greater WELLINGTON
REGIONAL COUNCIL
Te Pane Matua Taiao

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Committee	Council
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Amendment of Treasury Risk Management Policy

1. Purpose

To update the Treasury Risk Management Policy:

a) to introduce new controls in the way interest rate exposure risk is managed

b) to increase the counter party credit risk for New Zealand registered banks

c) to enhance the hedging of electricity price risk.

2. Background

The Treasury Risk Management Policy contains the Council's Liability Management and Investment Policies. These Policies form part of the funding and financial policies that the Council is required to adopt in accordance with section 102 of the Local Government Act 2002. The Council it is not required to use the special consultative procedure to adopt or amend its Liability Management or Investment Policies.

Currently, the Treasury Risk Management Policy is included in the Council's Long-Term Plan for ease of reference; it does not form part of the Plan.

2.1 Treasury Policy update

The Treasury Risk Management Policy was last updated and reviewed in July 2012. Since then Council has approved hedging of the new Matangi 2 debt which was outside policy. This was undertaken to provide certainty of interest cost for the new trains. It became apparent to us and our Treasury advisors (PWC) that our existing policy did not adequately cope with our rapidly increasing forecasted debt portfolio.

As a result of this our advisors have worked with us to develop an amendment to our policy to make it more robust with our rising debt profile. A copy of the revised Policy is attached (**Attachment1)** and further discussed under section 3 below.

2.2 Hedging Electricity price risk

At its meeting on 17 June 2014, the Strategy ad Policy Committee agreed to amend hedging requirements to allow for longer dated hedge contracts, ability to enter into forward dated contracts, and allowance to enter into contracts with non-Standard & Poor's (S&P) rated counter parties with appropriate approvals. It was noted that these amendments would be incorporated into the Council's Treasury Risk Management Policy at the next opportunity.

3. Comment

3.1 Hedging of electricity price risk

The Water Supply Group accounts for the majority of GWRC's total electricity consumption and is responsible for managing electricity procurement. Since 2010, the contract basis for the key wholesale water supply sites has been via a Spot and Hedge arrangement. Physical supply is provided through the wholesale electricity spot market and a hedge contract is used for price risk mitigation.

The updated Treasury Risk Management Policy includes the hedging of the electricity price risk based on existing approvals with three amendments:

1) The maximum hedge period will be extended from 18 month to a maximum duration of no more than three years.

2) The expiry of any hedge contract will be no more than four years, which allows for a forward hedging period of 1 year and a contract with 3-year duration.

3) The credit rating of the hedge counter-party will be at least Investment Grade from S&P at the time of entering into the contract (i.e., a long-term rating of not less than BBB-). In the event of the rating falling below this, the Council would be advised and a recommendation on how to deal with existing hedges and any new hedges contemplated would be made to the Council. If the preferred hedge counter-party does not have an external credit rating with Standard & Poor's the Chief Financial Officer may review the financial position of the proposed counter-party and provide a recommendation for approval by the Chief Executive.

3.2 Interest Rate Risk Management

Our Treasury advisors PWC have recommended the introduction of new interest rate control limits which replaces the current master fixed floating control limit and the resulting fixed rate maturity profile limits.

The purchase of the second tranche of trains (Matangi 2) has a peak debt level of around $165 million, with the majority of the payments scheduled to occur in the 2015/16 year. For that year the budgeted increase in external debt per 2014/15 annual plan is about $119 million. The existing policy does not recognise debt beyond one year i.e. in the 2015/16 year when the Matangi 2 are paid for this is discussed below.

Our current policy looks at the forecasted debt in a year's time and therefore, does not include or incorporate the forecasted rapid increase of our external debt beyond one year. This could lead to lost opportunities with interest rate risk management, especially when interest rates are at historical lows. The forecasted significant debt increase is not considered in the compliance calculations under the current policy.

This was negated to some extent as Council has approved hedging for the Matangi 2 trains which is outside of the current policy, and specifically notes existing policy may be breached.

This one-off approval, however, does not fully address the issue of a rapidly increasing debt profile. Therefore, the need for a more tailored and refined interest rate risk management has been developed.

The amended policy removes the calculation of the fixed / floating limits. This fixed/floating limit takes into account debt in one years' time and measures the fixed rate debt and fixed rate swaps in place at that time and into the future, compared to the floating rate debt.

This limit must be in the band (40% to 95%), it consequently highlights and avoids over hedging, which is very important especially if the debt profile going forward is decreasing or remaining constant.

The amended policy also removes the existing fixed rate maturity profile, which provides for interest rate risk re-pricing maturity to be spread between various bands and amends it with a more comprehensive and prescriptive fixed rate maturity profile extending out to 15 years.

The new policy looks at the forecasted debt at the end of a period (12 month, 24 months, 36 months, etc). from the reporting date and prescribes a minimum and a maximum percentage of that forecasted debt that needs to be at a fixed rate – usually via swaps. The Council needs to be within the prescribed limits in all periods. The new policy parameters are:

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

Debt Period Ending	Minimum Fixed debt	Maximum Fixed debt
Current	50%	95%
Year 1	45%	95%
Year 2	40%	90%
Year 3	35%	85%
Year 4	30%	80%
Year 5	25%	75%
Year 6	15%	70%
Year 7	5%	65%
Year 8	0%	60%
Year 9	0%	55%
Year 10	0%	50%

Year 11	0%	25%
Year 12	0%	25%
Year 13	0%	25%
Year 14	0%	25%

In addition to the above, it is proposed that Council management can now enter into contracts with duration of up to 15 years, an extension of 5 years when compared with the existing limit of 10 years.

As this is a significant policy change, a six month phasing in period is needed, therefore requiring compliance from 31st December 2014 onwards.

A chart of our existing Debt interest rate re-pricing profile showing compliance with the new policy is appended as **Attachment 2**. As can be seen we are almost in compliance with policy with some further hedging to be completed.

3.3 Increase of counter party credit risks

With the sale of the forestry cutting rights, the Council will receive a large cash sum. This will need to be placed on deposit until it can be used to repay debt as it matures, with the balance of the forestry cutting rights surplus placed on deposit to establish the above ground insurance fund.

Due to having these extra funds and for the Council to be able to maximise its return on short term deposits some counterparty credit limits under section 6.3 of the policy are requested to be increased by $10 million.

The updated policy would allow the Council to invest a maximum of $60 million (up from $50 million) with any one New Zealand bank which has an S&P rating of A- long term and / A2 short term.

This in turn increases the new total maximum exposure, which also includes interest rate risk management instruments, per New Zealand registered bank from currently $70 million to $80 million.

4. Communication

There are no communications required regarding this paper.

5. The decision-making process and significance

Officers recognise that the matters referenced in this report may have a high degree of importance to affected or interested parties.

The matter requiring decision in this report has been considered by officers against the requirements of Part 6 of the Local Government Act 2002. Part 6 sets out the obligations of local authorities in relation to the making of decisions.

5.1 Significance of the decision

Part 6 requires GWRC to consider the significance of the decision. The term ‘significance’ has a statutory definition set out in the Act.

Officers have considered the significance of the matter, taking the Council's significance policy and decision-making guidelines into account. Officers recommend that the matter be considered to have low significance.

Officers do not consider that a formal record outlining consideration of the decision-making process is required in this instance.

6. Recommendations

That the Council:

1. ***Receives** the report.*
2. ***Notes** the content of the report.*
3. ***Adopts** the amendments to the Treasury Risk Management Policy as attached in Attachment 1 to this report.*

Report prepared by:	Report approved by:
Mike Timmer	David Benham
Treasurer/Acting Chief Financial Officer	Chief Executive Officer

Attachment 1: Amended Treasury Risk Management Policy (marked up)
Attachment 2: Debt Interest rate risk re-pricing profile chart