

Chairperson and Committee Members
AUDIT AND RISK COMMITTEE

28 FEBRUARY 2019

Meeting Status: **Public**

Purpose of Report: For Information

QUARTERLY TREASURY COMPLIANCE REPORT

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 31 December 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:
 - cash/debt position;
 - liquidity/funding control limits;
 - interest rate risk control limits;
 - counterparty credit risk;
 - specific borrowing Limits; and
 - risk management performance.

DISCUSSION

Cash/Debt Position

- 6 Table 1 below shows the Council's net debt position as at 31 December 2018 against full year forecast, budget and the prior year closing balance.

Table 1	Dec YTD Actual \$000's	Full Year Forecast \$000's	Full Year Budget \$000's	Full Year 2017/18 \$000's
External debt	222,491	210,000	226,175	205,000
less borrower notes	(3,520)	(3,360)	(3,619)	(3,280)
less cash investments	(70,959)	(50,200)	(60,000)	(53,552)
Net debt	148,012	156,440	162,556	148,168

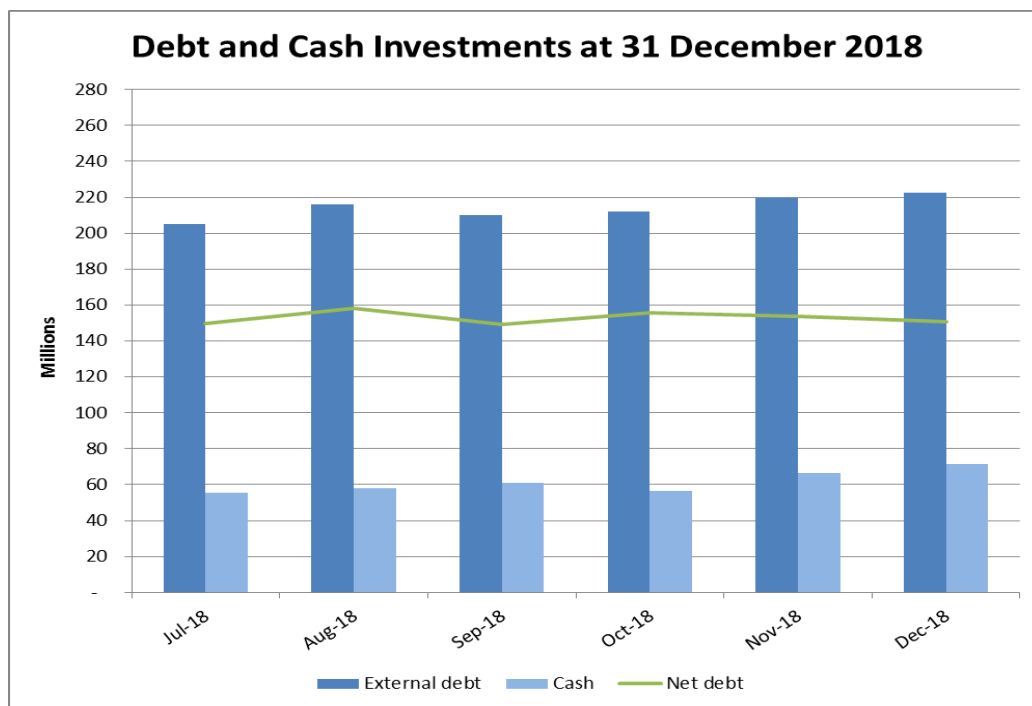
- 7 During the past quarter, the Council has issued \$10 million of new debt towards prefunding the April 2020 debt maturity, bringing the total amount of new debt acquired during the past six months to \$15 million. The funds were placed on term deposit as part of Council's prefunding programme, at the most favourable rates available in the market.
- 8 The Table below shows the movement in the Council's debt balance for the past six months.

Borrowings	Gross borrowings \$000	Explained by:			
		Pre-funding borrowings			Short term funding
		TD March 2019 \$000	TD September \$000	TD April 2020 \$000	Commercial Paper \$000
Opening balance 1 July 2018	205,000	30,000	15,000		
New Long term debt issued YTD	15,000	-	5,000	10,000	
Short term working capital funding	2,491	-	-	-	2,491
Total	222,491	30,000	20,000	10,000	2,491

- 9 \$30 million of long term debt is maturing March 2019. As seen from the table above this amount has been fully funded through our prefunding programme and will be repaid from term deposits maturing on the day.
- 10 As at 31 December 2018, the Council had \$74.48 million of cash, term deposits and borrower notes on hand. This is broken down as follow:

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
LGFA debt maturing April 2020	10,000	-	-	-	10,000
Surplus cash placed on TD for Capital Works Programme maturing June 2019	-	8,000	-	-	8,000
Surplus cash	-	-	-	2,959	2,959
Borrower notes held	-	-	3,520	-	3,520
Total	60,000	8,000	3,520	2,959	74,479

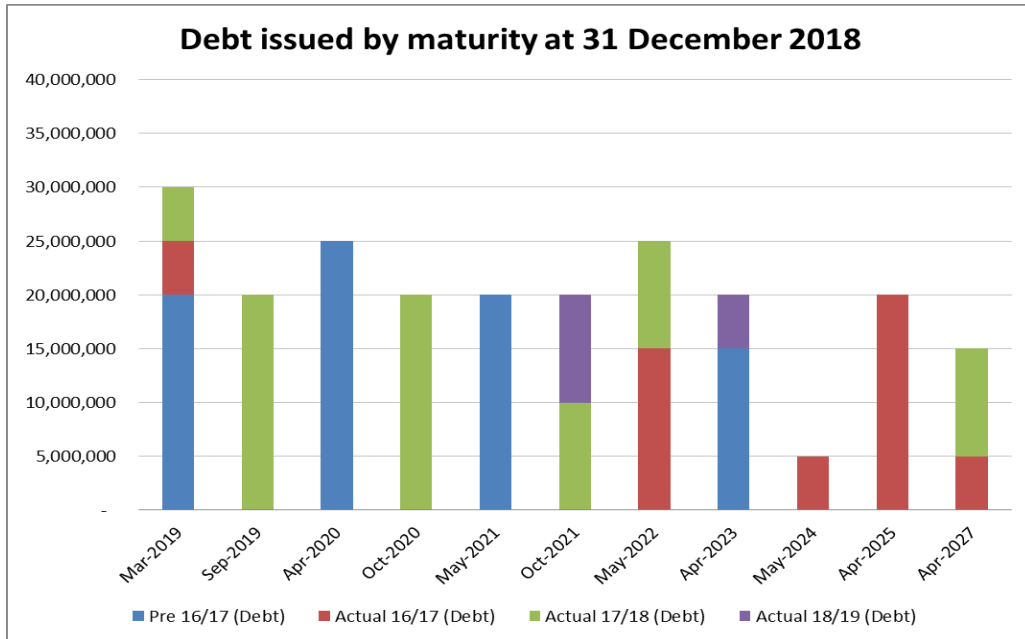
- 11 The Council is targeting through its financial strategy to keep net borrowings below 200% of total operating income. At 31 December 2018, the Council forecasts net borrowings as a share of operating income to be 198% at June year-end.
- 12 Excluding prefunding, the Council has not breached its upper borrowing limit as demonstrated in the chart below:



Liquidity/Funding control limits

- 13 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.
- 14 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.

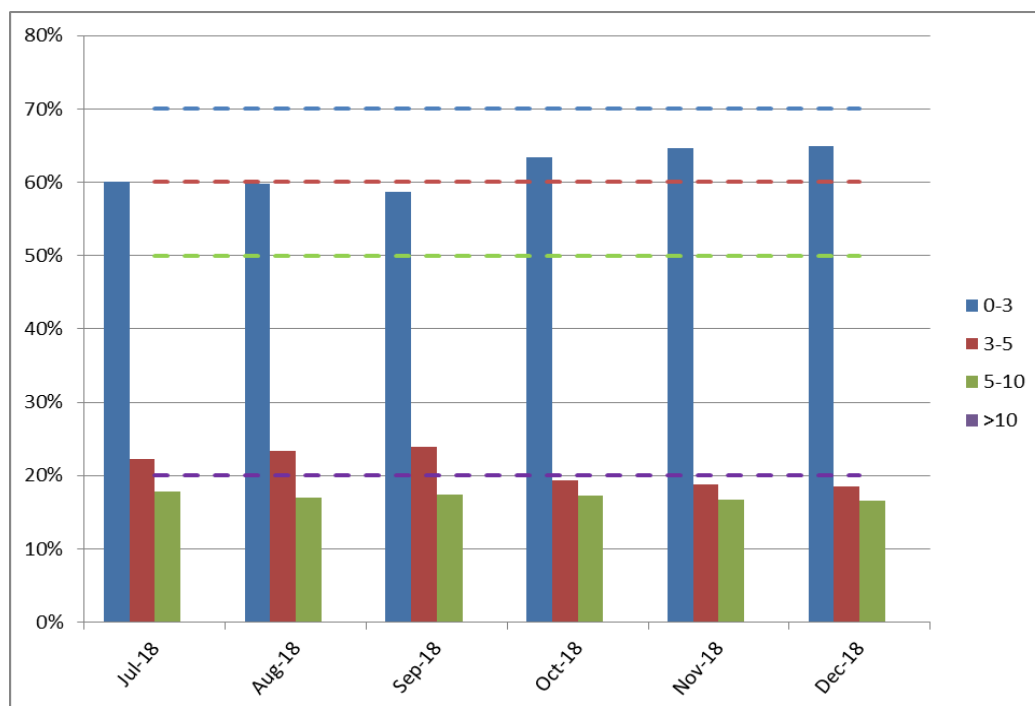
- 15 The graph below presents the Council’s debt maturity dates in relation to the financial year in which the debt was issued. This demonstrates that since 2016/17, the Council has actively reduced risk concentration by spreading debt maturity dates and debt maturity values.



- 16 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%

- 17 For the quarter ending 31 December 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

- 18 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.
- 19 Without such hedging, the Council would have difficulty absorbing adverse interest rate movements. A 1% increase in interest rates on \$220 million in net debt would equate to additional interest expense of \$2.2 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.
- 20 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

- 21 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.

- 22 The table below shows that the Council’s hedging was fully compliant with this Major control limit for the quarter ending 31 December 2018 as less than 100% of the external debt balance was fixed at any point in time.

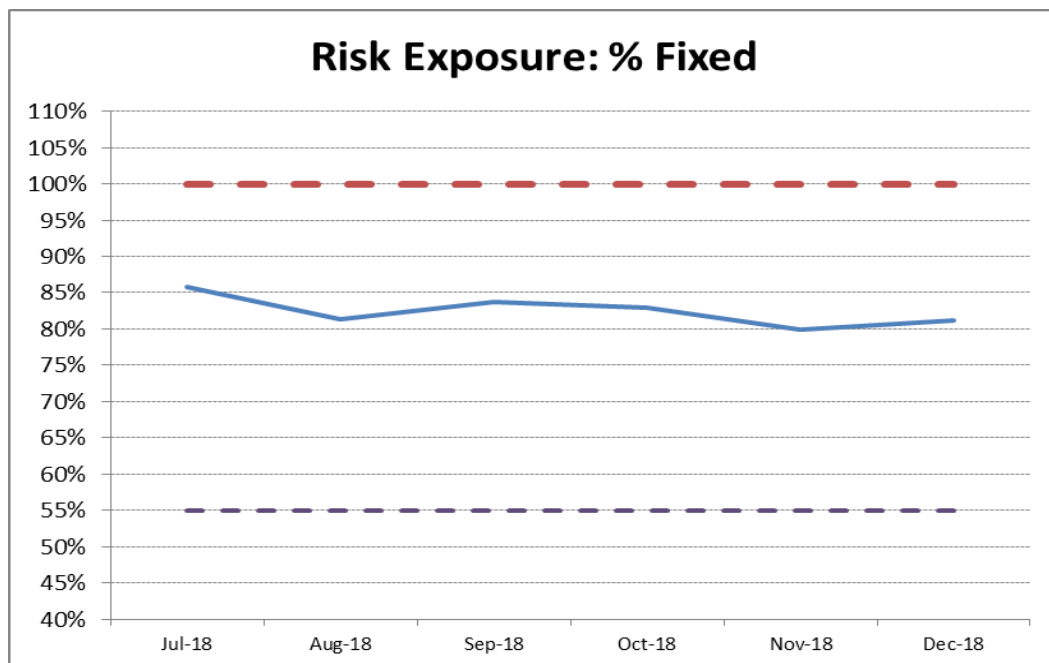
\$000's	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
External debt (floating rate)	205,000	216,000	210,000	212,000	220,000	222,500
Swaps (fixed portion)	175,800	175,800	175,800	175,800	175,800	180,800
Fixed %	85.8%	81.4%	83.7%	82.9%	79.9%	81.3%
Unfixed debt	29,200	40,200	34,200	36,200	44,200	41,700

Master Fixed/Floating Risk Control Limit

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

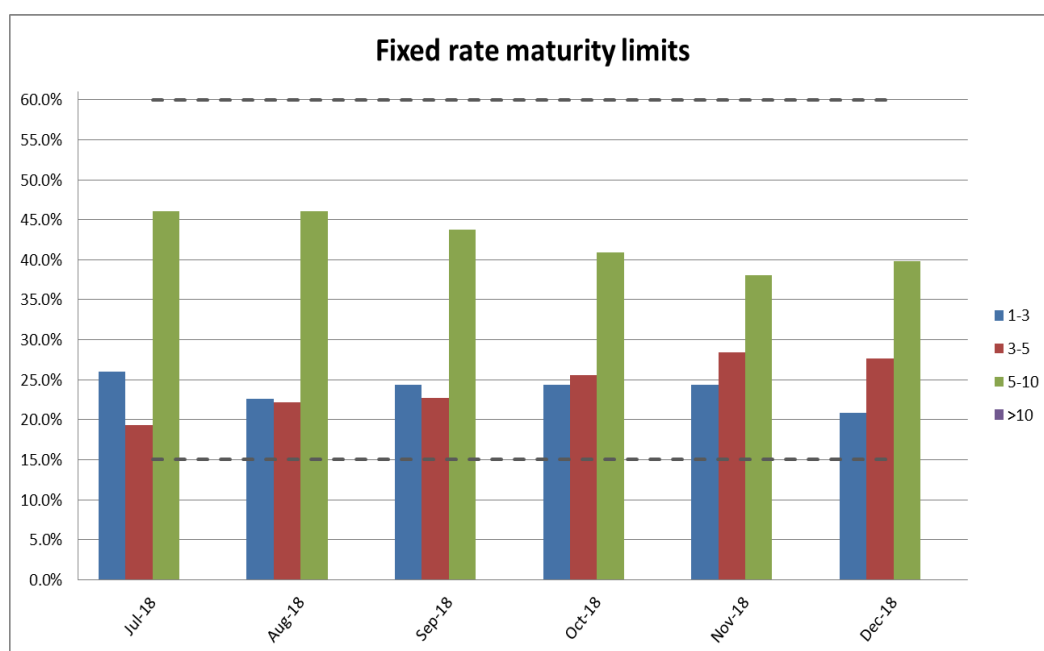
- 25 The following graph shows that the Council’s hedging for the quarter ended 31 December 2018 was fully compliant with these limits.



- 26 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%

- 27 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

- 28 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.

- 29 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

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

Term deposits

Counter party	Oct-2018		Nov-2018		Dec-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	10,000	18.87%	20,000	31.75%	28,000	41.18%	✓
NZ Registerd Bank 2	20,000	37.74%	20,000	31.75%	20,000	29.41%	✓
NZ Registerd Bank 3	-	0.00%	-	0.00%	-	0.00%	✓
NZ Registerd Bank 4	23,000	43.40%	23,000	36.51%	20,000	29.41%	✓
	53,000	100%	63,000	100%	68,000	100%	

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

Interest rate swaps

Counter party	Oct-2018		Nov-2018		Dec-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	55,000	31.29%	55,000	31.29%	60,000	33.19%	✓
NZ Registerd Bank 2	80,800	45.96%	80,800	45.96%	80,800	44.69%	✓
NZ Registerd Bank 3	40,000	22.75%	40,000	22.75%	40,000	22.12%	✓
	175,800	100%	175,800	100%	180,800	100%	

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

- 31 The Council was in full compliance with all counterpart credit limits during the quarter ended 31 December 2018.

Specific Borrowing Limits

- 32 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%	9.3%
Liquidity ((total debt +total committed facilities +cash on hand)/total debt))	> 110%	139.8%
Net External Debt/Total Operating Income (Projected 30 June 2019 figures)	< 240%	201.9%

Risk Management Performance

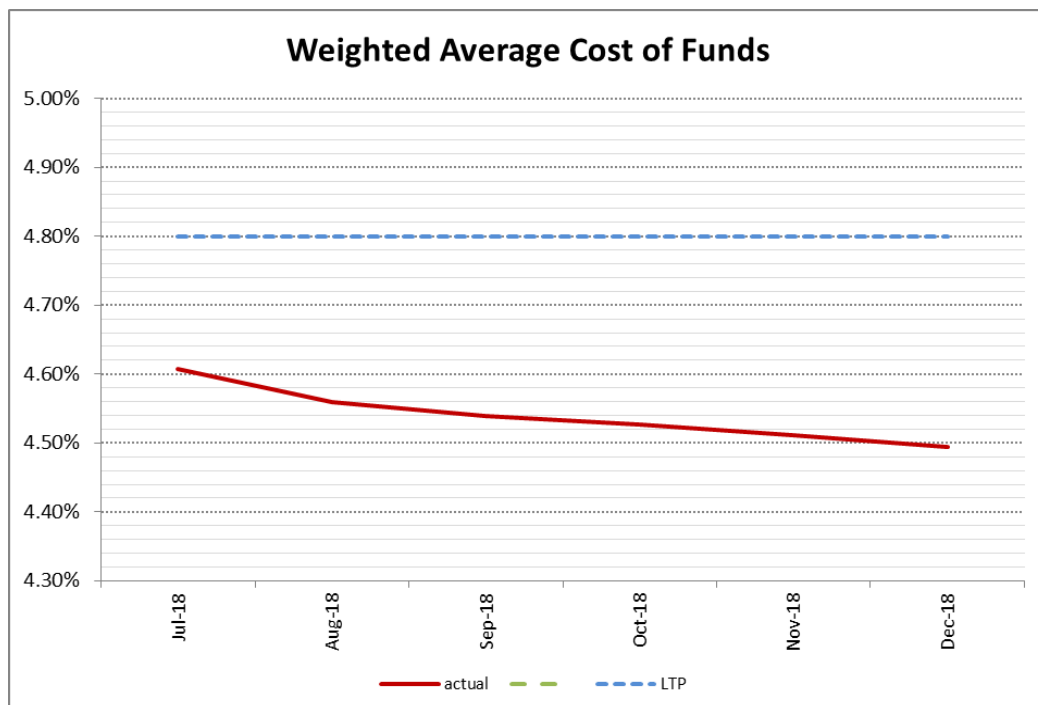
33 The following table shows the Council’s interest income and expense for the year to date, along with the weighted average cost of borrowing (WACB)

	December YTD Actual \$000's	YTD Budget \$000's	YTD Variance \$000's
External Finance Expense	4,826	5,102	276
/less: Interest Received	(1,071)	(1,357)	(286)
Net Interest Costs	3,755	3,745	(10)
Weighted Average Cost of Funds			
	4.49%	4.80%	0.31%

34 Council’s net actual interest cost year to date is \$10,000 unfavourable to budget. This is mainly due to Council’s decision to not progress further with the \$20 million of Kapiti Investment Funds. This creates a favourable variance for Interest expense of \$276,000, but an unfavourable position to budget for interest income of \$286,000.

35 Notwithstanding the above, the Council has still been effective in its treasury management with its weighted average cost of funds being 0.31% lower than budget as at the 31 December 2018.

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



Considerations

Policy considerations

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

Legal considerations

38 There are no legal considerations arising from this report.

Financial considerations

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

Tāngata whenua considerations

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

SIGNIFICANCE AND ENGAGEMENT

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

Publicity

42 There are no publicity considerations arising from this report.

RECOMMENDATIONS

43 That the Audit and Risk Committee notes that the Council was fully compliant with its Treasury Management Policy for the quarter ended 31 December 2018.

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Approved for submission

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