LIABILITY MANAGEMENT POLICY 402

Contents

1. Purpose

To state Council's policies in respect of the prudent management of both borrowing and other liabilities.

2. Scope

This policy covers all borrowings by Council, except where for hire purchase, credit, or 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 a total of $14,000,000.

3. Responsibility

The Chief Executive is responsible for implementing this policy.

The Chief Executive will be supported by a Treasury Management Team consisting of at least two of the following three positions:

- Corporate Services Group Manager
- Accountant
- Independent Treasury Advisor

4. Approved Borrowing Instruments

Council may borrow through a variety of market mechanisms, considered to be approved borrowing instruments. These primarily comprise:

Bank-Sourced Borrowing

Bank overdraft facilities are seen as the most flexible facility for day-to-day short term borrowings, but inevitably at a higher interest cost than longer term facilities. Therefore, they are primarily to be used where the term of borrowing is expected to be less than three months.

Revolving Credit Facilities (Flexible Rate Term Loan Facility)

Revolving credit facilities (or a Flexible Rate Term Loan) are similar to bank sourced borrowing from a borrower's perspective, except interest is paid in arrears rather than upfront as in the case of bank bills. Revolving credit facilities are usually for a term of up to three years but may be for as long as five years and like bank bills drawings under the facility are priced off the bank bill buy rate. Most facilities allow for the borrowers to draw up to the facility amount in various tranches of debt and for various terms out to a maximum term of the maturity date of the facility. Like bank bills most borrowers use these facilities to borrow on a 90 day basis.

Within Council's variable amount term loan limit, borrowing amounts may be separately identified and "ring fenced" to a known term and known interest rate cap, in order to align with the term and known interest income of a Council long term project by the use of a hedging instrument.

Costs

The principal costs are the same as with bank bills, the lending bank's yield sets the base rate at the time of lending, an arrangement fee, an acceptance fee and a line fee (expressed in basis points or percentage per annum) and the margin. Acceptance fees, arranger fees, line fees and margins in aggregate normally range between 35-300 basis points (i.e. 0.35% - 3.00%), depending on the credit worthiness of the borrower.

Short Term Money Market Lines

Short term money market loans or cash loans can be Committed or Uncommitted. A customer pays for a guarantee of the availability of the funds in a Committed Loan. In an Uncommitted Loan, funds are provided on a best endeavours basis and no line/commitment fee is payable. In addition to a line fee, a margin may be charged on any line usage.

The minimum amount for a cash loan is $1,000,000. Smaller loans can be arranged, although the interest rate quoted will be a reflection of the size of the loan.

The main usage of cash loans is to cover day-to-day shortfalls in funds. The interest rate is governed by the term of the borrowing and the implied or implicit credit rating of the borrower. Cash loans are short term only and are normally drawn for a term of one (overnight) to seven days. Interest collection can be daily.

Bank Bill Facilities

Council has a committed bank overdraft. Overdraft facilities are utilised as little as practical, (i.e. call funds are utilised to meet day-to-day expenses where possible).

An unconditional order in writing, addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at fixed or determinable future time, a sum certain in money to, or to the order of a specified person, or to bearer.

Bank bill facilities are normally for a term of up to three years but may be for as long as five years. Bank bills are bills of exchange, drawn or issued usually by the original borrower and accepted or endorsed by a bank.

For a Bank Accepted Bill, the bank makes the payment of the face value of the bill on maturity. Most bank bills traded in the New Zealand market are Bank Accepted Bills.

Bank Endorsed Bills have been endorsed by a bank with another part as acceptor. In the event of default of the original acceptor, payment can be sought through the chain of endorsers to the bill.

An investor in bank bills can sell the bills prior to maturity date and receive the cash. Bank bills are a longer term borrowing instrument than cash loans. Bills are normally drawn for terms of 30, 60, or 90 days with a few being drawn for 180 days. The 90 day bank bill is the underlying traded benchmark instrument for the short end of the market.

Costs

The principal costs to the borrower are the discounting bank's yield at which it discounts the bill at the time of drawdown, an arrangement fee, an acceptance fee and a line fee (expressed in basis points or percentage per annum) and margin. Acceptance fees, arranger fees, line fees and margins in aggregate normally range between 35 – 300 basis points (i.e. 0.35% - 3.00%), depending on the credit worthiness of the borrower.

Local Authority Bonds

Local Authority Bonds are issued by a variety of local governments by tender or private placement. The Bonds are registered securities. They are repayable on a fixed date, and are generally issued for terms ranging from one to fifteen years.

Local Authority Bonds are quoted on a semi-annual yield basis and priced on a discounted cashflow basis. A fixed coupon payment is made semi-annually to the holder of the security.

Structured and Project Finance

Project and structured financing matches up debt to suit the quantifiable income stream from the project. This type of financing is appropriate for the funding of standalone assets which are able to be ring-fenced and over which security can be taken. The sort of assets to which this usually applies are assets which are transferable, and for which an international equity market exists, e.g. infrastructural assets. The owner of the asset usually retains an equity interest in the asset.

5. Internal Borrowing

Objective

Council's primary objective in funding debt internally is to use cash held in capital replacement, depreciation, separate rate, and special and trust funds effectively by establishing an internal loan portfolio that provides funding to internal cost centres. This creates operational efficiencies as savings are created by eliminating the 'bankers margin' that would be owing through Council simultaneously investing and borrowing with the bank.

Legal Compliance

Internal borrowing was authorised by the Local Government (Rating) Act 2002. Council considers that by applying available funds against debt through an internal debt management process is using its funds to most efficient use at low risk.

General Policy

The internal loan portfolio is used as an input into determining Council's external debt requirements. Where possible, reserves are used to reduce external debt, effectively reducing Council's net interest cost. Where debt financing is approved by the Annual or Long Term Plan, Council in setting the treasury strategy will determine the effectiveness of using either external or internal debt.

Principles

The following principles apply to the management of Council's internal loan portfolio:

- The internal loan is recorded on a schedule of internal loans and reported to Council through the Annual Report.
- Principal amounts are repaid annually and interest repaid in quarterly instalments.
- Loan terms are agreed on establishment of the loan and determined on a table mortgage basis.
- Interest is charged to each internal loan and for short-term operational deficits in separate rate accounts.

- Interest will be paid to separate rate, depreciation reserves and special and trust funds quarterly, based on the prior 30 June end of year balance.
- All rate income collected for the purpose of a loan will be repaid to the loan. Where the actual interest rate varies from the budgeted interest rate, Council first applies the interest charge then holds the balance of the income in reserve.

Interest Rates

Interest rates applied to the internal investments and debt are calculated and set annually using the following guidelines:

- Council estimates the likely internal borrowing interest rate.
- The interest rate is based on Council's actual weighted average cost of funds and takes into account the following factors:
    - Estimated earnings on cash invested.
    - Estimated cost of external borrowings.

6. Policy

General Matters

Council will from time to time exercise its flexible and diversified borrowing powers within the terms of this policy, as provided for by the Local Government Act 2002 particularly the Principles of Good Financial Management as set out in the Local Government Act 2002 (Part 6, Subpart 3) in any borrowing decisions and aims to achieve the lowest possible net borrowing costs within these policy parameters.

Council raises borrowing for the primary purposes as set out in the Revenue and Financing Policy.

In evaluating any new or renewal borrowings (in relation to source, term, size and pricing) the following matters will be taken into account:

- The size and the economic life of the project.
- The impact of the new debt 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.

Foreign Exchange

From time to time Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated goods and services.

Where possible, all supplier invoices are raised in New Zealand Dollars. Where this is not possible, all significant commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is approved. Smaller payments are converted at the spot exchange rate on the date of payment. Both spot and forward foreign exchange contracts are used by Council.

Council does not borrow or enter into incidental arrangements within or outside New Zealand in currency other than NZ currency.

Interest Rate Exposure/Risk Management

Interest Rate Risk Management (for Borrowings)

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

The following table provides guidelines for achieving a floating rate mix, together with the appropriate discretionary authority:

For Debt Exceeding $2,000,000		
Term of Exposure	**Maximum Floating Rate Exposure**	**Revised Floating Rate Exposure Allowable Upon the Treasury Management Team Written Approval**
0-1 year	55%	75%
1-3 years	10%	30%
3-5 years	N.A	20%
5-7 years	N.A.	10%
7 years +	N.A.	N.A.

NOTE: Percentages in excess of these may be approved by Council. The table includes debt maturing in the current year, i.e. debt maturing in the current year is considered floating rate debt.

The Treasury Management Team recommends the interest rate risk management strategy by monitoring the interest rate markets on a regular basis and after undertaking appropriate research, evaluating the outlook for short term rates in comparison to the rates payable on its fixed rate borrowing.

Management then 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 products (refer note below) to convert fixed rate borrowing into floating rate, floating rate borrowing into fixed or hedged borrowing, and to manage maturity mismatches between its borrowings and investments.
- The following interest rate risk management instruments (refer Section 4 for definitions) may be used for interest rate risk management activity, after seeking formal prior approval of Council:
    - Forward rate agreements
    - Interest rate swaps
    - Purchase of interest rate options products including caps, bond options and swaptions
    - Interest rate collar type option strategies

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

Liquidity

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

Council budgets to repay term debt payments as they fall due. Council's treasury management approach will ensure sufficient facilities are available to renew floating debt, at all times. The main tool for this is to ensure that funds are available through committed bank facilities. Furthermore, Council maintains a line of available credit in the form of a bank overdraft with its principal bankers of $200,000.

With an active internal borrowing portfolio the Treasury Management Team need to ensure that the facilities are sufficient to cover the transfer of a portion of internal debt to external should a reserve be required to be used.

To minimise the risk of large concentrations of term debt maturing or being reissued in periods where credit margins are high for reasons within or beyond Council's control, Council ensures debt is spread over a band of maturities and ensures that:

No more than 33% of total term debt is subject to refinancing in the next financial year. Total term debt includes existing and forecast borrowings. For the purposes of determining this ratio, total term debt does not include Revolving Credit Facilities, as they are negotiated with the Bank every three to six years and in the last year are then fully subject to refinancing the next financial year, nor does it include Structured and Project Finance which is a specific funding of standalone assets.

Liquidity Profile throughout Council's Typical Year

Significant Monthly Outgoings

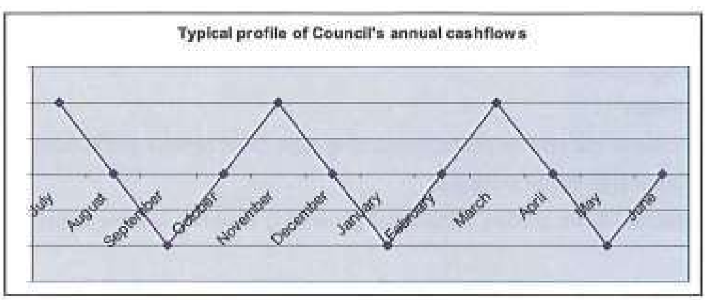
The most significant monthly outgoing for Council is accounts payable, in the form of sundry creditors. These are typically incurred at a relatively uniform rate for each month of the financial year with the exception that due to operational requirements for road construction and maintenance significant roading expenditures may be incurred in Council's last quarter (April/May/June). Furthermore, significant infrastructural project expenditure, such as Stimulus Funded projects, may also skew typical monthly outgoings.

Significant Monthly Incomings

Council's most significant income type is rates. Council rates are due to be paid in four instalments throughout the financial year, typically represented as follows:

For Period	Due
July/August/September	Last Friday in August
October/November/December	Last Friday in November
January/February/March	Last Friday in February
April/May/June	Last Friday in May

Note also that Council, in line with good Financial Management, promotes prompt payment and advance payments of its rating charges and typically achieves a very high proportion of rates instalments paid by month end in August, November, February and May.



Because of the patterns of cashflow incomings and outgoings above, Council typically operates with adequate liquidity from rates cashflow, to meet sundry creditors in the months of August, November, February and May. Any cashflow surplus to expenditure requirements in those months is deposited to a call account with Council's principle bankers, in order to maximise interest earned. In months where rates incoming cashflow is not sufficient to meet expenditure requirements, funding is drawn firstly from Council's interest bearing call account, and secondly, Council may draw on its bank overdraft facility.

Impact on Liquidity Ratio Requirement

For these reasons, the traditional measure of balance sheet solvency of current liabilities being matched by current assets on a 1:1 basis at all times is not appropriate or necessary in order for Council to meet its obligations to pay sundry creditors.

For the purposes of liquidity management, Council uses its line of credit in the form of unused bank overdraft with its principal bankers, to meet financial outgoings.

Credit Exposure

Council may be exposed to credit risk in circumstances where deterioration occurs, of the credit rating of an entity with whom Council has placed investments or has concluded financial derivate contracts or has concluded a major supply, construction or service contract.

In order to safeguard Council against such risk the following guidelines have been adopted:

- Investments are only placed with parties that meet certain minimum credit ratings and only up to certain limits.
- Financial derivative contracts are only to be concluded with registered banks with certain minimum credit ratings.
- All parties with whom Council intends to conclude major contracts will be subject to formal credit approval.
- Tenders for contracts will note that unacceptable credit reviews of a tenderer will be grounds for discretionary rejection of a tender.

Debt Repayment

The term of debt repayment should be aligned with expected life of the intergenerational asset funded or the expected period of Council involvement in an economic development initiative.

Note that the funding will be so aligned but external borrowings may be repaid on a shorter term to minimise interest costs to the Council.

Council may repay borrowings from either asset sale proceeds or from general reserves, including accumulated depreciation reserves.

Specific Borrowing Limits

Council is required to set a limit on borrowing in its Financial Strategy every three years as part of the Long Term Plan. In that document Council sets its limits for the period of the plan, taking account of growth expectations, expenditure and funding needs as well as community views around acceptable debt levels. The limits below are limits that it is financially prudent to operate within. Council in setting its Long Term Plan should be guidedby these upper limits.

In order to protect Council from a heavily debt weighted balance sheet, the following borrowing limits will be observed:

Limit will be the lowest after considering each of the following:-

- The gross annual interest expense of all borrowings will not exceed 10% of total annual rates income; or
- Net cash inflow from operating activities exceed gross annual interest expense by two times; or
- Debt to be no more than 5% of total reported value of property, plant and equipment.

The Giving of Securities and Guarantees

Security

Council offers rates as security for its borrowing programmes. From time to time, with prior Council approval, security may be offered by providing a charge over one or more of Council's assets, or a charge over rates.

7. Glossary

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 principal bankers that is able to be called upon instantly, divided by current liabilities.

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

8. Publication Details

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