Kaipara District Council

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From:	Alex Wondergem, John Hepburn
Date:	30 March 2020
Subject:	Treasury Management Policy Review

Background

We have reviewed Kaipara District Council's (Council) Treasury Management Policy (Policy) at the request of Management. The review of the Policy has been performed to satisfy internal requirements for a Policy review every three years and in light of changes currently impacting the local government sector.

The changes have been recommended to better align the Policy with the proposed changes by the Local Government Funding Agency (LGFA) as well as the changes to credit rating methodology by Standard & Poor's (S&P) earlier this year.

Furthermore, we have recommended an update to the current interest rate risk management framework whereby fixed rate minimum requirements are lowered, providing greater flexibility in the medium term management of interest rates whilst continuing to meet a prudent risk management approach.

Significant changes

The following are the key changes recommended to the Policy:

- Borrowing limit definitions have been updated to align with changes the LGFA has proposed in providing greater clarity for Councils (Section 4.1)
- Throughout the Policy, we recommend strengthening the policy framework around on-lending activity to Council Controlled Organisations (CCOs) (including Council Controlled Trading Organisations (CCTOs)). This is to allow for any potential on-lending activity that may be required along with allowing for the possibility of direct lending from the LGFA to these entities.
- Interest rate risk control limits have been reviewed and changes have been recommended that allows for flexibility in interest rate risk management (Section 6.3).
- Changes to the funding risk control limits are recommended to provide more flexibility in Council's funding arrangements (Section 6.4.2).
- Counterparty credit limits - we recommend a single limit is applied rather than having sub-limits for investments and risk management transactions, (Section 6.5) as well as a tiered approach for exposures to counterparties with differing credit ratings.

Section by section Policy update

Limits on Borrowing & Giving of Security (section 4.1)

To ensure consistency with the updates the LGFA is proposing in relation to its borrowing covenant definitions, we recommend amendments to Council's current definitions.

On-lending to Council Controlled Organisations and Council Controlled Trading Organisations (section 4.9 - new section)

We recommend a new Policy section outlining changes to CCO/CCTO lending activity in light of upcoming changes to the LGFA foundation policy which will consider direct lending opportunities. Whilst council does not currently engage in any lending activities in this space, the new Policy section is designed to future proof the Policy.

This new section is included to reflect the mechanics of LGFA borrowing (by Council) where there is an intention to on-lend to CCO/CCTOs and where the CCO/CCTO borrows directly from the LGFA and credit support is needed to be provided by Council.

Changes made to the founding documents of the LGFA were voted on at the end of 2018, however will not likely come into effect until late 2019 or early 2020. This period is being used by the LGFA to consult on the mechanics of the transactions. Early indications are that lending will be provided on a case by case basis, approved by the LGFA Board and will depend on the individual circumstances of the Council and the related entity.

The framework considers various factors briefly outlined below:

- Credit risk profile of the borrowing entity and the ability to timely meet repayments.
- Impact on Council's credit rating, debt cap amount (if any), lending covenants with the LGFA and other lenders and Council's future borrowing capacity.
- The form and quality of security arrangements provided.
- The lending rate and terms.
- Lending arrangements to CCTOs must be documented (through a term sheet) on a commercial arm's length basis.

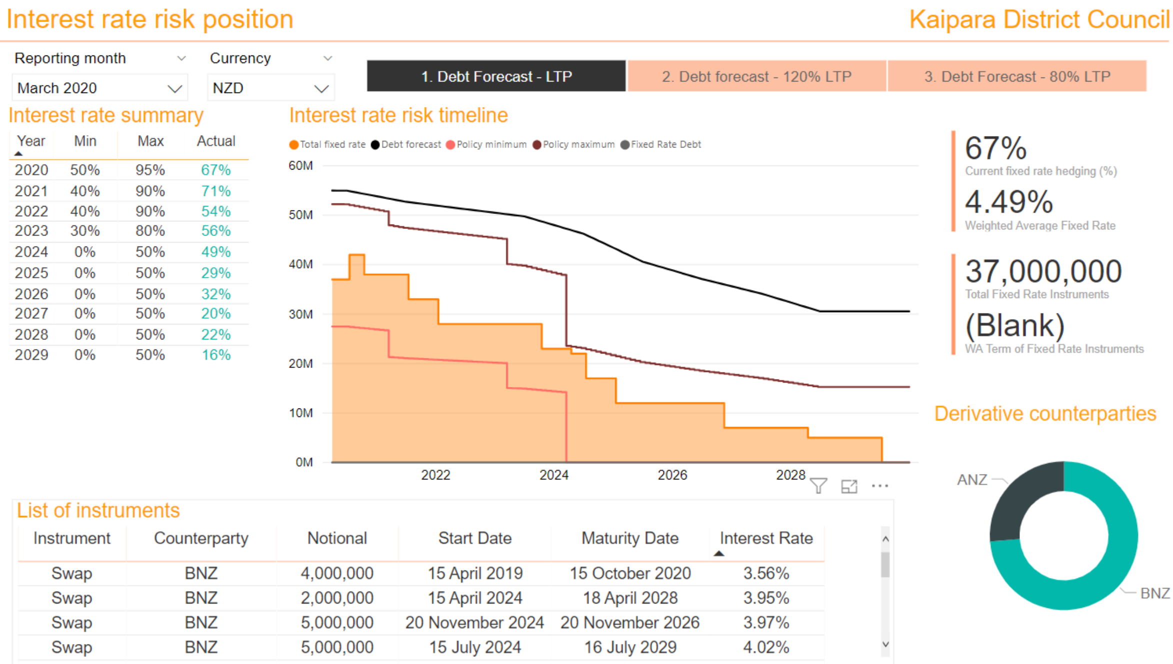
Approved financial instruments (section 6.2)

We recommend the inclusion of two new instruments which are now on offer by the LGFA. These are stand-by facilities and forward starting debt issuance, both through the LGFA.

Interest Rate Risk Management (Section 6.3)

We recommend Council considers an amendment to the interest rate risk control limits whereby the minimum interest rate fixing requirement is adjusted in order to relieve pressure on the policy framework when transacting longer dated interest risk management strategies. The recommendation is made to provide Council with additional flexibility in the management of its interest rate risks through having greater discretion between minimum and maximum fixing requirements and by having one more time frame to allow for a more orderly descent in the longer dated maturity buckets. Note that the limits are still conservative in supporting prudent financial management and delivery of interest costs to plans and budgets.

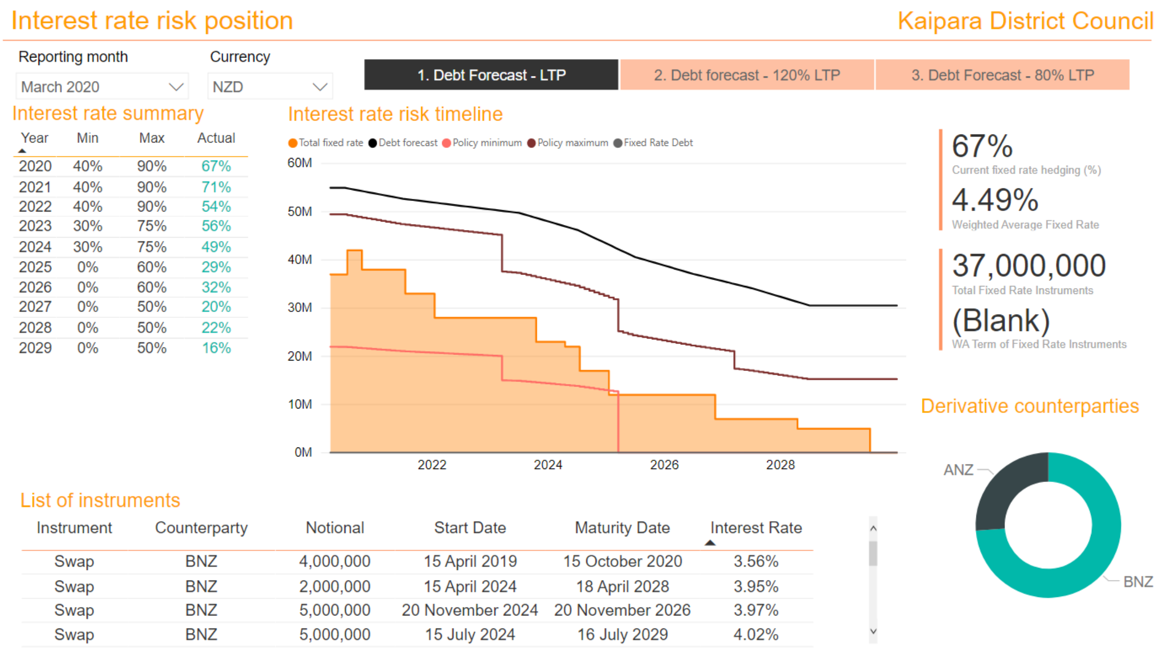
Council's current interest rate profile with suggested minimum fixing updates are shown below:



Year	Min	Max	Actual
2020	50%	95%	67%
2021	40%	90%	71%
2022	40%	90%	54%
2023	30%	80%	56%
2024	0%	50%	49%
2025	0%	50%	29%
2026	0%	50%	32%
2027	0%	50%	20%
2028	0%	50%	22%
2029	0%	50%	16%

Instrument	Counterparty	Notional	Start Date	Maturity Date	Interest Rate
Swap	BNZ	4,000,000	15 April 2019	15 October 2020	3.56%
Swap	BNZ	2,000,000	15 April 2024	18 April 2028	3.95%
Swap	BNZ	5,000,000	20 November 2024	20 November 2026	3.97%
Swap	BNZ	5,000,000	15 July 2024	16 July 2029	4.02%

Interest rate profile with recommended control limit amendments:



Year	Min	Max	Actual
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2021	40%	90%	71%
2022	40%	90%	54%
2023	30%	75%	56%
2024	30%	75%	49%
2025	0%	60%	29%
2026	0%	60%	32%
2027	0%	50%	20%
2028	0%	50%	22%
2029	0%	50%	16%

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Funding risk control limits (section 6.4.2)

We recommend an adjustment to the current funding risk maturity bands within the framework to allow for a 3 - 7 and 7 year + time frame. Having a wider time band allows more flexibility to strategically manage long term debt amounts and continues to enforce a spreading and smoothing approach avoiding a concentration of refinancing risk.

Counterparty credit risk (section 6.5)

Under the existing Policy, the overall counterparty credit limit is built up of a set amount ($15 million) for investments and an additional amount ($20 million) for the impact of derivative transactions (interest rate, foreign exchange and commodities).

We recommend a single limit of $30 million is applied for each counterparty and the makeup of that limit is flexible within the approved limit amount, i.e. there aren't set sub-limits for each exposure.

This will provide Council with the flexibility to vary the mix of transactions in order to obtain optimal pricing outcomes from each counterparty while continuing to maintain a spreading of risk. To ensure some spread of investment risk the policy will include a statement that no more than 50% of the investment portfolio will be held with one bank at any point in time.

This approach allows additional investment capacity where required for pre-funding activity, particularly in light of the recent S&P ratings methodology change which will place additional emphasis on this form of early refinancing.

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