Nelson City Council

Treasury Management Policy

Including Liability Management and Investment Policies

Effective:	***June 2024***
Review date:	***June 2027***
Contact:	***Group Manager Corporate Services***

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Liability Management Policy

1.0 Introduction

1.1. General Policy

To provide appropriate parameters in which Council will manage its borrowing activities and external liabilities to ensure compliance with the provisions of the Local Government Act 2002.

Section 102 of the Local Government Act 2002 (the "Act") requires Council to adopt a Liability Management Policy (the "Policy"). Section 104 of the Act outlines the contents of Council's policies in respect of the management of both borrowing and other liabilities, including:

- interest rate exposure; and
- liquidity; and
- credit exposure; and
- debt repayment.

The Policy is to be consistent with the Long Term Plan (LTP) and Annual Plan. The formalisation of such policies and procedures will enable treasury risks within Council to be prudently managed.

As circumstances change, the policies and procedures outlined in this Policy will be modified to ensure that treasury risks within Council continue to be well managed.

1.2. Objectives

Statutory Objectives
All external borrowing, investments and incidental financial arrangements (e.g. use of interest rate hedging financial instruments) will meet requirements of the Local Government Act 2002 and incorporate the Liability Management Policy and Investment Policy.

Council is governed by the following relevant legislation:

  - Local Government Act 2002, in particular Part 6 including sections 101,102, 104,105 112 and 116.
  - Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.
  - Trusts Act 2019. When acting as a trustee or investing money on behalf of others, the Trusts Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.

- All projected external borrowings are to be approved by Council as part of the Annual Plan or the Long Term Planning (LTP) process.
- All master legal documentation in respect to external borrowing and financial instruments will be approved by Council's legal counsel prior to the transaction being executed.
- Council will not enter into any borrowings denominated in a foreign currency.
- Council will not transact with any Council Controlled Trading Organisation (CCTO) on terms more favourable than those achievable by Council itself.
- Council is not allowed to guarantee loans to CCTOs under Section 62 of the Local Government Act.

A resolution of Council is not required for hire purchase, credit or deferred purchase of goods if:

- The period of indebtedness is less than 91 days (including rollovers); or

- The goods or services are obtained in the ordinary course of operations on normal terms for amounts not exceeding in aggregate, an amount determined by resolution of Council.

General Objectives

- Minimise Council's costs and risks in the management of its external borrowings.
- Minimise Council's exposure to adverse interest rate movements.
- Monitor, evaluate and report on treasury performance.
- Borrow funds and transact risk management instruments within an environment of control and compliance under the Council approved Policy so as to protect Council's financial assets and manage costs.
- Arrange and structure external long term funding for Council at acceptable margins and cost from debt lenders. Optimise flexibility and spread of debt maturity terms within the funding risk limits established by this Policy statement.
- Monitor and report on financing/borrowing covenants and ratios under the obligations of Council's lending/security arrangements.
- Comply with financial ratios and limits stated within this Policy.
- Maintain appropriate liquidity levels and manage cash flows within Council to meet known and reasonable unforeseen funding requirements.
- Minimise the impact of carbon risks on financial budgets.
- Minimise exposure to credit risk by dealing with and investing in credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- Ensure that financial planning will not impose an unequitable spread of costs/benefits over current and future ratepayers.
- To ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, LGFA, credit rating agencies, investors and investment counterparties.
- Any activity that is speculative in nature or where there is not a legitimate underlying business cash flow being managed is strictly prohibited.

1.3. Interest Rate Exposure

Interest rate exposure refers to the impact that changes in interest rates can have on the Council's cash flow. The Council's policy for interest rate risk management is to take a conservative, risk-averse approach by requiring a certain percentage of the Council's borrowing to be fixed rate or hedged borrowing. Both the long term nature of the Council's assets and the need for intergenerational equity mean it is important that the Council should:

- Have predictable interest costs;
- Avoid increases in annual rates caused by interest rate rises.

1.4. How Interest Rate Risk Is Managed: The Rules

Council's gross external core debt forecasts (as approved by the Group Manager Corporate Services) must be within the following fixed/floating interest rate risk control limits:

Debt Interest Rate Policy Parameters (calculated on rolling monthly basis)		
Debt Period Ending	**Minimum Fixed Rate**	**Maximum Fixed Rate**
Current	40%	90%
Year 1	40%	90%
Year 2	35%	85%
Year 3	30%	80%
Year 4	25%	75%
Year 5	20%	70%
Year 6	0%	65%
Year 7	0%	60%
Year 8	0%	50%
Year 9	0%	50%
Year 10	0%	50%
Year 11	0%	25%
Year 12	0%	25%
Year 13	0%	25%
Year 14	0%	25%
Year 15	0%	25%

"Fixed rate" is defined as all known interest rate obligations on forecast external core debt, including where hedging instruments have converted floating rate obligations into firm commitments.

"Floating rate" is defined as any interest rate obligation subject to movements in the applicable reset rate.

Gross forecast external core debt is the amount of total external debt for a given period. This allows for pre-hedging in advance of projected physical drawdowns of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to ensure compliance with the Policy minimums and maximums. Forecast debt does not include pre-funded debt amounts.

The Group Manager Corporate Services can consider alternative debt forecast scenarios that make assumptions around such matters as, the delivery and timing of the capital expenditure programme when designing and approving the interest rate strategy.

Any debt raised and on-lent to CCO/CCTOs is included in the forecast gross external debt amount and the related interest rate risk is managed within the limit framework. If fixed rate debt was raised, then the fixed rate amount would be included within the fixed rate/hedging interest rate risk position.

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 that is outside the above limits beyond 90-days requires specific approval by Council.

The Treasury team (Group Manager Corporate Services, Finance Manager, Financial Accountant) set the interest rate risk management strategy. The Group Manager Corporate Services approves the strategy.

Any fixed rate hedge with a maturity beyond 15 years must be approved by Council. The exception to this will be if LGFA introduce funding terms exceeding 15 years; in this event, management can position the fixed rate or hedged interest rate portfolio to maturities that match the LGFA's maximum funding term.

Hedging outside the above risk parameters must be approved by the Mayor or Deputy Mayor of the Council and the Chair of the Audit, Risk and Finance subcommittee.

2.0 Risk Management Instruments

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

Category	Instrument
Interest rate risk management	Forward rate agreements ("FRAs") on: • Bank bills Interest rate swaps including: • Forward start swaps/collars (start date <36 months, unless linked to existing maturing swaps/collars) • Swap extensions, deferrals and shortenings Interest rate options on: • Bank bills (purchased caps and one for one collars) • Interest rate swaptions (purchased swaptions and one for one collars only)

- One for one 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, only the sold side of the collar can be closed out (i.e. repurchased) otherwise, both sides must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate 'in-the-money';
- Interest rate options must not be sold outright;
- Purchased borrower swaptions must mature within 12 months;
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00% above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation;
- Forward start period on swaps and collars to be no more than 36 months from deal date except where the forward start swap/collar starts on the expiry date of an existing swap/collar and has a notional amount which is no more than that of the existing swap/collar;

Any other financial instrument must be specifically approved by the Council on a case-by-case basis and only be applied to the one singular transaction being approved.

3.0 Liquidity and Funding Risk Management

Liquidity risk management refers to the practice of making sure funds are available when needed, without incurring penalties for breaking investments before time. The Council does not hold its reserves in cash and must anticipate and plan for drawings against reserves.

The Council's objective for funding risk management is to minimise the risk of large concentrations of debt being reissued at a time of adverse movements in borrowing margins beyond the Council's control.

Council's ability to readily attract cost effective borrowing is largely driven by its ability to rate, maintain a strong financial standing and manage its relationships with its investors, LGFA, financial institutions/brokers and maintain a long-term credit rating of at least AA.

4.0 Policy

The Council's policy for liquidity and funding risk management is:

- Ensure that the Council's committed debt facilities and term loans mature over a wide time period;
- External debt plus unutilised committed debt facilities, plus liquid assets must be maintained at an amount of greater than 110% over existing external debt;
- The diversification of borrowing sources is achieved by the LGFA through the various funding markets accessed in its ongoing borrowing programme. Council diversifies its committed liquidity sources through both bank facilities and the LGFA. Matching expenditure closely to its revenue streams and managing cash flow timing differences;
- Maintaining its financial investments in cash/cash equivalent investments;
- Council has the ability to pre-fund up to 18 months of the forecast debt requirements including re-financings. Re-financings that have been pre-funded, will remain included within the funding maturity profile until their maturity date.

5.0 Rules

The Council's rules for managing liquidity and funding risk are that the maturity profile of the total committed funding in respect to all external term debt and committed debt facilities is to be controlled by the following system:

Period	Minimum %	Maximum %
1 to 3 years	15	60
3 to 7 years	25	85
7 years plus	0	60

- 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 outside of policy limits beyond 90-days requires specific approval by Council.
- Once debt has been refinanced with a contracted term deposit (pre-funded), the term deposit amount, will net off the maturing debt amount, from the funding maturity profile percentage calculation.
- External debt that is raised by Council to be on-lent debt to CCO/CCTO's is included in the funding maturity profile percentage calculation. The offsetting CCO/CCTO loan asset is not included in the debt funding maturity profile.
- To minimise concentration risk the LGFA requires that no more than the greater of NZD 100 million or 33% of a Council's borrowings from the LGFA will mature in any 12-month period.

6.0 Credit Exposure

The Council does impose a minimum long term credit rating on its bank lenders of A+ or better and short term rating of A-1 or better, as determined by Standard and Poor's or equivalent international credit rating agency (Fitch or Moody's). Hedging facilities are only transacted with banks that have a long term A+ or better credit rating.

Counterparty/Issuer	Minimum S&P long term/short term credit rating	Total maximum combined limit per counterparty ($million)*
NZ Registered Bank (per bank)	A+ / A-1	30.0
*This combined total maximum limit includes exposure to the counterparty via investment transactions per the Investment Policy.		

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

- Interest rate risk management (e.g. swaps, FRAs) – Transaction Notional X Maturity (years) X 3%
- Foreign Exchange Risk and forward carbon contracts (e.g. Forward Exchange Contract) – Transaction Face Value amount x ((square root of the maturity (years)) x 15%).

7.0 Debt Repayment

The Council repays borrowings from rates, debt raising, surplus funds, proceeds from the sale of investments and fixed assets.

Debt will be repaid as it falls due in accordance with the applicable borrowing arrangement. Subject to the appropriate approval and debt limits (per Council delegations register), a loan may be rolled over or re-negotiated as and when appropriate.

Note that the proceeds from sales of fixed assets and investments may also be used for the acquisition of other fixed assets.

8.0 Borrowing Mechanisms

The Council will borrow through a variety of market mechanisms including approved financial instruments as follows:

Category	Instrument
Cash management and borrowing	Bank overdraft Committed cash advance and debt funding facilities (short term and long term loan facilities) Committed standby facilities where offered by the LGFA Loan stock/bond issuance Retail and Wholesale Fixed Rate Bond and Floating Rate Note (FRN) Issuance Commercial paper (CP) Blend and extend lending arrangements with the LGFA Forward starting committed debt with the LGFA

Any other financial instrument must be specifically approved by the Council on a case-by-case basis and only be applied to the one singular transaction being approved.

9.0 Specific Borrowing Limits

The Council's policy for borrowing limits is to adhere to the following:

Item	Borrowing limit	LGFA lending covenant
Net interest expense on external debt as a percentage of total revenue to be less than	15%	20%
Net interest expense on external debt (secured by rates) as a percentage of rates revenue to be less than	20%	30%
Net external debt (secured by rates) as a percentage of total revenue to be less than	200%	280%
Liquidity (external debt + unutilised committed debt facilities + available liquid assets) over existing external debt to be greater than	110%	110%

- Total revenue is defined as cash earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non-government capital contributions, for example Development Contributions and vested assets;
- Net external debt is defined as total external debt less liquid assets;
- Liquid assets are defined as being:
  - Overnight bank cash deposits
  - Short term bank cash deposits (up to 30-days)
  - Bank registered certificates of deposit (RCD's) less than 181 days
  - Approved fixed interest securities
  - Listed, non-core equity investments
- External debt funding and related investment activity relating to pre-funding of upcoming debt maturities is excluded from the liquidity ratio calculation.
- Net interest is defined as the amount equal to all interest and financing costs less interest income for the relevant period.
- Annual rates income 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.
- Financial covenants are measured on Council only, not consolidated group.

10.0 Internal borrowing

The primary objective in funding internally is to use reserves and external borrowing effectively, by establishing a portfolio that provides funding to internal activity centres. This creates operational efficiencies, as savings are created by eliminating the margin that would be paid through Council separately investing and borrowing externally. In addition to external borrowing mechanisms all reserve accounts are used for internal borrowing purposes.

The interest cost will be set with reference to margins on external borrowing.

Actual rates of interest charged for internal borrowing will be approved as part of the Long Term Plan process and charged annually in arrears at the weighted average cost of external borrowing (including credit margin and other related costs).

11.0 Guarantees

Council, from time to time, provides financial guarantees to local organisations, groups or bodies for recreational and community purposes. In determining whether a guarantee is to be approved, the Council considers the social benefits provided to the community and the following:

- The potential for loss of capital;
- Where the Council assumes the asset in the case of default; the ongoing operating costs or completion costs of the asset;
- The nature of the organisation including its management, financial stability, cash flow forecasts and membership.

The total value of guarantees, to local organisations, groups or bodies for recreational and community purposes at any one time will not exceed 5% of the total annual rates, levied during that year. Total loan guarantees held at any time shall be taken into account when calculating the Council's maximum borrowing limit.

The Finance Department monitors the total value of guarantees provided, reporting annually to Council.

As a condition of the guarantee, the guarantor's annual financial statements are to be promptly given to Council after each year end and monthly reports can be requested at any time.

12.0 Borrowing and capital mechanisms to council controlled organisations and council controlled trading organisations

To better achieve its strategic and commercial objectives, Council may provide financial support in the form of called up capital, uncalled capital facilities, debt funding directly or indirectly to CCO/CCTOs. Approved CCO/CCTOs are those set up under the Local Government Act 2002.

Guarantees of financial indebtedness to CCTOs are prohibited, but financial support may be provided by subscribing for shares as called or uncalled capital.

Any lending arrangement (direct or indirect) to a CCO or CCTO must be approved by Council. Council approves LGFA membership of a CCO/CCTO, called up capital and uncalled capital facilities. In recommending an arrangement for approval the GMCS considers the following:

- Credit risk profile of the entity and the ability to timely meet interest and principal repayments to either Council or the LGFA directly.
- Impact on Council's credit rating, lending covenants with the LGFA and bank lenders as well as Council's future borrowing capacity.
- The form and quality of any security arrangements provided to Council.
- The lending rate given factors such as; CCO or CCTO credit profile, external Council borrowing rates, borrower note and liquidity buffer requirements, term etc.
- Lending arrangements to the CCO or CCTO must be documented on a commercial arm's length basis. A term sheet, including matters such as borrowing costs, interest payment dates, principal payment dates, security and expiry date is agreed between the parties.
- Accounting and taxation impact of on-lending or capital arrangement.
- All lending and capital arrangements must be executed under legal documentation (e.g. loan, guarantee) reviewed by Council's independent legal counsel and approved by Council.

13.0 Security Policy

Council's external borrowings and interest-rate risk management instruments will generally be secured by a charge over rates and rates revenue offered through a Debenture Trust Deed. Under a Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Rating Act. The security offered by Council ranks equally or pari passu (on equal terms in all respects, at the same rate, or proportionately) with other lenders.

From time to time, with Council and Trustee approval (the Trustee of the Debenture Trust Deed), security may be offered by providing a charge over one or more of Council's assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds, for example an operating lease, or project finance;
- Council considers a charge over physical assets to be appropriate;
- Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.

14.0 New Zealand Local Government Funding Agency

The Council may borrow from the New Zealand Local Government Funding Agency Limited (LGFA) as a Guaranteeing Local Authority. In connection with that borrowing, the Council may enter into the following related transactions to the extent it considers necessary or desirable:

- contribute a portion of its borrowing back to LGFA subordinated debt, convertible to redeemable preference shares in LGFA if required by LGFA;
- provide a guarantee of the indebtedness of LGFA;
- 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.

15.0 Foreign Exchange

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

Generally, all significant individual amounts of NZD100,000 or greater commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is approved and the currency amount, and timing are known. 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.

Approved financial instruments

Foreign exchange management	Spot foreign exchange Forward exchange contracts Purchased currency options and 1:1 option collars

16.0 Emissions Trading Scheme (ETS)

The objective of the ETS carbon policy is to minimise the financial impact of movements in the carbon credit unit price. The objective requires balancing Council's need for cost stability and protecting financial budgets along with the benefit of realising market opportunities to reduce costs and manage risks as they arise.

Exposures become committed in January to March (quarter following the emission period as Council incurs the carbon emissions liability from the previous calendar year).

The carbon emissions liability is risk managed under the following risk control limits.

Obligation period	Compliance requirements as at (month of current year)	**Minimum** holding as a percentage of annual gross obligations
Current calendar year	by 30 June	75%
	by 31 December	100%
Current calendar year plus 1	by 31 December	50%

The second stage of the framework is to set a minimum and maximum level of carbon units to be purchased and held by Council to cover future years as shown below:

Period	Minimum unit holding	Maximum unit holding
Year 3* - Year 4	0%	50%
Year 4 - Year 5	0%	50%

* Current calendar year plus 2

The Group Manager Corporate Services is authorised to act on Council's behalf as a bidder in the auction in line with this policy and reporting will be made to the relevant Committee.

Council purchases units through either the quarterly auction or the secondary market. Council is a registered participant on the Registrar of New Zealand Emissions Trading and posts collateral as required at each auction. Acceptable collateral is either cash, Letter of Credit or bank guarantee.

Transactions can only be entered into with counterparties, banks and brokers that have in place suitable legal documentation. Legal documentation is reviewed by Council's legal counsel before being executed.

Forward price transactions are limited to NZ registered banks per approved counterparties and approved ISDA documentation.

Approved financial instruments

Carbon price management	Units that are accepted by the Crown to settle obligations under the New Zealand Emissions Trading Scheme. Spot and forward purchase of carbon contracts through approved counterparty banks

17.0 Delegated Authorities and Limits

Pursuant to Clause 32 (2), Schedule 7, of the Local Government Act 2002, Council may make delegations to officers of Council to allow for the efficient conduct of Council business. Clause 32 (3), Schedule 7 of this Act allows officers to delegate those powers to other officers.

Notwithstanding Clause 32 (1) (c), Schedule 7, the power to borrow money, or purchase or dispose of assets, other than in accordance with the Long Term Plan remains the sole responsibility of the Council. This responsibility cannot be delegated.

Treasury transactions entered into without the proper authority are difficult to cancel given the legal doctrine of "apparent authority". Also, insufficient authorities for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays).To prevent these types of situations, the following procedures must be complied with:

- All delegated authorities and signatories must be reviewed at least annually to ensure that they are still appropriate and current.
- A comprehensive letter must be sent to all bank counterparties at least annually to confirm details of all relevant current delegated authorities empowered to bind Council.

Whenever a person with delegated authority on any account or facility leaves Council, all relevant banks and other counterparties must be advised in writing in a timely manner to ensure that no unauthorised instructions are to be accepted from such persons. Delegated responsibilities and authority limits are captured within Council's delegation register.

18.0 Operational Risk

Operational risk is the risk of loss as a result of human error (or fraud), system failures and inadequate procedures and controls. Operational risk is minimised through the adoption of all requirements of this Policy and detailed within Council's Treasury Procedures Manual.

19.0 Cash Management

From time to time, Council has daily cash flow surpluses and borrowing requirements, due to the mismatch of daily receipts and payments. All cash inflows and expenses pass through bank accounts controlled by the Finance Department. Council maintains a daily cash position report, and a yearly cashflow projection is prepared during the annual planning process. These reports determine Council's borrowing requirements and surpluses for investment for the year. Detail is captured within the Treasury Procedures Manual.

20.0 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.

21.0 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. If Council is unable to enforce its rights due to deficient or inaccurate documentation, Council will seek to minimise the 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 and carbon units must be signed by the Group Manager Corporate Services and the Chief Executive.
- 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.

22.0 Accounting Treatment of Financial Instruments

Council uses 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 Income Statement 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 Group Manager Corporate Services is responsible for advising the Chief Executive of any changes to relevant New Zealand Public Sector PBE Standards which 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.

23.0 Treasury Performance

In order to determine the success of Council's treasury management function, the following benchmarks and performance measures have been prescribed.

- Operational performance; compliance to Policy and treasury deadlines.
- The actual borrowing cost for Council (taking into consideration costs of entering into interest rate risk management transactions) should be below the budgeted borrowing costs.

Those performance measures that provide a direct measure of the performance of treasury staff (operational performance and management of debt and interest rate risk) are to be reported to Council or an appropriate sub-committee of Council on a quarterly basis.

24.0 Policy Review

The Policy is to be formally reviewed on a 3 yearly basis, and annually for internal purposes. The Council receives the report and approves or rejects recommended Policy changes.

Investment Policy

25.0 Purpose

Section 102(2)(c) of The Local Government Act 2002 requires Nelson City Council (Council) to adopt an investment policy which, under Section 105, must state Council's policies for its investments, including:

- the mix of investments;
- the acquisition of new investments;
- an outline of the procedures by which investments are managed and reported on to Council;
- an outline on how risks associated with investments are assessed and managed.

This investment policy has been developed as a guide to control all Council investments and may be changed only by a formal resolution of Council.

26.0 Investment Principles

The Council makes investments when they offer strategic benefits or when they are necessary for the Council to effectively carry out its functions. The Council recognises that, as a responsible public authority, any investments it holds will have an element of risk and that risk will be appropriately managed. The overall investment approach of the Council is to balance risk against long-term returns, accepting that lower risk generally means lower returns.

27.0 Objectives and Strategies

The main aim of an investment policy is to ensure the portfolio is managed in a prudent and competent manner, in terms of the governing legislation. The Council's primary objectives for investments to effectively carry out Council functions are:

- To protect the Council's investments and ensure they are risk averse and secure;
- To ensure the investments benefit the Council's ratepayers;
- Maintain a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements.

To achieve these objectives, Council's primary strategies are:

- Protect investment capital value and minimise the risk of loss;
- Optimise the investment value and return;
- Ensure investments are of a type that provides Council with funds when required;
- Diversify the mix of financial instruments;
- Promote economic and business development in Nelson (while recognising other policy considerations);
- Achieve the goals and objectives set out in the Council's Long Term Plan and Annual Plan.

28.0 Policy

The Council's general policy on investments is that Council may hold property, forestry, and equity investments if there are strategic, economic or other valid reasons, such as when an investment is the most appropriate way to administer a Council function.

The Council will not be involved in investments for purely income earning purposes, except for short-term investment of surplus funds. In this case, it will aim for maximum return with minimum risk within the parameters of the Policy.

The Council will keep under review its approach to all major investments, the monitoring of equities and the credit rating of approved financial institutions.

28.1. Policy on Acquisition of New Investments

In deciding to acquire new investments, Council considers the following questions:

Legal Issues

- Is there a statutory requirement for this investment?
- Is there a statutory authority for this investment?
- Does the Council have any other binding legal commitments to it?
- Effectiveness?
- Does the investment contribute to the Council achieving community outcomes now and in the future?
- Is there enough community interest to justify the Council's involvement?
- Does the Council have the control and influence needed to ensure the desired outcome?

Benefits

- What are the benefits – strategic, financial and others?
- Who benefits?

Risks

- What are the risks?
- Who bears them?
- How can they be managed?

Other Options

- What other options have been considered to achieve the same outcomes?

29.0 Treasury Investments

29.1. Background

The Council maintains treasury investments in order to invest:

- Surplus cash, and working capital funds;
- Funds allocated for the purpose of accumulating surplus;
- Funds allocated for approved future expenditure, implementing strategic initiatives, supporting intergenerational allocations and proceeds from the sale of assets;
- Proceeds from pre-funding activities as set out in the Liability Management Policy.

29.2. Policy

The Council's policy for its treasury investments is to use only credit-worthy counterparties with a strong Standard & Poor's rating or an equivalent credit rating agency rating as set out in the counterparty credit risk table later in this policy.

29.3. Rationale

The Council's primary objective is the protection of its investment. Council recognises that as a responsible public authority all investments held, should be low risk. Council also recognises that low risk investments generally mean lower returns.

29.4. Benefits

The main benefit of treasury investments is that they provide funds for operating and capital expenditure as needed.

29.5. Risk

Fixed rate investments are vulnerable to changes in interest rates caused by the opportunity cost of locking in investments at lower rates (than could be achieved from higher rates) and also lower rates when rolling over investments. This can impact on both the returns available, and the capital value of the investment (if sold before maturity).

The amount invested and the return is at risk from a counterparty default, where the party is unable to repay principal and interest amounts as they fall due. Accordingly, only approved credit worthy counterparties are acceptable and investment limits are imposed to avoid concentration of investment with any one counterparty.

The following principles capture the objectives outlined above and form the key assumptions of the operating parameters contained in the Counterparty Exposure Limits:

- Counterparty Credit risk (as defined in the Liability Management Policy) is minimised by placing maximum limits for each broad class of non-government issuer and by limiting investments to within prescribed limits.
- Liquidity risk (as defined in the Liability Management Policy) is minimised by managing investment maturity terms to future expenditure requirements and ensuring that all securities are capable of being liquidated.

The Council's treasury investments are structured to provide sufficient funds to meet Council's operational cash flow requirements and capital expenditure obligations as they fall due.

30.0 Investment Limits and Controls

30.1. Policy and Rules

The Council ensures it receives amounts owed to it in full and on due dates by undertaking investments only with institutions that have a strong Standard & Poor's credit rating, or an equivalent international credit agency rating, and by applying the following rules for investment counterparty controls:

- Limit total exposure to prescribed amounts, as set out in the matrix below.

30.2. Rules on Investment Risk

Approved financial instruments are as follows:

Category	Instrument
Cash management investments	Call and short term bank deposits Bank registered certificates of deposit (RCDs) less than 181 days
Investment cash received under pre-funding activities allowable under the Liability Management Policy (up to 18 months)	Bank term deposits (up to 18 months)
Investments	LGFA borrower notes (as required in conjunction with lending activity as set out in the Liability Management Policy)

Any other financial instrument must be specifically approved by the Council on a case-by-case basis and only be applied to the one singular transaction being approved.

All unsecured investment securities must be senior in ranking.

The following investment securities are expressly excluded:

- Structured debt where issuing entities are not primary borrower/issuers.
- Subordinated debt (other than borrower notes subscribed from the LGFA), junior debt, perpetual notes and debt/equity hybrid notes such as convertibles.

30.3. Counterparty Credit Risk

Counterparty credit risk is the risk of losses, realised or unrealised, arising from a counterparty defaulting on a financial instrument where the Council is a party. The credit risk to the Council in a default event will be weighted differently depending on the type of instrument entered into.

Credit risk will be regularly reviewed by the Council. Counterparties and limits can only be approved on the basis of long-term Standard & Poor's credit ratings, or equivalent international credit rating agency, being A+ and above or short term rating of A-1 or above.

Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

The following matrix guide will determine limits:

Counterparty/Issuer	Minimum S&P long term/short term credit rating	Total maximum combined limit per counterparty ($million)*
NZ Government	N/A	Unlimited
NZ Local Government Funding Agency	AA/A-1	Unlimited
NZ Registered Bank	A+/A-1	30.0
*This combined total maximum limit includes exposure to the counterparties via derivative transactions (interest rate and foreign currency) per the Liability Management Policy.		

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

- Investments (e.g. Bank Deposits) – Transaction Principal x Weighting 100% (unless a legal right of set-off exists).

30.4. Managing and Reporting on Investments

Council makes policies for property investments owned by Council, including Civic House and Council Controlled Trading Organisations.

The key reporting on investments is through the Council's Annual Report, covering the previous financial year. This is audited by Audit NZ. There are also a number of other reports to the Council or the Joint Shareholders Committee, including the six-monthly report from each Council Controlled Trading Organisation (CCTO) and the Council monthly abbreviated balance sheet and treasury compliance report. Return in relation to risk is also managed through the Statement of Intent (SOI) for CCTOs, the appointment of independent directors and the auditing of annual accounts. Further background and objectives for each type of investment are outlined in more detail below.

31.0 Infrastructure Holdings Limited (IHL)

31.1. Background

Nelson City Council and Tasman District Council have set up a holding company that holds the shareholding in Port Nelson Limited and Nelson Airport Limited. IHL's primary purpose is to operate as a centralised group treasury function with the objective of reducing borrowing costs and spreading the term of the debt portfolio. IHL is recognised as a council-controlled trading organisation (CCTO) for the purposes of the Local Government Act 2002, with Nelson City

Council and Tasman District Council owning 50% of the shares. Each Council provides a Council approved Uncalled Capital Facility to support IHL's borrowing arrangements with both the LGFA and the bank lenders.

Port Nelson Limited (PNL), which includes the wharves and much of the reclaimed land at the port, is one of Nelson's significant strategic assets. Nelson's relative isolation means the port's activities are critical to both the economy and recreation of the region. Local government was reorganised in 1989 and the Nelson Harbour Board was corporatised.

Nelson Airport is a significant strategic asset. Nelson's relative isolation means the airport's activities are critical to the economy of the region.

31.2. Policy

Nelson City Council's policy for Infrastructure Holdings Limited is to:

- Retain the Council's 50% ownership for the present;
- Review future options while still retaining community control of the port and the airport;
- Continue using dividends to ease the burden on ratepayers;
- Continue using any special dividends or capital proceeds to reduce external borrowings.

31.3. Rationale

The Council recognises that this investment is its largest in relation to total investments. The strategic importance of this gateway to the region as a natural monopoly, together with probable benefits from dividends, currently justifies the financial risk, which itself is acceptable.

31.4. Benefits

The benefits of Council's investment in Infrastructure Holdings Limited are ongoing and long term, though not guaranteed. The key strategic benefit is public control over critical strategic assets for the region with significant economic benefits.

31.5. Financial Benefits

Financial benefits include the following:

- any ordinary dividends will be used to ease the burden on ratepayers by being credited to the general rates account;
- Any special dividends or capital proceeds will be used to reduce external borrowings.

31.6. Risk

The risks of this investment are:

- Dividends depend on Port Nelson's and Nelson Airport's ability to generate profit;
- The uncalled capital facility provided to Infrastructure Holdings Limited to support the LGFA borrowing carries some risk to the Councils;
- There is some potential for competition from other ports to affect Port Nelson's business;
- Natural hazards and difficulty in getting full insurance coverage;
- Climate Change.

31.7. How the Investment is managed

The Council actively manages this investment by:

- Jointly appointing directors with appropriate expertise to the Board of Directors of Infrastructure Holdings Limited;

- Annually issuing a Letter of Expectation outlining the joint shareholders expectations in relation to Infrastructure Holdings Limited, Port Nelson Limited and Nelson Airport Limited;
- Annually approving and/or amending Infrastructure Holdings Limited Statement of Intent;
- Requiring a six-monthly report on Infrastructure Holdings Limited and its subsidiaries results and future outlook;
- Regularly considering the investment management options summarised below.

31.8. Options

Other options that Council could consider to reduce its exposure to risk include:

- The two Councils could sell a portion of their shareholding, though not to the extent that they would lose joint control; or
- The two Councils could sell their entire shareholding and exit the business completely.

32.0 Nelmac Limited

32.1. Background

Nelmac Limited was formed in 1995 and is 100% owned by the Nelson City Council. The company has around 60% of its contracts with the Council to provide essential services including:

- Recycling;
- Parks and open spaces management, including facilities management;
- Maintenance of the water supply, storm water, and wastewater systems;
- Conservation;
- Landscape architecture and planning.

The balance of Nelmac Ltd work is from non-Nelson City Council clients sourced on the open market. It currently owns its base in Bullen Street, and has modern maintenance plant, vehicles, and equipment.

32.2. Ten Year Goal

Retain community control of Nelmac Limited with a modest growth goal.

32.3. Policy

Nelson City Council's policy for Nelmac Ltd is to:

- Retain Nelson City Council ownership as a strategic partner delivering key services to Council;
- Continue using Nelmac dividends to ease the burden on ratepayers;
- Maintain a focus on Nelson City Council work by undertaking work for other clients only where:
    - The additional scale of work improves the level of service available to the Nelson City Council;
    - The work is clearly profitable;
    - After giving due consideration to Nelmac Limited's place in the market and the capital requirement.

32.4. Rationale

The Council believes it is important to retain control over the critical services that Nelmac Limited provides for the city. In addition, the company is performing well and Council considers it is desirable for several reasons to keep the company's business, profits, and spending within the Nelson community.

32.5. Benefits

The benefits of the investment in Nelmac Limited are ongoing, although these are not guaranteed. The strategic benefits are that Council retains control over critical services provided by Nelmac Limited. It also provides true and complete costing information on contractor performance.

32.6. Financial Benefit

Any dividends are used to ease the burden on the ratepayer by being credited to the general rates account.

32.7. Risks

The risks of this investment are:

- Returns depend on Nelmac Limited's ability to generate revenue and profit;
- The investment relies on Nelmac Limited's ability to provide an effective and efficient service to Council.

32.8. How the Investment is managed

The Council manages this investment by:

- Appointing all directors on Nelmac Limited Board of Directors;
- Annually approving and/or amending Nelmac Limited Statement of Intent;
- Annually issuing a Letter of Expectation outlining the shareholder's expectations;
- Requiring a six-monthly report on Nelmac Limited results and future outlook.

32.9. Options

Council regularly reviews its investment in Nelmac Limited.

33.0 Forestry

33.1. Background

The Council has invested in and been involved in managing forestry interests since the 1940s including Council-owned forests in the Brook, Marsden, Maitai and Roding. The total net stocked area as at 30 June 2024 is estimated at approximately 600 hectares.

Following a review in 2016, Council agreed to remain in commercial forestry but to transition approximately 25% of its commercial forestry to alternative forest.

That work was followed up with a comprehensive review in 2023 as to how Council-owned commercial forestry should be managed. That review recommended that Council transition away from commercial forestry into continuous-canopy forest systems, mostly of mixed species, that best meet community values and address climate risks and to manage all Council forests as a single, multi-purpose forest system encompassing all conservation, water and landscape reserves (approximately 10,000+ Ha). These recommendations were supported by Council who resolved accordingly on the 9 November 2023 and will be consulted on as part of the 2024-34 LTP.

33.2. Policy

The Council's current policy (as at 9 November 2023) for commercial forestry is to transition to a mixed species continuous canopy forest system.

Recognising that this will be a long-term undertaking, in the case that Council intends to harvest existing commercial forestry, Council will:

- Endorse and observe the provisions of the New Zealand Forest Accord (August 1991);
  - Comply with the National Environmental Standard on Commercial Forestry;
  - Comply with and maintain Forestry Stewardship Council (FSC) certification;
  - Implement best practice forest industry standards whilst protecting environmental, biodiversity and recreational values;
  - To fulfil its obligations under the NZ Emissions Trading Scheme (as set out in the Liability Management Policy).

33.3. Rationale

The rationale for transitioning away from commercial forestry and to manage all forests as a whole is based on many factors including low financial returns of its commercial blocks, acknowledging that Nelson is set against a forested landscape much of which drains through the city and its suburbs, and is a valuable community asset particularly in the face of a rapidly changing climate.

33.4. Benefits

Transitioning away from commercial forestry will enhance the many environment, recreational, biodiversity and social benefits recognising public access for walking, biking, hunting and other recreation.

33.5. Financial Risks

The cost to transition to mixed-species continuous canopy forest systems is anticipated to cost in the range of $13,000-$84,000 per hectare and is expected to be rate funded. To improve the transition's affordability, Council has been recommended to undertake an independent costs and benefit analysis to identify opportunities to raise revenue for transition costs via:

- selling identified cutting rights to select stands for one rotation, inclusive of conditions relating to: ongoing public access, forest management, harvesting, time frames and hand-back;
- optimising New Zealand Emissions Trading Scheme benefits from eligible stands;
- using local government powers to raise loans or levies through facilities specifically supporting nature-based investments."

33.6. Environmental Risk and Benefits

Transitioning away from commercial forestry will lead to better environmental outcomes and will reduce risks from commercial logging, including: reduced erosion and sedimentation of natural waterways, impacts on municipal water supply, enhanced slope stability and flood management, enhanced biodiversity, permanent carbon sequestration and enhanced community values.

33.7. How the Investment is managed

The Council will actively manage its commercial forestry assets during the transition phase by:

- Contracting out forest management to reputable service providers and harvesting at the appropriate time to maximise returns and in accordance with governance resolutions;
- Maintaining appropriate insurance cover for fire and wind damage.

34.0 Property Investments

34.1. Background

The Council owns a large number of properties but the majority of these are not held for investment purposes. Most Council properties are occupied by the Council for community facilities, to enable the delivery of services; conservation reserves; reserves for recreation; utilities; or roads. In most of these cases there is no intention to dispose of these properties because of their ongoing benefits to the community. A small number of Council properties are owned for investment or strategic purposes that include a component of investment benefit. Although the Council has taken part in subdivision developments in the past, it does not currently pursue further subdivision opportunities as an investment.

34.2. Policy

The Council's general policy on property investments is:

- The Council will not be involved in property investments purely for income earning purposes;
- There might be strategic, social, or other valid reasons for Council to be involved in property ownership or investment, for example when it is the most appropriate way to administer a Council function or achieve community outcomes;
- The Council will not become involved in any further property development or major subdivisions unless there are Council objectives or social benefits arising from the investment that cannot be achieved by other means.

Subject to the first two policies above, the Council may take a facilitating role in subdivisions, whether or not it owns all the land to be subdivided.

35.0 Loans and Advances to Community Groups and Ratepayers Miscellaneous Loans and Advances

35.1. Background

The Council occasionally provides loans and advances to assist a community group or ratepayer to fund a capital work that is in the best interests of the Council and community. These loans and advances are provided only on rare occasions, and only with the prior agreement of the Council.

36.2. Policy

The Council's policy for miscellaneous loans and advances to community groups and ratepayers is to continue providing loans and advances but only as a means to achieve a particular objective consistent with the Council's strategic goals and policies and with the prior approval of the Council. Where loans relate to buildings on Council land, the Council will take security over the building and chattels.

35.3. Risks

Risks are specific to each loan and are mainly around the ability of the community group or ratepayers to repay the loan.

35.4. How these Investments are managed

Loans are monitored by Council management and recommendations are made to Council if action is considered to be required.

36.0 Civic Financial Services Limited (previously New Zealand Local Government Insurance Corporation Limited)

36.1. Background

Civic Financial Services Limited was initially set up as a national corporation to ensure local authorities have access to adequate insurance arrangements at a reasonable cost. Almost all local authorities became shareholders. The value of shares held by Nelson City Council, which was $140,000 as at 30 June 2020, is not significant relative to the Council's total investment holdings.

Services administered by Civic Financial Services Ltd include LAPP (www.lappfund.co.nz) and the SuperEasy and SuperEasy KiwiSaver Superannuation Schemes (www.supereasy.co.nz).

36.2. Rationale

Council originally invested in Civic Financial Services Limited to ensure that the insurance market is competitive and that the local government sector is in a strong position to manage its own risk. Given the changes in the insurance market post the Christchurch earthquakes, Civic Financial Services Limited has now withdrawn from the insurance market. As shares are not readily transferable it is unlikely a reasonable offer for their purchase would be received by Council.

36.3. Risks

Risks associated with Civic Assurance are mitigated with the use of suitably qualified staff and directors of the company.

36.4. How the Investment is managed

The investment is managed through the Statement of Intent and Annual Reporting process as well as voting for directors.

Glossary of Terms

Amortising Swap: An interest rate swap contract that has a reducing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an amortising swap is the weighted average maturity, not the final maturity date.

Accreting Swap: An interest rate swap contract that has an increasing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an accreting swap is the weighted average maturity, not the final maturity date.

Arbitrage: A method or action that allows the securing of profit (with no market risk) by taking advantage of a mispricing of one financial instrument between two markets/time zones.

Bank Bill: A "bill of exchange" security document issued by a corporate borrower, but guaranteed by a bank, who then in turn sells the security into the bank/investor market to re-liquefy itself with cash. Normally for terms of 30, 60, 90 or 180 days.

Base Rate: Normally a lending bank's cost of funds/interest rate for a particular funding period. The base or "prime" rate will be changed by the bank from time to time, but not every day like market rates.

Basis Point(s): In financial markets it is normal market practice to quote interest rates to two decimal places, e.g. 6.25% - one basis point is the change from 6.25% to 6.26%, one hundred basis points is the change from 6.25% to 7.25%.

Basis Risk: The risk that the interest rate difference between the current physical debt instrument (say, a bank bill) market interest rate and the interest rate quoted for that debt instrument's future price (say, a bank bill futures price) changes over the period to the date of the future price.

Benchmark: An agreed market related yardstick that investor returns, funding costs or average exchange rate achieved are compared against for performance measurement purposes.

Bid-Offer Spread: The exchange points (FX) or basis points (interest rates) difference between the bid and offer rate when quoted by a bank is known as the "bid-offer spread". Banks make their profits from dealing at their own bid and offer prices, thus earning the spread.

Bid Rate: Exchange rates and interest rate securities/instruments that are traded between banks are always quoted as a two-way price. One rate is where the quoting bank will buy – the bid rate, the second rate or price where the bank will sell at – the offer rate.

BKBM: The FRA settlement rate as determined at 10:45am each business day on Reuters page BKBM.

Bond: The security instrument that is issued by a borrower whereby they promise to repay the principal and interest on the due dates. A bond's interest rate is always fixed.

Bond FRA: A tailored contract to buy or sell a bond (government or corporate) at a fixed interest rate at some specified future date. The Bond FRA contract rate will differ from the current physical market bond yield, depending on the slope of the interest rate yield curve.

Bond Option: The right, but not the obligation by the owner/holder of the option to buy or sell bonds (government or corporate) at a predetermined interest rate at a specified future date. The buyer pays a "premium" in cash up-front to reduce risk and have insurance-type protection, the seller or grantor of the bond option receiving the premium for assuming the risk.

Call Option: The owner or buyer of a call option has the right, but not the obligation, to buy the underlying debt security/currency/commodity at the price stated in the option "contract".

Cap: A series or string of bought interest rate put options whereby a borrower can have protection against rising short-term interest rates, but participate in the lower rates if market rates remain below the "capped rate". A cap is normally for more than one 90-day funding period.

Certificate of Deposit "CD": A debt instrument (normally short-term) issued by a bank to borrow funds from other banks/investors.

Closing-Out: The cancellation/termination of a financial instrument or contract before its maturity date, resulting in a realised gain/loss as the current market rate differs from the contract rate.

Collar Two: Option contracts linked together into the one transaction or contract. A borrower's collar is normally a bought "cap" above current market rates and a sold "floor" below current rates. Over the term of the collar contract, if rates go above the cap the borrower is protected and pays an interest cost no more than the cap rate. Likewise, if market rates fall below the floor, the borrower pays the floor rate and does not participate in the lower market rates. Also called a "cylinder".

Collateral: A legal term means "security".

Commercial Paper: The debt security instrument issued by a prime (and normally credit-rated) borrower to raise short-term funds (30, 60, 90 or 180 days). Also called "one-name paper" and "promissory notes" issued by competitive public tender to investors or by private treaty to one investor.

Commoditised: When a financial market or instrument becomes so popular and "plain vanilla" that there is no longer any difference in the prices quoted by participants in the market.

Convexity: A measure of the degree of curve or slope in an interest rate yield curve.

Coupon: The interest rate and amount that will be paid on the interest due dates of a bond. The coupon will normally differ from the purchase or issue yield/interest rate on a bond instrument.

Counterparty: The contracting party to a financial transaction or financial instrument.

Covenants: Special conditions and financial ratios required to be met or maintained by a borrower for a lender under the legal security documents.

Cover: A term used to describe any action of entering financial instruments that reduces risk or puts protection in place against adverse future price movements.

Credit Risk or Exposure: The risk that the other party to a financial transaction (bank deposit, interest rate swap contract) will default on or before the maturity date and not be able to fulfil their contractual obligations.

Credit Spread: The interest rate difference (expressed as basis points) between two types of debt securities. The credit spread being a reflection of the difference in credit quality, size, and liquidity between the two securities e.g. five year corporate bonds may be at a credit spread of 200 basis points above Government bonds.

Current Ratio: A liquidity measure to determine how quickly Council can generate cash. Current assets are divided by current liabilities.

Debenture: A debt instrument similar to a bond whereby a borrower (normally a finance company) borrows for a longer term at a fixed rate. Also a legal instrument provided as security to a lender.

Delta: "Greek" letter that measures how the price of an option (premium) changes given a movement in the price of the underlying asset/instrument.

Derivative(s): A "paper" contract whose value depends on the value of some "underlying" referenced asset e.g. share market stocks, bank bills, bonds or foreign currency. Also called a "synthetic". The value of the assets will change as its market price changes; the derivative instrument will correspondingly change its value.

Discount: A bond or bank bill is discounted when the interest rate is applied to the face value of the security and the net proceeds after deducting the interest is paid out to the borrower. Investors pay for the discounted (NPV) value at the commencement of the investment and receive the interest coupon payments along the way and the full face value at the maturity date.

Duration: Not the simple average maturity term of a debt or investment portfolio, but a measure of the interest rate risk in a portfolio at a particular point in time. The duration of a portfolio is the term (measured in years and months) if the total portfolio of bonds/fixed interest investments was revalued at market rates and expressed as one single bond. The profit/loss on revaluation of a one basis point movement being the same in both cases.

Embedded Option: An option arrangement that may be exercised by a borrower at a future date, but the determining conditions are buried or "embedded" in a separate debt or financial instrument.

Emissions Trading Scheme (ETS): 'Emissions trading' is a market-based approach for reducing emissions of greenhouse gases. The ETS puts a price on emissions, by charging certain sectors of the economy for the greenhouse gases they emit. These sectors are required to acquire and surrender New Zealand Units (NZUs) or other eligible emission units to account for their direct greenhouse gas emissions or the emissions associated with their products.

Eurodollar: The borrowing and depositing of a currency outside its domestic financial markets.

Event Risk: The risk of a major/unforeseen catastrophe e.g. earthquake, year 2000, political elections adversely affecting a Council's financial position or performance.

Exchange Traded: A currency, debt or financial instrument that is quoted and traded on a formal exchange with standardised terms, amounts and dates.

Exercise Date/Price: The day and fixed price that an option contract is enforced/actioned or "exercised" because it is in the interests of one of the parties to the contract to do so.

Fair Value: The current market value of an off-balance sheet financial instrument should it be sold or closed-out on the market rates ruling at the balance date.

Federal Reserve: The US Government's central bank and/or monetary authority.

Fixed Rate: The interest rate on a debt of financial instrument is fixed and does not change from the commencement date to the maturity date. Fixed is defined as an interest rate that does not change in the next 12 months.

Floating Rate: The interest rate on a loan or debt instrument is re-set at the ruling market interest rates on the maturity date of the stipulated funding period (usually 90-days). Floating is defined as an interest rate that changes in the next 12 months.

Floor: The opposite of a "cap: An investor will buy a floor, or a series/string of call options (the right to buy) to protect against falling interest rates, but be able to invest at higher interest rates if rates move upwards. A borrower may sell a floor as part of a collar structure to generate premium to pay for the "linked" bought cap.

Forward Rate Agreement: A contract ("FRA") whereby a borrower or investor in Bank Bills or Government Bonds agrees to borrow or invest for an agreed term (normally 90-days) at a fixed rate at some specified future date. A FRA is an "over-the-counter" contract as the amount and maturity date is tailored by the bank to the specific requirements of the borrower/investor.

Forward Start Swap: An interest rate swap contract that commences at a future specified date. The rate for the forward starting swap will differ from the current market rate for swaps by the shape and slope of the yield curve.

Funding Risk: The risk that a borrower cannot re-finance its debt at equal or better terms at some date in the future, in terms of lending margin, bank fees and funding time commitment. Funding risk may increase due to the Council's own credit worthiness, industry trends or banking market conditions.

Futures: Exchange-traded financial and commodity markets which provide forward prices for the underlying asset, instrument or commodity. Futures contracts are standardised in amount, term and specifications. Futures markets are cash-based, transacting parties do not take any counter party credit risk on each other. Deposits and margin-calls are critical requirements of all futures markets.

Gamma: "Greek" letter used in option pricing that measures how rapidly the delta of an option changes given a change in the price of the underlying asset/instrument.

Hedging: The action of reducing the likelihood of financial loss by entering forward and derivative contracts that neutralise the price risk on underlying financial exposures or risks. The gain or loss due to future price movements on the underlying exposure is offset by the equal and opposite loss and gain on the hedge instrument.

High-Yield Bonds: Corporate bonds issued by borrowing companies that are non-prime i.e. have a low or no credit rating. The margin or credit spread above Government bonds yields is high (>300 basis points) to compensate the investor into the bond for the higher credit and liquidity risk.

Implied Volatility: Used in option pricing. To estimate the future volatility of the underlying asset or instrument, the option pricing models use historical volatility (expressed as percentage) as a key variable to calculate the option premium amount. The movement in option prices is therefore a good indicator of future market volatility, as volatility is "implied" in the option price.

Index Linked Bonds: Debt instruments that pay an interest coupon or return that is wholly or partially governed by the performance of another separate index e.g. a share market index, or the gold price.

ISDA International Swaps Dealers Association: A governing body that determines legal documentation/standards for over-the-counter swaps/options/FRAs and other derivative instruments for interest rates, currencies, commodities etc. Corporate users of such instruments sign an ISDA Master Agreement with banking counterparties that covers all transactions.

Incidental Arrangements: The term used in the Local Government Act for interest rate risk management instruments or derivatives.

Interest Rate Collar Strategy: the combined purchase (or sale) of a cap or floor with the sale (or purchase) of another floor or cap.

Interest Rate Swaption: the purchase of a swaption gives Council the right but not the obligation to enter into an interest rate swap, at a future date, at a specific interest rate.

Interest Rate Swaps: A binding paper contract where one party exchanges, or swaps, its interest payment obligations from fixed to floating basis, or floating to fixed basis. The interest payments and receipts under the swap contract being offsetting, equal and opposite to the underlying physical debt.

"In-the-Money" Option: An option contract that has a strike price/rate that is more favourable or valuable than the current market spot or forward rate for the underlying currency/instrument.

Inverse Yield Curve: The slope of the interest rate yield curve (90-days to years) is "inverse" when the short-term rates are higher than the long-term rates. The opposite, when short-term rates are lower than long-term interest rates is a normal curve or "upward sloping". In theory, a normal curve reflects the fact that there is more time, therefore more time for risk to occur in long-term rates; hence they are higher to build in this extra risk premium.

Liability Management: The policy, strategy and process of proactively managing the treasury exposures arising from a portfolio of debt.

LIBOR: London Inter-bank Offered Rate, the average of five to six banks quote for Eurodollar deposits in London at 11.00 am each day. The accepted interest rate-fixing benchmark for most offshore loans.

Limit(s): The maximum or minimum amount or percentage a price or exposure may move to before some action or limitation is instigated. Also called "risk control limits".

Liquidity Risk: The risk that Council cannot obtain cash/funds from liquid resources or debt facilities to meet foreseen and unforeseen cash requirements. The management of liquidity risk involves working capital management and external bank/credit facilities.

Local Government Funding Agency (LGFA): The LGFA was enabled under the Local Government Borrowing Act 2011. It is a Council Controlled Organisation operating under the LGA. Its purpose is to provide more efficient funding costs and diversified funding sources for the sector (local authorities). Each of the shareholding councils has to guarantee the obligations of the LGFA. In addition any non-shareholding council who borrows in excess of $20 million must also guarantee the obligations of the LGFA. All shareholding and borrowing councils have entered into a debenture trust deed giving security over their rates.

To ensure that the LGFA has an adequate capital structure for the level of its borrowings from the market they issue Borrowers Notes to the local authorities borrowers. They are subordinate debt instruments which are required to be held by each local authority that borrows from the LGFA. It is equal to 1.6% of the aggregate borrowings by that local authorities.

***LGFA* – "blend and extends"** of existing funding: Similar to interest rate swap blend and extends, the LGFA provides a similar restructure offering for existing funding of Council through the LGFA. Under this arrangement, the LGFA will allow Council to take the existing valuation of a bond or FRN that has a maturity date within the next 12 months and 'blend' this into a new bond with an extended maturity term. The funding margin for this extended borrowing maturity term will reflect the present value of the existing funding maturity as well as the prevailing funding margins for the extended maturity.

LGFA – **"forward commitments"**: The LGFA will, on a case by case basis, provide Councils the ability to obtain a commitment to funding provision from the LGFA ahead of the physical requirement for funds.

"Long" Position: Holding an asset or purchased financial instrument in anticipation that the price will increase to sell later at a profit.

Marked-to-Market: Financial instruments and forward contracts are revalued at current market rates, producing an unrealised gain or loss compared to the book or carrying value.

Margin: The lending bank or institution's interest margin added to the market base rate, normally expressed as a number of basis points.

Medium Term Notes: A continuous programme whereby a prime corporate borrower has issuance documentation permanently in place and can issue fixed rate bonds at short notice under standard terms.

Moody's: A rating agency similar to Standard & Poor's.

Multi-currency facility: A committed banking facility that allows the borrowing of several alterative currencies to the NZ dollar.

Netting: Method of subtracting currency receivables from currency payables (and vice versa) over the same time period to arrive at a net exposure position.

Open Position: Where a Council has purchased or sold an asset, currency, financial security or instrument unrelated to any physical exposure, and adverse/favourable future price movements will cause direct financial loss/gain.

Option Premium: The value of an option, normally paid in cash at the commencement of the option contract, similar to an insurance premium.

Order: The placement of an instruction to a bank to buy or sell a currency or financial instrument at a preset and pre-determined level and to transact the deal if and when the market rates reach this level. Orders are normally placed for a specific time period, or "good till cancelled". The bank must deal at the first price available to them once the market level is reached. Some banks will only take orders above a minimum dollar amount.

"Out-of-the-Money": An option contract which has a strike price/rate that is unfavourable or has less value than the underlying current spot market rate for the instrument.

Over-the-Counter: Financial and derivative instruments that are tailored and packaged by the bank to meet the very specific needs of the corporate client in terms of amount, term, price and structure. Such financial products are non-standard and not traded on official exchanges.

Perpetual Issue: A loan or bond that has no final maturity date.

Pre-hedging: Entering forward or option contracts in advance of an exposure being officially recognised or booked in the records of the Council.

Primary Market: The market for new issues of bonds or MTNs.

Proxy Hedge: Where there is no forward or derivative market to hedge the price risk of a particular currency, instrument or commodity. A proxy instrument or currency is selected and used as the hedging method as a surrogate. There needs to be a high correlation of price movements between the two underlying prices to justify using a proxy hedge.

Put Option: The right, but not the obligation to sell a debt security/currency/commodity at the contract price in the option agreement.

Registered Certificate of Deposit (RCD): A debt instrument (normally short-term) issued by a bank to borrow funds from other banks/investors.

Revaluation: The re-stating of financial instruments and option/forward contracts at current market values, different from historical book or carrying values. If the contracts were sold/bought back (closed-out) with the counter party at current market rates, a realised gain or loss is made. A revaluation merely brings the contract/instrument to current market value.

Roll-over: The maturity date for a funding period, where a new interest rate is reset and the debt re-advanced for another funding period.

Secondary Market: The market for securities or financial instruments that develops after the period of the new issue.

"***Short" Position***: Selling of an asset or financial instrument in anticipation that the price will decrease or fall in value to buy later at a profit.

Spot Rate: The current market rate for currencies, interest rates for immediate delivery/settlement, and normally two business days after the transaction is agreed.

Standard & Poor's: A credit rating agency that measures the ability of an organisation to repay its financial obligations.

Stop Loss: Bank traders use a "stop-loss order" placed in the market to automatically closeout an open position at a pre-determined maximum loss.

Strike Price: The rate or price that is selected and agreed as the rate at which an option is exercised.

Strip: A series of short-term interest rate FRAs for a one or two year period, normally expressed as one average rate.

Structured Options: An option instrument where the relationship/profile to the underlying referenced asset or liability is not linear, i.e. 1:1.

Swap Deferral: A swap in which the payments are deferred for a specified period.

Swaption: An option on an interest rate swap that if exercised the swap contract is written between the parties. The option is priced and premium paid similar to bank bill and bond interest rate options.

Swap Spread: The interest rate margin (in basis points) that interest rate swap rates trade above Government bond yields.

Station: An option on an interest rate swap that if exercised the swap contract is written between the parties. The option is priced and premium paid similar to bank bill and bond interest rate options.

Time Value: Option contracts taken for longer-term periods may still have some time value left even though the market rate is a long way from the strike rate of the option and the option is unlikely to be exercised.

Tranches: A loan may be borrowed in a series of partial drawdowns from the facility, each part is called a tranche.

Treasury: Generic term to describe the activities of the financial function within Council that is responsible for managing the cash resources, financial investments, debt, and interest rate risk.

Treasury Bill: A short-term (<12 months) financing instrument/security issued by a government as part of its debt funding programme.

Vega: Another "Greek" letter that is the name given to the measure of the sensitivity of the change in option prices to small changes in the implied volatility of the underlying asset or instrument price.

Volatility: The degree of movement or fluctuation (expressed as a percentage) of an asset, currency, commodity or financial instrument price over time. The percentage is calculated using mean and standard deviation mathematical techniques.

Yield: Read-interest rate, always expressed as a percentage.

Yield Curve: The plotting of market interest rate levels from short-term (90-days) to long-term on a graph i.e. the difference in market interest rates from one term (maturity) to another.

Zero Coupon Bond: A bond that is issued with the coupon interest rate being zero i.e. no cash payments of interest made during the term of the bond, all interest paid on the final maturity date. In effect the borrower accrues interest on interest during the term, increasing the total interest cost compared to a normal bond of paying interest quarterly, half-yearly or annually.