day basis. Credit ratings should be reviewed by the Accounting Manager on an ongoing basis and in the event of material credit downgrades should be immediately reported to the EDES and assessed against exposure limits. Counterparties exceeding limits should be reported to the Audit & Risk Committee.

## Risk management

To avoid undue concentration of exposures, financial instruments should be used with a range of approved counterparties. Maturities should be well spread. The approval process must take into account the liquidity of the market and prevailing market conditions the instrument is traded in and repriced from.

### 6.6 Foreign currency

Council has minor foreign exchange exposure through the occasional purchase of foreign exchange denominated services, plant and equipment.

Generally, significant commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts can be used by SDC.

Council shall not borrow or enter into incidental arrangements, within or outside New Zealand, in currency other than New Zealand currency. Council does not hold investments denominated in foreign currency.

### 6.7 Operational risk

Operational risk is the risk of loss as a result of human error (or fraud), system failures and inadequate procedures and controls.

Operational risk is very relevant when dealing with financial instruments given that:

- Financial instruments may not be fully understood.
- Too much reliance is often placed on the specialised skills of one or two people.

- Most treasury instruments are executed over the phone.
- Operational risk is minimised through the adoption of all requirements of this Policy.

#### 6.7.1 Dealing authorities and limits

Transactions will only be executed by those persons and within limits approved by the Council.

#### 6.7.2 Segregation of duties

As there are a small number of people involved in treasury activities, adequate segregation of duties among the core functions of deal execution, confirmation, settling and accounting/reporting is not strictly achievable. The risk will be minimised by the following process:

- The EDES reports directly to the CE.
- The AM will report directly to the EDES in relation to transactional activities.
- There is a documented approval and reporting process for borrowing, interest rate and liquidity management activity.

#### 6.7.3 Procedures

All treasury instruments should be recorded and diarised within a treasury spreadsheet or Hedgebook, with appropriate controls and checks over journal entries into the general ledger. Deal capture and reporting must be done immediately following execution/confirmation. Details of procedures should be compiled in an appropriate operations and procedures manual separate to this Policy.

Procedures should include:

- Regular management reporting.
- Regular risk assessment, including review of procedures and controls as directed by the Council or appropriate sub-committee of Council (e.g. Audit and Risk Committee).
- Organisational, systems, procedural and reconciliation controls to ensure:
- All borrowing, investing, interest rate and cash management activity is bona fide and properly authorised.
- Checks are in place to ensure Council accounts and records are updated promptly, accurately and completely.
- All outstanding transactions are revalued regularly and independently of the execution function to ensure accurate reporting and accounting of outstanding exposures and hedging activity.

#### 6.7.4 Organisational controls

- The CSM has responsibility for establishing appropriate structures, procedures and controls to support borrowing, investing, interest rate and cash management activity.
- All borrowing, investing, cash management and interest rate risk management activity is undertaken in accordance with approved delegations authorised by the Council.

#### 6.7.5 Electronic banking signatories

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



### 6.7.6 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.

### 6.7.7 Recording of deals

- All deals are recorded in Hedgebook by the AM and approved by the EDES. Deal summary records for borrowing, investments, interest rate risk management and cash management transactions (on spreadsheets) are maintained and updated promptly following completion of transaction.

### 6.7.8 Confirmations

- All inward deal confirmations including LGFA/ bank funding and registry confirmations are received and checked by the AM against completed deal tickets and the treasury spreadsheet records to ensure accuracy.
- All deliverable securities are held in the Council's safe.
- Deals, once confirmed, are filed (deal ticket and attached confirmation) by the AM in deal date/ number order.
- Any discrepancies arising during deal confirmation checks which require amendment to the Council records are signed off by the EDES.

### 6.7.9 Settlement

- The majority of borrowing, investing, interest rate and cash management transactions are settled by direct debit authority.

- For electronic payments, batches are set up electronically. These batches are checked by authorised signatories to ensure settlement details are correct. Payment details are authorised by two approved signatories as per Council registers or by direct debit as per setup authority by Council.

### 6.7.10 Reconciliations

- Bank reconciliations are performed monthly by the Fina and checked and approved by the
- Corporate Accountant. Any unresolved unreconciled items arising during bank statement reconciliation which require amendment to the Council's records are signed off by the CSM.
- A monthly reconciliation of the treasury spreadsheet/ Hedgebook to the general ledger is carried out by the AM and approved by the EDES.

## 6.8 Legal risk

Legal 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, SDC may be exposed to such risks. SDC 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.

### 6.8.1 Agreements

Financial instruments can only be entered into with banks that have in place an executed International Swaps and Derivatives Association (ISDA) Master Agreement with Council.

Council's internal/appointed legal counsel must sign off on all documentation.

### 6.8.2 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.

## 7. Measuring treasury performance

To determine the success of Council's treasury management function, the following benchmarks and performance measures have been prescribed.

Those performance measures that provide a direct measure of the performance of treasury staff (operational performance and management of debt and interest rate risk) are to be reported to Council or an appropriate sub-committee of Council on a quarterly basis.

### 7.1 Management of debt and interest rate risk

The actual borrowing cost for Council (taking into consideration costs of entering into interest rate risk management transactions) compared with the budgeted borrowing costs.



## 7.2 Financial investments

The emphasis is on appropriate risk/return. The long-term portfolio will be benchmarked to the midpoints of the investment portfolio's risk control limits. The duration has been determined as 3.5 years; accordingly performance will be measured against the 3-year swap rate for the reporting period.

## 8. Cash management

The Management Accountant has the responsibility to carry out the day-to-day cash and short-term cash management activities. All cash inflows and outflows pass through bank accounts controlled by the finance function.

- The Management Accountant will calculate and maintain comprehensive rolling cash flow projections on a, weekly (four weeks forward) and monthly (12 months forward) basis. These cash flow forecasts determine Council's borrowing requirements and surpluses for investment.
- On a daily basis, electronically download all Council bank account information.
- Co-ordinate Council's operating units to determine daily cash inflows and outflows with the objective of managing the cash position within approved parameters.
- Undertake short term borrowing functions as required, minimising overdraft costs.
- Ensure efficient cash management through improvement to forecasting.
- Minimise fees and bank charges by optimising bank account/facility structures.
- Monitor Council's usage of overdraft and

committed debt facilities. Overdraft facilities are utilised as little as practical. Committed bank overdraft facilities of not more than \$400,000 are maintained.

- Match future cash flows to smooth overall timeline.
- Provide reports detailing actual cash flows during the month compared with those budgeted.
- Maximise the return from available funds by ensuring significant payments are made within the suppliers payment terms, but no earlier than required, unless there is a financial benefit from doing so.
- Interest rate management on cash management balances is not permitted.
- Cash is invested for a term of no more than 12 months and in approved instruments and counterparties.



## 9. Reporting

When budgeting interest costs, the actual physical position of existing loans and interest rate instruments must be considered.

### 9.1 Treasury reporting

The following reports are produced:

Report Name	Frequency	Prepared By	Reviewed By	Recipient
Weekly Cash Position	Weekly	Management Accountant	Accounting Manager	HF
Treasury Spreadsheet				
Treasury Exceptions Report	Weekly	Management Accountant	Accounting Manager	HF
<ul style="list-style-type: none"> <li>• Treasury Report</li> <li>• Policy limit compliance</li> <li>• Borrowing limits</li> <li>• Interest Rate Position</li> <li>• Borrowing</li> <li>• New treasury transactions</li> <li>• Cost of funds vs budget</li> <li>• Cash flow forecast report</li> <li>• Liquidity risk position</li> <li>• Counterparty credit</li> <li>• Treasury performance</li> <li>• Debt maturity profile</li> <li>• Treasury investments (equities, cash, financial investments)</li> </ul>	Quarterly	Accounting Manager	EDES	Council/ARC
Trustee Report	As required by the Trustee	Accounting Manager	EDES	Trustee Company
Revaluation of financial instruments	Quarterly	Accounting Manager	HF	EDES
LGFA Covenant Reporting	At least annually	Accounting Manager	EDES	LGFA
CCO Report	Quarterly	CCO	EDES	Council/ARC



## 9.2 Accounting treatment of financial instruments

Council uses financial arrangements (“derivatives”) for the primary purpose of reducing its financial risk to fluctuations in interest rates. The purpose of this section is to articulate Council’s accounting treatment of derivatives in a broad sense. Under NZ IPSAS accounting standards changes in the fair value of derivatives go through the Income Statement unless derivatives are designated in an effective hedge relationship.

Council’s principal objective is to actively manage the Council’s interest rate risks within approved limits and chooses not to hedge account. Council accepts that the marked-to-market gains and losses on the revaluation of derivatives can create potential volatility in Council’s annual accounts. The EDES is responsible for advising the CE of any changes to relevant NZ IPSAS which may result in a change to the accounting treatment of any financial derivative product.

All treasury financial instruments must be revalued (marked-to-market) at least every six months for risk management purposes.

The EDES has the responsibility to prepare a review report that is presented to the Council. The report will include recommendations as to changes, deletions and additions to the Policy. The Council receives the report, approves Policy changes and/or rejects recommendations for Policy changes.

## 10. APPENDIX 1 - Investments

### Equity investments

- The Council holds the following equity investments:
- Orion New Zealand Limited Limited (10.725% owned). Orion New Zealand Limited (Orion) owns and maintains the electricity distribution network in Christchurch and Selwyn. Dividends from Orion are credited to General Rate funds. The strategic nature of Orion’s operation means that the Council’s policy is to hold its investment in the long term and the Council’s equity in Orion is classified as a strategic asset of the Council. This means that it a decision to dispose of this investment can only be undertaken if it is provided for in the Long Term Plan.
- CORDE Limited (100% owned). CORDE Limited is a contracting company operating in Canterbury and on the West Coast. It provides maintenance and construction services in relation to roads, water, sewerage and reserves infrastructure. Dividends from Sicon Limited are credited to General Rate funds. The Council holds this investment for commercial return.
- Transwaste Canterbury Limited (3% owned). Transwaste Canterbury Limited (Transwaste) provides a regional landfill facility for a number of Councils in Canterbury and this investment reflects the Council’s contribution to the construction of a regional landfill. The investment is integral to the Council waste collection and disposal service provided by the Council and therefore the Council intends to hold its investment in Transwaste in the long term. Dividends from Transwaste are credited to General Rate funds.

- Central Plains Water Limited (CPWL) – CPWL provides an irrigation schemes that serves the Canterbury Plains. CPW is operated as a co-operative with irrigators holding shares in the Company in proportion to their water requirements and the Council holds shares for its irrigated land in Darfield and Hororata. The Council also owns two shares arising from its initial support for the Company.

### New Zealand Local Government Funding Agency Limited Investment

The Council may invest in the Local Government Funding Agency (LGFA) and may borrow to fund that investment.

Council’s objective in making any such investment will be to:

- obtain a return on the investment; and
- ensure that the Local Government Funding Agency has sufficient capital to become and remain viable, meaning that it continues as a source of debt funding for Council.
- access loan funding at lower rates.

Because of this dual objective, Council may invest in Local Government Funding Agency shares in circumstances in which the return on that investment is potentially lower than the return it could achieve with alternative investments, where it is to the overall benefit of Council.

If required in connection with the investment, the Council may also subscribe for uncalled capital in the LGFA.

The company dividend policy is to pay a dividend that provides an annual return to shareholders equal to the Local Government Funding Agency cost of funds plus 2 percent.

Risks surrounding the Local Government Funding Agency are mitigated through the use of the New Zealand Government debt management office and appropriately qualified professional directors and staff. There are also in place cross guarantees between most shareholder councils.

## Trusts

Central Plains Water Trust (CPWT)

### Objectives

- CPWT is a trust for charitable purposes for the benefit of the present and future inhabitants of the regions, being the respective areas within the geographical boundaries of the Councils.
- CPWT will encourage, support and facilitate sustainable development of the
- water resources of the regions for the benefit of the inhabitants.
- CPWT will provide and facilitate opportunities for agricultural and horticultural diversity in the regions.
- CPWT will provide and facilitate education to the inhabitants of the
- regions in relation to water issues affecting the regions.

CPWT will appropriately balance enhancement of economic benefits for the regions with enhancement of ecological, social and recreational values for the regions.

The Trustees and settlors (Selwyn District Council and Christchurch City Council) may amend the objectives to make sure they are fully aligned with the charitable purposes of the Trust.

## Tramway Reserve Trust

### Objectives

Tramway Reserve Trust is a charitable trust formed on 22 August 2003. The purpose of the Trust as set out in section 4.1 of the Trust Deed is to:

- Develop the area being Reserve 5020 and known as Tramway Reserve located at
- Tramway Reserve Road as a recreational, educational and scientific venue by:
- Restoring and enhancing the wetlands.
- Establishing and protecting a wide range of native flora, native fauna, game birds and sports fish.
- Providing walking tracks to facilitate public access to the restored wetlands.
- Promote the restoration of waterways of all types.
- Increase water dissipation via natural methods.
- Encourage planting to restore water quality.
- Encourage biodiversity.
- Restore the natural riparian habitat for aquatic species and bird life.
- Undertake any other activity incidental or conducive to the attainment of the purposes for activities of the Trust.

## Selwyn District Charitable Trust

### Objectives

Selwyn District Charitable Trust is a trust for charitable purposes. It holds and distributes funds to support and encourage Selwyn District Council's provision of public services and amenities for the benefit of the public within the Selwyn District by making funds available for the following purposes.

- Water/wastewater facilities - the construction, maintenance, operation and upgrading of water and wastewater facilities for the benefit of the public.
- Roothing - the construction, maintenance, operation and upgrading of roading for the benefit of the public.
- Transport facilities - the acquisition, construction, maintenance, operation and upgrading of public transport facilities.
- Parks/reserves - the establishment, maintenance operation and upgrading of parks and reserves for the benefit of the public.
- Recreational facilities - the construction, maintenance, operation and upgrading of swimming pools or other recreational or leisure-time occupation facilities for the benefit of the public.
- Community facilities - the construction, maintenance, operation and upgrading of public libraries or other similar community facilities for the benefit of the public.
- Cultural facilities: -the construction, maintenance, operation and upgrading of cultural facilities for the benefit of the public.
- Other infrastructure - the construction or establishment of new infrastructure projects

of a charitable nature, or the maintenance and operation of existing infrastructure facilities that are of benefit to the public.

## 11. Appendix 2 - Glossary of Treasury Management Term

**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.

**Arbitrage** - A method or action that allows the securing of a profit (with no market risk) by taking advantage of a mis-pricing of one financial instrument between two market makers.

**Asset/Liability Management** - The management process a bank uses to ensure its assets (loan made to customers) matches its liabilities (deposits taken from customers).

**Average Rate Forward** - A series of forward exchange contracts to different dates for the same amount, but at different rates. The series of contracts is re-stated as one contract at the one average rate. Also called a "par forward".

**Balloon Payment** - The repayment terms of a loan being the full principal amount due for repayment in one amount on the final maturity date. Also called a "bullet" payment.

**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-liquify itself with cash. Normally for terms of 30, 60, 90 or 180 days.

**Barrier Option** - An option that will come into existence or cease to exist if the underlying asset, currency, commodity price trades at a pre-determined price prior to expiration.

**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.

**Basis Swap** - A variation of an interest rate swap whereby interest payments are exchanged on a floating to floating basis to change the timing of interest payments on a bank loan i.e. quarterly payments swapped to monthly basis.

**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 pre-determined 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 of 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 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. Also called a “ceiling”.

**Caplet** – A series of call options (caplets) which exist for each period the cap agreement is in existence.

**Certificate of Deposit “CD”** - A debt instrument (normally short term) issued by a bank to borrow funds from other banks/investors.

**Collateralised Debt Obligations** - (CDOs) are a type of asset-backed security and structured credit product. CDOs are constructed from a portfolio of fixed-income assets. These assets are divided into different tranches:

- Senior Tranches (rated AAA)
- Mezzanine Tranches (AA to BB)
- Equity tranches (unrated).

Losses are applied in reverse order of seniority and so junior tranches offer higher coupons (interest rates) to compensate for the added default risk. CDOs serve as an important funding vehicle for fixed-income assets.

**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 “cap” above current market rates and a “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.

**Compound Option** - An option contract on the premium of an option i.e. the right, but not the obligation, to enter an option contract at a pre-determined premium amount.

**Convexity** - A measure of the degree of curve or slope in an interest rate yield curve.

**Convertible Bonds** - A debt instrument issued to investors by a borrower that has a fixed interest rate for a period and then converts (under a strict pricing formula) to shares in the issuing company.

**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.

**Counterparty** - 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 Default Swap** - A credit default swap (CDS) is a credit derivative between two counterparties, whereby one makes periodic payments to the other and receives the promise of a payoff if a third party defaults. The former party receives credit protection and is said to be the “buyer” while the other party provides credit protection and is said to be the “seller”. The third party is known as the “reference entity”. CDS resemble an insurance policy, as they can be used by debt owners to hedge, or insure against credit events such as a default on a debt obligation. However, because there is no requirement to actually hold any asset or suffer a loss, credit default swaps can also be used for speculative purposes.

**Credit Rating** – The credit rating of a Corporation/ Council is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Standard & Poor's, Moody's or Fitch Ratings and have letter designations such as AAA, B, CC. A poor credit rating indicates a high risk of defaulting, therefore constitutes a higher level of interest rates.

**Credit Risk** - 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.

**Cross Currency Interest Rate Swap** - A borrower exchanges (swaps) one set of interest payments. From a loan in one currency for another set of interest payments in a second currency. Interest payments are swapped from fixed to floating and vice versa. See "Interest Rate Swaps".

**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" asset e.g. sharemarket 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.

**Earmarking** - purchased options on foreign exchange may be entered for short periods, but "earmarked" as cover related to longer periods and reported as such against risk control limits. The options being used as an entry tactic to longer dated forward cover.

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

**Eurobond** - A fixed rate bond issued by a non-resident borrower in a European country.

**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, Y2K, political elections, adversely affecting a company'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 closedout 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.

**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).

**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.

**Floorlet** – A series or string of floor options which exist for each period the floor agreement is in existence.

**Forward Exchange Contract** - A contract to buy and sell one currency against another at a fixed price for delivery at some specified future date.

**Forward Forwards** - A forward exchange contract on the forward points for foreign exchange forward contracts i.e. a hedge on the forward points which are determined by the two separate interest rates of the currencies involved.

**Forward Points** - The difference in interest rates between two currencies expressed as the exchange rate points i.e. 152 forward points is a 0.0152 adjustment to the 0.6500 NZ\$/US\$ exchange spot rate.

**Forward Rate Agreement** - A contract (“FRA”) whereby a borrower or investor in Bank Bills agrees to borrow or 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 Starting 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 company’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 a 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 sharemarket index, or the gold price.  
**Indirect FX Risk** - A company has indirect foreign exchange risk where their costs, revenues or profits can be adversely affected by exchange rates that they are not directly paying or receiving. The prices they pay or receive in the domestic currency are influenced by the exchange rate movements.



**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 counterparties that covers all transactions.

**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 10 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.

**Junk Bonds** - High yield bonds at the bottom-end of the credit quality spectrum.

**Knock-in/Knock-out Options** - Option contracts for currencies or interest rates that are either activated or de-activated on pre-determined market rates being achieved.

**Liability Management** - The policy, strategy and process of actively managing a portfolio of debt.

**LIBOR** - London Inter-bank Offered Rate, the average of five to six banks quote for Eurodollar deposits in London at 11:00 am 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 a company 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 (MTN)** - A continuous programme whereby a prime corporate borrower

has issuance documentation permanently in place and can issue fixed rate bonds at short notice under standard terms.

**Multi-currency Facility** - A committed banking facility that allows the borrowing of several alternative currencies to the NZ dollar.

**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 Market Operations** - are the means of implementing monetary policy by which a central bank controls its national money supply by buying and selling government securities, or other financial instruments. Monetary targets, such as interest rates or exchange rates, are used to guide this implementation.

**Open Position** - Where a company 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” Option** - 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.

**Path Dependent Options** – Are characterised by payoffs that are a function of the particular path that asset prices follow over the life of the relevant option. The path of the underlying asset price is used to determine the payoff or the structure of the option. Path dependent options are driven primarily by the ability to reduce option premiums, increase the probability of gain and match underlying assets and liabilities.

**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 company.

**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 or 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.

**‘Real’ Option** - Real option analysis applies put option and call option valuation techniques to capital budgeting decisions. A real option is the right, but not the obligation, to undertake some business decision, typically the option to make a capital investment. For example, the opportunity to invest in the expansion of a firm’s factory is a real option. In contrast to financial options, a real option is not often tradeable—e.g. the factory owner cannot sell the right to extend his factory to another party, only he can make this decision; however, some real options can be sold, e.g., ownership of a vacant lot of land is a real option to develop that land in the future. Some real options are proprietary (owned or exercisable by a single individual or a company); others are shared (can be exercised by many parties). Therefore, a project may have a portfolio of embedded real options; some of them can be mutually exclusive.

**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 counterparty at current market rates, a realised gain or loss is made. A revaluation merely brings the contract/instrument to current market value.

**Repurchase Agreement (Repo)** – A sale and repurchase agreement has a borrower sell securities for cash to a lender and agrees to repurchase those securities at a later date for more cash. The repo rate is the difference between borrowed and paid back cash expressed as a percentage. For example, the RBNZ in open market operations buys securities

from financial institutions who agree to buy them back at a cost of OCR plus margin.

**Reverse Repo** – The same repurchase agreement from the buyers’ perspective, i.e. the seller executing the transaction would describe it as a ‘repo’, while the buyer in the same transaction would describe it as a ‘reverse repo’.

**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, normally two business days after the transaction is agreed.

**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.

**Stop Profit** – The opposite of a “stop-loss order” where a “stop-profit order” is placed in the market to automatically closeout an open position at a pre-determined maximum gain/profit.

**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.

**Swap Spread** - The interest rate margin (in basis points) that interest rate swap rates trade above Government bond yields.

**Swaption** - 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.

**Swaption Collar** – The simultaneous position of entering into 2 option contracts on 2 interest rate swaps linked together into one transaction. A swaption collar performs similarly to a ‘collar’ where from a borrower’s perspective a top-side position above current market rates and a bottom-side position below current market rates are entered into. On maturity of the options and depending on current interest rates relative to the strike levels on the swaps will determine if either swap is transacted.

**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 a company that is responsible for managing the cash resources, debt, foreign exchange risk, and sometimes the commodity price and energy price 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.

**Yankee Bond** - A non-resident US borrower issuing a corporate bond in the domestic US bond market.

**Yield** - 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.

**Yield to Maturity** - The Yield to Maturity (YTM) or redemption yield is the yield promised by the bondholder on the assumption that the bond or other fixed-interest security such as gilts will be held to maturity, that all coupon and principal payments will be made and coupon payments are reinvested at the bond’s promised yield at the same rate as invested. It is a measure of the return of the bond.

**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.



