

Chairperson and Committee Members
AUDIT AND RISK COMMITTEE

1 NOVEMBER 2018

Meeting Status: **Public**

Purpose of Report: For Information

TREASURY MANAGEMENT COMPLIANCE

PURPOSE OF REPORT

- 1 This report provides confirmation to the Audit and Risk Committee of the Council's compliance with its Treasury Management Policy (Policy) for the quarter ended 30 September 2018.

DELEGATION

- 2 The Audit and Risk Committee has delegated authority to consider this report under the following delegation in the Governance Structure, Section B.3.
Ensuring that the Council has in place a current and comprehensive risk management framework and making recommendations to the Council on risk mitigation.

BACKGROUND

- 3 The Policy sets out a framework for the Council to manage its borrowing and investment activities in accordance with the Council's objectives and incorporates legislative requirements.
- 4 The Policy mandates regular treasury reporting to management and the Council's Operations and Finance Committee and quarterly compliance reporting to the Audit and Risk Committee.
- 5 In order to assess the effectiveness of the Council's treasury management activities and compliance to the Policy, certain performance measures and parameters have been prescribed. These are as follow:
 - cash/debt position;
 - liquidity/funding control limits;
 - interest rate risk control limits;
 - counterparty credit risk;
 - specific borrowing Limits; and
 - risk management performance.
- 6 This report is the first compliance assessment against the updated July 2018 policy. The revised policy was adopted mainly to cater for and support the proposed establishment of two investment funds as part of the 2018/38 Long Term Plan, adopted during June 2018.
- 7 As at 30 September, the Council has not yet established or entered into these managed funds and therefore no additional compliance reporting concerning financial assets have been provided in this report.

DISCUSSION

Cash/Debt Position

- 8 Table 1 below shows the Council's net debt position as at 30 September 2018 against full year budget and the prior year closing balance.

Table 1	Sep YTD Actual \$000's	Full Year Budget \$000's	Full Year Variance \$000's	Full Year 2017/18 \$000's
External debt	210,000	226,175	16,175	205,000
/less borrower notes	(3,360)	(3,619)	(259)	(3,280)
/less cash investments	(57,966)	(60,000)	(2,034)	(53,552)
Net debt	148,674	162,556	13,882	148,168

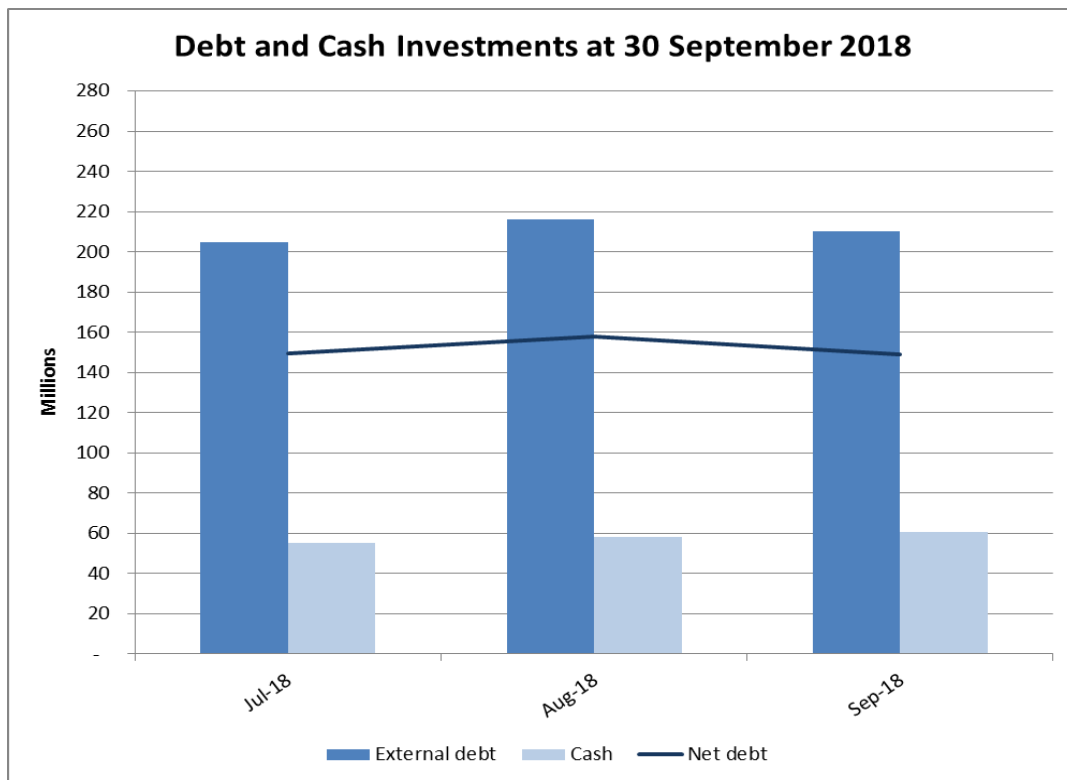
- 9 During the past three months, the Council has issued \$5 million of new debt towards prefunding the September 2019 debt maturity. The funds were placed on term deposit at the most favourable market rates.
- 10 The Table below shows the movement in the Council's debt balance for the year.

Borrowings	Gross borrowings \$000	Explained by:	
		Pre-funding borrowings	
		TD March 2019 \$000	TD September 2019 \$000
Opening balance 1 July 2018	205,000	30,000	15,000
New Debt issued YTD	5,000	-	5,000
Maturities	-	-	-
Total	210,000	30,000	20,000

- 11 As at 30 September 2018, the Council had \$61.33 million of cash, term deposits and borrower notes. This is broken down as follows:

Term deposits & borrower notes	Prefunding borrowings \$000	Prefunding capex \$000	Borrower notes \$000	Cash \$000	Total cash, term deposits and borrower notes \$000
LGFA debt maturing March 2019	30,000	-	-	-	30,000
LGFA debt maturing September 2019	20,000	-	-	-	20,000
Surplus cash placed on TD for Capital Works Programme maturing October (\$4.5m) and December (\$3.0m)	-	7,500	-	-	7,500
Surplus cash	-	-	-	466	466
Borrower notes held	-	-	3,360	-	3,360
Total	50,000	7,500	3,360	466	61,326

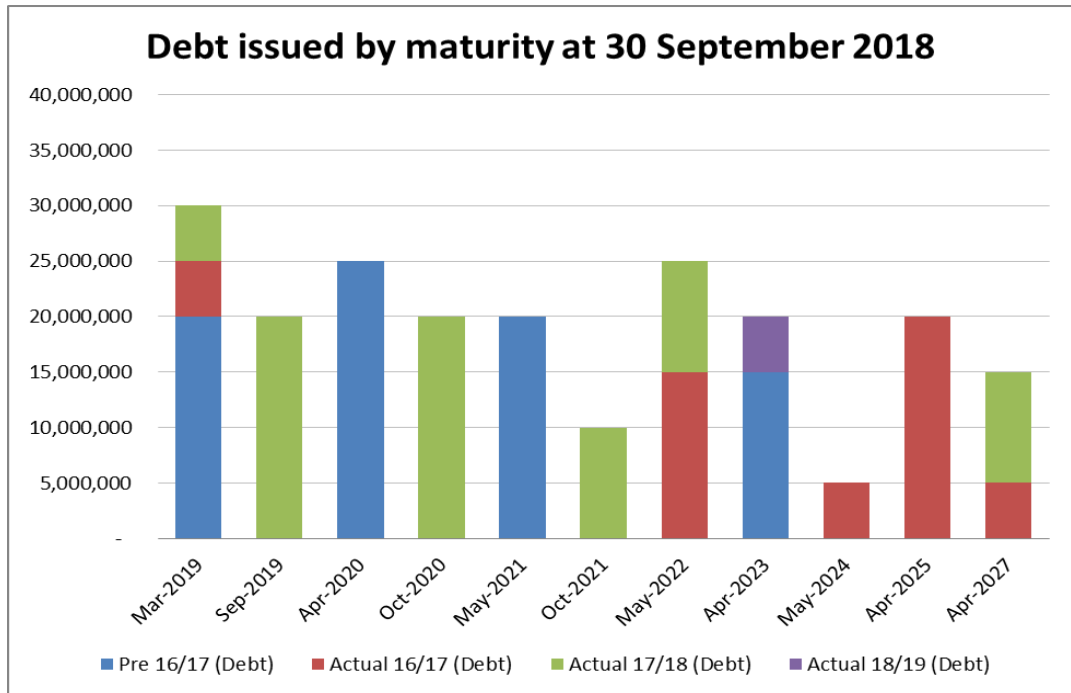
- 12 The Council is targeting through its financial strategy to keep net borrowings below 200% of total operating income. In June 2018, the Council reported for the first time a result below this preferred limit, at 198%. The Council will continue striving to maintain or improve this result.
- 13 Excluding prefunding, the Council has not breached its upper borrowing limit as demonstrated in the chart below:



Liquidity/Funding control limits

- 14 Liquidity and funding management focuses on reducing the concentration of risk at any point so that the overall borrowings cost is not increased unnecessarily and/or the desired maturity profile is not compromised due to market conditions. This risk is managed by spreading and smoothing debt maturities and establishing maturity compliance buckets.
- 15 Since October 2015 the Council’s treasury strategy has included a significant prefunding programme. The policy allows pre-funding of the Council debt maturities up to 18 months in advance, including re-financing. Market conditions have been favourable for this approach, where the Council draws down debt early and is able to invest the funds for a positive net return.

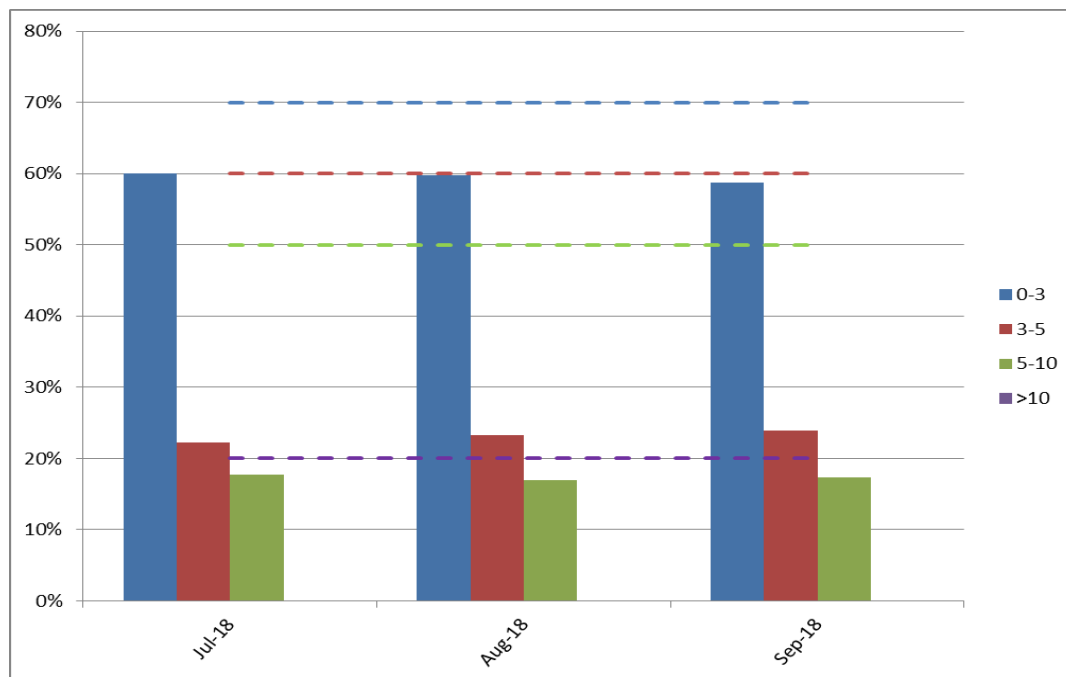
- 16 The graph below presents the Council’s debt maturity dates in relation to the financial year in which the debt was issued. This demonstrates that since 2016/17, the Council has actively reduced risk concentration by spreading debt maturity dates and debt maturity values.



- 17 Debt maturities must fall within compliance buckets. The buckets are:

Period	Minimum	Maximum
1 to 3 years	10%	70%
3 to 5 years	10%	60%
5 to 10 years	10%	50%
10 years plus	0%	20%

- 18 For the quarter ending 30 September 2018, the Council has been fully compliant with its debt maturity limits, as shown by the chart below. The upper limits, as shown by dashed lines, relate to the bars of the same colour. For example, the 0-3 year upper limit of 70% is in blue. Actual maturities in the 0-3 year bucket are represented by the blue bars.



Interest rate risk control limits

- 19 The Council issues all debt on a floating rate basis, as lower interest rates are realised this way, and uses fixed interest rate swaps to minimise exposure at any one time to interest rate fluctuations.
- 20 Without such hedging, the Council would have difficulty absorbing adverse interest rate movements. A 1% increase in interest rates on \$210 million in net debt would equate to additional interest expense of \$2.1 million per annum. Conversely, fixing interest rates does however reduce the Council's ability to benefit from falling and/or more favourable interest rate movements.
- 21 The objectives of any treasury strategy are therefore to smooth out the effects of interest rate movements, while being aware of the direction of the market, and to be able to respond accordingly.

Major control limit

- 22 The Policy ensures that, at any point in time, the total notional amount of all interest rate risk management instruments (i.e. interest rate swaps) must not exceed the Council's total actual debt.

23 The table below shows that the Council’s hedging was fully compliant with this Major control limit for the quarter ending 30 September 2018 as less than 100% of the external debt balance was fixed at any point in time.

\$000's	Jul-18	Aug-18	Sep-18
External debt (floating rate)	205,000	216,000	210,000
Swaps (fixed portion)	175,800	175,800	175,800
Fixed %	85.8%	81.4%	83.7%
Unfixed debt	29,200	40,200	34,200

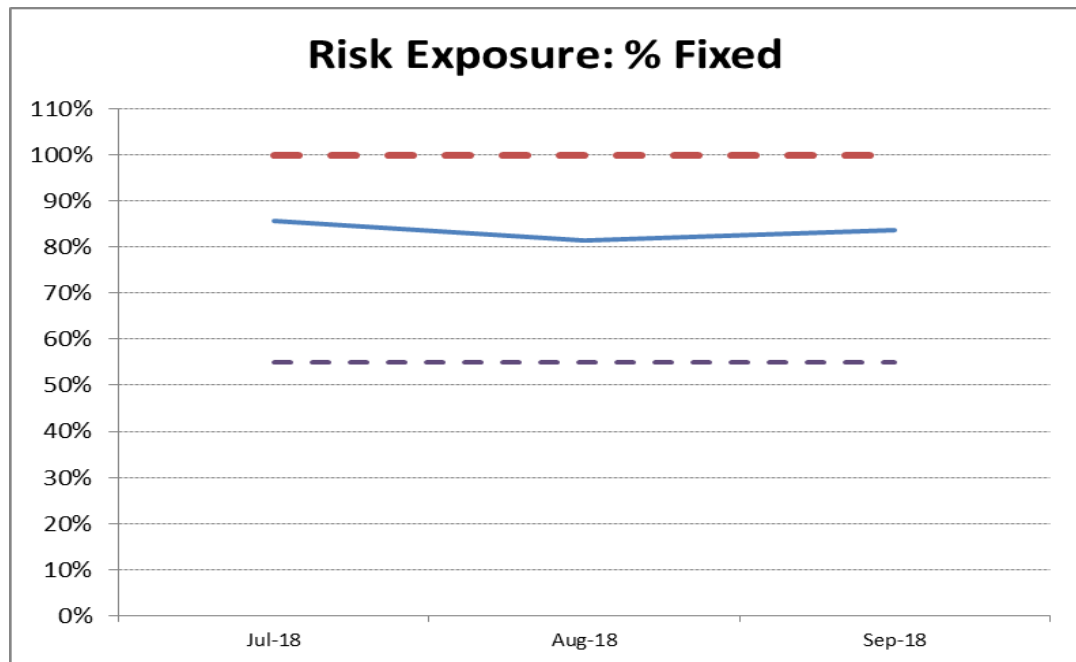
Master Fixed/Floating Risk Control Limit

24 Exposure to interest rate risk is managed and mitigated through risk control limits.

25 Hedging of the Council’s debt must be within the following fixed/floating risk control limits:

	Minimum	Maximum
Council’s fixed/floating risk control limits	55% Fixed	100% Fixed

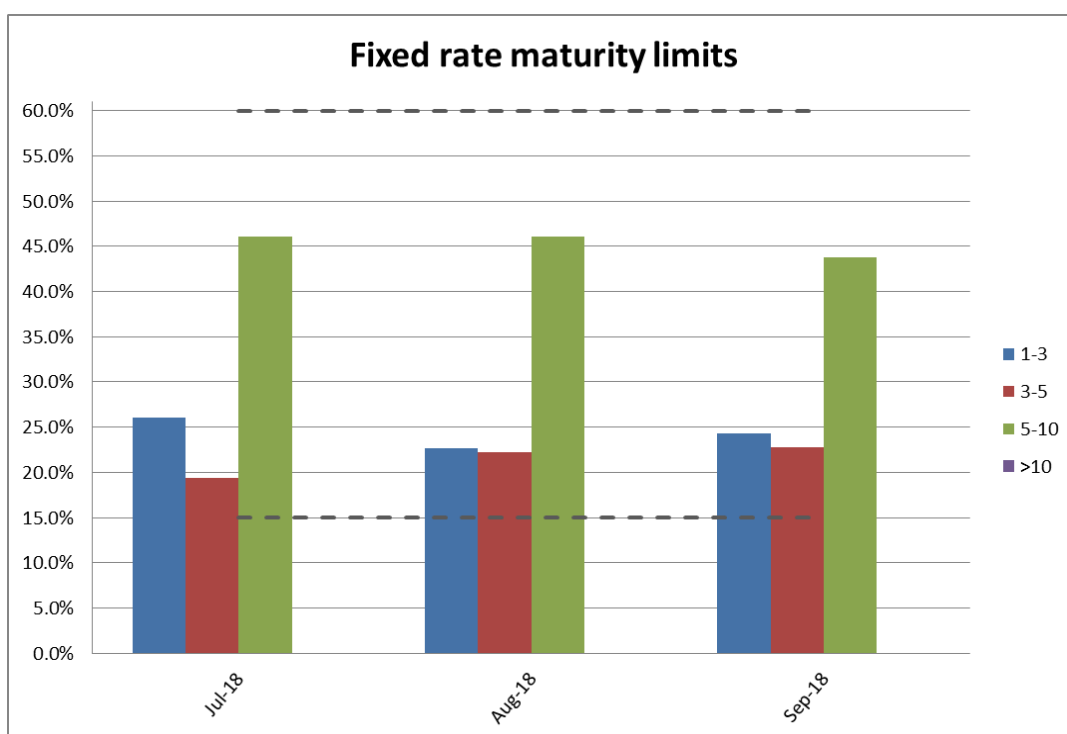
26 The following graph shows that the Council’s hedging for the quarter ended 30 September 2018 was fully compliant with these limits.



27 Similarly to debt maturities, hedging instrument maturities must also fall within compliance buckets. These compliance buckets are as follows:

Period	Minimum	Maximum
1 to 3 years	15%	60%
3 to 5 years	15%	60%
5 to 10 years	15%	60%
10 years plus	0%	20%

28 The Council has been fully compliant, as shown by the following chart. Note that maturities falling within 1 year are not included.



Counterparty Credit Risk

29 The policy sets limits for the maximum that can be traded per counterparty. The purpose of this is to ensure the Council does not concentrate its investments or risk management instruments with a single party.

30 The policy sets the gross counter party limits as follows:

Counterparty/Issuer	Minimum Standard and Poor's long term	Investments maximum per counterparty	Risk management instruments maximum per counterparty	Borrowing maximum per counterparty
NZ Government	N/A	Unlimited	None	Unlimited
LGFA	AA-/A-1	\$20m	None	Unlimited
NZ registered bank	A+/A-1	60% of total investments or \$25m; whichever is greater.	50% of total investments or \$25m; whichever is greater.	\$50m

- 31 The tables below show the Council's investments and risk management instruments holdings per counter party during the quarter.

Term deposits

Counter party	Jul-2018		Aug-2018		Sep-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	14,500	27.88%	14,500	26.61%	14,500	25.22%	✓
NZ Registerd Bank 2	17,500	33.65%	20,000	36.70%	20,000	34.78%	✓
NZ Registerd Bank 3	-	0.00%	-	0.00%	-	0.00%	✓
NZ Registerd Bank 4	20,000	38.46%	20,000	36.70%	23,000	40.00%	✓
	52,000	100%	54,500	100%	57,500	100%	

*Policy Limit: 60% of total investments or \$25 million; whichever is greater

Interest rate swaps

Counter party	Jul-2018		Aug-2018		Sep-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	55,000	31.29%	55,000	31.29%	55,000	31.29%	✓
NZ Registerd Bank 2	80,800	45.96%	80,800	45.96%	80,800	45.96%	✓
NZ Registerd Bank 3	40,000	22.75%	40,000	22.75%	40,000	22.75%	✓
	175,800	100%	175,800	100%	175,800	100%	

*Policy Limit: 50% of total instruments or \$80 million; whichever is greater

- 32 The Council was in full compliance with all counterpart credit limits during the quarter ended 30 September 2018.

Specific Borrowing Limits

- 33 In managing debt, the Council is required to adhere to the limits below. The actual results for the year are presented in the 2018/19 column.

Borrowing limit	Policy limit	2018/19
Net interest expense/Total Operating Income	< 20%	9.6%
Liquidity ((total debt +total committed facilities +cash on hand)/total debt))	> 110%	137.1%
Net External Debt/Total Operating Income (Projected 30 June 2019 figures)	< 240%	200.6%

Risk Management Performance

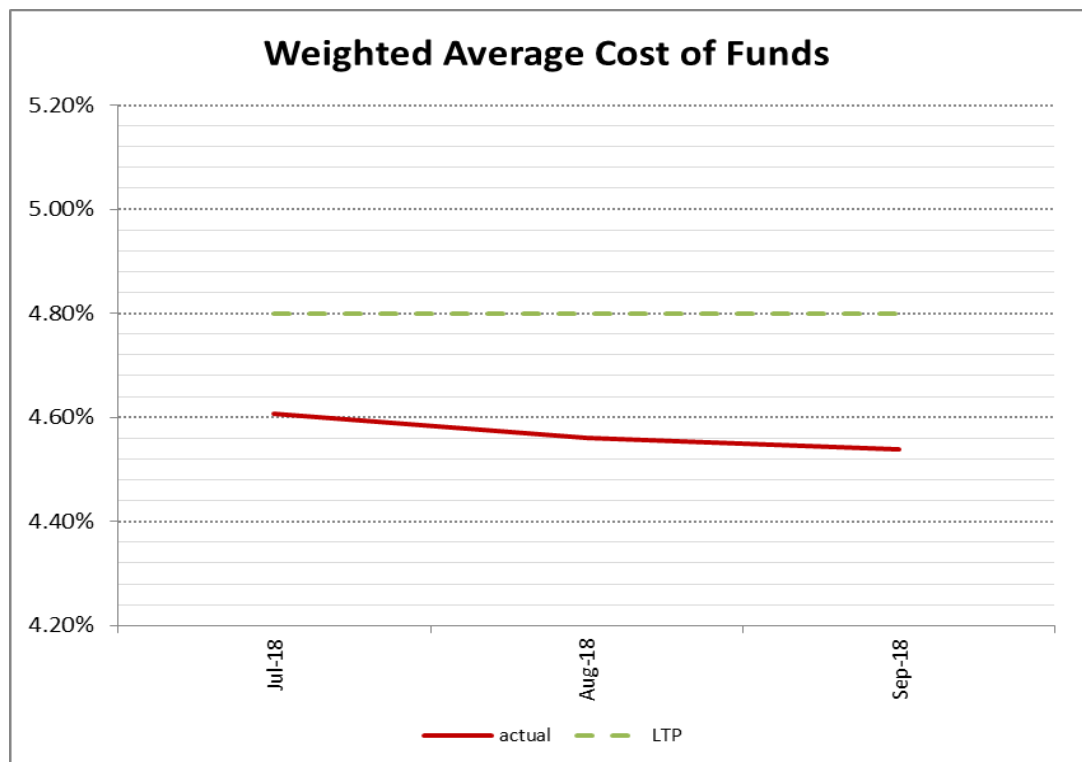
- 34 The following table shows the Council's interest income and expense for the quarter, along with the weighted average cost of borrowing (WACB).

	Sep YTD Actual \$000's	YTD Budget \$000's	YTD Variance \$000's
External Finance Expense	2,397	2,471	74
less: Interest Received	(503)	(565)	(62)
Net Interest Costs	1,894	1,907	13
Weighted Average Cost of Funds	4.54%	4.80%	0.26%

35 The Council’s actual interest income year to date is less than the budget, as the 2018/38 Long Term Plan included additional interest income generated by the two investment funds. Since the establishment of these funds have not been confirmed, the interest income planned to be earned during the first quarter of the year has been foregone. The shortfall between actual and budget will grow with the progression of time until these funds are established and active.

36 Notwithstanding the above, the Council has still been effective in its treasury management with the net interest costs year to date being \$13,000 less than budget.

37 The following graph shows the cost of borrowing each month.



Considerations

Policy considerations

38 There are no policy considerations other than those already noted in this report.

Legal considerations

39 There are no legal considerations arising from this report.

Financial considerations

40 There are no financial considerations other than those already noted in this report.

Tāngata whenua considerations

41 There are no tāngata whenua considerations arising from this report.

SIGNIFICANCE AND ENGAGEMENT

42 This matter has a low level of significance under Council Policy.

Publicity

43 There are no publicity considerations arising from this report.

RECOMMENDATIONS

44 That the Audit and Risk Committee notes that the Council was fully compliant with its Treasury Management Policy for the quarter ended 30 September 2018.

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