LIABILITY MANAGEMENT POLICY 2012

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 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 predicable interest costs
- Avoid increases in annual rates caused by interest rate rises.

HOW INTEREST RATE RISK IS MANAGED: THE RULES

The Council's core net debt should be within the following fixed/floating interest rate risk control limits:

Master Fixed/Floating Risk Control Limits	
Minimum Fixed Rate	**Maximum Fixed Rate**
55%	90%

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

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

The percentages are calculated on the rolling 12 month projected net debt level calculated by management and signed off by the Council Chief Executive Officer. Net debt is the amount of total debt net of cash or cash equivalents. This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved forecasts are changed, the amount of fixed rate protection in place may have to be adjusted to ensure compliance with the policy minimums and maximums.

The fixed rate amount should be within the following maturity bands:

Fixed Rate Maturity Profile Limit		
Period	**Minimum %**	**Maximum %**
1 to 3 years	15	60
3 to 5 years	15	60
5 years plus	15	60

Floating rate debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months.

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 • Government bonds Interest rate swaps including: • Forward start swaps (start date <24 months) • Swap extensions and shortenings Interest rate options on: • Bank bills (purchased caps and one for one collars) • Government bonds • Interest rate swaptions (purchased swaptions and one for one collars only)

- Interest rate options must not be sold outright. However, 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'

- Purchased borrower swaptions 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 24 months from deal date
- Any interest rate swaps with a maturity beyond 10 years must be approved by Council.

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.

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 all 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 when interest rates are high for reasons beyond the Council's control.

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 term debt plus committed debt facilities, plus cash and cash equivalents must be maintained at an amount of at least 110% over existing external debt
- Diversify borrowing over a range of bank and debt capital market lenders
- Council has the ability to pre-fund up to 12 months of the forecast debt requirements including re-financings.

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 term debt and committed debt facilities is to be controlled by the following system:

Period	Minimum %	Maximum %
0 to 3 years	15	60
3 to 5 years	15	60
5 years plus	10	40

A maturity schedule outside these limits will require specific Council approval.

CREDIT EXPOSURE

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

DEBT REPAYMENT

The Council repays borrowings from rates, debt raising, surplus funds, proceeds from the sale of investments and fixed assets.
Note that the proceeds from sales of fixed assets and investments may also be used for the acquisition of other fixed assets.

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 bank accepted bill facilities (short term and long term loan facilities) Uncommitted money market facilities Retail and Wholesale Fixed Rate Bond and Floating Rate Note (FRN) issuance Commercial paper (CP)

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.

SPECIFIC BORROWING LIMITS

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

Item	Borrowing Limit
Net interest expense on external debt as a percentage of total revenue to be less than:	15%
Net interest expense on external debt (secured by rates) as a percentage of rates revenue to be less than:	20%
Net external debt (secured by rates) as a percentage of total revenue to be less than:	150%
Net external debt (secured by rates) as a percentage of equity to be less than:	20%
Liquidity (external term debt + committed debt facilities + cash/ cash equivalents) over existing external debt to be at least:	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 debt is defined as total debt less cash or cash equivalent and investments
- Liquidity is defined as external debt plus committed debt facilities plus cash or cash equivalents divided by external debt
- 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.

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, 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.

UPDATED

New Zealand Local Government Funding Agency Limited

Despite anything earlier in this Liability Management Policy, 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
- commit to contributing additional equity to LGFA if required;
- secure its borrowing from the LGFA, and the performance of other obligations to the LGFA or its creditors with a charge over the Council's rates and rates revenue.

Nelson City Council
te kaunihera o whakatū

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