Liability management policy

Introduction

This policy has been prepared to fulfil the Council's obligations under Section 102(2)(b) and Section 104 of the Local Government Act 2002.

Legislative requirements

Section 104 of the Act sets out what is to be included in the Council's Policies with respect to the management of both borrowing and other liabilities and must include the following:

- interest and rate exposure
- liquidity
- credit exposure
- debt repayment
- specific borrowing limits
- the giving of securities.

General policy

The Carterton District Council will use term borrowing to fund capital expenditure providing assets where the benefits of such expenditure are received over terms greater than one financial year and the term of borrowing would be related to the expected economic life of the assets purchased.

Internal borrowing

The Council will fund its borrowing programme for both the purchase of new assets and the re-financing of existing term debt by way of internally borrowing if it is considered prudent to do so in any given circumstances. The rate of interest charged on internal borrowing is calculated to be the weighted average rate that the Council receives on its investment portfolio.

Interest rate exposure policy

Interest rate exposure refers to the impact that movements in interest rates has on the Council's debt servicing costs and cash flow.

Factors that influence interest rates for long- and short-term securities are beyond the control of the Council. It is prudent to be aware of where interest rate cycles are when making a decision as to the type of borrowing to be undertaken and what arrangements might need to be entered into to manage the interest on borrowing.

The Council's objective in managing interest risk is to minimise debt servicing cost and to maintain stability of debt servicing costs.

Liquidity management policy

Liquidity refers to the availability of financial resources to meet all obligations as they arise, without incurring penalty costs.

The Council requires a minimum level of surplus liquidity to meet unexpected cash expenditure or revenue shortfall.

Short-term liquidity management is monitored and controlled through daily cash management activities with long-term liquidity management being monitored and controlled through the annual plan and long-term plan.

As part of its overall liquidity policy, the Council seeks to avoid a concentration of debt maturity dates and may maintain an overdraft facility to meet cash requirements if required.

Credit exposure policy

The only credit exposure risk to the Council in relation to its borrowing activities is the risk that a counterpart to an incidental arrangement may default.

Any incidental arrangement involving a contract or arrangement for the hedging of financial risks is restricted to only those with credit worthy counterparts. Creditworthy counterparts are selected on the basis of their current rating with Standard & Poors, which must be A- or better.

Any incidental arrangements involving contracts or arrangements with underwriters, brokers or any other agents are considered to be low risk and therefore do not require Council approval.

Debt payment policy

The objective of the debt payment policy is to ensure that the Council is able to repay debt on maturity with minimum impact on Council cash flows.

The Council repays its debt from targeted rates, general funds, debt repayment reserves, or from any other source that the Council may resolve to use for debt repayment.

The Council may establish 'debt repayment reserves' for external loans but will have the discretion whether to repay or reinvest those funds having regard to the comparative interest rates and other relevant market conditions.

Borrowing limits

The Council will limit its borrowing such that all three of the following conditions are met:

- total debt as a percentage of total assets will not exceed 15 percent
- in any financial year, gross interest paid on term debt will not exceed 12 percent of gross operating revenue
- in any financial year, gross interest expense will not exceed 50 percent net cash inflow from operating activities.

Borrowing mechanisms

Council is able to borrow external funds through bank borrowing and the Local Government Funding Agency (LGFA). External borrowing is to be in New Zealand dollars. Internal borrowing will be utilised where funds are available and it is prudent to do so. In evaluating strategies for new borrowing the following considerations should be taken into account:

- available terms from banks and the LGFA;
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time;
- Where a specific asset or group of assets is to be funded by the external borrowing, the term of the loan should not exceed to the expected useful life of the asset;
- Prevailing interest rates and margins;
- The market outlook on future credit margins and interest rates;
- Implied finance terms within specific debt or lease arrangements should be at least as favourable as the Council could obtain through other means;
- Legal documentation and financial covenants together with security considerations.

The Council will not enter into derivative financial arrangements, with the exception of interest rate cover, where appropriate.

Security

The objective of the security policy is to ensure that the Council is able to provide suitable security to investors whilst retaining maximum flexibility and control over assets.

The Council will offer as a security for borrowing a charge over the Council's 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 Local Government Rating Act. The security offered by Council ranks equally or *pari passu* with other lenders. The Council will not offer security over assets of the Council, with the exception of borrowing by way of financial lease or some other form of trade credit under which it is normal practice to provide security over the asset concerned.

Local Government Funding Agency

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

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA;
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required;
- Subscribe for shares and uncalled capital in the LGFA; and
- 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.

Management of borrowing

The Council approves all proposed borrowing through the annual plan process and reports public debt levels in the annual report.

The Council's borrowing activities are managed through its finance function, which has the following responsibilities:

- provide appropriate finance, in terms of both maturity and interest rates and manage the Council's borrowing programme to ensure funds are readily available at the best margins and costs available to the market
- minimise adverse interest rate related increases on ratepayers' charges and maintain overall interest cost and revenues within budgeted parameters
- management the overall cash and liquidity position of the Council's operations
- provide timely and accurate reporting of treasury activity and performance.