Chairperson and Committee Members
OPERATIONS & FINANCE COMMITTEE

21 SEPTEMBER 2017

Meeting Status: **Public**

Purpose of Report: For Information

TREASURY MANAGEMENT ANNUAL REVIEW

PURPOSE OF REPORT

1 This report provides an annual overview of the Council's treasury management activity for the 2017 financial year and seeks Committee approval for the current deposit and hedging profiles.

DELEGATION

2 The Operations and Finance Committee has the delegation to consider this matter. The current Governance Structure and Delegations for the 2016-19 triennium states that the Operations and Finance Committee has been delegated:

> *the responsibility to deal with monitoring and decision-making on all broader financial management matters including financial policies.*

BACKGROUND

3 The Treasury Management Policy (the policy) was reviewed by the Corporate Business Committee in April 2015 (report Corp-15-1535 refers). This 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 is scheduled to be reviewed three yearly or earlier if required. One driver for a policy change would be market conditions changing that create unforeseen outcomes. Another policy change driver is shortcomings to the application of the policy in practice, which can (and has) identified a number of minor improvements required. These policy changes are the subject of a separate report to this meeting of the Operations and Finance Committee. Please refer to report "Treasury Management Policy Update" (Corp-17-305).

5 Reporting requirements are excluded largely from the current policy however, there is provision for regular reporting to the Council. While the majority of this reporting is by way of the quarterly financial report to the Operations and Finance Committee (replacing the Corporate Business Committee), the expectation for an annual report is retained. This is the annual report, providing an overview of activity for the past twelve months.

DISCUSSION

Treasury performance

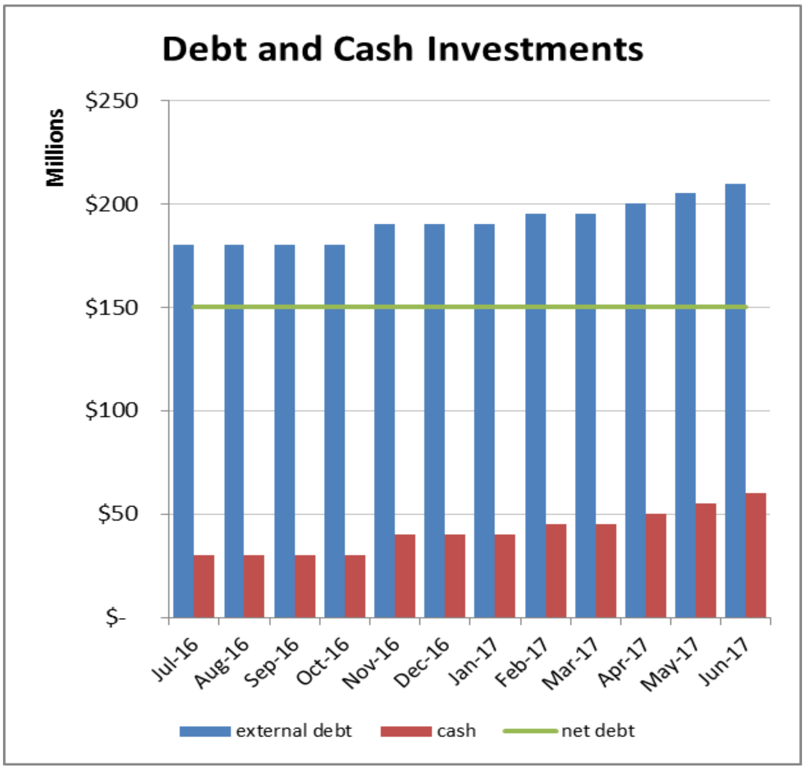
6 Since October 2015 the treasury strategy has included a significant prefunding programme. The policy allows pre-funding Council debt maturities up to 18 months in advance, including refinancing. Market conditions have been favourable for this approach, where the Council draws down debt early and is able to invest the funds for a positive net return.

7 A key objective in commencing this approach was to prepare for managing a concentration of liquidity risk. The Council has $60 million of debt maturing in December 2017. This is just over 40% of the total net debt as at 30 June 2017. 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.

8 Assessment of the Council's treasury management is in the context of this treasury strategy, and considers four reporting areas, which are covered in the following sections.

Cash/debt position

9 The following graph demonstrates the implemented strategy. As at 30 June 2017, a total of $60 million of debt maturing in December 2017 and May 2018 was pre-funded. Specifically, $45 million of debt was drawn down towards the December 2017 maturity and $15 million of debt was drawn down towards the May 2018 maturity. These funds are held on term deposit.

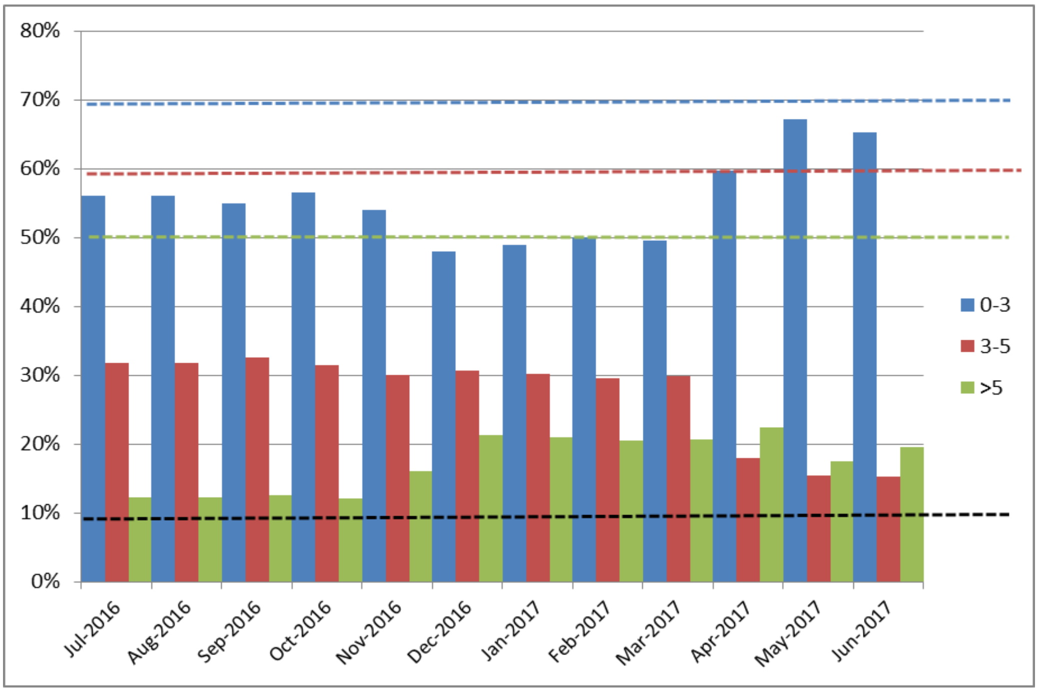


10 Council's net debt has tracked lower than budget, due to the changes made to the Council's 2016/17 capital works programme and no new debt was issued for capital works in 2016/17.

11 Debt maturities must fall within compliance buckets. The buckets are:

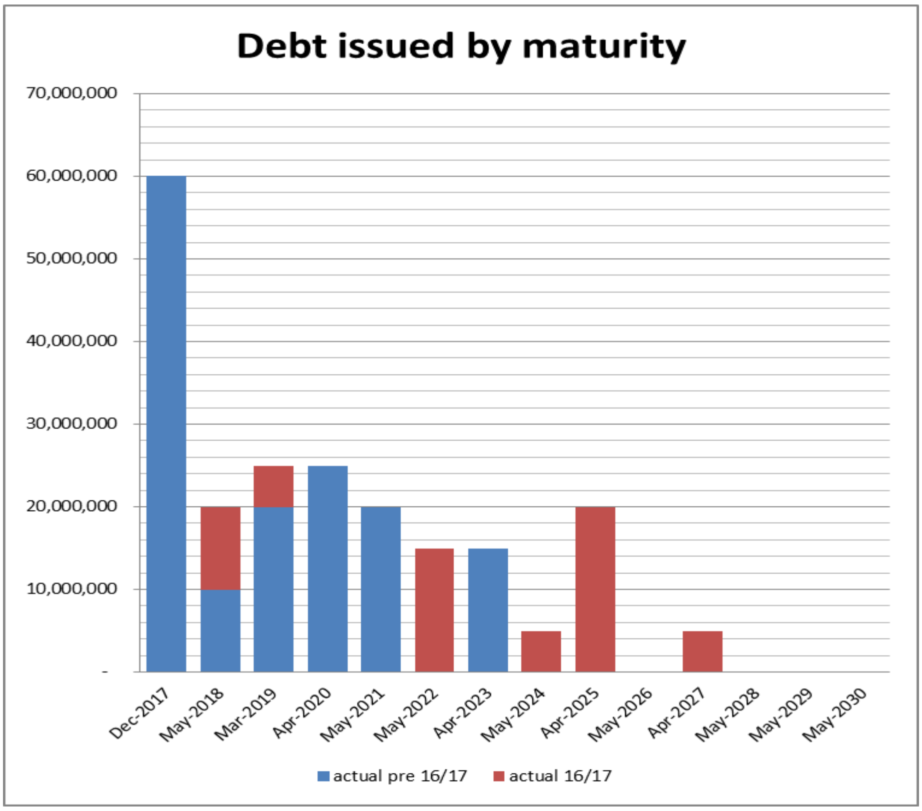
Period	Minimum	Maximum
0 to 3 years	10%	70%
3 to 5 years	10%	60%
5 years plus	10%	50%

For 2016/17, the Council has been fully compliant, 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 limit in blue is 70%. Actual maturities in the 0-3 year bucket are represented by the blue bars.



12 The high proportion in the 0-3 years bucket reflects the $80 million of debt maturing in 2017/18, with $60 million maturing in December 2017.

13 As already noted, $60 million of debt prefunding was drawn during 2016/17, all of which has been placed on term deposit. The average age to maturity for Council debt is 36 months. By way of comparison, the total LGFA debt issuance at the same point in time has an average age to maturity of 58 months, or almost 5 years.



Risk exposure position

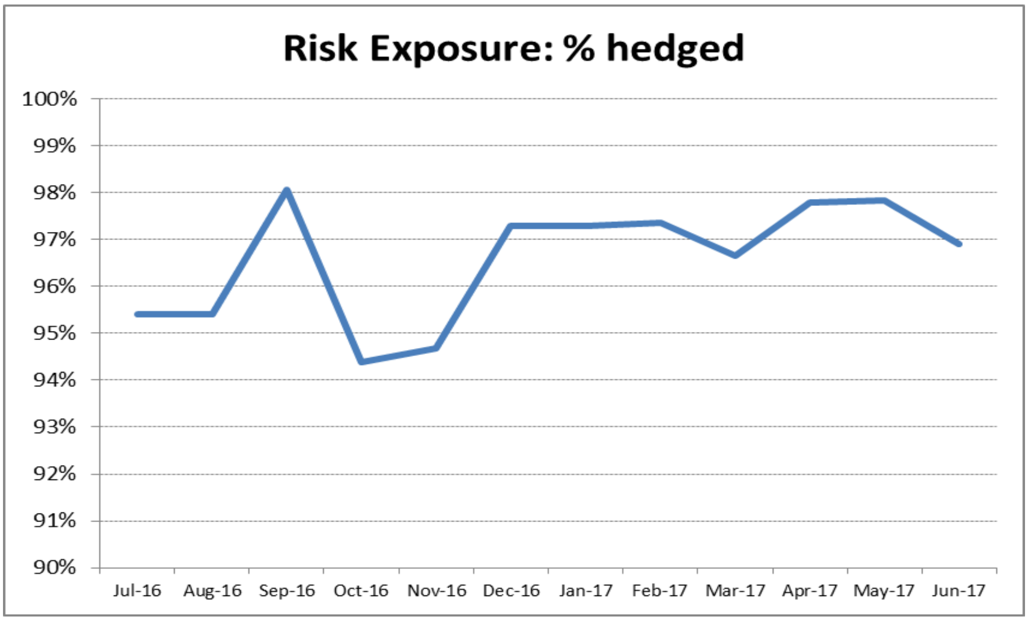
14 The policy ensures that, at any point in time, the total amount of all interest rate risk management instruments must not exceed Council's total debt. This means that Council may fix up to 100% of the actual external debt level at any time. The reason for requiring a majority of Council debt to be fixed is to minimise exposure at any one time to interest rate fluctuations. The Council would have difficulty absorbing adverse interest rate movements. A 1% increase in interest rates on $146 million in net debt would equate to additional interest expense of $1.46 million per annum.

15 Conversely, fixing interest rates does however reduce Council's ability to benefit from falling and/or more favourable interest rate movements. The objectives of any 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.

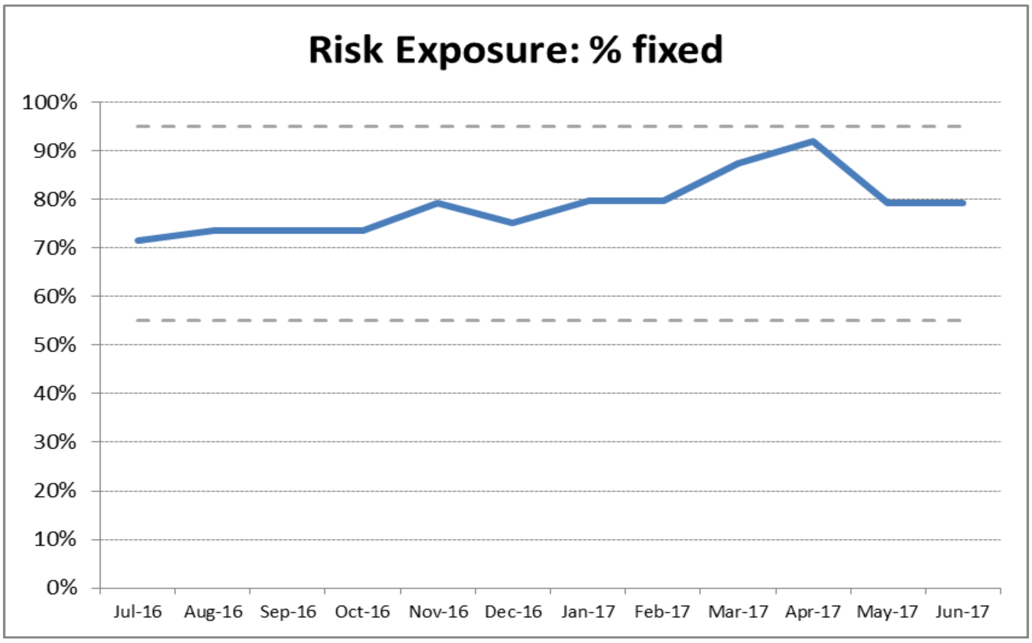
16 Hedging of Council's debt must be within the following fixed/floating risk control limits.

	Minimum	Maximum
Calculated on the 24 month projected external debt levels in Council's approved Long Term Plan and/or Annual Plan (as approved by the Group Manager Corporate Services).	55% fixed 45% floating	95% fixed 5% floating

17 The following chart shows the Council's actual interest rate hedging for 2016/17. This confirms that total hedging was fully compliant in 2016/17.



18 The policy requires the Council to fix between 55% and 95% of its projected debt levels for the next 24 months. The Council was fully compliant with the projected levels, as shown in the following chart.

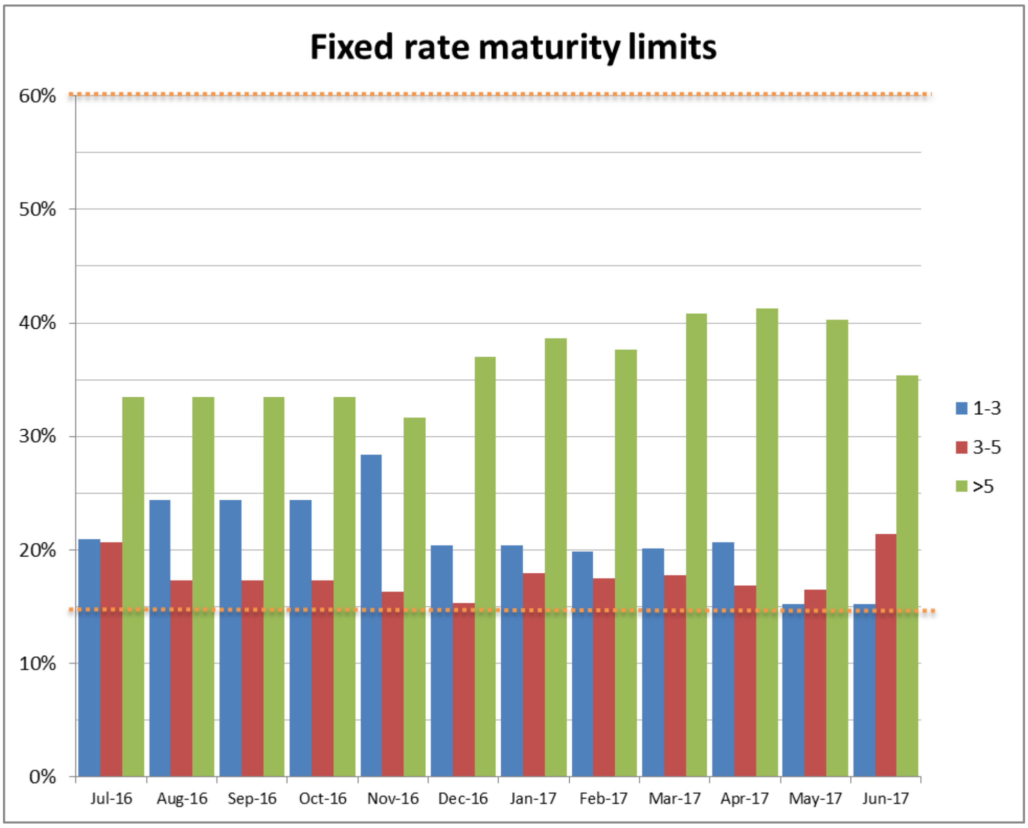


19 As can be seen, the hedging has been at the high side of the compliance range, since approximately $10 million of new debt was not required during the 16/17 financial year. Furthermore, in August 2017, the Council reduced its approved 2017/18 capital works programme by 7.5 million to $27.1 million. This means that new 24 month debt forecasts will be required for the 2017/18 year and beyond.

20 Hedging maturities must also fall within compliance buckets. The buckets are as follows:

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

21 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 next 12 months.



Risk management performance

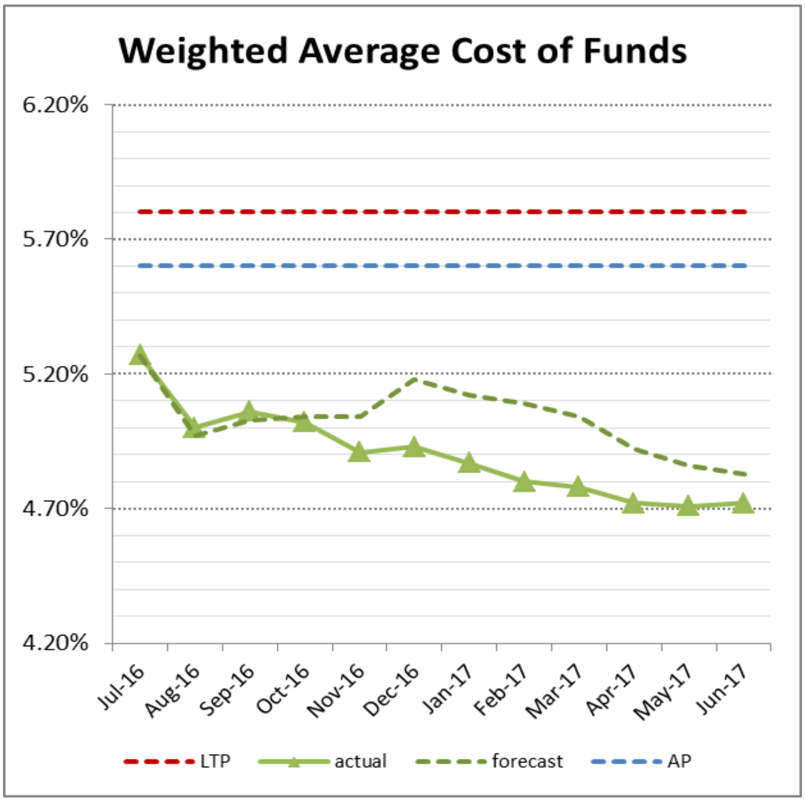
22 The following table shows the Council's interest income and expense for the year, along with the weighted average cost of borrowing.

Interest	Full Year Actual $000's	Full Year Budget $000's	Full Year Variance $000's
External Interest Expense	9,385	9,408	23
less: Interest Received	(1,563)	(1,140)	423
Net Interest Costs	**7,822**	**8,268**	**446**
Weighted Average Cost of Borrowing	4.89%	5.60%	-0.71%

23 To provide some context regards Council's treasury management effectiveness, net interest costs are slightly less than for the 2015/16 year, despite the average amount of debt for the year being higher.

24 The budgeted cost of borrowings for 2016/17 was set at 5.60%. Interest cost reductions that resulted in an actual weighted average cost of borrowing of 4.89%, is approximately $1.06 million for the year.

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



Treasury management policy compliance

26 There are two compliance exceptions for the year. These relate to counterparty credit risk, for investments and hedging instruments.

27 **Investments profile:** The policy sets limits for the maximum that can be invested per counterparty. The purpose of this is to ensure the Council does not concentrate its investments with a single bank. The limit is $25 million with any New Zealand registered bank.

28 In 2016/17, the Council placed $60 million on term deposit, $45 million of which was placed with the Bank of New Zealand (BNZ).

29 The cause of the non-compliance was the wide range of deposit rates being quoted from all participating New Zealand registered banks, reflecting the funding needs of the respective banks that Council deals with. BNZ has offered significantly more competitive rates than the others, for the maturities that the Council has been seeking.

30 By way of example, the current 'blackboard' deposit rates being advertised on bank websites are as follows:

Bank	180 days	270 days	12 months+
ANZ	3.10%	3.35%	3.25%
BNZ	3.10%	3.60%	3.15%
Westpac	3.30%	3.50%	3.35%

31 A difference of 20 basis points on a deposit of $5 million is equivalent to $10,000 per annum in interest. It has not been in the Council's best interests to take lower rates for policy compliance reasons.

32 Notwithstanding that it is prudent to spread the investments across counterparties and to cap the amount with any single counterparty. Results have shown that the current policy limits are too low for the Council's short term needs, again caused by the $60 million maturing in December 2017.

33 From February 2017, the Council no longer sought term deposit pricing from BNZ. At this point the Council had $45 million with BNZ, on deposit. This was considered the maximum that was appropriate at this time. The maximum will reduce after December 2017.

34 Approval is sought for this compliance exception. The alternative, should the exception not be approved, will be for the Council to break its term deposits and reinvest for the short term remaining at lower rates. Indicative short term rates are 1.50% for 60 days.

35 **Hedging profile:** A parallel has occurred with the limits for risk management instruments (or swaps). The policy sets limits for the maximum that can be transacted per counterparty. The limit is $80 million with any NZ registered bank.

36 In December 2016 the Council entered into two swap transactions with BNZ, taking the total value of live swaps held with BNZ to $88 million. This is out of a total of $198 million of live swaps.

37 There are also a further $60 million of future dated start swaps, $30 million of which are with BNZ.

38 Approval is sought for this compliance exception. The alternative, should the exception not be approved, will be for the Council to cancel one or more swap transactions. The cost of this has not been calculated but will be significant as these are contracted cashflows to maturity. Council will suffer realised losses should these be cancelled.

CONSIDERATIONS

Policy considerations

39 A number of changes to the Treasury Management Policy are being recommended. Please refer to report (Corp-17-305).

Legal considerations

40 There are no legal considerations arising from this report.

Financial considerations

41 There are no costs associated with this review. The financial implications of the treasury activity have been discussed throughout this report.

Tāngata whenua considerations

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

SIGNIFICANCE AND ENGAGEMENT

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

Publicity

44 There are no publicity considerations arising from this report.

RECOMMENDATIONS

45 That the Operations and Finance Committee notes the treasury management performance over the 2016/17 financial year.

46 That the Operations and Finance Committee approves the investments profile and compliance exception for the 2016/17 financial year.

47 That the Operations and Finance Committee approves the hedging profile and compliance exception for the 2016/17 financial year.

Report prepared by	**Approved for submission**
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Approved for submission

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