

## Part Four – Funding and Financial Policies

# LIABILITY MANAGEMENT POLICY

This policy is provided in accordance with section 104 of the Local Authority Act 2002.

### 3 Borrowing Policy

#### 3.1 General Policy

Council needs to source funds for capital development to ensure that the District continues to progress, and loan borrowing is an important part of that equation. It is critical to the sound management of Council's finances that the level of debt is planned and carefully monitored. Council exercises its flexible and diversified borrowing powers prudently, generally approves borrowing by resolution during the Annual Planning process. Projected debt levels are ascertained from detailed cash flow forecasts prepared during the Long term and Annual planning process.

Council raises borrowing for the following primary purposes:

- General debt to fund Council's Balance Sheet.
- Specific debt associated with "one-off" projects and capital expenditure.
- To fund assets with intergenerational qualities.
- To assist Council in it's day to day financing, through leases and hire purchases, of equipment purchases and replacement.

Bridging finance advances for particular capital projects may be authorised by Council when there are excess balances in Special Funds.

#### 3.1.1 Funding by Borrowing Policy

The Council considered borrowing principles and confirmed the following specific policies: -

1. All routine capital expenditure is to be funded from revenue or special funds.
2. All major projects, which have intergenerational effect, should be funded by borrowing, serviced by rates.
3. All urban growth projects should be funded by borrowing, serviced by growth in the rating base.

Loan servicing costs funded from rates should not exceed 5% of comprehensive income in any one year.

As policy, Council considers that borrowing is the more prudent way of funding major projects, which have an intergenerational benefit, and it is highly likely such projects would not be affordable if financed from current revenue.

#### 3.1.2 New Borrowings

Council is able to borrow through a variety of market mechanisms including the issue of stock and direct bank borrowing.

In evaluating new borrowings (in relation to source, term, size and pricing) the Finance Manager takes into account the following:

- The size and the economic life of the project.
- The impact of the new debt on the borrowing limits.
- Relevant margins under each borrowing source.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at re-issue/rollover time.

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- Prevailing interest rates relative to term for both stock issuance and bank borrowing and management's view of future interest rate movements.
- Available term from bank and stock issuance.
- Ensuring that the implied finance terms within the specific debt are at least as favourable as Council could achieve in its own right.
- Legal documentation and financial covenants.

### 3.2 Borrowing Limits

In managing borrowing, Council will adhere to the following limits:

- *The cost of servicing borrowing must not exceed 5% of comprehensive income.*
- *Net cash flow from operating activities (excluding interest) exceeds gross annual interest expense by two times.*
- *Liquidity ratio of not less than 1:1.*
- *Net Debt less than 20% of equity*
- *Net Interest less than 30% of annual rates income*

### 3.3 Liquidity and Credit Risk Management

Council's ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet as well as its ability to rate, manage its image in the market and its relationships with bankers. Where practical, Council seeks a diversified pool of borrowing and ensures that bank borrowings are sought only from the approved list of registered banks.

To ensure funds are available on repayment of debt, treasury investments are maintained in liquid assets and Council ensures that:

- ***A liquidity ratio of not less than 1:1 is maintained at each year-end.***
- ***Refer to Section 4.4.1 for liquidity of investments.***

To minimise the risk of large concentrations of debt maturing or being re-issued in periods where credit margins are high for reasons within or beyond Council's control, Council ensures debt maturity is spread widely over a band of maturities. Council manages this specifically by ensuring that:

- *No more than 30% of total borrowing is subject to refinancing in any financial year. Total borrowing includes existing and forecast borrowing.*

Due to the conservative levels of debt held, Council authorises that greater than 30% of total debt may mature in any one year provided it does not place adverse strain on Council's ability to fund such maturities. In accepting this deviation liquidity ratios are to be maintained.

### 3.4 Interest Rate Risk Management

Council's borrowing gives rise to direct exposure to interest rate movements. Given the long-term nature of Council's assets, projects and intergenerational factors, the Council's preference to avoid an adverse impact on rates, there is a general tendency to manage this risk via a maturity spread. The use of hedging instruments could be considered where appropriate.

The Finance Manager may approve interest rate risk management strategies after taking appropriate advice, and evaluating the outlook for short-term rates in comparison to the rates payable on its fixed rate debt.

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### 3.4.1 Floating Rate Mix

Council sets the following limit for achieving a floating rate mix on Council's total debt (existing and forecast), together with the appropriate discretionary authority. The limit sets the maximum floating rate exposure, to reflect Council's preference for fixed rate or hedged debt in the longer term. In Addition, Council is exposed to interest rate repricing risk on the maturing of existing fixed rate debt that is refinanced, as well as issue yield risk on planned new debt. Council manages these exposures using the following operational parameter:

- **The Finance Manager can approve up to 30% of total debt to have a floating rate profile. Percentages beyond 30% authority require Council approval.**

Floating rate profile refers to interest rate risk management instruments where interest rates are reset on a frequency of 180 days or less.

### 3.4.2 Interest Rate Risk Management Tools

Management implements interest rate risk management strategy through the use of the following:

- Adjusting the average maturity of its borrowings, thereby managing interest rate risk within the confines of liquidity management.
- Interest rate risk management products to convert fixed rate debt into floating rate, floating rate debt into fixed or hedged debt.
- Using interest rate risk management instruments to hedge repricing risk on existing fixed rate debt and issue yield risk on planned debt.

The following interest rate risk management instruments may be used for interest rate risk management activity: -

- Forward rate agreements.
- Interest rate swaps.

- Purchase of interest rate option products.
- Interest rate collar type option strategies.

Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.

### 3.5 Security

Council borrowing is secured by way of a charge over rates and Council remains free to deal with its other assets as it sees fit. All new borrowings rank equally with existing stock issues. In all borrowing and related activities, Council complies with the relevant provisions of the Securities Act.

Council does not have, nor intends to seek, a recognised credit rating.

### 3.6 Repayment

Council repays borrowings from the specific sinking fund allocated to that borrowing, from general funds, from asset sales, or through raising renewal loans.

### 3.7 Contingent Liabilities

Council provides financial guarantees to sporting and community organisations. Management ensures that the business plan of the guaranteed party furthers the strategic objectives of Council and that financial statements are received on a regular basis. Should the guarantee be called up, Council takes immediate action to recover the money.

### 3.8 Stock Management

Council stock is managed by the Reserve Bank of New Zealand, in Wellington, who charge a regular fee based on the number of registered stockholders.