

Waimate 2020

**Waimate District Council
Financial Policy 403**

Investment Policy



**Version 2.2
1st March 2006**

CONTENTS

1	Purpose	87
2	Scope	87
3	Responsibility	87
4	Glossary of Terms	87
5	Policies	88
6	Procedures	91
7	Appendix 1	92
8	Publication Details	93

Waimate 2020

Financial Policy 403 - Investment Policy

1. PURPOSE

To guide Council in the making of Investment decisions.

This Policy must be read in conjunction with Council Financial Policy 304 entitled, “Economic Development Policy”.

2. SCOPE

This policy applies to all surplus funds of Council.

3. RESPONSIBILITY

Responsibility to implement this policy will apply to:

Bank Reconciliation Clerk

- in relation to day-to-day surplus arising in Council’s main chequing account

Financial Accountant

- in relation to identifying long-term surpluses from Council’s Statement of Cashflow Projections.

Corporate Services Manager

- to make reports/recommendations on appropriate investment vehicles to Council.

Council

- to approve recommendations for investment vehicle choices from time to time in line with this policy.

4. GLOSSARY OF TERMS

BKBM

The Forward Rate Agreement, (FRA) settlement rate as determined at 10.45 am each business day on Reuters page BKBM.

Bond Options

Council when purchasing a bond option, has the right but not the obligation to buy or sell a specified Government stock maturity on an agreed date and time, and at an agreed rate.

Forward Exchange Contract

Council when entering into a Forward Exchange Contract agrees a rate today at which one currency is sold or bought against another for delivery on a specified future date.

Forward Rate Agreement

An agreement between Council and a counterparty (usually a bank) protecting Council against a future adverse interest rate movement. Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM).

Interest Rate Collar Strategy

The combined purchase (or sale) of a cap or floor with the sale (or purchase) of another floor or cap.

Interest Rate Options

The purchase of an interest rate option gives the holder (in return for the payment of a premium) the right but not the obligation to borrow (described as a cap) or invest (described as a floor) at a future date. Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM).

Interest Rate Swap

An Interest Rate Swap is an agreement between Council and a counterparty (usually a bank) whereby Council pays (or receives) a fixed interest rate and receives (or pays) a floating interest rate. The parties to the contract agree notional principal, start date of the contract, duration of the contract, fixed interest rate and the benchmark rates (usually BKBM).

Liquidity Ratio

This ratio measures the ability of Council to generate cash from assets in order to meet its obligations. Council's liquidity or acid test ratio consists of the sum of cash, marketable securities, short term notes and receivables, supplemented by any unused bank overdraft facility that Council may have with its principle bankers, that is able to be called upon instantly, divided by current liabilities.

Swaption

The purchase of a swaption gives Council the right but not the obligation to enter into an interest rate swap, at a future date, at a specific interest rate.

5. POLICIES

5.1. Investment Policy

5.1.1. Investment Mix

Council maintains investments in the following financial assets:

- Loans Advances (covered in Section 5.1.3)
- Equity Investments (covered in Section 5.1.4)
- Property Investments (covered in Section 5.1.5)
- Forestry Investments (covered in Section 5.1.6)

- Financial Investments (covered in Section 5.1.7)
- Sinking Funds (covered in Section 5.1.8)

5.1.2. General Policy

Council's philosophy in the management of investments is to optimise returns in the long term while balancing risk and return considerations. Council recognises that as a responsible public authority any investments that it does hold should be low risk, giving preference to conservative investment policies and avoiding speculative investments. It also recognises that lower risk generally means lower returns.

Any new investments are approved by the appropriate delegated authority, which provides that the Corporate Services Manager may approve such investments up to a value of \$2,000,000 for a term of six months. Beyond this, Council resolution is required.

Council does not hold financial investments other than those involving general and specific reserves, and cash management balances. In its financial investment activity, Council's primary objective, when investing, is the protection of the investment capital value and to minimise the risk of loss.

Accordingly, only credit worthy counterparties are acceptable. Council's policy on managing credit risk is contained in Section 5.1.7.

Within the credit constraints contained in Section 5.1.7, Council also seeks to:

- Optimise investment return.
- Ensure investments are liquid and sufficiently flexible.
- Diversify the mix of financial investments.
- Manage potential capital losses due to interest rate movements if investments need to be liquidated before maturity.

5.1.3. Loan Advances

Loan advances include loans for housing, recreational and community organisations which further the Council's strategic objectives.

Waimate 2020

Interest rates charged on sports and recreational loans are set at concessional rates by Council. These loans are made to incorporated organisations which will provide, improve, or develop amenities for the purposes of sport and recreation.

Council provides internal loan advances to Council activities not funded from general rates. Loans are provided for activity deficits which are greater than one-quarter of the activity's annual income. Deficits arise from capital work programmes or the purchase of fixed assets and not ordinary operating costs. Interest and principal amounts are paid on a quarterly basis.

All loan advances are charged at market interest rates (other than sports and recreational loans) and reviewed on the anniversary of the loan.

Interest received on sports and recreational loans are credited to the specific loans fund account. Interest on other loan advances are credited to general funds.

All loan advances are approved by the Council.

The Council receives annual financial statements and reviews performance of these investments on a regular basis, to ensure objectives are being achieved, and that interest and principal repayments are being made in accordance with the loan agreement.

Specific Policy

Council intends to hold loan investments until maturity.

5.1.4. Equity Investments

Council's current equity investments and other shareholdings, are included in Council's most recent Annual Report.

Council's investments in such assets fulfil various strategic and financial objectives and comply fully with Council's statutory powers.

All income from Council's equity investments, including dividends, are included in general funds and used for the reduction of general rates.

The Council receives annual financial statements and reviews performance of these investments to ensure that the stated performance objectives are being achieved.

Any disposition of equity investments requires Council approval. Proceeds from the disposition of equity investments are applied to, either:

- The repayment of general debt, or
- Capital development, or
- Forestry investment purposes

Proceeds are not used for operational expenditure purposes.

Specific Policy:

The investments in Council Controlled Trading Organisations, (CCTO's), and deemed CCO's (e.g. Alpine Energy Limited), are held in trust for the benefit of the community, regardless of their commercial return.

All other equity investments earn a commercial return or are sold at a suitable price to Council.

5.1.5. Property Investments

Council's overall objective is to only own property (including land holdings, buildings and excluding operating assets), that is necessary to achieve its strategic objectives. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements which could deliver the same results. This assessment is based on the most financially viable method of achieving the delivery of Council services. Council generally follows a similar assessment criteria in relation to acquiring new property and land investments.

Property rentals are charged at commercial levels, and all income, including rentals and ground rent from property investments, is included in general funds.

The Council reviews the performance of its investment properties through regular monthly exception reporting.

Any disposition of property requires the approval of Council. Any proceeds on disposition are firstly used to repay related debt and then allocated to capital development purposes.

Council intends to dispose of all surplus land holdings by tender, or at the most recent

independent valuation, whilst being cognisant of the requirement to offer back under the Public Works Act 1981.

Specific Policy:

Operating assets are held for strategic purposes.

Surplus or under-utilised parcels of land which do not generate a commercial rate of return may be disposed at a price suitable to Council.

Commercial property that does not generate a commercial return, nor has a strategic intent, may be disposed of at a price suitable to Council.

5.1.6. Forestry Investments

Forestry assets are primarily held as long term investments on the basis of their net positive discounted cashflows, factoring in projected market prices and annual maintenance and cutting costs. Ongoing costs are paid from general rates.

The management of forestry assets is contracted to Resource Management Limited who complete ongoing plantation maintenance and six monthly performance reporting to the Council. Operating performance is reported to the Council. An annual audit of the plantation is completed by an independent forestry consultant.

Any disposition requires Council approval. Proceeds from the disposition of forestry investments, (ie: the real estate, leases, etc.), are firstly applied to the repayment of the Forestry Encouragement Loan, and then to the re-establishment of existing or new Council Forests.

Disposition of revenue derived from forestry operations, (ie: harvesting of trees), is to general reserves as defined in Council Policy, 401, "Revenue and Financing Policy".

Specific Policy:

Council intends to retain its forestry investment and harvest when stump value is maximised.

5.1.7. Financial Investments

Council maintains financial investments for the primary reasons:

- Investment proceeds from the sale of assets.
- Invest amounts allocated to general and specific reserves.
- Invest funds allocated for approved future expenditure.
- Invest surplus cash, and working capital funds.

Interest income earned on financial investments is taken to general reserves. The Finance and Administration Committee reviews financial investment performance through standard monthly reporting.

Objectives for Management of Financial Investments and Equity Investments

Investment Objectives

Council's primary objective when investing is the protection of its investment. Accordingly, only credit worthy counterparties are acceptable. Credit worthy counterparties are selected on the basis of their current Standard and Poors (S & P) rating, which must be strong or better. Credit ratings are monitored on a six monthly basis by the Financial Accountant from updated S & P advices.

The Council approves investment strategy, as recommended by the Corporate Services Manager, who after seeking appropriate advice, incorporates plans for approved expenditure and strategic initiatives, and evaluates the outlook for interest rates and the shape of the yield curve.

The following principles capture the above objectives and form the key assumptions of the operating parameters contained in Appendix 1 – Counterparty Exposure Limits:

- Credit risk is minimised by placing maximum limits for each broad class of non-Government issuer, and by limiting investments to local authorities, registered banks, strongly rated SOE's, and corporates within prescribed issuer and portfolio limits.
- Liquidity risk is minimised by ensuring that all investments must be capable of being liquidated in a readily available secondary market.

Waimate 2020

5.1.8. Sinking Funds

Since the enactment of the Local Government Amendment (No 3) Act 1996, Council is not required to use specific funding mechanisms. Accordingly, Council does not establish Sinking Funds for new borrowing. Established Sinking Funds are wound down as loans mature, or are used to repay existing borrowing at the earliest opportunity. Remaining Sinking Funds are managed as part of Council's investment portfolio.

A statement of Sinking Funds is prepared annually by the Sinking Fund Commissioners.

6. PROCEDURES

6.1. Procedures to Manage Investments and Report to Council

Cash Management

From time to time, Council has daily cashflow surpluses and borrowing requirements due to the mismatch of daily receipts and payments. All cash inflows and expenses pass through bank accounts controlled by the finance function.

Bank Reconciliation Clerk

A daily bank reconciliation is taken from the ANZ Direct electronic banking system by the Bank Reconciliation Clerk. Any cash not expected to be needed within one week is transferred immediately to Council's Call Account, to ensure interest is earned at the most advantageous rate.

Cash management activities must be undertaken within the following parameters:

- Cash management instruments are limited to:
 - Call deposits and registered banks.
 - Negotiable instruments issued by banks with a maturity less than three months.
 - Term deposits with registered banks (less than three months). Not recommended if early break penalties are enforced.

- Cash may only be invested with approved counterparties as detailed in Appendix 1.
- An optimal range of \$50,000 is targeted for in Council's main bank account.
- Interest rate risk management on cash management balances is not permitted.

Financial Accountant

Every month, Council's Statement of Cashflows, extending at least 12 months into the future, must be reviewed and updated by Council's Financial Accountant. Where longer term surpluses (in excess of three months) are identified, Financial Accountant should bring this to the attention of Corporate Services Manager.

Corporate Services Manager

Must report on Investments every month to the Council. Details of reports should include:

- Level of investments at current time.
- Investments expected over next three months and further.
- Performance of investments currently.
- Outlook for interest rates in future recommendations.

6.2. Procedures to Assess and Manage Risks Associated with Investment

(Approved by Strategies and Policies Committee, 4 June 2002)

Interest Rate Risk Management (for Investments)

Council's investments give rise to a direct exposure to a change in interest rates, impacting the return and capital value of its fixed rate investments.

The Treasury investing advisor sets interest rate risk management strategy by monitoring the interest rate markets on a regular basis, and after taking appropriate advice, evaluates the outlook and determines the interest rate profile to adopt for investments.

Management implements interest rate risk management strategy by reviewing rolling

cashflow forecasts and using risk management instruments to protect investment returns, and/or to change interest rate and maturity profile.

The following interest rate risk management instruments (refer to Section 4 for definitions), may be used for interest rate risk management activity, after formal prior approval of Risk Management Consultant:

- Forward rate agreements.
- Interest rate swaps.
- Purchase of interest rate options products including floors, bond options and swaptions.
- Interest rate collar type strategies.

Selling interest rate options for the purpose of generating premium income is not permitted.

7. APPENDIX 1

7.1. Counterparty Exposure Limits

Council ensure that all investment, interest rate risk management as well as any foreign exchange activity is undertaken with institutions that are of high quality credit, to ensure amounts owing to Council are paid fully and on due date.

More specifically, Council minimises its credit exposure by:

- Transacting with entities which have a strong credit rating.
- Limiting total exposure to prescribed amounts and portfolio limits.
- Timely and rigorous compliance monitoring.

The following table summaries credit requirements and limits:

Institution	Minimum S&P Short Term Credit Rating 10	Minimum S&P Long Term Credit Rating 11	Total Exposure Limit for each Counterparty	Portfolio Limit (% of Total Portfolio)
Government	N.A.	N.A.	Unlimited	100%
Local Authorities	N.A.	N.A.	\$2 million	100%
Registered Banks	A-1	A-	\$12 million	100%
Strongly Rated Corporates and State Owned Enterprises	A-1	A-	\$2 million	40%

¹⁰ Short-term refers to securities with a remaining maturity of 12 months or less.

¹¹ Long term refers to securities with a remaining maturity of more than 12 months.

If any counterparty's credit rating falls below the minimum specified in the above table, then immediate steps are taken to reduce the credit exposure to that counterparty to zero.

Waimate 2020

8. PUBLICATION DETAILS

All inquiries or suggestions regarding this Document should be referred to:-	Policy Analyst
Proposed Revision	2.3
Revision Date	9th March 2006
Effective Date	1st July 2006
Minimum Review by:	1 March 2007 to align with LTCCP
Document Owner – Release Signature	Corporate Services Manager
Chief Executive – Release Signature	

