greater WELLINGTON
THE REGIONAL COUNCIL

Treasury Management Policy

March 2003

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1. Treasury Policy Overview

The Council undertakes borrowing, investment and risk management activities. ("Treasury activities") These treasury activities are carried out within the requirements of the Local Government Act 2002.

This Treasury Management Policy, which incorporates Council's liability management and investment policies, provides the policy framework for all of the Council's treasury activities and defines key responsibilities and the operating parameters within which borrowing, investment and risk management activity are to be carried out. It covers treasury activities at the Council level and at the total Group level as the Council provides treasury management services to its 100% owned subsidiary companies using the treasury management framework outlined in this policy. However, the Council's main operating subsidiary, CentrePort Ltd has its own Treasury Management Policy.

This policy will be reviewed and updated at least each three years as part of the update of Council's Long-term Council Community Plan.

1.1 Borrowing

The capital works programme, mainly related to regional water supply, flood protection and forestry activities largely drives the Council's borrowing activity. The Council's borrowing policy is discussed in Section 2 of this document.

1.2 Investments

The Council manages a significant portfolio of investments comprising equity investments, forestry, property, special funds, sinking funds, bank deposits and advances.

The Council's investment policy is discussed in Section 3 of this document.

1.3 Philosophy with respect to Treasury activities

The Council acknowledges that there are various financial risks such as interest rate risk, liquidity risk and credit risk arising from its borrowing and investment activities.

The Council is a risk averse entity and does not wish to incur additional risk from its treasury activities. Therefore the focus of the Council's treasury function is on protecting the Council's budgeted interest costs and stabilising the Council's cashflows.

- **The Council will only undertake treasury risk management activities that are related to its underlying cashflows.**

1.4 Policy Setting and Management

The Council approves policy parameters in relation to its treasury activities through the adoption of this policy.

The Council also exercises on-going governance over its subsidiary companies (WRC Holdings Ltd, Pringle House Ltd, Port Investments Ltd and the CentrePort group of companies). In particular, the Council is involved in approving the Constitutions, Statements of Intent and appointing the Directors of these companies. In addition, the Council exercises ongoing governance over the Wellington Regional Stadium Trust to ensure that its interests in the Stadium Trust are appropriately protected.

The Council's Chief Financial Officer (CFO) has overall financial management responsibility for the Council's Treasury activities.

The Council has established a Treasury Management Group (TMG) to oversee, manage and monitor the risks arising from its treasury activities. The TMG is responsible for:

- Providing advice to Council and recommending changes to the Treasury Management Policy;
- Approving treasury strategy and ensuring that it is consistent with the Long-term Council Community Plan, appropriate legislation and the Treasury Management Policy;
- Evaluating the treasury function's performance and effectiveness;
- Monitoring compliance with legislation and the Treasury Management Policy.

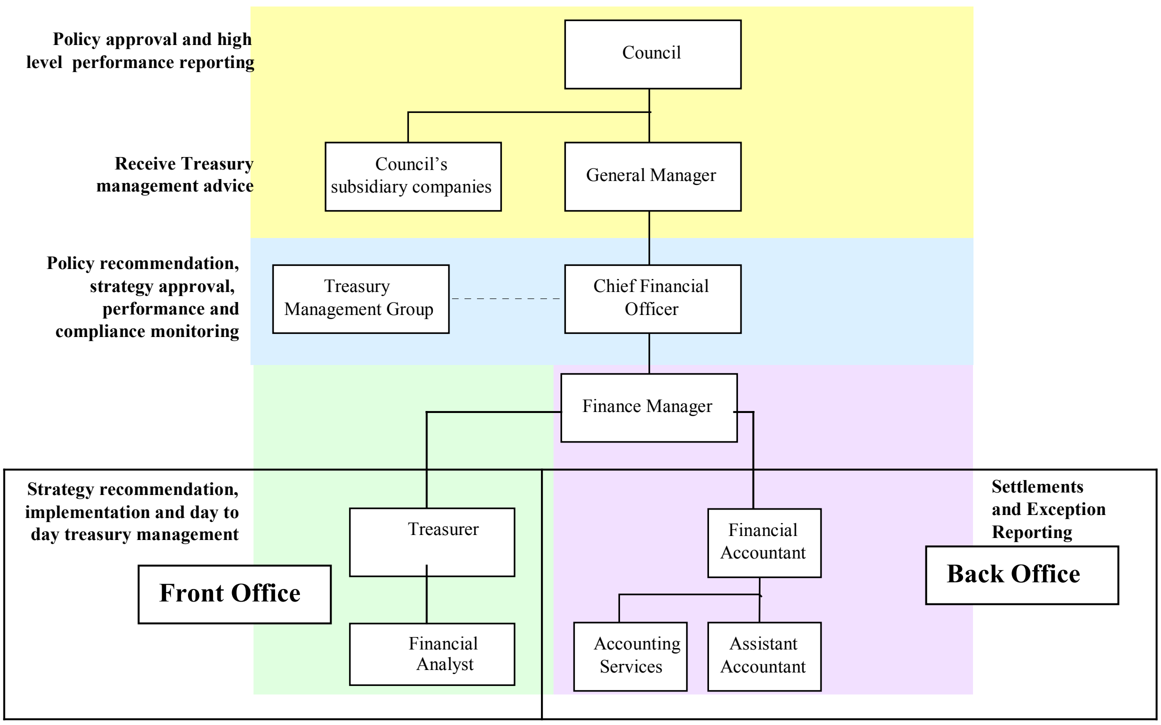
Details of the composition of the TMG are included in Appendix I. The CFO is Chairman of the TMG.

The Council's treasury function manages the Council's borrowing, investments and cash management activities and is broadly charged with responsibility to:

- Develop and maintain professional relationships with financial markets in general, as well as the Council's bankers and investment advisors;
- Manage the Council's borrowing programme to ensure funds are readily available at margins, costs, maturities and interest rates favourable to the Council;
- Manage the Council's investment portfolio;
- Manage the overall cash and liquidity position of the Council's operations to ensure that surplus cash is invested in appropriate instruments in terms of liquidity and credit risk;
- Manage the impact of market risks such as interest rate risk by undertaking hedging activity in the financial markets;
- Avoid adverse interest rate related increases on ratepayer charges and maintain an overall interest cost within budgeted parameters;
- Realise the economies of scale from operating as a centralised function on behalf of Council's operating divisions and business units;
- Manage the Council's internal debt portfolio;
- Manage the Council's internal reserves;

- Provide timely and accurate reporting of treasury activity and performance.

The following organisation chart represents the Council's treasury activities.



2. Borrowing Policy

2.1 General Borrowing Policy

The Council borrows as it considers appropriate pursuant to the Local Government Act 2002. The Council approves the overall borrowing programme for each financial year during the annual planning process, although specific approval for any new borrowing facility is approved by the Council. The arrangement of the precise terms and conditions associated with each borrowing is generally delegated to the CFO through the appropriate Council resolution.

The Council has large infrastructural assets with long economic lives that yield long term benefits (particularly regional water supply and flood protection assets) as well as significant strategic investment holdings. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to the Council's assets and investments.

External debt in the context of this policy refers to the Council's net external public debt, which is derived from the Council's gross external public debt, reduced by the amount of the Council's sinking funds.

The Council raises external debt primarily for the following purposes:

- To fund Council's capital expenditure programme;
- To manage timing differences between cash inflows and outflows and to maintain appropriate liquidity;
- To fund one-off projects (e.g. Council's involvement in the Stadium);
- To fund other investment activity as appropriate.

In approving new external debt the Council considers the impact on its borrowing limits (refer Section 2.2).

2.2 External Borrowing Limits

In managing external debt the Council will adhere to the following limits (based on the Council's latest financial statements) with the objective of maintaining a long-term credit rating of at least AA- from Standard & Poor's:

2.2.1 Core Council

- **Total interest expense (after interest rate risk management costs/benefits) on net external public debt will not exceed 20% of total annual rates and levies;**
- **Percentage of net external public debt to annual rates and levies will not exceed 175%;**
- **Net external public debt per capita will not exceed $300.**

2.2.2 Consolidated Group

- **Net interest expense will not exceed 10% of total operating revenue;**
- **Net external debt will not exceed 100% of total operating revenue.**

2.3 Borrowing Mechanisms

The Council's ability to readily attract low risk, cost effective borrowing is largely driven by its ability to rate the community, maintain a strong credit rating and manage its relationships with investors and financial institutions.

The Council uses a mixture of facilities to achieve an effective borrowing mix, balancing the requirements of risk, liquidity and cost. In evaluating strategies for new borrowing the TMG takes into account the following:

- The Council's projected external debt levels in future years;
- The Council's overall external debt maturity profile. Concentration of external debt is avoided at reissue/rollover time (excluding routine rollovers as part of a committed facility);
- Current interest rates and margins relative to term;
- The market's outlook for future interest rate movements as well as TMG's own outlook;
- Different terms from the funding options available to the Council (including banks, capital markets and issuing local government stock);
- Specific implied finance terms within proposed funding (e.g. project finance terms).
- Legal documentation and financial covenants.

2.4 Liquidity Risk Management

Liquidity risk management refers to the timely availability of funds when needed, without incurring penalty costs. Funds are required to support the Council's day to day operations and may be required to fund withdrawals from Council reserves. The Council does not hold its reserves in cash and although some drawdowns against reserves are planned, other reserves are contingency reserves (e.g. flood contingency) and need to be available at short notice (for further information on reserves refer Section 2.9).

The Council minimises its liquidity risk by:

- Endeavouring to match expenditure closely to its revenue streams and managing cashflow timing differences to its favour;
- Ensuring, that where sinking funds are maintained to repay borrowing such funds are held for maturities not exceeding the borrowing repayment date (see Section 3.5);
- Maintaining a mixture of liquid financial investments, undrawn committed lines and uncommitted credit lines with its relationship banks;

- Minimising the risk of large concentrations of debt maturing or being reissued when credit margins are high by ensuring that debt maturity is spread widely over a band of maturities.

Specifically for current debt and planned debt the Council manages liquidity by ensuring that:

- **A mixture of undrawn committed lines and liquid investments of no less than $7.5 million are available for normal operations;**
- **A mixture of undrawn committed lines and liquid financial investments are available for the Council's self-insured infrastructural assets and contingency reserves. The amount is to be calculated annually (currently $42 million).**

2.5 Borrowing Interest Rate Risk Management

Interest rate risk refers to the impact that movements in interest rates can have on the Council's cashflows. The Council is exposed to interest rate risk on the maturity of existing fixed rate external debt that will be refinanced, on floating external rate debt (that is not hedged) and on planned new external debt.

Generally, the Council tends to have a high percentage of fixed rate or hedged borrowing because of:

- The Council's desire to have predictable interest costs that avoid large adverse impacts on annual rates and levies arising from interest rate movements;
- The long term nature of the Council's assets and the related intergenerational factors.

However, at times it is appropriate for the Council to have a proportion of borrowing with a floating rate profile to give the Council flexibility in managing its cash flows and to take advantage of favourable interest rates.

The Council's policy in managing interest rate risk on borrowings is:

- **The CFO will be able to approve (following a recommendation from the TMG) hedging, which must be within the following parameters:**
  - **Planned external debt within the next three years, minimum hedged 40%, maximum hedged 100%;**
  - **Planned external debt between three and six years, minimum hedged 20%, maximum hedged 90%;**
  - **Planned external debt beyond six years, minimum hedged 0%, maximum hedged 80%.**

The Council utilises interest rate risk management instruments (derivatives) to convert fixed rate borrowing into floating rate or hedged borrowing, and where appropriate floating rate borrowing into fixed rate or hedged borrowing.

The Council's policy in relation to the use of derivatives on borrowings is:

- **Only interest rate risk management instruments that have been approved by Council can be used;**
- **Additions to, and deletions from the list of approved interest rate risk management instruments can only be approved by the Council;**
- **The CFO has delegated authority to authorise the use of Council approved interest rate risk management instruments on a case by case basis.**

A current list of approved interest rate risk management instruments with appropriate definitions is included in the Risk Management Toolkit in Appendix II.

2.6 Granting of Security

The Council's policy on granting of security over Council assets is:

- **The Council will not offer security over Council assets for general borrowings. However in unusual circumstances security may be offered over specific assets, but only with prior Council approval.**

All Council debt issued before 30 June 1997 is secured against separate rates and levies, whereas all debt issued after 1 July 1997 is unsecured, supported by a negative pledge.

The negative pledge is a document designed to give an investor with the Council comfort that even though they will not be granted security, no other investor will be granted security. This ensures that all investors will be unsecured and rank equally.

2.7 Debt Repayment

The Council may use rates/levies, surplus funds, proceeds from the sale of investments and assets, or sinking funds to repay debt.

The Council's policy in relation to repayment of debt is:

- **Surplus funds and proceeds from the sale of investments and assets will be used to repay debt, unless the Council determines otherwise.**

2.8 Internal Debt Management

The treasury function is responsible for administering the Council's internal debt portfolio. Internal loans are set up within the internal debt portfolio for each department's loan funded capital expenditure (or operating expenditure in the case of forestry).

The Council approves the internal debt programme for each financial year during the annual planning process, although the arrangement of the precise terms and conditions associated with each borrowing is delegated to the CFO.

The following operational parameters apply to the management of the Council's internal debt portfolio:

- Each month an internal loan for each department is set up based on new capital expenditure and other internal borrowing requirements;
- Interest is charged by treasury to each department on the outstanding internal debt balance each month at the internal debt interest rate;
- The internal debt interest rate is reviewed annually as part of the annual planning process for the next financial year. The internal debt interest rate is based on:
  - The Council's expected weighted average cost of funds;
  - Recovery of treasury's operational costs;
  - A margin to compensate treasury for risk.
- Principal on internal loans is paid off over the life of each internal loan so that the sum of interest and principal remains constant over the life of the loan (except where the interest rate is adjusted);
- The internal loan lives are designed to spread the cost of capital works over time to ensure that current ratepayers do not pay for all the cost of assets that benefit future ratepayers (intergenerational equity). In line with prudent financial management principles, internal loan lives are set at less than the expected life of the assets they are funding (normally not greater that 50% of the expected asset life). The Council's loan lives for its major classes of assets are currently as follows:
  - Land purchases 20 years
  - Regional Water Supply assets 30 years
  - Floodplain management plans 15 years
  - Flood Protection assets 20 years
  - Forestry silviculture & roading 15 years
  - Regional parks assets 15 years
- Where funding surpluses are generated in areas of the Council that are funded separately (e.g. Water Supply, which is funded by the Bulk Water Levy) these surpluses are applied to additional debt repayment in that area of benefit (or to an area of benefit reserve). Any additional debt repayment is applied to the debt that next matures.

Internal Debt Limits and Targets

Internal debt limits are set to monitor the level of debt utilised by departments and business units. The ratios are consistent with the Council's external borrowing limits outlined in Section 2.2 and the principle of prudent financial management.

The following limits are monitored quarterly by the TMG:

Activity	Ratio	Limit
Regional Water Supply	Net Debt to Levy	300%
Regional Water Supply	Net Financial Costs to Levy	40%
Flood Protection Western	Net Debt to Rates	400%
Flood Protection Western	Net Financial Costs to Rates	50%
Flood Protection Wairarapa	Net Debt to Rates	80%
Flood Protection Wairarapa	Net Financial Costs to Rates	10%
Parks & Forests	Net Debt to Rates	50%
Parks & Forests	Net Financial Costs to Rates	10%
Forestry	Net Debt to Market Value	70%

In addition, the TMG monitors internal debt targets for areas of the Council that have significant internal debt. Internal debt targets have been established in addition to internal debt limits in order to provide guidance on the long term sustainable debt levels of each area of Council's activity, should they be stand alone. (N.B. compliance is reported against the internal debt limits rather than the internal debt targets.)

The internal debt targets are as follows:

Activity	Ratio	Target
Regional Water Supply	Net Debt to Levy	220%
Regional Water Supply	Net Financial Costs to Levy	20%
Flood Protection Western	Net Debt to Rates	250%
Flood Protection Western	Net Financial Costs to Rates	25%
Flood Protection Wairarapa	Net Debt to Rates	80%
Flood Protection Wairarapa	Net Financial Costs to Rates	10%
Parks & Forests	Net Debt to Rates	50%
Parks & Forests	Net Financial Costs to Rates	10%
Forestry	Net Debt to Market Value	35%

2.9 Reserves

The Council has a number of reserves which have been created for specific purposes which the treasury function is responsible for administering. One of the roles of treasury is to ensure that area of benefit issues are appropriately managed.

The Council does not generally hold liquid assets to support reserves, rather funding is arranged as required to match withdrawals from reserves. The Council maintains committed lines and liquid bank deposits sufficient to cover the sum of the Council's contingency reserves (refer Section 2.4).

The following operational parameters apply to the management of the Council's reserves:

- Each month transfers to reserves, transfers from reserves and reserve interest adjustments are made based on movements included in the annual plan and adjusted for actual movements;
- Reserve interest is applied by treasury to each reserve each month at the reserve interest rate;
- The reserve interest rate is reviewed annually as part of the annual planning process. For normal balances (where the reserve balance is positive) the reserve interest rate is based on:
  - The Council's marginal cost of borrowing;
  - Less a margin to recover treasury's operational costs.

  For negative reserve balances (where the department owes treasury) the reserve interest rate is set the same as the internal debt rate (refer Section 2.8).
- Where a reserve balance is negative adjustments are made (at the next budget round) to planned transfers to reserves to bring the reserve balance back into funds within, what the CFO considers to be, an appropriate period of time (generally three years).
- Where funding surpluses or deficits are generated in areas of the Council that are funded separately (e.g. Transport is funded by the Transport Rate), these surpluses or deficits are applied to the reserve balance in that area of benefit (or to debt in the same area of benefit).

2.10 Credit Risk Management

While the Council will only borrow from reputable financial institutions, there is no minimum credit rating requirements imposed by the Council on its lenders. Also, there is no limit on the level of borrowing to which the Council may commit from any one lender. This limit is one imposed by the lender.

3. Investment Policy

3.1 General Investment Policy

The Council has a significant portfolio of investments comprising:

• Equity Investments	(covered in Section 3.3)
• Liquid Financial Deposits	(covered in Section 3.4)
• Sinking Funds	(covered in Section 3.5)
• Special Funds	(covered in Section 3.6)
• Forestry Investments	(covered in Section 3.7)
• Stadium Advance	(covered in Section 3.8)

The Council's philosophy in managing investments is to optimise returns in the long term while balancing risk and return considerations. The Council recognises that as a responsible public authority any investments that it holds should be held for the long-term benefit of the community, with any risk being appropriately managed. It also recognises that lower risk generally means lower returns.

From a risk management point of view, the Council is well aware that its investment returns to the rate line are exposed to the success or otherwise of its two main investments – the WRC Holdings Group (including CentrePort) and its liquid financial deposits. At an appropriate time in the future the Council believes that it could continue to reduce its risk exposure by reducing its investment holdings, and using the proceeds to repay debt. The timing of these divestments will be in accordance with the Council's objective to optimise the overall return to the ratepayer.

The Council's general policy on investments is:

- **The Council will not hold financial investments other than sinking funds, special funds, self insurance funds and funds required for liquidity management purposes;**
- **When considering financial investments the Council's primary objective is the protection of the investment. Accordingly, only creditworthy counterparties will be acceptable. The Council's policy on managing credit risk is contained in Section 6;**
- **The Council will not make other (non-financial) investments except where approved by Council.**

The Council also seeks to:

- Optimise investment returns over time.
- Ensure that, where appropriate, investments match the Council's liquidity requirements.

3.2 Investment Interest Rate Risk Management

Interest rate risk refers to the impact that movements in interest rates can have on the Council's cashflows. The Council is exposed to interest rate risk on short-term financial investments (that are not hedged by way of a derivative) and on planned new financial investments.

The main exposure of the Council to interest rate risk is the Council's liquid financial deposits (refer Section 3.4). Interest rate risk on this investment is minimal as, from a group perspective, this offsets borrowings within the WRC Holdings Group.

When deciding hedging strategies on financial investments the Council takes into account the following:

- The Council's desire to have predictable interest costs that avoid large adverse impacts on annual rates and levies arising from interest rate movements;
- The requirement to have flexibility and reasonably liquid funds (in the case of contingency investments);
- The Council's desire to optimise investment returns.

The Council's policy in managing interest rate risk on financial investments is:

- **The CFO will be able to approve (following a recommendation from the TMG) hedging, which must be within the following parameters:**
  - **Planned investments within the next three years, minimum hedged 0% maximum hedged 100%.**

The Council utilises interest rate risk management instruments (derivatives) to convert floating rate investments into fixed rate (or hedged) investments, and, where appropriate, fixed rate investments into floating rate investments.

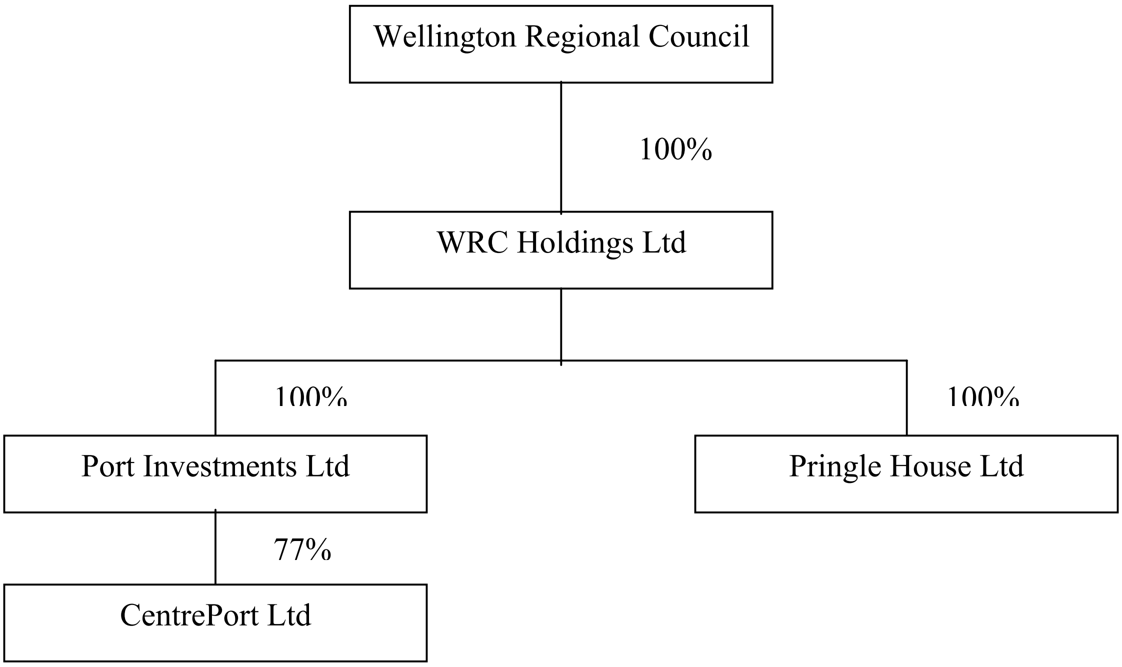
The Council's policy in relation to the use of derivatives on investments is:

- **Only interest rate risk management instruments that have been approved by Council can be used ;**
- **Additions to, and deletions from the list of approved interest rate risk management instruments can only be approved by the Council;**
- **The CFO has delegated authority to authorise the use of Council approved interest rate risk management instruments on a case by case basis.**

A current list of approved interest rate risk management instruments with appropriate definitions is included in the Risk Management Toolkit in Appendix II.

3.3 Equity Investments

The Council has the following equity investments:



WRC Holdings Ltd and Port Investments Ltd are in essence investment holding companies. The main operating companies in the group are CentrePort Ltd (refer Section 3.3.1) and Pringle House Ltd (refer Section 3.3.2) Each year WRC Holdings Ltd provides to the Council as 100% shareholder a Statement of Intent for the WRC Holdings Group.

The WRC Holdings Group structure was originally set up for a number of reasons that remain applicable, including:

- Appropriate separation of management and governance;
- Imposing commercial discipline on the Group's activities to produce an appropriate return by ensuring appropriate debt/equity funding and requiring a commercial rate of return;
- Separation of Council's investment assets from public good assets.

The WRC Holdings Group is the Council's prime investment vehicle and the main mechanism by which the Council will own and manage any additional equity investments should they be acquired in the future. Periodically the Council reviews the structure to determine if it is still an appropriate vehicle for holding the Council's investments.

In addition, the Council has minor equity interests in Civic Assurance (refer 3.3.3) and Airtel Ltd (refer 3.3.4).

3.3.1 CentrePort Ltd

Nature of Investment

On 1 November 1989 the Council became the owner of 76.9% of CentrePort.

The Council currently owns, via a 100% owned subsidiary company, 76.9% of CentrePort Ltd. The balance of shares are held by Horizons MW (the Manawatu-Wanganui Regional Council).

CentrePort is a significant strategic asset held by the Council on behalf of the regional community with its activities intertwined in the economic fabric of the Region.

CentrePort has consistently paid to shareholders by way of dividend at least 50% of post tax paid profit. In addition, the Council has received capital repayments and special dividends as follows:

1992	$3.8 million
1995	$12.3 million
1999	$5.8 million

Rationale for Holding Investment

An analysis of events and decisions since 1989 is critical in clarifying the Council's current position in relation this investment. In May 1991 the Council confirmed its policy on ownership of CentrePort. At that time on the basis of professional financial advice, the Council resolved:

- That the determination of alternative shareholding should be driven by "what is best for the ultimate success of the Port" and "what is most appropriate for the role of local government in Port ownership".

- That the most appropriate role for local government is one of being able to "influence" and not necessarily "control" a regionally essential operation such as a Port Company.

- That CentrePort would benefit from a wider base of shareholding, especially if drawn from key Port users.

- That, in line with an influencing role, the Council should agree to a programme of planned divestment with the aim of achieving a position of around 30 percent shareholding in CentrePort.

- That in order to demonstrate publicly the Council's commitment to having the Region's transportation welfare as its prime objective, an initial divestment of around 25 percent of CentrePort should be undertaken, either by way of public float or placement.

In the long term the Council intended via this resolution to hold no less than 30% of the shares in CentrePort in order to 'influence' rather than necessarily 'control' the company. An initial divestment of around 25% was considered appropriate at that time, meaning the Council would still hold 51% in the interim (76.9% - 25% = 51.9%).

In March 1992 the Council resolved to effect a capital reduction of up to $16 million to replace capital with debt and issue new shares to allow public participation in ownership of CentrePort. Under this resolution, the two Councils were to retain control (i.e. 51%) of CentrePort and the debt/equity ratio would be optimised by introducing new capital.

Since the 1992 resolution, the Council has kept under review its strategy to achieve these long-term objectives. In that time there have been a number of factors which have continued to impact the Council's plans for future ownership of the Port Company:

- Since 1991 Council has remained concerned with the issue of Port Company land. The most significant asset owned by the Port Company is the land that is considered by Council to be of strategic interest to the residents of the Region. Council has been keen to ensure that any divestment of shares does not result in the ownership of prime strategic land going outside the Region. The Council is continuing to work with the Port Company and advisors in respect of the land issue meanwhile the port has successfully diversified into property related revenue which has reduced the risk to the Port Company and shareholders of heavy reliance on variable revenue streams.

- Capital restructuring by CentrePort in 1992, 1995 and 1999 has had the effect of reducing the Council's exposure to this investment, and has gone some way to achieving the primary objective of risk reduction as shareholder.

- During the 1995 restructuring, convertible notes were issued to shareholders and up until 30 June 1999 provided a flow of interest equivalent to a market interest rate, thereby further reducing the Council's exposure to solely dividend income during this period.

- CentrePort's integration plans were put into effect in May 1995 at which time CentrePort purchased Container Terminals Ltd. Since 1972 the Port's container terminal had been leased to a consortium of shipping companies and prior to its acquisition in 1995, Wellington remained the only Port Company in the country where the container terminal was not controlled by the Port Company. The integration in May 1995 was a significant step for CentrePort and enhanced its ability to increase efficiency and ultimately value for the shareholders and its customers.

- In 1998 the Council restructured its ownership of CentrePort by selling its interests to one of its subsidiaries, Port Investments Ltd. CentrePort remains part of the Council group for tax loss sharing purposes.

Since 1991, the Council has retained (through its 100% subsidiaries) its 76.9% holding in CentrePort but much has been achieved to reduce Council's exposure to the risks associated with this investment.

Notwithstanding the history of Council's investment holding in CentrePort, in March 1998 the Council reviewed its investment policy in relation to the Port company and resolved that it should be "a seller at the right price rather than a holder at all costs". This policy was reconfirmed in April 1999. By reaffirming its policy as being "a seller at the right price rather than a holder at all costs", the Council was mindful of the following objectives:

- Long term risk reduction for ratepayers
- Maximisation of sale value
- Protection of future land use

Dealing appropriately with the land issue remains at the cornerstone of any exit strategy with the first key step being a revision of the Port Company Property Plan. In the short to medium term the Council intends to retain its CentrePort investment. In the long term the Council is not a desperate seller and wishes to ensure the land issue has been dealt with appropriately before any further moves towards ultimate sale. As the Port Company is a strategic asset held on behalf of the community any move towards sale would be preceded by a full public consultation process.

Disposition of Revenue

Dividend revenue from CentrePort is ultimately used to reduce rates. Dividends and other cashflows from CentrePort are received by Port Investments Ltd (Council's 100% owned subsidiary) and then passed onto the Council, via WRC Holdings Ltd, in accordance with Council's funding requirements.

Dividends paid or declared by CentrePort relating to any one year are recognised in the same period by Port Investments Ltd when a constructive obligation exists.

Risk Management

The Council's investment in CentrePort is not without risk. The level of profitability that CentrePort can continue to generate drives returns to the shareholders. Given the fixed cost nature of CentrePort's business, the level of revenue it can generate and the asset utilisation it can achieve are the prime drivers of profitability. Both the returns the Council can expect to receive from the investment and the ultimate value of its investment, are therefore very dependent on the ability of CentrePort to protect and enhance its revenue base. Strategies employed by CentrePort to reduce the extent of costs that are fixed and increase the extent of revenue that is fixed have contributed to an overall risk reduction for shareholders.

Also, past repayments of capital and special dividends have reduced the Council's risk exposure to the CentrePort investment.

The Council's ongoing risk management procedures include:

- Proactive governance over its investment in CentrePort via Port Investments Ltd (a 100% owned subsidiary of Council).
- Appointing external directors with appropriate expertise to the Boards of Directors of CentrePort Ltd and Port Investments Ltd.
- Appointing the Council's Chief Financial Officer as reporting officer to the Council on CentrePort related matters. The Council's CFO has quarterly briefings from CentrePort.
- Approving on an annual basis CentrePort's Statement of Corporate Intent (via the approval of the Statement of Intent for Port Investments Ltd).
- Receiving a formal briefing, and a half-year report from CentrePort on the results achieved and future outlook.
- Monitoring, and where appropriate, providing proactive leadership on the issue of port sector rationalisation.

Management/Reporting Procedures

The impact of CentrePort on the Council is reported as part of the financial statements presented to the WRC Holdings Group of companies (including Port Investments Ltd). The impact on the Council's rate line depends on the level of dividends paid by the WRC Holdings Group.

Other management/reporting issues have been noted under risk management issues above.

The following policies will be applied by the Council in the management of its investment in CentrePort:

- **The Council will continue to maintain the current governance framework over CentrePort via its 100% owned subsidiary Port Investments Ltd, including the review of CentrePort's Constitution, Statement of Corporate Intent, and the appointment of the Board of Directors;**
- **The Council will, in conjunction with CentrePort, continue to employ risk mitigation strategies to reduce the risk exposure for the Council as a shareholder;**
- **The Council will, via Port Investments Ltd, continue to review CentrePort's policy for the payment of dividends (currently 55% of net profit after tax is paid out in dividends) to ensure the right balance between reinvestment and returns to shareholders;**
- **The Council will continue to hold its strategic investment in CentrePort on behalf of the community but, in the long term, it will remain a seller at the right price (of some or all of its Port investment) should that be the wish of the Regional community at that time.**

3.3.2 Pringle House Ltd

Nature of Investment

Pringle House Ltd which owns the Regional Council Centre (RCC) in Wakefield Street, Wellington is 100% owned by the Council via WRC Holdings Ltd (refer Section 3.3). The Council currently occupies 7 1/2 of the 9 floors in the RCC and is therefore the major tenant of the building. All rentals are set at commercial rates based on advice from the Council's property consultants.

Rationale for Holding Investment

The Council periodically reviews the rationale for holding its investment in Pringle House Ltd. The Council continues to retain ownership of the RCC (via Pringle House Ltd) at the present time for the following reasons:

- The Council's property consultants consider that Pringle House Ltd is in the enviable position of owning a building which is functioning well, is occupied by three major tenants, is relatively modern and is poised to take advantage of any upward movement in the market. The view of most property market commentators and analysts is that the NZ commercial property market is going to be in a stable environment for a long time:
- In the view of the property consultants, if sale is contemplated in the future it should be at a time when the Council needs to dramatically alter in size and/or when the market for commercial property is perceived to be about to enter a downward trend:
- Furthermore, to sell now will be to lose the ability to recover some of the capital value lost in past years and the Council, as major tenant is likely to be subject to rent increases to the benefit of other parties. While the property is owned by Pringle House Ltd, the Council enjoys the benefits of being tenant and ultimate landlord should the need ever arise to dramatically alter the area occupied or amend the term of the lease.

Disposition of Revenue

Any surpluses generated from Pringle House Ltd are returned to the Council through either subvention payments or dividends. This return is then used within the Council to offset the cost of debt servicing attached to the RCC.

Risk Management

The risks of the Council's investment in Pringle House Ltd are inextricably linked to its investment in the RCC and the Council takes advice on all matters relating to the RCC from its property consultants.

Based on advice received the Council considers that the NZ commercial property market is going to be in a stable environment for a long time which should mean modest growth in the medium term to rentals and the valuation of the RCC.

Property maintenance, if not completed, will create risks for Pringle House Ltd as property owners. The Council, through its governance of Pringle House Ltd ensures that all such maintenance is carried out as required.

Management/Reporting Procedures

The financial results of Pringle House Ltd are reported regularly within the financial statements that are produced for the WRC Holdings Group of Companies. Each year Pringle House Ltd, as part of the WRC Holdings Group is required to prepare a Statement of Intent outlining planned achievements and at the end of each year an annual report is prepared. The RCC property is revalued annually.

The Council currently has 3 representatives on the Board of Directors of Pringle House Ltd (out of a total of 5).

The following polices will be applied by the Council in the management of its investment in Pringle House Ltd:

- **The Council will continue to exercise governance over Pringle House Ltd, via WRC Holdings Ltd, to ensure the value of its prime asset (the Regional Council Centre) is appropriately protected through planned maintenance;**
- **The Council will continue to pay market rentals and maintain a long term accommodation agreement with Pringle House Ltd;**
- **The Council will continue to rely on the advice of its property consultants with respect to all property matters relating to Pringle House Ltd;**
- **Decisions on future ownership of Pringle House Ltd will be driven by the requirement to maximise ratepayer benefit.**

3.3.3 NZ Local Government Insurance Corporation Ltd (Civic Assurance)

Nature of Investment and Rationale for Holding

The shares in Local Government Insurance Corporation Ltd (LGIC) were acquired by virtue of the Council being a local authority. The purpose of the company, in which almost all local authorities are shareholders, is to ensure that adequate insurance arrangements are available to local authorities at the lowest possible cost. The shares in LGIC continue to be held, as the shares are not readily transferable. The amount involved is immaterial relative to the Council’s total investment holdings.

Disposition of Revenue

Revenue earned from the shares in LGIC is minimal.

Risk Management

Risks associated with the Council's investment in LGIC are limited.

Management/Reporting Procedures

Annual reports are received and reviewed by Council. Election of Directors takes place at the Corporation's AGM held at the time of the Local Government New Zealand annual conference. The Council votes by proxy.

Policies for LGIC Investment

- **Due to the limited transferability of shares and limited risks, the Council's policy is to retain shares in LGIC.**

3.3.4 Airtel Ltd

Nature of Investment and Rationale for Holding

The shares in Airtel Ltd were acquired by virtue of the Council being a member of the Wairarapa Radio Telephone Users Association (the Association). The Council had been a member of the Association to allow access to radio telephone services in the Wairarapa. The decision was recently taken to wind up the Association and undertake the activities of the association in a Company, Airtel Ltd. Consequently members of the Association were allocated shares at no cost. WRC's share allocation is 21,000 shares.

The shares in Airtel Ltd continue to be held as there is a restriction on the transfer of shares before 31 August 2005 (with exceptions for shareholders liquidation or bankruptcy). In addition, any amount involved is immaterial relative to the Council's total investment holdings.

Disposition of Revenue

Revenue earned from the shares in Airtel Ltd is minimal.

Risk Management

Risks associated with the Council's investment in Airtel Ltd are limited.

Management/Reporting Procedures

Annual reports are received and reviewed by Council.

Policies for Airtel Ltd Investment

- **Due to the restriction on transferability shares and limited risks in holding them, the Council's policy is to retain shares in Airtel Ltd.**

3.4 Liquid Financial Deposits

Nature of Investment

The Council holds in liquid bank deposits $44 million as a result of selling its interest in CentrePort Ltd to one of its wholly owned subsidiaries, Port Investments Ltd. Subject to this policy document, the Council is free to use these funds as it sees fit and the Treasury Management Group reviews alternate options for their use on an ongoing basis (particularly just prior to each investment maturity date).

Rationale for Holding Investment

The regular TMG review of the rationale for holding the $44 million bank deposit investment takes into account a number of relevant factors including:

- General provisions of the Treasury Management Policy including the Council's attitude to risk and credit worthy counterparties;
- The specific Treasury Management Policy requirement to hold sufficient deposits or have committed funds available as part of its self insurance of infrastructural assets (refer Section 2.4);
- The after tax rate of return from alternative uses of the funds (purchasing productive assets, reducing the Council's debt, alternative financial investments).
- The requirement to hedge the $44 million of debt in WRC Holdings Ltd if (from a Group perspective) the Council did not have a corresponding $44 million investment

Disposition of Revenue

Revenue earned from Council's liquid bank deposits contributes to the Council's operating surplus.

Risk Management

The Council currently has its liquid financial deposits invested with NBNZ (the Council's transaction banker) on the basis that this provides the highest after tax rate of return to the Council, as well as complying with the other requirements of the Council's Treasury Management Policy.

Management Reporting Procedures

The investment is monitored regularly by Council's Treasury function and the TMG.

Policies for Liquid Financial Deposits:

- **The Council will continue to monitor its investment through the Council's treasury function;**

- **The Council will continue to consider alternative uses for its liquid financial deposits and will, after taking into account other relevant provisions in the Treasury Management Policy, determine the best use of the funds on an after tax rate of return basis.**

3.5 Sinking Funds

Nature of Investment

Sinking funds are investments maintained by Local Authorities for all pre 1 July 1997 debt to ensure that on the maturity of loans, funds are available to repay them. However, the Local Government Act provides for Local Authorities to unwind established sinking funds with the permission of relevant creditors and the sinking fund commissioner, so long as the Local Authority has available in easy realisable funds, such amounts as may be required to repay the principal or interest when it becomes due.

Sinking funds on loans raised up to 1991 are managed by the National Provident Fund. Under this arrangement a guaranteed and constant interest rate is paid on all sinking fund contributions over the life of the loan.

Sinking funds on loans raised after 1991 are administered by commissioners appointed by the Council because the National Provident Fund no longer undertakes new sinking funds management.

Many Council assets have a life of 30 years or more (e.g. bulk water assets) and therefore the loans relating to these assets are usually renewed several times within this period. However, the sinking fund contributions are determined by reference to the original loan resolution, and not the term of each individual loan.

Rationale for Holding Investment

The Council is currently required to hold sinking fund investments in those instances where loan repayments relating to pre 1 July 1997 debt do not allow for principal repayments until maturity and where the necessary creditor and Sinking Fund Commissioner approval to unwind has not been received.

The Council intends to continue to unwind existing sinking funds where possible, in order to mitigate the disadvantages of the negative spread outlined below (risk management issues). Since July 1997 a number of sinking funds have been unwound where the necessary approvals have been received or where the associated debt has matured.

Disposition of Revenue

Revenue earned on sinking funds is added to the sinking fund balance to ensure that the sinking fund contributions plus interest over the term, will be sufficient to repay the loan on maturity.

Risk Management

The management of sinking funds typically exposes the Council to costs and risks. The earnings rate on the sinking fund investments will usually be less than the interest rate cost of the underlying debt. This is called the "negative spread" and represents the return of the bank or other provider of funds.

In addition the dollar amount of this negative spread for a particular loan is not known until loan maturity. This is because for a fixed rate loan, the interest rate payable is known at the commencement of the loan but the interest rate that will be received on sinking fund contributions throughout the life of the loan will not be known until the investment is rolled over. This means that the Council is exposed to an additional interest rate risk each time funds are reinvested.

Credit risk is managed by limiting investments to high quality credit institutions consistent with limits outlined in Section 6.

Management/Reporting Procedures

Sinking funds are managed as part of the Council's overall treasury function.

The performance of sinking funds is monitored quarterly as part of the quarterly review process operating within Council.

At least annually the level of contributions into sinking funds is reviewed and if necessary adjusted to ensure future contributions plus interest will result in sufficient funds to repay debt on maturity.

The following policies will be applied by the Council to reduce as far as is possible, the costs and risks of operating sinking funds:

- **The Council will cease to operate sinking funds where the necessary creditor and Sinking Fund Commissioner approval has been received, or where the associated debt has matured;**
- **Proceeds from the unwinding of existing sinking funds will be used to repay debt;**
- **Sinking fund assets will continue to be invested over terms that will enable unwinding of sinking funds at the earliest practical time;**
- **Sinking fund investments will continue to be made in the context of the Council's policy on managing credit risk as outlined in Section 6. The**

highest possible interest rate return will be earned within the credit and term limits.

3.6 Special Funds

3.6.1 Regional Water Supply Self Insurance Fund

Nature of Investment

The Regional Water Supply Self Insurance Fund was established during the 1995/96 financial year. The fund was established as a result of the Council's decision to self-insure a significant portion of its bulk water assets. It is maintained as a separate fund by the Council but managed, as part of the Council's treasury function, much in the same way as sinking funds.

Rationale for Holding Investment

During 1995/96 Council decided that insurance costs associated with insurance of the bulk water infrastructure were prohibitive. The Council has therefore chosen to self insure a portion of its bulk water infrastructure. Each quarter the agreed level of contribution is added to the fund (in lieu of insurance premiums) and interest accrues on an ongoing basis.

In March 1999 the Council reaffirmed the policy of self insurance for these assets.

Disposition of Revenue

Revenue earned on the fund is added to the fund. The fund is reduced in the event of claims being made.

Risk Management

It is important that amounts relating to this fund are kept in liquid instruments to ensure ready conversion to cash. Accordingly, the fund is invested in short term wholesale market instruments such as bank deposits, bank bills and negotiable certificates of deposit. These instruments can be liquidated in an actively traded secondary market. The fund is only invested with approved counterparties within the limits outlined in Section 6 of this policy.

Should an event occur which requires Council to spend more than has been built up in the self-insurance fund, Council's Treasury function will lend the balance needed to the water activity.

Management/Reporting Procedures

As the fund is managed as part of the treasury function it is subject to regular monitoring.

The performance of the fund is formally reported on a quarterly basis as part of the quarterly review process operating within Council and by TMG. As part of each year's annual planning process the level of contribution to the fund is reviewed taking into account the fund balance and the claims history.

The following policies will be applied by the Council in the management of the Regional Water Supply Insurance Fund:

- **The fund will only be placed with approved counterparties (as per Section 6) in short term instruments that are able to be readily liquidated;**
- **The Council will continue to contribute into the fund until it is determined that such contributions are no longer required;**
- **At least annually the level of contribution will be reviewed in conjunction with the fund balance and claims history;**
- **All interest earned on the fund will continue to be added to the balance of the fund for reinvestment purposes;**
- **The Council will approve all withdrawals from the fund.**

3.6.2 Major Flood Recovery Fund

Nature of Investment

In March 1999 the Council agreed that it should self insure its flood protection assets in the same manner as its regional water supply assets (noted in Section 3.6.1 above).

Commencing in 1999/00, the Council has set aside $200,000 per annum in a major flood recovery fund to be invested in a similar manner to the Regional Water Supply Self Insurance Fund.

Rationale for Holding Investment

Self insurance is seen as an appropriate means of managing the risks inherent in the flood protection infrastructure. While in any given year insurance premiums may appear a more cost efficient option, self insurance is seen as an effective and efficient option long term.

Disposition of Revenue

Revenue earned on the fund is added to the fund. The fund is reduced in the event of claims being made.

Risk Management

As with the Regional Water Supply Self Insurance Fund, the fund will be kept in liquid investments to ensure that it is readily convertible into cash if required. (refer section 6) Should an event occur which requires Council to spend more than has been built up in the self-insurance fund, Council's Treasury function will lend the balance needed to the flood protection activity.

Management Reporting Procedures

As the fund is managed as part of the Treasury function, it is subject to daily monitoring.

The following policies will be applied by the Council in the management of the major flood recovery fund:

- **The fund will only be placed with approved counterparts (as per Section 6) in short term instruments that are able to be readily liquidated;**
- **The Council will continue to contribute $200,000 per annum into the fund until it is determined that such an amount requires adjustment;**
- **At least annually the level of contribution will be reviewed in conjunction with the fund balance and claims history;**
- **All interest earned on the fund will continue to be added to the balance of the fund for reinvestment purposes;**
- **The Council will approve all withdrawals from the fund.**

3.7 Forestry

Nature of Investment

The Council and its predecessor organisations have been involved in forestry for many years. When indigenous logging and saw-milling on Council land ceased in the early 1970s, exotic planting increased. These new plantation forests were added to those forests already established in the late 1950s and 1960s for soil conservation and water quality purposes. The Council currently holds approximately 6,000 hectares of plantation and soil conservation reserve forests of which approximately 4000 hectares are in the western or metro part of the Region, with the remaining 2,000 hectares in the Wairarapa. With these holdings, the Council is the fourth largest plantation forest owner in the lower North Island.

Rationale for Holding Investment

Forestry has been undertaken in response to both a need to check soil erosion and to minimise water sedimentation. As a result, forestry should not be considered to be a pure investment in which profit maximisation is paramount. Having said that, the Council is the owner of a significant forestry resource with ongoing logging potential that needs to be prudently managed to maximise returns.

The overall investment policy of the Council with regard to forestry has been to maximise long-term returns while meeting soil conservation, water quality and recreational needs. This policy assumes that harvesting will be on a sustainable yield basis and, furthermore, will be maintained without any demand on regional rates.

The Council periodically reviews its rationale for holding its forestry investment. In March 1998 the Council reviewed its investment policy in relation to its investment in forestry and resolved that it should be "a seller of cutting rights at the right price rather than a holder at all costs". The Council reaffirmed this policy in April 1999 and resolved to undertake a sale scoping exercise as a precursor to ultimate sale of cutting rights. That scoping study indicated there was minimal market interest in the Council's forestry assets.

Disposition of Revenue

Both plantation and reserve forests within the Region are required to budget for an 'internal dividend' to Corporate irrespective of the budgeted operating result for the year. The internal dividend reflects the intergenerational equity issues inherent in the forestry investment and recognition of the cost of ratepayer equity.

The level of internal dividend contribution to the rates line from forestry is reviewed annually.

Where a deficit is incurred in any one year the deficit is debt funded to ensure that at no time the forestry activity is a drain on rates. Debt funding is considered appropriate because the forestry activity has historically carried a low level of debt relative to the underlying value of the investment and to ensure there is intergenerational fairness. Forestry is therefore treated as a self contained activity of Council.

Risk Management

The most significant risk management issues relate to revenue flows. The first key risk is the product price returns achieved from forestry, which are dependent on world markets. This means that forestry returns are dependent on commodity prices driven by other countries, principally in Asia. From a Council perspective the risk of revenue returns is mitigated in the short term through having a set level of contributions towards rates by way of internal dividend. This policy has the effect of immunising the rates line from the fluctuations in commodity prices. However, the value of the forestry investment is still affected by changing commodity prices.

The other key risk area impacting the Council's returns is pulp and paper prices which are essentially a US dollar driven commodity. Accordingly, while the Council is selling its logs either domestically or to an exporter in New Zealand dollars, the underlying price is still heavily influenced by United States newsprint and pulp prices and the NZD/USD exchange rate. The Council potentially faces the same risks as a direct exporter of goods priced in USD. There are currently no robust and proven commodity hedging solutions for newsprint and pulp prices. Furthermore, the Council is prohibited by law from directly entering into any incidental arrangements in foreign currency.

Management/Reporting Procedures

Plantation Forestry and Reserve Forests are set up as separate business units within the Council and as a result financial information is reported separately to the Council on a monthly basis.

The Council uses a combination of in-house contracting expertise with external consultants to manage the forestry investment. Silviculture is carried out in accordance with a defined management plan and all forestry operations including logging is contracted out.

The following policies will be applied by the Council in the management of forestry:

- **The various roles of forestry in terms of soil conservation, water catchment and recreation facilities will be protected regardless of any future ownership structures;**
- **Harvesting will continue to be on a sustainable yield basis;**
- **Forestry will continue to be treated as two self contained units (plantation forestry and reserve forestry) for accounting purposes to ensure that there is no negative impact on rates, but management will be co-ordinated through the Forestry Management Group;**
- **The level of dividend contribution from forestry towards the rates line will continue to be reviewed annually;**
- **The Council will continue to be a seller of cutting rights at the right price rather than a holder at all costs.**

3.8 Stadium Advance

Nature of Investment

On 6 August 1998 the Council advanced to the Wellington Regional Stadium Trust $25 million for the planning, development and construction of the Regional Stadium. The advance is interest free with limited rights of recourse, although it is expected to be repaid from surplus funds generated by the Stadium Trust in future years.

Rationale for Holding Investment

In August 1995 the Council agreed in principle to participate in the establishment of the Wellington Regional Stadium Trust and the Wellington Regional Council (Stadium Empowering) Act 1996 empowered the Council to lend up to $25 million to the Trust. The Council reached this decision after extensive public consultation that was supported by a market research survey.

The Council continues to hold the advance as an investment on the basis that it is repayable by the Trust.

Disposition of Revenue

There is no revenue earned on the investment as the Council's advance to the Stadium Trust is interest free.

Risk Management

An extensive risk management exercise was carried out prior to the Council advancing the $25 million to the Stadium Trust. Ongoing monitoring is carried out of the Trust's financial affairs and formal reporting is received from the Trust on a regular basis.

Management Reporting Procedures

The Council receives regular reports from the Stadium Trust pursuant to the funding deed signed by the Stadium Trust and the Council (in conjunction with the Wellington City Council).

Policies for the Stadium Advance:

- **The Council will continue to hold its advance as an investment until such time as the Stadium Trust has repaid it in full;**
- **The Council will continue to closely monitor the financial performance of the Trust.**

4. Cash Management

The treasury function is responsible for managing the Council's cash surpluses and/or deficits. The Council also manages cashflows on behalf of its 100% owned subsidiaries although cash management functions for CentrePort are handled wholly within that company.

The Council maintains one main bank account for its operating cashflows as well as other bank accounts for specialist activities such as sinking funds. To assist with cash management the Council maintains a rolling daily cashflow projection for the next 12 to 18 months. The Council attempts to match expenditure closely to its revenue streams.

The following policies apply to the Council's cash management activities:

- **Cashflow surpluses will be placed in call deposits, negotiable certificates of deposits or bank bills with the Council's relationship banks. Amounts invested must be within the limits specified in Section 6;**
- **An optimal daily range of -$100,000 to +$300,000 is targeted for in the Council's main bank account;**
- **The Council will maintain a committed bank overdraft facility of not less than $500,000;**
- **The use of interest rate risk management on cash management balances is not permitted.**

5. Foreign Exchange Management

The Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated plant and equipment. However section 113 of the Local Government Act prohibits the Council from borrowing or entering into incidental arrangements in any currency other than NZ currency.

The Council's Policies are:

- **The Council will not borrow or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency;**
- **Where appropriate, foreign exchange cover will be arranged through the supplier.**

6. Treasury Counterparty Exposure Limits

The Council ensures that all investment, interest rate risk management as well any foreign exchange activity is undertaken with institutions that are of high quality credit to ensure amounts owing to the Council are fully paid by the due date.

The Council's policies to minimises its credit exposure are:

- **Ensuring all investment, cash management, interest rate risk management and any foreign exchange transactions are undertaken with entities that have at least a *very strong* Standard and Poor's (S&P) credit rating;**
- **Limiting total exposure to prescribed amounts;**
- **Rigorously monitoring compliance against set limits.**

The following table summarises credit requirements and limits:

Institution	Minimum S&P Short Term Credit Rating	Minimum S&P Long Term Credit Rating	Total Exposure Limit for each Counterparty
Government	**N/A**	**N/A**	**Unlimited**
Registered Bank **- On balance sheet exposures** **- Off balance sheet exposures**	 **A1+** **A1+**	 **AA-** **AA-**	 **$10 million**(1) **$10 million**
Corporates, SOEs and Local Authorities (on balance sheet exposures only)	**A1+**	**AA-**	**$5 million**

(1) $50 million for National Bank of New Zealand given that NBNZ has funded the Council's Stadium Loan (originally $25 million) and has committed line facilities with the Council of $24 million (although no legal right of set off exists).

If any counterparty's credit rating falls below the minimum specified in the above table all practical steps are taken to reduce the credit exposure to that counterparty to zero as soon as possible.

Exposures to each counterparty are calculated as follows:

On-balance sheet

➢ Total amounts invested with that counterparty.

Off- balance sheet

- Credit exposure on interest rate contracts computed by multiplying face value of outstanding transactions by an interest rate movement factor of 2.5% pa or part thereof over the term of the contract.

Netting Arrangements

Exposures calculated above can be netted where there is a right to set-off which is enforceable by law. e.g. transactions entered into under a single master agreement.

7. Banking Relationships

As in other parts of its activities, the Council's preference in the treasury management area is to deal with preferred suppliers. The Council's choice of relationship banks is determined by its desire to benefit from long term relationships rather than seeking the best returns in the short term.

Each financial institution must be capable of providing the Council with:

- Comprehensive treasury services in NZD products. In this regard whilst day to day transactional requirements are important, the Council's borrowing requirements are likely to drive key relationships;
- Proven expertise and a track record in arranging local capital markets facilities;
- A desire to accommodate the Council with funding without additional security requirements.

The Council's cash management and interest rate risk management activities are undertaken with its relationship banks.

The Council's Policy is:

- **The Council's banking relationships will be reviewed at least every three years by the Treasury Management Group.**

8. Reports and Meetings

8.1 Reports

The following reports will be produced:

Report Name	**Frequency**	**Prepared by**	**Reviewed by**	**Recipients**
Daily Treasury Report (Detailing Council cash position exceptions and counterparty exposure)	Daily	Assistant Accountant	Financial Accountant	CFO Finance Manager Treasurer
Quarterly Treasury Review (Including projected debt, borrowings and hedging)	Quarterly	Financial Analyst	Treasurer Finance Manager	TMG CFO General Manager Councillors (each 6 months)
Treasury Compliance Report	Quarterly	Financial Analyst	Treasurer	CFO TMG Council
Treasury Back Office Report	Daily by exception Prior to each TMG	Assistant Accountant	Financial Accountant	CFO TMG
Statement of Sinking Funds	Annually	Financial Analyst	Treasurer Finance Manager	CFO

8.2 Meetings

A meeting of the TMG will continue to be held approximately eight times a year to consider treasury activity since the last meeting and likely future activity. In particular TMG:

- Reviews borrowing, investment and risk management strategies;
- Provides operating guidelines to the Financial Analyst and Treasurer for implementation.

The Financial Analyst is responsible for preparing the agenda for TMG meetings as well as documenting any follow up actions required.

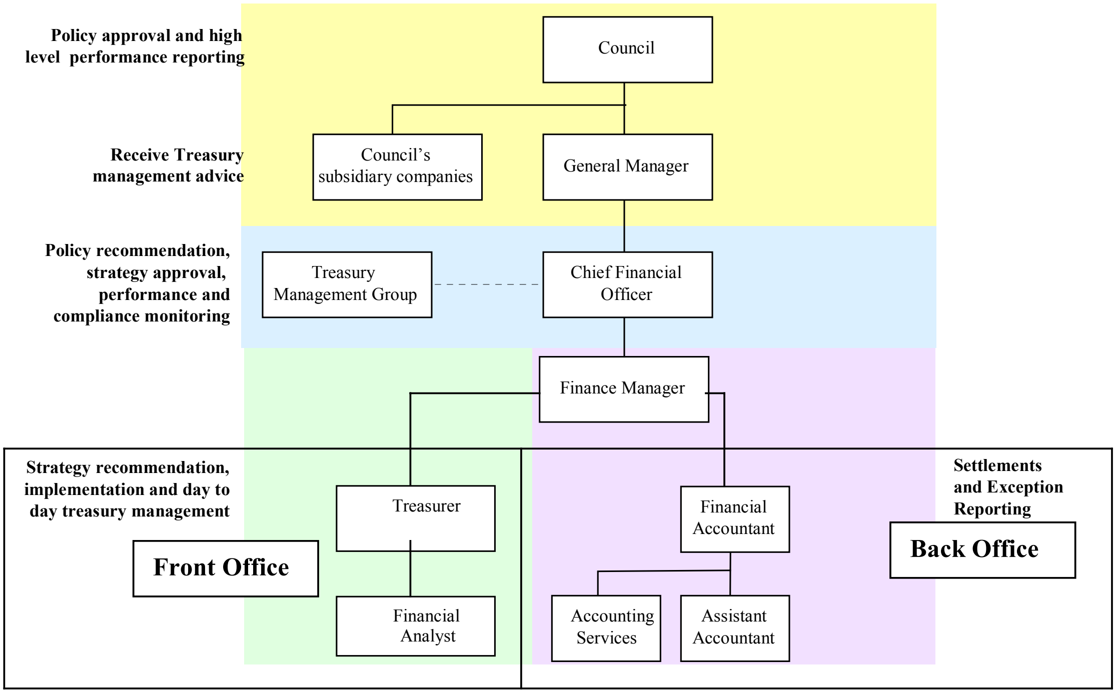
9. Delegated Authorities

Activity	Delegated to:
Approve Treasury Management Policy	Council
Alter Treasury Management Policy	Council
Open / close bank accounts	General Manager and Chairperson (jointly)
Manage the Council's borrowing and financial investment strategy	CFO (Approve strategy as Chairman of TMG) Treasurer / Financial Analyst (Execute approved strategy, daily management)
Acquire and dispose of investments other than financial investments	Council
Approve the external borrowing programme (including new debt facilities and debt repayments)	Council
Approve new external loans and adjustments to existing loans, in accordance with Council resolutions	CFO
Approve charging assets as security over external borrowing	Council
Approve internal borrowing programme	Council (in conjunction with approving the Annual Plan)
Approve reserve transfers	Council
Approve cheque signatories	General Manager and Chairperson (jointly)
Approve Direct Link funds transfer signatories	As per register approved by the General Manager and Chairperson
Approve the use of interest rate risk management instruments (contained in the Risk Management toolkit in Appendix III)	Council
Authorise use of Council approved interest rate risk management instruments	CFO
Manage Council cash requirements	Financial Analyst, Treasurer
Manage Council foreign exchange exposures (via external suppliers)	CFO (amounts over $20,000) Treasurer (amounts up to $20,000)

10. Treasury Structure & Key Internal Controls

10.1 Treasury Organisational Structure

As noted in section 1.4 the organisation chart for treasury activity is as follows:



10.2 Key Internal Controls

The 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. However, as there are a small number of people involved in treasury activity strict segregation of duties is not always achievable. The risk from this will be minimised by the following processes:
  - A documented discretionary approval process for treasury activity;
  - Regular management reporting;
  - Review of front and back office activities by TMG.

- Organisational, systems, procedural and reconciliation controls to ensure:
  - All treasury activity is bona fide and properly authorised;
  - Controls are in place to ensure the Council's accounts and records are updated promptly, accurately and completely;
  - All outstanding transactions are reviewed regularly and independently of the execution function to ensure accurate reporting and accounting of outstanding exposures and hedging activity.

More specifically, key internal controls are as follows:

Organisational Controls

- The CFO has responsibility for establishing appropriate structures, procedures and controls to support treasury activity;
- All borrowing, investment, cash management and risk management activity is undertaken in accordance with approved delegations authorised by the Council;
- Personnel with dealing responsibilities cannot perform bank reconciliation's or act as a cheque signatory.

Cheque / Electronic Banking Signatories

- Positions approved by the General Manager and Council Chairperson as per register;
- Dual signatures are required for all cheques and electronic transfers.

Authorised Personnel

- All counterparties are provided with a list of personnel approved to undertake transactions, standard settlement instructions and details of personnel able to receive confirmations.

Recording of Deals

- All deals are recorded on deal tickets by the Financial Analyst and approved by the Treasurer.
- Market quotes for deals (other than cash management transactions) are perused by the Treasurer before the transaction is executed.
- Treasury records for borrowing, investments, interest rate risk management and cash management transactions are maintained and updated promptly following completion of transactions.

Confirmations

- Same day faxed confirmations are requested from banks and checked by the Assistant Accountant.
- All inward letter confirmations including registry confirmations are received and checked by the Assistant Accountant against completed deal tickets ensure accuracy.
- Deals, once confirmed, are filed (deal ticket and attached confirmation) in deal date order.
- Any discrepancies arising during deal confirmation checks, which require amendment to the Council records, are signed off by the Finance Manager.

Settlement

- Payment batches for treasury payments are set up on Direct Link by Accounting Services and checked by the Financial Analyst to ensure settlement details are correct.
- Payment details are authorised by two approved signatories.

- The Financial Analyst and Treasurer are not included in the list of approved Direct Link payment signatories.

Reconciliations

- Bank reconciliations are performed regularly by the Assistant Accountant and checked by the Financial Accountant. Any unresolved unreconciled items arising during bank statement reconciliation, which require amendment to the Council's records are signed off by the Finance Manager.
- A monthly reconciliation of the treasury system / spreadsheets to the general ledger is carried out by the Financial Analyst and approved by the Financial Accountant.

10.3 Borrowing

In addition to the controls listed under Section 10.2, the following controls apply to borrowing:

- Borrowing activity is undertaken within borrowing limits specified in Section 2 of this policy.
- All borrowing is undertaken with relationship banks or by using competitive bidding processes.

10.4 Investments

In addition to the controls listed in Section 10.2, the following controls apply to investments:

- Investment activity is undertaken within limits specified in Section 6 of this policy.
- All deliverable certificates of investments (for example, bank bills) are held in safe custody with Austraclear or with the originating bank.
- NZ Government stock, Treasury bills, local authority stock and debentures are registered with the RBNZ. The Council receives notice of the stocks transferred into its name from the RBNZ. This notice is checked to the Council's treasury records.

10.5 Incidental Arrangements (Derivatives)

In addition to the controls listed under Section 10.2, the following controls apply to incidental arrangements:

- The use of incidental arrangements is confined to managing interest rate risk of Council borrowings and investments and is to be within the confines of the parameters and instruments specified in Section 2 of this policy.
- The use of incidental arrangements requires formal prior approval of the CFO.
- Standard master agreements for incidental arrangements are completed by the Council with its relationship banks.

11. Content of Appendices

Appendix I
Treasury Management Group - Composition

Appendix II
The Risk Management Toolkit

Appendix I

Treasury Management Group - Composition

The General Manager approves the composition of the Treasury Management Group. The following table details the positions within the Council that form part of the Treasury Management Group:

Position	Input Value
Chief Financial Officer	Overall responsibility for treasury functions. Chairman of TMG.
Divisional Manager Utility Services	Perspective from the Council's largest user of debt.
Finance Manager	Overall responsibility for front and back office.
Treasurer	Management of treasury function. Development of treasury strategy. Analysis of treasury performance.
Financial Analyst	Operational responsibility. Reports on treasury performance and assists in development of strategy.
Financial Accountant	Settlements and exception reporting.
Assistant Financial Accountant	Checks settlement confirmations. Produces daily treasury report.
External Risk Advisor	Technical expertise, outlook on market movements.

Appendix II

The Risk Management Toolkit

1. Approved Interest Rate Risk Management Instruments

A. **Interest rate risk management instruments approved for use, consistent with this policy are:**
- **Fixing through physical borrowing or investment instruments - loan stock, debentures, medium term notes, bank term loan;**
- **Floating through physical borrowing or investment instruments - short term revolving stock, bank borrowing, promissory note programme;**
- **Forward rate agreements on approved funding instruments;**
- **Interest rate swaps;**
- **Purchase of interest rate options on approved funding instruments;**
- **Interest rate collar type option strategies.**

B. **The following interest rate risk management instruments, among others, are available for interest rate risk management activity, but are to be specifically approved by the Council in the future:**
- **Nil**

C. **The following interest rate risk management instruments are <u>not</u> permitted for use:**
- **Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature;**
- **Structured or leveraged interest rate option strategies where there is any possibility of the Council's total interest expense increasing in a declining interest rate market or where the Council's total interest cost is increasing faster than the general market rate;**
- **Interest rate futures contracts, mainly for administrative ease.**

2. Interest Rate Risk Management Instruments and terms - Definitions

Forward Rate Agreement
An agreement between the Council and counterparty (usually a bank) protecting the Council against a future adverse interest rate movement for a specified period of time. The Council and the counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM).

Interest Rate Options
The purchase of an interest rate option gives the holder (in return for the payment of a premium) the right but not the obligation to borrow (described as a cap) or invest (described as a floor) at a future date for a specified period. The Council and the

counterparty agree to a notional future principal amount, the future interest rate, the benchmark dates and the benchmark rate (usually BKBM). Interest rate option products include caps, floors, bond options and swaptions.

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

Interest Rate Swap
An Interest Rate Swap is an agreement between the Council and a counterparty (usually a bank) whereby the Council pays (or receives) a fixed interest rate and receives (or pays) a floating interest rate. The parties to the contract agree notional principal, start date of the contract, duration of the contract, fixed interest rate and the bench mark rates (usually BKBM).