TREASURY POLICY

Incorporating:

Liability Management and Investment Policy

as required by s.102
Local Government Act 2002

Palmerston North City Council

Adopted 14 February 2024 &
updated 26 June 2024 to incorporate changes incorporated in the 2024-34 Long-term Plan

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PALMERSTON
NORTH
CITY

ID: 16414630

TREASURY POLICY

[Incorporating Liability Management and Investment Policy[1]]

Contents

[1] As required by sections 102, 104 & 105 Local Government Act 2002

1. Preface and Objectives

1.1 Preface

1.1.1 The Local Government Act 2002 (LGA) requires councils to have a Financial Strategy (s.101A) and a Revenue and Financing Policy (s.103), both of which form part of its Long-Term Plan (LTP). These policies are publicly consulted on as part of LTP consultation process.

1.1.2 The LGA also requires councils to adopt a Liability Management Policy (s.104) and an Investment Policy (s.105). The LGA provides lists of matters which must be included in those policies. As these policies are more operational in nature they can be adopted by ordinary council resolution rather than by using the public consultative process. The Council has decided to incorporate these policies together in a Treasury Policy document which also contains more comprehensive detail than required by the legislation.

1.1.3 Treasury policy is concerned with the management of the organisation's financial assets and liabilities to optimise liquidity and to minimise the cost of borrowed funds and to do so within defined risk parameters.

1.1.4 The Council has risks arising from debt raising, investments and associated interest rate management activity. Other liabilities may arise as a result of Council's normal activities. To mitigate the risks associated with the incorrect use or misuse of financial instruments this policy sets restrictions and parameters around their use.

1.1.5 The LGA (s.113) prohibits local authorities from borrowing or entering incidental arrangements in foreign currencies. This policy confirms that requirement in paragraph 5.1. but note the exception in paragraphs 5.2 – 5.5. The Council does not trade in commodities.

1.1.6 Interest rate risk is one of the key financial risks which Council seeks to manage. Because the Council is a net borrower at the time of adopting this policy, any increase in interest rates causes the cost of projects to rise.

1.1.7 It is generally considered that having certainty about the cost structure is preferable to having uncertainty. This includes the possibility of paying slightly more interest expense at some times than otherwise would be required when interest rates are low in order to not have to pay considerably more when interest rates are high. Accordingly, like many other large organisations, Council makes arrangements through its banks to use hedging instruments to manage risk levels to achieve an acceptable interest expense.

1.1.8 Interest rate changes also affect the value of some assets, for example bonds and forests. The market value of these assets is affected by interest rate changes for potential buyers of the bonds or cut timber.

1.1.9 There are three basic hedging instruments for managing interest rate risk. These are forward rate agreements, swaps and options. Swaps and options, and other hedging instruments (which combine some characteristics from more than one of these, e.g. swaptions) are more sensibly used for ongoing activities, and repetitive transactions.

1.1.10 There is also foreign currency risk relating the purchase of goods and services denominated in foreign currency. A forward contract would normally be used to hedge the risk associated with a significant one-off transaction such as when Council purchases a recycling sorting machine from an Australian supplier.

1.1.11 Forwards and swaps are agreements to do something in the future. Options are agreements which give the right to one party to choose to do something in the future, while the other party to the contract has an obligation to perform.

1.2 Objectives

1.2.1 The Council's broad objectives in relation to this activity are as follows:

- manage all of its investments within its strategic objectives and invest surplus cash in liquid and creditworthy investments
- arrange and structure long term funding for Council at the lowest achievable interest margin from debt lenders. Optimise flexibility and spread of debt maturity within the funding risk limits
- borrow funds and transact interest rate hedging financial instruments within an environment of control and compliance
- develop and maintain relationships with the Trustee, financial institutions, LGFA, credit rating agencies, and investors
- maintain liquidity levels and manage cash flows within Council to meet known and reasonable unforeseen funding requirements
- monitor, evaluate and report on treasury performance
- to ensure adequate internal controls exist to protect the Council's financial assets and to prevent unauthorised transactions
- ensure the council, management and relevant staff are kept abreast of latest treasury products, methodologies, and accounting treatments through training and in-house presentations
- comply with the Local Government Act 2002 and other relevant local authority legislation
- to be consistent with Council's Long-Term Plan, Financial Strategy and Revenue and Financing Policy.
- maintain a long-term credit rating of at least AA.

1.2.2 In meeting these objectives Council is a risk averse entity and subject to particular policies, and generally does not wish to seek risk from its borrowing and investment activities. Interest rate risk, liquidity risk, funding risk and credit risk are risks Council seeks to manage, not capitalise on. Speculative activity is forbidden.

1.2.3 The key elements in the management of risk are:

Risk Type	Aim	Risk Managed By
Liquidity and funding risks	Funds available when required at cost effective rate. Successfully refinance and raise new debt at a future time at the same or more favourable terms	Maintain accurate cash forecasting systems. Limit and spread concentration of debt maturities within policy risk control limits. Maintain relationships with the Trustee, financial institutions, LGFA, credit rating agencies, investors. Maintain external debt and committed available bank/loan facilities at or above 110% of existing external debt. Adhere to self-imposed prudent debt limits. Demonstrate prudent financial management practice.
Interest Rate	Minimise exposure to adverse interest rate movements.	Maintain the interest rate risk profile within prescribed policy risk control limits. Use hedging instruments in a controlled manner.
Credit	Eliminate risk through failure of counterparty.	Invest cash only in entities with strong credit ratings (by S&P Global or equivalent agency). Maintain liquid and negotiable investments. Spread investments and risk management instruments across issuers and counterparties.

2. Delegated Authorities

2.1 Treasury transactions entered into by Council without the proper authority are difficult to cancel given the legal doctrine of "apparent authority". Also, insufficient authorities for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays).

2.2 To prevent these types of situations, clear schedules of delegated authorities and signatories will be maintained and regularly reviewed.

2.3 The following procedures must be complied with:

- All delegated authorities and signatories must be reviewed at least every six months to ensure that they are still appropriate and current
- A comprehensive letter must be sent to all bank counterparties at least every year which details all relevant current delegated authorities of Council and contracted personnel empowered to bind Council. This letter will also include standard settlements instructions and will detail who can receive information on behalf of the Council.

2.4 Whenever a person with delegated authority on any account or facility leaves Council, all relevant banks and other counterparties must be advised in writing immediately to ensure that no unauthorised instructions are to be accepted from such persons

2.5 Council has the following responsibilities, either directly itself, or via the following stated delegated authorities:

Activity	Delegated Authority	Limit
Approving and changing policy	Council	Unlimited
Borrowing new debt	Council	Unlimited (subject to legislative and other regulatory limitations)
Re-financing existing debt	Chief Executive Officer	Unlimited
Approving transactions outside policy	Council	Unlimited
Approving credit counterparty limits	Council	Unlimited
Adjust interest rate risk profile	Chief Executive Officer	Fixed rate maturity profile limit as per risk control limits

Managing funding maturities in accordance with Council approved facilities	Chief Executive Officer	Per risk control limits
Maximum daily transaction amount (borrowing, investing, interest rate risk management)	Council Chief Executive Officer Chief Financial Officer Strategy Manager - Finance	Unlimited $50 million $40 million $20 million
Authorising lists of signatories	Chief Financial Officer	Unlimited
Opening/closing bank accounts	Chief Financial Officer	Unlimited
Annual review of policy	Chief Financial Officer	N/A
Ensuring compliance with policy	Chief Financial Officer	N/A
Approving new and refinanced lending activity with CCO/CCTOs	Council	Unlimited
Approving of Council guarantees or uncalled capital relating to CCO/CCTO indebtedness	Council	Unlimited (subject to legislative and other regulatory limitations)
Negotiation and ongoing management of lending arrangements to CCO /CCTOs	Chief Financial Officer	Per approval / per risk control limits

All management delegated limits are authorised by Council.

3. Liability Management Policy

3.1 Borrowing Activity

3.1.1 The Council may borrow to:

- fund its balance sheet activities, including working capital requirements and borrowing to fund its investments in Council Controlled (CCO), and Council Controlled Trading Organisations (CCTO) or other trading enterprises
- fund "special one-off" projects and capital expenditure
- fund assets with intergenerational qualities.
- debt finance lending to CCO/CCTOs.

3.1.2 The level of borrowing will be determined by the Long-Term Plan as confirmed or modified each year by the Annual Plan. All external debt of the Council must be authorised by resolution of the Council.

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

- the period of indebtedness is less than 91 days (including rollovers); or
- the goods or services are obtained in the ordinary course of operations on normal terms for amounts not exceeding in aggregate, an amount determined by resolution of the Council.

3.1.4 The debt portfolio will be managed, within the framework of this policy, by the Chief Executive and Council staff under delegated authority.

3.1.5 Council is able to borrow through a variety of market mechanisms including:

- wholesale and retail registered commercial paper, stock and bond issues
- Local Government Funding Agency
- debentures
- Housing New Zealand Corporation loans
- direct bank borrowing
- hire purchase and leasing arrangements

3.1.6 All borrowing in currencies other than NZ dollars is forbidden.

3.2 Interest Rate Risk

3.2.1 Due to the long-term nature of Council's assets, projects and intergenerational factors, and Council's preference to avoid an adverse impact on rates, there is a preference for a minimum percentage of long-term fixed rate or hedged debt. In addition, interest rate repricing risk is spread over a range of maturities.

3.2.2 Exposure to interest rate risk is managed and mitigated through the risk control limits below. Council's forecast gross external debt should be within the following fixed/floating interest rate risk control limits.

3.2.3 Forecast gross external debt is the amount of total external debt for a given period. This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved forecasts are changed (signed off by the Chief Financial Officer or equivalent), the amount of interest rate fixing in place may have to be adjusted to ensure compliance with the policy minimum and maximum limits. The Chief Financial Officer can consider alternative debt forecast scenarios that make assumptions around such matters as, the delivery and timing of the capital expenditure programme when designing and approving the interest rate strategy.

Any debt raised and on-lent to CCO/CCTOs is on a fixed rate basis and therefore is netted for interest rate management purposes. This debt is not included in the debt forecast for Council's ongoing interest rate management purposes.

Debt Interest Rate Policy Parameters (calculated on a rolling monthly basis)

Debt Period Ending	Debt Amount	Minimum Fixed	Maximum Fixed
Current		40%	90%
Year 1		40%	90%
Year 2		35%	85%
Year 3		30%	80%
Year 4		25%	75%
Year 5		20%	70%
Year 6		0%	65%
Year 7		0%	60%
Year 8		0%	50%
Year 9		0%	50%
Year 10		0%	50%
Year 11 plus		0%	25%

A fixed rate maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this policy. However, maintaining a maturity profile beyond 90 days requires specific approval by Council.

3.2.4 Fixed interest rate percentages are calculated based on the average amount of fixed interest rate obligations relative to the average forecast gross external debt amounts for the given period (as defined in the table above).

Hedging outside of the above risk parameters must be approved by Council.

3.2.4 "Fixed Rate" is defined as all known interest rate obligations on forecast gross external debt, including where hedging instruments have fixed movements in the applicable reset rate.

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

3.2.7 Pre-hedging in advance of projected physical drawdowns of new debt is allowed.

3.2.8 Management implements the interest rate risk management strategy through the use of the following approved instruments in the manner outlined below:

- Forward rate agreements ("FRAs") on bank bills or government bonds
- Interest rate swaps
- Interest rate options on bank bills and swaps

3.2.9 The Chief Financial Officer approves the interest rate risk management strategy, as recommended by the Strategy Manager-Finance who develops the strategy after monitoring the interest rate market, evaluating the outlook for rates/credit spreads, the current and forecast yield curve, policy parameters and existing and planned borrowing amounts. External treasury strategy advice may also be sought.

3.2.10 Officers implement the risk management strategies through the use of the following approved instruments (refer Appendix for glossary of terms):

Category	Instrument
Cash management and borrowing	Bank overdraft Committed cash advance and funding facilities (short term and long-term loan facilities) Committed standby facilities (where offered) from the LGFA Uncommitted money market facilities Retail and Wholesale Bond and Floating Rate Note (FRN) issuance Commercial paper (CP) Forward starting committed debt with the LGFA

Investments (term <365 days)	Short term bank deposits Bank certificates of deposit (RCDs)
Investments	LGFA borrower notes / CP / bills / bonds
Interest rate risk management	Forward rate agreements ("FRAs") on: ● Bank bills ● Government bonds Interest rate swaps including: ● Forward start swaps/collars. Start date < 36 months, unless linked to existing maturing swaps/collars ● Amortising swaps (whereby notional principal amount reduces) ● 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)
Liquidity management	Short term bank deposits (less than 30 days) Bank certificates of deposit (RCDs) (less than 181 days) Committed cash advance and funding facilities Committed standby facilities (where offered) from the LGFA

3.2.11 Interest rate swap maturities beyond the maximum LGFA bond maturity must be approved by Council through a specific approval.

3.2.12 Interest rate options must not be sold outright because of its speculative nature. However, 1:1 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, the sold option can be purchased back. The sold option leg of the collar structure must not have a strike rate "in-the-money".

3.2.13 The forward start period on swap/collar strategies is to be no more than 36 months, unless the forward start swap/collar starts on the expiry date of an existing swap/collar and has a notional amount which is no more than that of the existing swap/collar.

3.2.14 Purchased borrower swaptions will mature within 12 months.

3.2.15 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.

3.2.16 Buying and selling of financial futures is not permitted, primarily due to the administrative burden.

3.2.17 Any other financial instrument must be specifically approved by Council on a case-by-case basis and only be applied to the one singular transaction being approved. Credit exposure on these financial instruments is restricted by specified counterparty credit limits as set out in section 3.4.

3.3 Liquidity/Funding Risk

3.3.1 Council is exposed to liquidity risk in that due to unforeseen circumstances or events, it may not be able to meet its commitments, including debt maturities. Liquidity risk management focuses on the ability to borrow at that future time to fund the liquidity gaps. Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and funding margins) and maturity terms of existing facilities.

3.3.2 Council's objective is to always be in a position to meet its day-to-day commitments, to maintain its reputation and prevent any financial loss occurring, whilst ensuring the level of cash balances and/or committed unutilised bank facilities are kept to a minimum in accordance with good cashflow management practices.

3.3.3 Managing Council's funding risks is important since several risk factors can arise to cause an adverse movement in funding margins, term availability and general flexibility including:

- Local Government risk is priced to a higher fee and margin level
- Council's own credit-standing or financial strength as a borrower deteriorates due to financial, regulatory or other reasons
- A large individual lender to Council experiences their own financial/exposure difficulties resulting in Council not being able to manage their debt portfolio as optimally as desired
- New Zealand investment community experiences a substantial "over supply" of Council investment assets
- Financial market shocks from domestic or global events.

3.3.4 A key factor of funding risk management is to spread and control the risk to reduce the concentration of risk at one point in time so that if any of the above events occur, the overall borrowing cost is not unnecessarily increased and desired maturity profile compromised due to market conditions.

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

3.3.5 As a prime borrower Council should always be in a position to raise additional funds when required. However, to minimise liquidity and funding risk, Council will ensure:

- Comprehensive daily and weekly cash management reporting, together with rolling 12-month forecasting
- External term debt plus committed available bank/loan facilities plus liquid financial assets (as defined in section 3.6.1 of this policy) must be maintained at an amount of

greater than 110% of existing external debt. External debt funding and associated investment activity relating to pre-funding (described below) is excluded from the liquidity ratio calculation.

- Council has the ability to pre-fund up to 18 months of forecast debt requirements including re-financings. Once debt has been refinanced with a contracted term deposit (pre-funded), the term deposit amount, will net off the maturing debt amount, from the funding maturity profile percentage calculation.
- To minimise concentration risk the LGFA require that no more than the greater of NZD 100 million or 33% of a Council's borrowings from the LGFA will mature in any 12 month period.
- The maturity profile of the total committed funding in respect to all loans and committed facilities, is to be controlled by the following system:

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

- Membership of the Local Authority Protection Programme (LAPP) is retained (for as long as this is appropriate given the possible transfer of three waters assets to a new water service entity) or appropriate levels of infrastructure insurance is obtained.
- External debt that is raised by Council to be on-lent debt to CCO/CCTO's is included in the funding maturity profile percentage calculation. The CCO/CCTO loan asset is not included in the funding maturity profile.
- A funding maturity profile that is outside that above limits, but self corrects within 90 days is not in breach of this policy. However, maintaining a maturity profile beyond 90 days requires specific approval by Council.

3.4 Counterparty Credit Risk

3.4.1 Council ensures that all investment, interest rate and foreign currency risk management activity is undertaken with institutions that have a strong credit rating. This is to ensure that the amounts owing to Council are paid fully and on due date. More specifically, Council minimises its credit exposure by:

- Transacting with entities that have a strong or better S&P Global's (or equivalent) short and long-term credit rating of at least "A-1" and "A" respectively
- Limiting total exposure to prescribed amounts
- Diversifying transactions across a number of counterparties to avoid concentration of credit risk
- Monitoring of compliance against set limits

3.4.2 The following table summarises credit requirements and limits:

Institution	Minimum S&P Short/Long Term Credit Rating	Total Exposure Limit for each Counter party
NZ Government	N/A	Unlimited
NZ Local Government Funding Agency (LGFA)	N/A	Unlimited
Registered Bank	A-1 / AA-	$35 million
Registered Bank	A-1 / A	$25 million

3.4.3 Approval is required from the Council for any alterations to these limits. 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. Counterparties exceeding limits are reported to Council. Counterparties other than 'registered banks' require the specific approval of Council.

3.4.4 Maximum financial exposure to the counterparties is computed as follows:

- Financial investments; the total principal amount invested with that counterparty
- Credit exposure on interest rate contracts is computed by multiplying the face value of outstanding transactions by an interest rate movement factor of 3% per annum i.e. notional amount * maturity (years) * 3%
- Credit exposure on foreign exchange is computed by multiplying the face value amount by the (square root of the maturity (years) · 15%)

3.5 Debt Repayment

3.5.1 The Council will generally use a “consolidated debt” approach to manage its financial position. Debt repayment and new debt creation are managed by application of the specific borrowing limits. Within this framework the Council may, from time to time, allocate debt and interest cost to a specific activity. The Council’s aim is to fund debt repayment over the average life of the class of assets for which the debt has been raised though from time to time the Council may decide to fund accelerated debt repayment as part of its financial strategy to ensure future generations are left with adequate headroom to enable them to borrow to fund high priority capital investments.

3.5.2 Operating surpluses will normally be applied to the reduction of debt unless the Council specifically resolves otherwise.

3.6 Specific Borrowing Limits

3.6.1 In managing borrowing, the Council considers the following to be prudent limits (based on Council’s core financial statements):

Borrowing Limits [2]	
Net external debt as a percentage of total assets	<20%
Net external debt as a percentage of total revenue	<250%
Net Interest as a percentage of total revenue	<15%
Net Interest as a percentage of annual rates income	<20%
Liquidity ratio	>110%

Total Revenue is defined as income from rates, grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes mark to market gains/losses on financial instruments, revaluations of assets and grants or development contributions for capital programmes.

Net external debt is defined as total external debt less liquid financial assets and liquid investments. External debt that is specifically borrowed for on-lending to a CCO/CCTO is netted (if consistent with LGFA covenant testing practice), with the corresponding loan asset.

Liquid financial assets are defined (for liquidity purposes) as overnight bank cash deposits, wholesale/retail bank term deposits no greater than 30 days and bank issued RCD’s less than 181 days. Funds on deposit in association with pre-funding activity is excluded from this

[2] The net external debt as a percentage of total revenue ratio was increased to 250% through the adoption of the Council’s 2024-34 Long-term Plan on 26 June 2024.

definition.

Net Interest is defined as all interest and financing costs (on external debt) less interest income for the relevant period.

Annual Rates Income is defined as the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 (including metered water charges).

Liquidity is defined as external debt plus committed available bank facilities plus liquid financial assets (as defined above) divided by external debt.

3.6.2 The context for and framework for establishing these limits is contained in the Council's Financial Strategy, adopted as a component of the Long-Term Plan.

3.6.3 If circumstances arose which would result in these limits being exceeded the issue would be considered by the Council and a determination made as to the most appropriate course of action, having particular regard for the principles of financial management contained in the Local Government Act 2002.

3.7 Security

3.7.1 The security for Council debt will be the ability to levy rates. This policy authorises the use of Deed of Charge or Debenture Trust Deed security documents as well as the appointment of a professional Trustee if this approach is assessed as being the most cost-effective means of borrowing.

3.7.2 In unusual circumstances, with prior Council approval, a specific charge may be given over one or more of the Council's assets.

3.7.3 Physical assets will be pledged only where:

- There is a direct relationship between the debt and the asset purchase/construction e.g. operating lease or project finance. Council considers a pledge of physical assets to be appropriate.

3.7.4 Any pledging of physical assets must comply with the terms and conditions contained within the Debenture Trust Deed.

3.7.5 Any direct and indirect lending by Council to a CCO or CCTO will be on a secured basis and be approved by Council.

3.7.6 Council is prohibited to guarantee loans to Council Controlled Trading Organisations under section 62 of the Local Government Act. Council may act as a financial guarantor to Council wholly owned, Council Controlled Organisations, once approved by Council.

3.8 Contingent Liabilities

3.8.1 From time to time the Council provides financial guarantees to recreation and community organisations to enable them to undertake capital projects on Council land. Applications for guarantee support will be considered only if the community group is based in the City and satisfactory projections of the financial strength and long-term viability of the group or club are received by the Council. The guaranteed party's performance is monitored through communications with the lending institution and by assessing their financial statements.

3.9 Internal Borrowing

3.9.1 The use of Council investment funds, structured as an internal loan is allowed as a valid means of funding projects, minimising the cost of borrowing and still providing a market return on investment funds.

3.9.2 The treasury function is responsible for administering the Council's internal debt portfolio. Transparent operating procedures will apply to the setting up and repayment of the notional loan and the charging and payment of interest.

3.10 Performance Measurement

3.10.1 Performance of Council's borrowing management activities shall be judged against a number of subjective and objective measures including:

- adherence to all policy limits
- number and cost of processing errors
- breaches of borrowing limits
- comparison of actual interest costs to budget
- all treasury deadlines are to be met, including reporting deadlines.

3.11 Management of Debt and Interest Rate Risk

3.11.1 Since senior management is granted discretion by Council to manage debt and interest rate risk within specified limits, the actual funding rate achieved must be compared against an appropriate external benchmark interest rate that assumes a risk neutral position within the existing policy. Note: in this respect, a risk neutral position is one that is always precisely at the mid-point of the minimum and maximum percentage limits specified within the policy.

3.11.2 Given fixed/floating risk control limits and fixed rate maturity profile limits as defined in section 3.2 of this policy. Policy mid-point represents an average maturity term of 7-years.

The market benchmark rate will be calculated every month and represent the 7-year swap rate monthly rolling average over a 7-year period.

3.11.3 Accordingly, the actual weighted average interest rate for the financial year to date (which incorporates all issuance margins and derivative settlements) must be compared against the micro-benchmark rate on a monthly basis, with historical comparison reported graphically over the previous 12 months.

3.12 Management of Other Liabilities

3.12.1 From time to time the Council will also enter into transactions and agreements that can expose the Council to financial liability. Such transactions may include employee contracts, contract for service (e.g. issue of consents, provision of infrastructure services) and loan guarantees for assets constructed on Council-owned land.

3.12.2 Any potential risk from such activities will be managed by implementing appropriate systems and procedures and ensuring Council staff are appropriately trained to recognise and mitigate such risks.

3.13 New Zealand Local Government Funding Agency Limited

3.13.1 Despite anything earlier in this 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. For example, Borrower Notes;
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required;
- Subscribe for fully paid 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.

3.14 Borrowing Mechanisms to Council Controlled Organisations and Council Controlled Trading Organisations

3.14.1 To better achieve its strategic and commercial objectives, Council may provide financial support in the form of debt funding directly or indirectly to CCO/CCTOs.

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

Any lending arrangement (direct or indirect) to a CCO or CCTO must be approved by Council. In recommending an arrangement for approval the Chief Financial Officer considers the following:

- Credit risk profile of the borrowing entity, and the ability to repay interest and principal amount outstanding on due date.
- Impact on Council's credit standing and rating, debt cap amount (where applied), lending covenants with the LGFA and other lenders and Council's future borrowing capacity.
- The form and quality of security arrangements provided.
- The lending rate given factors such as; CCO or CCTO credit profile, external Council borrowing rates, borrower note and liquidity buffer requirements, term etc.
- Lending arrangements to the CCO or CCTO must be documented on a commercial arm's length basis. A term sheet, including matters such as borrowing costs, interest payment dates, principal payment dates, security and expiry date is agreed between the parties.
- Accounting and taxation impact of on-lending arrangement.

All lending arrangements must be executed under legal documentation (e.g. loan, guarantee) reviewed by Council's legal counsel and approved by Council.

4. Investment Policy

4.1 General Policy

4.1.1 In its treasury investment activity, Council's primary objective when investing is the protection of its investment so only creditworthy counterparties are acceptable. The Council invests in non-speculative strongly credit rated, liquid negotiable investments which are readily convertible into cash.

4.1.2 The Council, as a net borrower, will have only operational cash surpluses.

4.1.3 The Council will, from time to time, make investments in activities which support a specific strategic policy or aim. Its philosophy in the management of investments is to optimise returns in the long term while balancing risk and return considerations. The Council recognises that as a responsible local authority any investments that it does hold should be low risk and that lower risk usually means lower returns.

4.1.4 The Council seeks to invest in an ethical manner which it defines as meaning that it will invest in entities that engage in activities that demonstrate a positive approach to the environment, society and governance. The Council will not invest where there are significant legal or ethical concerns, and will specifically exclude investment in the following areas:

- the manufacturing or development of controversial weapons
- the manufacturing of tobacco
- the production of fossil fuels
- generating revenue from the operation of casino gambling.

4.1.5 For the purposes of this policy the Council defines investment as relating to financial assets and other assets not directly related to service delivery as outlined below:

- treasury investments
- equity investments (including CCO/CCTOs)
- other investments (including forestry, real estate investments not relating to service

delivery and sundry advances).

4.2 Investment Policy – Treasury Investments

4.2.1 General Management Policy

The Council will hold treasury investments to:

- meet statutory obligations by funding certain reserves;
- match retentions held 'in trust' for the benefit of contractors under the Construction Contracts Act 2002;
- manage short- or medium-term cash surpluses;
- maintain operating cash levels;
- pre-fund refinancing of maturing debt.

4.2.2 Mix of Investments

Investments will be held in a form consistent with the anticipated funding requirement. For short term investments that are generally held for liquidity management purposes, investments are held for periods up to three months and in the form of call deposits or negotiable instruments (i.e. cash or cash equivalents) with registered banks. For investments held for periods beyond three months, government securities, LGFA, or other strongly credit rated securities will be held.

The Council will maintain a schedule of approved counterparties and issuers.

4.2.3 Acquisition of New Investments

The Council will source its approved investment instruments from major financial institutions at the "best price".

4.2.4 Treatment of Income

Interest (or other) revenue from invested funds will be credited to Council's general income. The interest income from statutory reserves will be credited to those funds.

4.2.5 Proceeds of Sale

Funds from the sale of financial investments will be applied to the repayment of debt, reduce new borrowing requirements or expenditure generally.

4.2.6 Management and Reporting

The assets will be managed under delegated authority by the Chief Executive and Council staff. The funds will be subject to quarterly reporting.

4.2.7 Risks

4.2.7.1 Counterparty Creditworthiness:

Funds will be placed with strongly credit rated counterparties with a minimum short-term and long-term credit rating of "A-1" and "A" respectively under the S&P Global's or equivalent credit rating system and be spread across issuers within the parameters outlined in 3.4.

4.2.7.2 Liquidity Risk

Funds held for liquidity management purposes will be invested in instruments which have a readily accessible secondary market or a maturity period of no more than 30 days. Short-term operational liquidity is monitored and controlled through daily cash management activities. Long-term financial liquidity is monitored and controlled through long-term financial planning. Although overdraft facilities are utilised as little as practical the Council will maintain a committed bank overdraft facility to meet interim cash and liquidity requirements.

4.3 Investment Policy - Equity Investments

4.3.1 The Council currently maintains equity investments in the following entities:

- Palmerston North Airport Ltd – the owner and operator of Palmerston North Airport
- Central Economic Development Agency Ltd – a provider of economic development and tourism services for the Council and the Manawatu District Council
- Civic Financial Services Ltd – a provider of a range of risk management products for NZ local government

4.3.2 Further capital investments in these entities will only be contemplated to achieve stated strategic objectives and will be by specific resolution of the Council. Sale of the investments would also require a specific resolution of the Council and be subject to the requirements of the Local Government Act 2002.

4.3.3 It is envisaged that any other equity investments which the Council may hold in the future would only be as a result of a gift, through a restructuring of the Council or to enable the Council to participate in a central Government or regional initiative associated with the provision of a key infrastructural activity. Council may also hold equity investments in CCO/CCTOs (such as LGFA). From time to time the Council will establish "shelf" companies so it is able to respond appropriately to any opportunities which arise.

4.3.4 Each equity investment is evaluated and managed within the following framework:

4.3.4.1 Objectives

The rationale for the investment is determined and reviewed from time to time.

The present investments are held primarily to meet strategic economic and transportation objectives.

4.3.4.2 Monitoring Mechanism

The Council will manage its shareholding in a manner which is dependent on the size and nature of the shareholding and in instances where it is not the 100% shareholder will seek to do so in conjunction with other major shareholders. It will do so by:

- participating in the appointment of directors;
- monitoring the developments in the particular industry;
- monitoring company performance;
- acting to preserve the value of the Council's investment;
- monitoring the impact of the company's operations on the people of Palmerston North.

4.3.4.3 Income from the Investment

In the normal course income from each investment will be applied against current expenditure.

4.3.4.4 Proceeds of Any Future Sale

If the Council were to sell its shareholding, the sale proceeds would be applied to:

- reduction of debt;
- developing new assets
- investment in an appropriately managed diversified fund.

4.3.4.5 Management of the Investment

The shareholding will be managed through the shareholder representatives who are appointed by the Council. In instances where the company concerned is required to prepare a statement of intent the Council will review these and actively make its views known to the company.

4.3.4.6 Risks

The Council will assess the risks associated with each investment. In the normal course, if the principal reason for the investment is for financial return then the Council will expect the commercial risks associated with the investment to be low.

If the reason for the investment is to achieve some other stated strategic purpose the Council may be prepared to accept higher commercial risks.

4.3.4.7 Public Consultation

In the event that the Council contemplates divesting its shareholding, public consultation would be undertaken to an extent that was consistent with the size and public sensitivity of the investment.

At the present time the Council contemplates maintaining each of its present equity investments at least for the medium term.

In the event of a sudden occurrence where either the company or industry is severely impacted, the Council could possibly see a large drop in the value of its shares. Under these circumstances, the public would not be consulted and the Council could resolve to sell the shares. All actions will be in a manner which is consistent with the Council's policy on determining significance and the requirements of the Local Government Act 2002.

4.4 New Zealand Local Government Funding Agency Limited

4.4.1 Despite anything earlier in this Policy the Council may invest in shares and other instruments of the New Zealand Local Government Funding Agency Limited (LGFA) and may borrow to fund that investment.

4.4.2 The Council's objective in making any such investment will be to:

- Obtain a return on the investment; and
- Ensure that the LGFA has sufficient capital to remain viable, meaning that it continues as a source of debt funding for the Council.

4.4.3 Because of the dual objective, Council may invest in LGFA shares in circumstances in which the return on that investment is potentially lower than the return it could achieve with alternate investments.

4.4.4 If required in connection with the investment, the Council may also subscribe for uncalled capital in the LGFA.

4.5 Investment Policy – Other Investments

4.5.1 Forestry

4.5.1.1 The Council is the sole owner of a second rotation forestry crop (known as the Gordon Kear Forest) at the head of the Kahuterawa Valley. The second rotation trees were planted from 2010 to 2016 following harvest of the first tree crop and will be ready for harvest again at around age 28-30 years. As log prices are subject to significant price changes there is a high commercial risk. The net proceeds of harvest will be used to repay general debt.

4.5.1.2 Replanting the forest was seen as important for maintaining the value of the land. One of the other key drivers for the replanting regime was the Emissions Trading Scheme (ETS). The ETS enables the trees to be harvested without penalty provided the forest is replanted or allowed to regenerate and the requirements of the ETS are met, particularly in relation to the number of stems per hectare, tree crown cover and height.

4.5.1.3 The Council also owns a neighbouring forest (known as Arapuke Forest Park) for the principal purpose of recreation. The forestry crop is incidental to the principal use and is classified as Plant, Property and Equipment rather than an investment. The first rotation pine tree crop has been harvested and the forest has been replanted in a range of longer-lived exotic species. Native regeneration is being encouraged on the steeper slopes and around waterways. Several kilometres of mountain bike and walking tracks have been established by local volunteers in conjunction with the Council throughout the block.

4.5.1.4 The Council also has a forestry plantation within the Turitea water supply catchment area. The forestry activity is not expected to generate significant revenue and is ancillary to the water supply activity.

4.5.1.5 There are no plans to expand the Council's investment in forestry. The Council has decided to retain ownership of the Gordon Kear Forest as it has a number of current and potentially strategically important social values combined with providing a commercial return from the forestry investment.

4.5.2 Real Estate Held For Investment Purposes

4.5.2.1 The Council holds real estate when it considers ownership to be essential to the delivery of relevant services. These assets are not accounted for as investments but form part of the plant, property and equipment of the appropriate activity or function. From time to time the Council reviews its ownership by assessing the benefit of continued ownership in comparison to other arrangements. This assessment is based on the most financially viable method of achieving the delivery of Council services. The Council generally follows the same assessment criterion in relation to new real estate acquisitions. From time to time these assets become surplus to operational requirements and then are considered investments, which are assessed for sale.

4.5.2.2 The major real estate holdings which do not form part of the operational activities are:

- library building shops
- Regent Theatre shops
- Civic Centre shops

4.5.2.3 The shops mentioned above form a relatively small component of the overall property in each case and so in practical terms it is unlikely the sale of the of the shops would be contemplated.

4.5.2.4 The Council also has land in Whakarongo being developed and sold as a residential subdivision. Given the subdivision is progressing this land is being accounted for as inventory rather than as an investment. Other blocks of Council owned land are being reviewed for potential development. Any significant change to the nature of use or the form of ownership will be the subject of specific resolution of the Council.

4.5.2.5 From time to time, usually in the process of selling one of these investments, the Council may consider it necessary to invest in commercial mortgages and deferred payment licences.

4.5.3 Sundry Advances

4.5.3.1 From time to time the Council makes loan advances to charitable trusts and incorporated societies for the furtherance of their activities which are consistent with the Council's objectives. The Council will only consider such advances on rare occasions where is not practical to offer financial guarantees. Any such advances would be the subject of specific resolution by the Council following an assessment of the financial strength and long-term viability of the entity concerned.

4.5.3.2 Interest and principal repayments are monitored to ensure they comply with the loan agreement. In the case of default on such advances the assets of the organisation will be required to revert to the Council.

4.5.3.3 Under exceptional circumstances the Council may make advances to residential and commercial property owners to encourage them to connect to basic reticulation systems such as water and wastewater. Any such advances will be subject to a charge being placed over the land.

4.6 Internal Investment/Borrowing

4.6.1 The use of Council investment funds, structured as an internal loan is allowed as a valid means of funding projects, minimising the cost of borrowing and still providing a market return on investment funds.

4.6.2 The treasury function is responsible for administering the Council's internal debt portfolio. Transparent operating procedures will apply to the setting up and repayment of the notional loan and the charging and payment of interest.

4.6.3 Where possible the Council's internal reserves are utilised to minimise the need for external debt, effectively reducing the Council's net interest cost.

5. Foreign Exchange Policy

5.1 Borrowing and investing in foreign currencies is prohibited apart from the one exception mentioned below.

5.2 The Council has foreign exchange exposure through the occasional purchase of foreign exchange denominated plant, equipment and services. Most of these transactions are small and are considered to carry no significant foreign exchange risk.

5.3 For foreign exchange requirements over NZ$100,000 consideration will be given to managing Council's exposure to exchange rates movements using forward exchange rate contracts and/or purchased foreign exchange options. Forward exchange rate contracts can only be entered into once the exact timing and amount of the approved exposure is known. Purchased foreign exchange options can be used when an approved purchase order is raised but not confirmed.

5.4 Credit exposure on these instruments is restricted by specified counterparty credit limits as set out in section 3.4.

6. Accounting Treatment of Financial Instruments

6.1 As a general rule, financial risk management instruments on initial recognition are valued at cost and thereafter carried at fair value with any period unrealised fair value gains or losses booked through the Statement of Comprehensive Revenue & Expense, at any particular reporting date.

6.2 All financial risk management instruments are fair valued (marked-to-market) on a consistent basis, at least six-monthly for internal treasury management and accounting purposes.

6.3 Underlying rates to be used to value treasury instruments are as follows:

- Official daily market rates for short-term treasury instruments (e.g. FRA settlement rates calculated by Reuters from price maker quotations as displayed on the BKBM page)
- Relevant market mid-rates provided by Council's bankers at the end of the business day (5.00pm) for other over-the-counter treasury instruments e.g. swaps
- For markets that are illiquid, or where market prices are not readily available, rates calculated in accordance with procedures approved by the Chief Executive.

6.4 As a general rule bank and loan stock funding is held to maturity and consequently accounted for on an amortised cost basis.

7. Reporting

7.1 When budgeting forecast interest costs/returns, the actual physical position of existing loans, investments and interest rate instruments must be taken into account.

7.2 The following reports are produced:

Report Name	Frequency	Prepared By	Recipient
Daily Cash Position Treasury Spreadsheet	Daily	Senior Financial Administration Officer	Strategy Manager Finance
Treasury Exceptions Report	Monthly	Strategy Manager - Finance	CFO
Treasury Report ● Policy limit compliance ● Borrowing limits ● Funding and Interest Position ● Funding facility ● New treasury transactions ● Cost of funds v. budget ● Cash flow forecast report ● Liquidity risk position ● Counterparty credit ● Treasury performance ● Debt maturity profile ● Revaluation of Financial Instruments ● Statement of Public Debt	Quarterly	Strategy Manager - Finance	CFO/CEO/ Council
LGFA Covenant Reporting	At least annually	Strategy Manager - Finance	LGFA
Trustee Reporting	Six Monthly	Strategy Manager - Finance	Trustee

8. Policy Review

8.1 This Policy is to be formally reviewed on at least a triennial basis. The CFO has the responsibility to prepare a review report that is presented to the Council. The report will include:

8.1.1 Recommendation as to changes, deletions and additions to the Policy.

8.1.2 Overview of the treasury function in achieving the stated treasury objectives, including performance trends in actual borrowing cost against budget (multi-year comparisons).

8.1.3 Summary of breaches of Policy and one-off approvals outside Policy to highlight areas of Policy tension.

8.1.4 Analysis of bank and lender service provision, share of financial instrument transactions etc.

8.1.5 Comments and recommendations from Council's external auditors on the treasury function, particularly internal controls, accounting treatment and reporting.

8.2 An annual audit of the treasury system/spreadsheets and procedures should be undertaken.

8.3 Total net debt servicing costs and debt should not exceed limits specified in the covenants of lenders to Council.

8.4 The Council receives the report, approves Policy changes and/or rejects recommendations for Policy changes.

Appendix:- Glossary of Terms

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

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

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

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

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

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

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

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

Borrower Notes; On occasion when Council borrows from the LGFA it will be required to contribute part of that borrowing back as equity in the form of "Borrower Notes". A Borrower Note is a written, unconditional declaration by a borrower (in this instance the LGFA) to pay a sum of money to a specific party (in this instance the Council) at a future date (in this instance upon the maturity of the loan). A return is paid on the Borrower Notes and can take the form of a dividend if the Borrower Notes are converted to redeemable preference shares.

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

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

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

Collateral; A legal term means “security”.

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

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

Counter party; The contracting party to a financial transaction or financial instrument.

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

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

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

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

Debenture; A debt instrument similar to a bond whereby a borrower borrows for a longer term at a fixed rate. Also a legal instrument provided as security to a lender.

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

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

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

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

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

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

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

Fixed Rate; The interest rate on a debt of financial instrument is fixed and does not change from the commencement date to the maturity date.

Floating Rate; The interest rate on a loan or debt instrument is re-set at the ruling market interest rates on the maturity date of the stipulated funding period (usually 90-days).

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

Forward Exchange Contract; Council when entering into a Forward Exchange Contract agrees a rate today at which one currency is sold or bought against another for delivery on a specified future date.

Forward Points; The difference in interest rates between two currencies expressed as the exchange rate points.

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

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

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

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

Indirect FX Risk; A company has indirect foreign exchange risk where their costs revenues or profits can be adversely affected by the exchange rate that they are not directly paying or receiving. The prices they pay or receive in the domestic currency are influenced by the exchange rate movements.

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

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

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

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

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

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

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

Liability Management; The policy, strategy and process of pro-actively managing the treasury exposures arising from a portfolio of debt.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Standard & Poor's (S&P Global Ratings); A credit rating agency that measures the ability of an organisation to repay its financial obligations.

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

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

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

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

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

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

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

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

Treasury Bill; A short term (<12 months) financing instrument/security issued by a Government as part of its debt funding program.

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

Yankee Bond; A non-resident US borrower issuing a corporate bond in the domestic US bond market.

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

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