Liability Management Policy

1. Introduction and Application

This Liability Management Policy has been prepared pursuant to Section 104 of the Local Government Act 2002. The policy is intended to apply, as appropriate, to every transaction that falls within the statutory definition of "borrowing", which is defined in Section 112 of the Local Government Act 2002 as:

"Borrowing"–

a. Means the incurring, by any means of debt, to raise money.

b. Includes the incurring of debt:

   i. Under any contract or arrangement for hire purchase, deferred payment, instalment payment, sale and lease back or buy back, financial lease, loan, overdraft, or other arrangement for obtaining debt finance;

   ii. By the drawing, acceptance, making, endorsement, issue, or sale of bills of exchange, promissory notes and other negotiable instruments and debt securities; but

c. Does not include debt incurred in connection with the hire purchase of goods, the deferred purchase of goods or services, or the giving of credit for the purchase of goods or services, if:

   i. The period for which the indebtedness is outstanding is less than 91 days and the indebtedness is not incurred again promptly after payment.

   ii. The goods or services are obtained in the ordinary course of the local authority's performance of its lawful functions, on terms and conditions available generally to parties of equivalent creditworthiness, for amounts not exceeding in aggregate an amount:

      (a) Determined by resolution of the local authority as not being so significant as to require specific authorisation.

      (b) Recorded for the purposes of this subparagraph of this paragraph of this definition in the then current borrowing management policy of the local authority.

d. And "borrow" has a corresponding meaning:

For the purposes of subparagraph c ii (b) of the above definition, this Liability Management Policy does not apply to hire purchase, deferred payment, or the giving of credit for goods where transactions are for less than 91 days, or do not exceed in value $400,000.

For the purposes of this policy, schemes are defined as those functional areas covered:

- By activities of a catchment board under the Soil Conservation and Rivers Control Act 1941 (for soil conservation and flood protection);
- In respect of these former drainage areas: Moutoa, Makerua, Manawatū, Oroua and Sluggish River, under Part XXIX of the Local Government Act 1974; and
- Separate rating area institutes under the Local Government Act 2002.

Section 113 of the Local Government Act 2002 prohibits Horizons from borrowing or entering into incidental arrangements other than in New Zealand currency.

Horizons is also governed by Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.

New Zealand Local Government Funding Agency Limited

Despite anything in this policy, Council may borrow from the New Zealand Local Government Funding Agency Limited (LGFA) and, in connection with that borrowing, may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA, for example borrower notes;
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required;

- Secure its borrowing from the LGFA and the performance of other obligations to the LGFA or its creditors with a charge over the Council's rates and rates revenue; and
- Subscribe for shares and uncalled capital in the LGFA.

The policy is structured as follows:

- Use of Borrowing;
- Borrowing Limits;
- Form of Borrowing;
- Security;
- Interest Rate Exposure Policy;
- Debt Repayment Policy;
- Liquidity Policy;
- Credit Exposure Policy;
- Cash Management Borrowing; and
- Incidental Arrangements.

2. Use of Borrowing

Council's liabilities comprise of borrowings (external) and various other liabilities. Council maintains external borrowings in order to:

- Raise specific debt associated with projects and capital expenditures;
- Fund the balance sheet as a whole, including working capital requirements; and
- Fund assets whose useful lives extend over several generations of ratepayers.

Borrowing provides a basis to achieve inter-generational equity by aligning long-term assets with long-term funding sources, and ensure that the costs are met by those ratepayers benefiting from the investment.

Council may also borrow to fund investments in CCOs, CCTOs and its 100 per cent owned holding company, MWRC Holdings Limited (MWRCH), or elect to borrow to fund commercial investments directly through Council. Council will assess the most appropriate structure to ensure maximum benefits to the ratepayer on a case-by-case basis.

Internal borrowing as a funding option is not covered by the definition of "borrowing". Council considers it appropriate to maintain the option of internal borrowing to fund scheme capital works, provided overall risk is not increased, and provided the individual risk from each loan is within Council parameters.

The only form of borrowing to meet operating shortfalls would be the use of overdraft facilities or other committed bank facilities to cover mismatches in operating cash flow.

As part of the Revenue and Financing Policy, Council will take a project-by-project view of its activities, and allocate the funding resources accordingly. These may include term borrowing.

3. Delegated Authorities

The Liability Management Policy related delegations are outlined below.

Activity	Responsibility
Approve policy document	Council
Alter policy document	Council
Approval of borrowing programme for the year	Council
Approval for charging assets as security over borrowing	Council
Approve new loans and borrowing facilities in accordance with the Council general resolution or through the adoption of the AP/LTP	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)
Refinancing of existing debt	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)
Negotiate bank facilities	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)

Activity	Responsibility
Approve borrowing and interest rate transactions outside policy	Council
Open/close bank accounts	Chief Financial Officer (delegated by Council)
Approve authorised cheque/electronic signatory positions	Chief Executive (delegated by Council)
Transfers of stock/register new debt issues	Seal register signatories
Borrowing management activity	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)
Interest rate risk management activity	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)
Approve allowable risk management instruments	Council
Adjust interest rate risk profile	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council) Per risk control limits
Manage funding maturities	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council) Per risk control limits
Maximum daily transaction amount (approved borrowing, cash management, interest rate risk management) excludes roll-overs on existing debt, interest rate swaps and financial investments	Council (unlimited) Chief Executive ($30 million) Chief Financial Officer ($20 million)
Ensure compliance with policy	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)
Policy review	Chief Executive (delegated by Council) Chief Financial Officer (delegated by Council)

4. Borrowing Limits

Borrowing will be managed within the following limits:

Item	Borrowing Limit
External debt as a percentage of total revenue*	<175%
Net external interest as a percentage of total revenue*	<15%
Net external interest as a percentage of annual rates revenue (debt secured under debenture)	<20%
Liquidity (term debt + committed loan facilities + available cash or cash equivalent) over existing external debt	>110%

Council also ensures that internal borrowing is no more than 67 per cent of total infrastructural assets.

Disaster recovery requirements are to be met through the liquidity ratio.

For the purpose of calculating the above ratios:

- Revenue is defined as revenue from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue. It excludes government capital contributions (eg. developer contributions and vested assets).
- Annual rates revenue is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 together with any revenue received from other local authorities for services provided (and for which the other local authorities rate).
- The liquidity ratio does not include cash/cash equivalents held within MWRCH.
- Cash/cash equivalents are defined as:
    - Overnight bank cash deposits;
    - Wholesale/retail bank term deposits no greater than 90 days;
    - Bank issued Registered Certificates of Deposits less than 181 days; or
    - Wholesale/retail bank term deposits linked to pre-funding of maturing term debt amounts.

Infrastructural assets

Infrastructural assets are assets such as roads, bridges, water, sewage, gas, telephone and electricity reticulation systems, dams, docks, railways, airports, stopbanks, river control works and drainage systems.

Infrastructural or system assets are fixed assets with the following characteristics:

- They comprise a system or network of interdependent components;
- This system interdependency may limit a component life to a lesser period than the expected life of the component by itself;
- Infrastructural assets have very long lives and the normal expectation is of an *indefinite* life. A finite life is determinable only when a decision is taken to replace the entire network, or to discontinue a section of it;
- Infrastructural assets are renewable rather than replaceable. Although, at any point in time, all components (excluding land and similar assets like earthworks) have a finite useful life, the asset as a whole can be maintained at a specified level of service potential by the continuous replacement and refurbishment of its components; and
- If infrastructural assets suffer severe failure, equivalent service levels from other sources are usually unobtainable for months or years.

Net interest

Interest expense less interest received recorded in Council's accounts.

5. Form of Borrowing

Trade credit

Horizons will arrange such terms and conditions as Council considers necessary for the establishment and provision of normal trade credit to enable the carrying out of business activities. Such credit shall not normally involve the issue of any security, undertaking or collateral, as a condition of the provision of such credit. Finance leases and hire purchase are included within trade credit and **will** normally include a charge over the assets being purchased.

Primary instruments

The primary instruments for other Horizons borrowing will be:

- Committed bank call and term funding facilities including provision of overdrafts and cash advance facilities, term loans or other credit facilities;
- Issue of commercial paper (CP), bills, fixed rate bonds, floating rate notes (FRNs), to the wholesale and retail investor markets and the Local Government Funding Agency (LGFA); and
- Council may also use internal funds as a borrowing mechanism.

Alternative funding mechanisms such as leasing must be evaluated with financial analysis in conjunction with traditional on-balance sheet funding. The evaluation should take into consideration ownership, redemption value and effective cost of funds.

Other

Instruments not specifically referred to in this policy may be used only with specific Council approval, with the provision that Council **shall not** utilise any off-balance sheet funding instruments.

6. Security

It is Council's general policy to offer security under a Debenture Trust Deed for borrowing and interest rate management instruments by way of a charge over the rating revenues accessible overall, or portions of rateable property within Council's jurisdiction. In the normal course of business, the policy is not to offer security over any of Council's other assets. However, where doing so would help further Council's goals and objectives, Council may, by specific Council resolution, offer such security on a case-by-case basis.

Any internal borrowing will be on an unsecured basis.

Where borrowing is by way of finance lease, or some other form of trade credit under which it is normal practice to provide security over the asset concerned, Council **may** offer security over the asset.

7. Interest Rate Exposure Policy

Exposure to interest rate risk is managed and mitigated through the controls below. These risk control limits will be only activated once 12 month forecast external core debt exceeds $30 million.

Master Fixed/Floating Risk Control Limit	
Minimum Fixed Rate	**Maximum Fixed Rate**
50%	90%

Fixed Rate is defined as an interest rate re-pricing date beyond 12 months forward on a continuous rolling basis.

Floating Rate is defined as an interest rate re-pricing within 12 months.

The percentages are calculated on the rolling 12 month projected external core debt level calculated by management and signed off monthly by the chief financial officer. (External core debt is the amount of total external core debt). This allows for pre-hedging in advance of projected physical drawdown of new external debt. When approved forecasts are changed, the amount of fixed rate/hedging in place may have to be adjusted to comply with the policy minimums and maximums.

At any time, the total of the fixed rate external core debt should be within the following maturity bands:

Fixed Rate Maturity Profile Limit		
Period	**Minimum**	**Maximum**
0 to 2 years	40%	100%
2 to 4 years	20%	80%
4 to 8 years	0%	60%

- A fixed rate maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this Policy. However, maintaining a maturity profile beyond 90 days requires specific approval by Council.
- Floating rate debt may be spread over any maturity. Bank advances may be for a maximum term of 12 months.
- Interest rate options must not be sold outright. However, 1:1 collar option structures are allowable whereby the sold option is matched precisely by amount and maturity to the simultaneously purchased option. During the term of the option, one side of the collar cannot be closed out by itself; both must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate "in-the-money".
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 1.00 per cent above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation.
- The forward start period on swap/collar strategies to be no more than 24 months, unless the forward start swap/collar starts on the expiry date of an existing swap/collar and has a notional amount that is no more than that of the existing swap/collar.
- Any fixed rate hedge with a term greater than 10 years must be approved by Council.

Dealing in interest rate instruments is limited to the approved interest rate instruments as follows:

Category	Instrument
Interest rate risk management	• Forward rate agreements (FRAs) on: ○ Bank bills

	• Interest rate swaps including:
	  ○ Forward start swaps/collars (start date less than 24 months, unless linked to existing maturing swaps/collars)
	  ○ Amortising swaps (whereby notional principal amount reduces)
	  ○ Swap extensions and shortenings

	• Interest rate options on: ○ Bank bills (purchased caps and one for one collars) • Purchased interest rate swaptions, with the option term up to 18 months

Any other interest rate instrument must be specifically approved by Council on a case-by-case basis and only be applied to the one singular transaction being approved. Credit exposure on these financial instruments is restricted by specified counterparty credit limits.

8. Debt Repayment Policy

Council's policy is to repay debt as it falls due utilising one or more of the following:

- Surplus operating funds;
- Rating revenues established for that purpose;
- Proceeds from the disposition of surplus assets or investments;
- Regular instalments of principal and interest, especially with internal scheme capital works loans; and/or
- Refinancing with new debt.

Total debt levels are determined through the Long-term Plan, Annual Plans and Asset Management Plans.

9. Liquidity and Funding Risk Policy

Cash flow deficits in various future periods based on long-term financial forecasts are reliant on the maturity structure of term debt and bank facilities. Liquidity risk management focusses on the ability to borrow at that future time to fund the gaps. Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and borrowing margins) and maturity terms of existing facilities.

It is Council's policy to ensure the timely availability of funds to enable the related expenditure to be carried out, and for obligations to be paid on due date, without incurring penalties or holding unnecessary cash reserves.

To manage and mitigate Council's liquidity and funding risks, Council has imposed the following controls:

- Match revenue requirements with expenditure streams and ensure timing differences, if any, are favourable to Council;
- Ensure replacement/renewal funds are available no later than the repayment date, whether sourced from re-financing loans or other sources. Council has the ability to pre-fund up to 12 months of forecast debt requirements including re-financings in liquid investments. Debt re-financings that have been pre-funded will remain included within the funding maturity profile until their maturity date;
- Avoid significant concentration of credit risk, exposure or debt repayment maturities; and
- Term debt and committed bank funding facilities plus cash/cash equivalents over existing external debt to be greater than 110 per cent. The liquidity ratio does not include cash/cash equivalents held within MWRCH.

The chief financial officer and chief executive have the discretionary authority to re-finance existing debt on more acceptable terms and within the parameters of this policy.

The maturity profile of total committed funding in respect to all term debt and committed bank funding facilities is to be controlled by the following system with percentages calculated off existing external debt.

Period	Minimum	Maximum
0 to 2 years	40%	100%*
2 to 4 years	20%	80%*
4 to 8 years	0%	60%*

*To be adhered to when external debt levels are greater than $30 million.

- A funding maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this Policy. However, maintaining a maturity profile beyond 90 days requires specific approval by Council.

- To minimise concentration risk the LGFA require that no more than the greater of NZD $100 million or 33 per cent of a Council's borrowings from the LGFA will mature in any 12-month period.

10. Credit Exposure Policy

In using Financial Risk Management instruments, Council can be exposed to counterparty credit risk. This is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where the Council is a party.

Credit risk will be regularly reviewed by Council. Treasury related transactions would only be entered into with counterparties and limits approved on the basis of long-term credit ratings (Standard & Poor's, Fitch or Moody's) being A+ and above or short-term rating of A-1 or above.

The following framework will determine limits.

Counterparty/ Issuer	Minimum Long-term/Short-term Credit Rating	Interest Rate Risk Management Instrument Maximum Per Counterparty ($m)
NZ Registered Bank (per bank)	A/ A-1+	10.0

In determining the usage of the above gross limits, the following weightings will be used:

- Interest rate risk management (eg. swaps, FRAs) – Transaction Notional × Maturity (years) × 3 per cent; and
- Foreign Exchange – Transactional Principal Amount × the square root of the Maturity (years) × 15 per cent.

To avoid undue concentration of exposures, financial instruments must be used with as wide a range of counterparties as possible. Where possible, transaction notional sizes and maturities should also be well spread. The approval process to allow the use of individual financial instruments must take into account the liquidity of the market the instrument is traded in and re-priced from.

11. Borrowing for Cash Management

This section applies to what might be described as borrowing to manage day-to-day fluctuations in cash flow.

For cash management purposes Council maintains a committed bank funding facility and/or cash/cash equivalents not exceeding a limit of $7,000,000, primarily for the urgent financing of emergency-related works and services. This facility may also be used for unexpected short-term fluctuations in operating cash flow. In day-to-day cash management, the target is to maintain operating cash balances as close as possible to zero to minimise bank costs and maximise deposit rates, while meeting obligations to staff and suppliers.

12. Incidental Arrangements

Council may, on terms and conditions as considered appropriate, enter into and perform any contract or arrangement that is referred to as an "incidental arrangement" (known as financial risk management instruments). Incidental arrangements are further defined in Section 112 of the Local Government Act 2002 as:

a. A contract or arrangement for the management, reduction, sharing, limiting, assumption, offset, or hedging of financial risks and liabilities in relation to any investment or investments or any loan or loans or other incidental arrangement, whether or not that contract or arrangement involves:

   i. the expenditure, borrowing, or lending of money; or

ii. the local authority undertaking to make payments in exchange for another person undertaking to make payments to the local authority; or
iii. the creation or acquisition or disposal of any property or right; or

b. A contract or arrangement with any bank, financial institution, or other person providing for any person to act as underwriter, broker, indemnifier, guarantor, accommodation party, manager, dealer, trustee, registrar, or paying fiscal, or other agent for, or in connection with, any loan or investment including the creation of a charge.

Agents

Where it is considered necessary for the efficient management of the Liability Management Policy, and to assist in compliance with Council's legislative requirements, Council will appoint only reputable persons or companies to fulfil the following roles:

- Financial/Investment Advisors;
- Registrars/Paying Agents;
- Brokers; and
- Trustees.

Foreign exchange

Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated goods and services.

Generally, all significant commitments for foreign exchange are hedged, using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts can be used by Council.

By legislative restriction, Council cannot borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

Other

Other forms of incidental arrangement may be entered into only with specific resolution of Council, and in accordance with the Long-term Plan.

13. Internal Controls

Council's systems of internal controls over treasury activity include:

- Adequate segregation of duties among the core treasury functions of deal execution, confirmation, settling and accounting/reporting. There are a small number of people involved in treasury activity. Accordingly strict segregation of duties is not always achievable. The risk from this is minimised by the following processes:
  - A documented discretionary approval process for treasury activity;
  - Regular management reporting;
  - Regular operational risk control reviews by an independent audit function; and
  - Organisational, systems, procedural and reconciliation controls to ensure:
    - All treasury activity is bona fide and properly authorised; and
    - Checks are in place to ensure Council's accounts and records are updated promptly, accurately and completely.

14. Legal Risk

Legal and regulatory risks relate to the unenforceability of a transaction due to an organisation not having the legal capacity or power to enter into the transaction, usually because of prohibitions contained in legislation. While legal risks are more relevant for banks, Council may be exposed to such risks.

Council will seek to minimise this risk by adopting policies regarding:

- The use of standing dealing and settlement instructions (including bank accounts, authorised persons, standard deal confirmations, and contacts for disputed transactions) to be sent to counterparties;
- The matching of third party confirmations and the immediate follow-up of anomalies; and
- The use of expert advice for any non-standardised transactions.

Agreements

- Financial instruments can only be entered into with banks that have in place an executed ISDA Master Agreement with Council. All ISDA Master

Agreements for financial instruments must be signed under seal by the Council.

- Council's appointed legal counsel must sign off on all documentation for new loan borrowings, re-financings and investment structures.

Financial covenants and other obligations

- Council must not enter into any transactions where it would cause a breach of financial covenants under existing contractual arrangements.
- Council must comply with all obligations and reporting requirements under existing funding facilities and legislative requirements.

15. Accounting Treatment of Financial Instruments

Council use financial arrangements ("derivatives") for the primary purpose of reducing its financial risk to fluctuations in interest rates. The purpose of this section is to articulate Council's accounting treatment of derivatives in a broad sense. Further detail of accounting treatment is contained within the appropriate operations and procedures manual.

Under New Zealand Public Benefit Entity (PBE) International Public Sector Accounting Standards (IPSAS) changes in the fair value of derivatives go through the prospective Statement of Comprehensive Revenue and Expense unless derivatives are designated in an effective hedge relationship.

Council's principal objective is to actively manage the Council's interest rate risks within approved limits and chooses not to hedge account. Council accepts that the marked-to-market gains and losses on the revaluation of derivatives can create potential volatility in Council's annual accounts.

The chief financial officer is responsible for advising the chief executive of any changes to relevant New Zealand Public Sector PBE Standards that may result in a change to the accounting treatment of any financial derivative product.

All treasury financial instruments must be revalued (marked-to-market) at least every six months for risk management purposes.