

33.3 LIABILITY POLICY

Source: LTCCP 2004/2005, adopted 30/6/04

BACKGROUND

Section 102(4)(c) of the Local Government Act 2002 states that a local authority must adopt an liability management policy. The liability management policy must state the local authorities policies in respect of investments including:

- Interest rate exposure
- Liquidity
- Credit Exposure
- Debt Repayment
- Specific Borrowing Limits
- The giving of Securities

POLICY

Council exercises its flexible and diversified borrowing powers within the provisions of the Local Government Act 2002. Council approves the core borrowing programme by resolution during the Annual Planning process. Core borrowing is defined as term borrowing which is expected to remain outstanding for at least one year.

A resolution of Council is not required for hire purchase, credit or deferred purchase of goods if:

- the period of indebtedness is less than 91 days; or
- the goods or services are obtained in the ordinary course of operations on normal terms for amounts not exceeding in aggregate, an amount determined by resolution of Council, subject to Chief Executive approval.

Projected borrowing levels are ascertained from cashflow projections prepared whilst setting strategic objectives during the Annual Planning process. Council primarily has core borrowing to fund assets with intergenerational qualities as well as general debt to fund Council's Balance Sheet and specific debt associated with "special one-off" projects and capital expenditure.

Council is able to borrow through a variety of market mechanisms including the issue of loan stock, debentures and direct bank borrowing or through accessing the capital markets directly. Council does not borrow within or outside New Zealand in currency other than NZ currency.

Before raising external borrowings, the Manager Corporate Services reviews Council's ability to make loans internally from existing reserves. In evaluating borrowings (in

relation to source, term, size and pricing) the Manager Corporate Services takes into account the following:

- The size and the economic life of the project
- The impact of the new borrowing on the borrowing limits
- Relevant margins under each borrowing source
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time
- Prevailing interest rates relative to term for both stock issuance and bank borrowing and management's view of future interest rate movements
- Available term from bank and stock issuance
- Legal documentation and financial covenants

Specific Borrowing Limits

In managing borrowing, Council adheres to the following limits:

- *Total annual interest expense to be no greater than 10% of total annual income or 15% of total rates revenue¹.*
- *Debt to total income ratio of not more than 2.5 times².*
- *Net cashflows from operating activities exceed gross annual interest expense by at least 2 times³.*
- *Total non infrastructural asset related debt not to exceed 50% of Net Assets (excluding infrastructural assets)*
- *Total borrowing for infrastructural assets not to exceed 20% of the total value of all infrastructural assets.*

Liquidity and Credit Risk Management

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

¹ Total annual income includes general rates, targeted rates, user charges and fees, subsidies and grants, sundry income, interest income, dividends and capital contributions.

² Debt to income ratio includes the multiple of total annual income required to extinguish public debt. Public debt includes all public debt owing.

³ Net cash from operating activities before total interest expense and taxation divided over total interest expenses

Where possible Council seeks a diversified pool of borrowing and ensures that bank borrowings are only sought from the approved list of registered banks.

To ensure funds are available on repayment of debt, treasury investments are maintained in liquid assets and funds are available through a committed overdraft facility. Council ensures that:

- *A liquidity ratio of not less than 1:1 is maintained at each month end.*
- *Liquid investments are held.*

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high, Council ensures debt maturity is spread over a band of maturities. Council manages this specifically by ensuring that:

- *No more than 35% of total borrowing (or \$1 million, whichever is the higher) is subject to refinancing in any financial year. Total borrowing includes any existing and forecast borrowing.*

Interest Rate Exposure

Council's borrowing gives rise to a direct exposure to interest rate movements. Generally, given the long term nature of Council's infrastructural assets, projects and intergenerational factors, and Council's preference to avoid an adverse impact on rates, there is a general tendency to have fixed rate borrowing.

The Council approves interest rate risk management strategy, as recommended by the Manager Corporate Services who monitors the interest rate markets on a regular basis and after taking appropriate advice, evaluates the outlook for short term rates in comparison to the rates payable on its fixed rate borrowing. Notwithstanding Council's preference for fixed rate borrowing, it may be appropriate from time to time, depending on Council's outlook, for interest rates to have a floating rate profile. Council is able to participate in a floating rate mix through the below operating parameter:

- *The Manager Corporate Services can approve up to 55% of total borrowing to have a floating rate profile. A floating rate profile beyond the authority of the Manager Corporate Services requires the approval of the Chief Executive to 75% of borrowing in any one year or the approval of Council.*

Management implements interest rate risk management strategy through the use of the following:

- Adjusting the average maturity of its borrowings, thereby managing interest rate risk within the confines of liquidity management.
- Interest rate risk management instruments to convert fixed rate borrowing into floating rate, floating rate borrowing into fixed borrowing.

The following interest rate risk management instruments may be used for interest rate risk management activity, after formal prior approval of Council:

- Forward rate agreements
- Interest rate swaps
- Purchase of interest rate options products
- Interest rate collar type strategies

Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.

Buying and selling of financial futures is not permitted primarily due to the administrative burden.

Security

Generally Council does not offer assets or special deemed rates as security for general borrowing programmes. In some special circumstances, with prior Council approval, security may be offered:

- On borrowings by charging a special deemed rate or floating charge over general rates revenue
- By providing a charge over one or more of the Council's assets

Debt Repayment

Council repays borrowings from the specific sinking fund allocated to that borrowing, renewal loans or from general operating reserves.

Where an asset has an economic life of greater than 25 years, the maximum term of the loan shall be 25 years.

Contingent Liabilities

Council from time to time provides financial guarantees, low interest or interest free loans to community organisations. Council passes a resolution to approve all financial guarantees. Management ensures that the business plan of the guaranteed party furthers the strategic objectives of Council, and that financial statements are received on a regular basis.

Should the guarantee be called up, Council will take immediate action to recover the money.