

**Chairperson and Committee Members**  
AUDIT AND RISK COMMITTEE

3 MAY 2018

Meeting Status: **Public**

Purpose of Report: For Information

## **QUARTERLY TREASURY MANAGEMENT COMPLIANCE**

### **PURPOSE OF REPORT**

- 1 This report provides confirmation to the Audit and Risk Committee of Council's compliance with its Treasury Management Policy (Policy) for the quarter ended 31 March 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 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 Council objectives and incorporates legislative requirements.
- 4 The Policy mandates regular treasury reporting to management and Council's Operations and Finance Committee, and quarterly compliance reporting to the Audit and Risk Committee.
- 5 In order to assess the effectiveness of Council's treasury management activities and compliance to the Policy, 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
  - Risk management performance

## DISCUSSION

### Cash/Debt Position

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

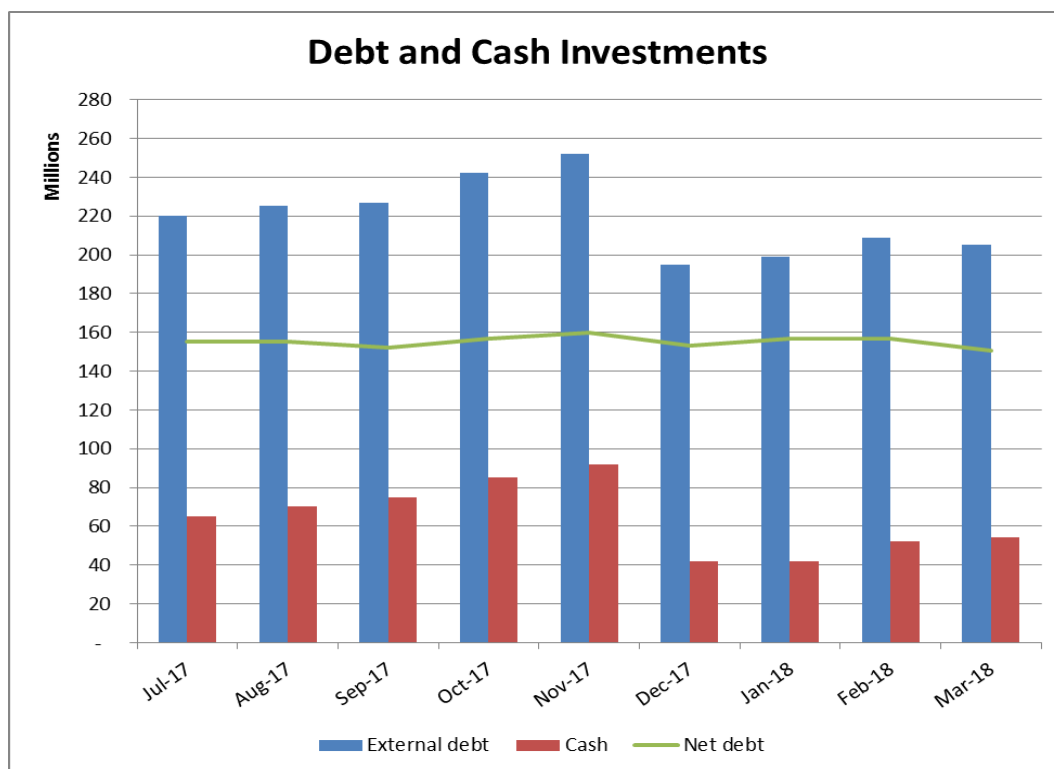
<b>Table 1</b>	<b>March YTD Actual \$000's</b>	<b>December YTD Actual \$000's</b>	<b>Full Year Budget \$000's</b>	<b>Full Year 2016/17 \$000's</b>
External debt	205,000	195,000	186,548	210,000
<i>less</i> borrower notes	(3,280)	(3,120)	(2,960)	(3,360)
<i>less</i> cash investments	(55,164)	(42,644)	(15,200)	(60,455)
<b>Net debt</b>	<b>146,556</b>	<b>149,236</b>	<b>168,388</b>	<b>146,185</b>

- 7 Council had \$54.5 million invested on term deposits as at 31 March 2018. This is broken down as follows:

<b>Term deposits</b>	<b>Prefunding \$000</b>	<b>Capex \$000</b>
LGFA debt maturing May 2018	20,000	
LGFA debt maturing March 2019	20,000	
2017/18 Capital works programme maturing May 2018		7,000
First quarter rates instalment placed on TD for 2017/18 Capital works programme maturing April 2018		5,000
2017/18 Capital works programme maturing August 2018		2,500
<b>Total</b>	<b>40,000</b>	<b>14,500</b>

- 8 Council's maximum net borrowings limit (as set out in Council's Financial Strategy) is \$200 million. Council's net debt as at 31 March 2018 is \$150.5 million consisting of gross borrowings of \$205 million and prefunding of \$54.5 million

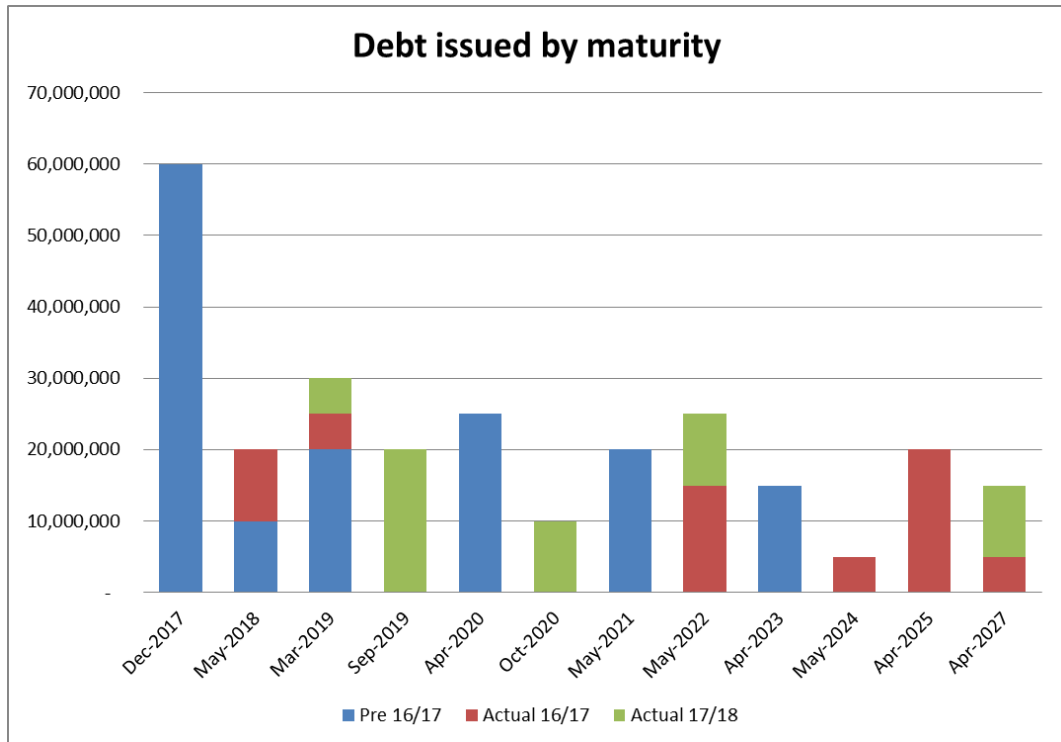
- 9 Excluding prefunding, the Council has not breached its upper borrowing limit as demonstrated in the chart below:



**Liquidity/Funding control limits**

- 10 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.
- 11 Since October 2015 the Council’s treasury strategy has included a significant prefunding programme. The policy allows pre-funding of 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.
- 12 A key objective in commencing this approach was to prepare for managing a concentration of liquidity risk. The Council had \$60 million of debt maturing in December 2017 with another \$20 million in May 2018. If the Council were to wait until that maturity date before refinancing, assuming full refinancing is possible, the Council is exposed to the risk that market conditions are unfavourable at that time, and is forced to refinance a significant portion of its debt portfolio at high interest rates.

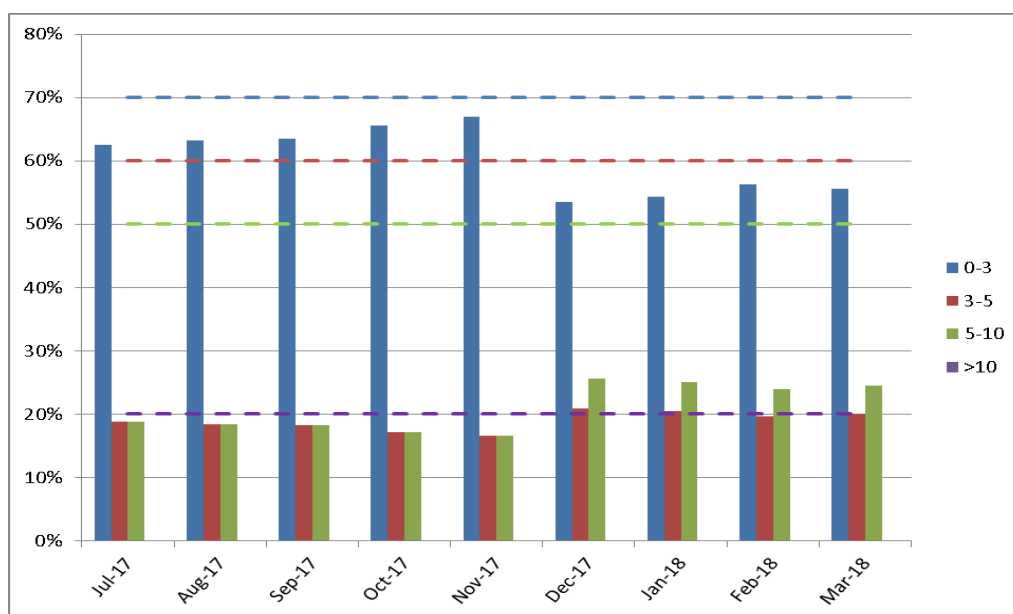
- 13 The graph below presents Council’s debt maturity dates in relation to the financial year in which the debt was issued. This demonstrates that since 2016/17, Council has actively reduced risk concentration by spreading debt maturity dates and debt maturity values.



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

Period	Minimum	Maximum
<b>0 to 3 years</b>	10%	70%
<b>3 to 5 years</b>	10%	60%
<b>5 to 10 years</b>	10%	50%
<b>10 years plus</b>	0%	20%

- 15 For the nine months ending 31 March 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.
- 16 The high proportion in the 0-3 years bucket reflects the \$80 million of debt maturing in 2017/18, with \$60 million that matured in December 2017.



**Interest rate risk control limits**

- 17 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.
- 18 Without such hedging, the Council would have difficulty absorbing adverse interest rate movements. A 1% increase in interest rates on \$150 million in net debt would equate to additional interest expense of \$1.50 million per annum. Conversely, fixing interest rates does however reduce Council’s ability to benefit from falling and/or more favourable interest rate movements.
- 19 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**

- 20 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 Council’s total actual debt.

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

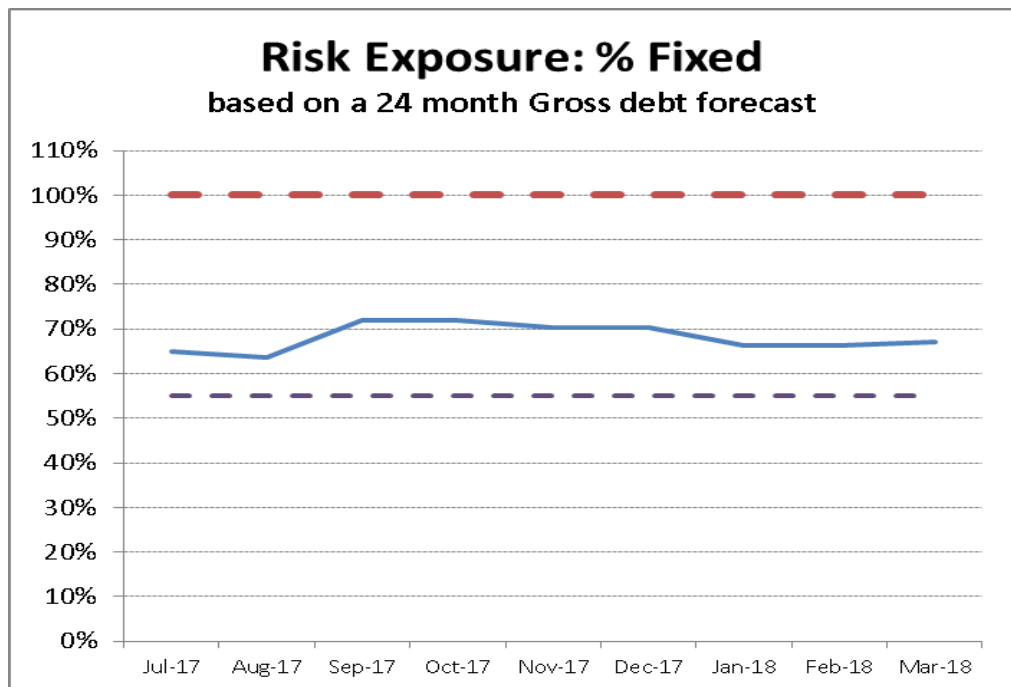
\$000's	Jan-18	Feb-18	Mar-18
External debt (At floating rate)	198,990	208,990	205,000
Swaps (fixed portion)	168,075	168,075	173,075
Fixed %	84.5%	80.4%	84.4%
Unfixed debt	30,915	40,915	31,925

**Master Fixed/Floating Risk Control Limit**

- 22 Exposure to interest rate risk is managed and mitigated through risk control limits. These limits are calculated on a 24 month projected gross debt balance.
- 23 Hedging of Council’s debt must be within the following fixed/floating risk control limits:

	Minimum	Maximum
<b><i>Council’s fixed/floating risk control limits</i></b>	55% Fixed	100% Fixed

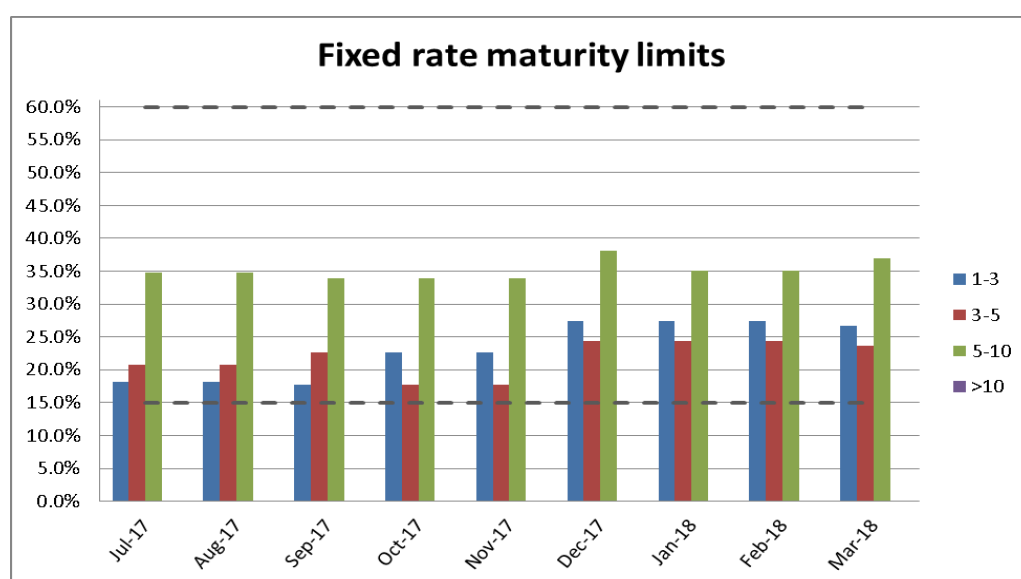
- 24 The following graph shows that the Council’s hedging for the quarter ended 31 March 2018 was fully compliant with these limits.



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

Period	Minimum	Maximum
<b>1 to 3 years</b>	15%	60%
<b>3 to 5 years</b>	15%	60%
<b>5 to 10 years</b>	15%	60%
<b>10 years plus</b>	0%	20%

- 26 The Council has been fully compliant, as shown by the following chart. Note that maturities falling within 1 year are not included. There is a significant amount of hedging in place for the \$80 million of debt that is maturing within the 2017/18 financial year.



### Counterparty Credit Risk

- 27 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 with a single party.
- 28 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

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

#### Term deposits

Counter party	Jan-2018		Feb-2018		Mar-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	15,000	35.71%	15,000	28.85%	15,000	27.52%	✓
NZ Registerd Bank 2	17,000	40.48%	17,000	32.69%	19,500	35.78%	✓
NZ Registerd Bank 3	10,000	23.81%	10,000	19.23%	10,000	18.35%	✓
NZ Registerd Bank 4	-	0.00%	10,000	19.23%	10,000	18.35%	✓
	42,000	100%	52,000	100%	54,500	100%	

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

#### Interest rate swaps

Counter party	Jan-2018		Feb-2018		Mar-2018		Compliance
	\$000	%	\$000	%	\$000	%	
NZ Registerd Bank 1	50,000	29.75%	65,000	32.01%	50,000	29.75%	✓
NZ Registerd Bank 2	73,075	43.48%	93,075	45.83%	73,075	43.48%	✓
NZ Registerd Bank 3	45,000	26.77%	45,000	22.16%	45,000	26.77%	✓
	168,075	100%	203,075	100%	168,075	100%	

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

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

#### Specific Borrowing Limits

- 31 In managing debt, Council is required to adhere to the following limits:

Borrowing limit	Policy limit	2017/18
Net interest expense/ Total Operating Income (YTD)	< 20%	9.9%
Liquidity ((total debt +total committed facilities +cash on hand)/total debt) (YTD)	> 110%	136.7%
Net External Debt /Total Operating Income (Projected 30 June 2018 figures)	< 240%	204.5%

#### Risk Management Performance

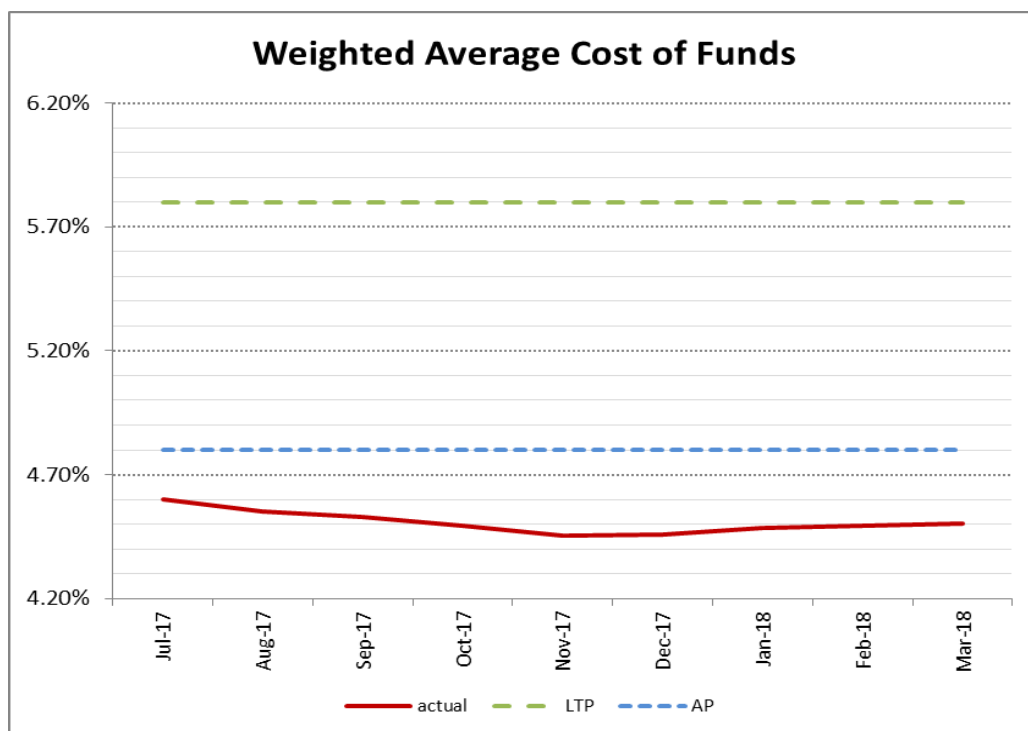
- 32 The following table shows the Council's interest income and expense for the quarter, along with the weighted average cost of borrowing (WACB).

	March YTD	YTD	YTD
	Actuals	Budget	Variance
	\$000	\$000	\$000
External Interest Expense	7,418	7,291	(127)
less: Interest Income	(1,739)	(1,280)	459
Net Interest Cost	5,679	6,011	332
Weighted Average Cost of Borrowings	4.50%	4.80%	0.30%



33 To provide some context regards Council’s treasury management effectiveness, the net interest costs year to date are \$332,000 less than budget.

34 The following graph shows the cost of borrowing each month. The uplift in the WACB in December 2017 is primarily due to less interest income being realised post 15 December 2017 as Council’s total term deposits were reduced by \$50 million on the same date.



## Considerations

### Policy considerations

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

### Legal considerations

36 There are no legal considerations arising from this report.

### Financial considerations

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

### Tāngata whenua considerations

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

## SIGNIFICANCE AND ENGAGEMENT

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

Publicity

40 There are no publicity considerations arising from this report.

**RECOMMENDATIONS**

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

**Report prepared by**

**Anelise Horn  
Manager, Financial Accounting**

**Approved for submission**

**Natasha Tod  
Group Manager  
Regulatory Services**

**Approved for submission**

**Janice McDougall  
Acting Group Manager  
Corporate Services**