



**Waimate**  
District Council

# **INVESTMENT POLICY 403**

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## **1. Purpose**

To guide Council in the making of investment decisions and managing investments.

## **2. Scope**

This policy applies to all financial assets, equity investments and investment properties.

## **3. Responsibility**

The Chief Executive is responsible for implementing this policy.

## **4. Investment Mix**

Council may maintain investments in the following:

- Loans Advances
- Equity Investments
- Property Investments
- Forestry Investments
- Financial Investments

## **5. Policy Statements**

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 Chief Executive may approve such cash investments with approved counterparties 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 10.

Within the credit constraints contained in Section 10, 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.

## **6. 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 credited to the Investment & Finance Activity, thereby included in general funds and used for the reduction of rates generally. Council is however aspiring to reduce reliance on investment income as a rates mitigating tool in order to alleviate the impact on rates when investment returns fluctuate.

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

Council will periodically review equity investments and reassess its reasons for ownership and consider whether the return on investment is acceptable, given these reasons for ownership, and whether continued ownership of the investment is prudent and in the best interest of the community.

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
- Alternative investment purposes.

Proceeds are not used for operational expenditure purposes, unless Council considers it prudent to do so.

## **7. 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 criterion in relation to acquiring new property and land investments.

Property rentals, excluding Community Housing and internal rents, are charged at commercial levels, and all income, including rentals and ground rent from property investments, is held in property reserves.

Council reviews the performance of its investment properties at least annually.

Any disposition of property over \$40,000 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 by such method that market value is achieved, whilst being cognisant of the requirements of legislation including to offer back under the Public Works Act 1981.

## **8. 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, annual maintenance and cutting costs; and to generate carbon credits. On-going costs are held in a reserve to be funded from forestry sales.

The management of forestry assets is contracted. The contractor will complete on-going plantation maintenance and six monthly reporting to 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, including real estate, leases, forestry sales, etc. may be applied to the repayment of the Forestry Reserve deficits, Forestry Loans, re-establishment of existing or new Council forests or such other use as Council specifically directs.

## **9. 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 accounted for within general reserves. The Environment Services and Finance Committee reviews financial investment performance through standard monthly reporting.

## **10. Objectives for Management of Financial Investments**

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 considered when a new investment is made and changes monitored by Council finance staff through updated S & P rating advice.

Council approves investment strategy, as recommended by the Treasury Management Team (as defined in the Liability Management Policy), 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 – 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.

## **11. Procedures**

### **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.

Any excess cash not expected to be needed in the short term is transferred 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 for an appropriate term which optimizes the return on investment, giving consideration to forecasted cashflow requirements. Not recommended if early break penalties are enforced.
  - Cash may only be invested with approved counterparties.
  - An optimal balance of \$100,000 is targeted for in Council's main bank account.
  - Interest rate risk management on cash management balances is not permitted.

### **Procedures to Assess and Manage Risks Associated with Investment**

#### **Interest Rate Risk Management (for Investments)**

Where 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, investment interest rate risk management is required..

The Treasury Management Team recommends 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.

Finance staff implement 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, within the strategy determined by the Treasury Management Team.

The following interest rate risk management instruments may be used for interest rate risk management activity, after formal prior approval of the Treasury Management Team:

- 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.

## 12. 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 that have a strong credit rating.
- Limiting total exposure to prescribed amounts and portfolio limits.
- Timely and rigorous compliance monitoring.

The following table summarises credit requirements and limits:

<b>Institution</b>	<b>Minimum S&amp;P Short Term Credit Rating 10</b>	<b>Minimum S&amp;P Long Term Credit Rating 11</b>	<b>Total Exposure Limit for each Counterparty</b>	<b>Portfolio Limit (% of Total Portfolio)</b>
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%

Note:

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

## 13. 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 principle 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.



## 16. Publication Details

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