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 increase the fixed debt interest rate risk management policy parameters from year 11 to year 15

b) to change the methodology how the counter party credit risk threshold is calculated and update counter party credit risk limits.

c) Adjust the funding chart maturity bands.

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

With a rapidly rising debt profile and significant changes in debt markets during the last years, it became apparent to us and our Treasury advisor (PWC) that our existing policy did not adequately cope with these changes.

As a result of this, our advisors have worked with us to develop amendments to our policy to make it more robust and adaptable with our rising debt profile. A copy of the revised Policy is attached (**Attachment 1**) and further discussed under section 3 below.

All of the proposed changes are recommendations by our Treasury Adviser, PWC

3. Comment

3.1 Debt Interest Rate Risk Management Policy Parameters

Our Treasury advisor PWC have re-assessed GWRC's interest rate risk management policy parameters. The purpose of this exercise was to ensure that the current policy parameters align with council's risk management objectives and also support council's forecasted increase in debt.

The existing policy provides for a reducing maximum percentage of forecasted debt to be fixed, with the maximum hedging limits currently tailing off at 25% by year 15 (**Attachment 2**) This current structure does not adequately facilitate Council's significant rise in debt over coming years and conflicts with the current market environment, enabling Council to secure favourable long term market interest rates at historically low levels.

The updated policy increases the maximum percentage of forecasted debt that can be fixed from year 11 onwards to 50% of the forecasted debt. For years 1 – 10 the limits stay unchanged.

The new maximum hedging limits better align with GWRC's debt forecast, with current 12 month debt forecast providing a minimum floor level of debt for the next 15 years. The new maximum percentages are at a level that any delays in key capital projects will not lead to the Council having more fixed rate debt then needed.

3.2 Counterparty credit risk to be calculated as a percentage of rates and water levy revenue.

In dealing with any bank GW incurs a risk when depositing funds or when entering into any derivative contract. The risk is that a bank would become insolvent and GW would not be able to receive its funds back or any derivative contract would not be honoured by the counterparty. To reduce this risk GW deals only with counter parties whose long term S&P credit rating is at least risk A-, which means that the obligor's has a strong or better capacity to meet its financial commitment on the obligation.

To avoid a concentration of risk the current policy limits the counter party credit limit to $80 million for any NZ registered banks (long term credit rating of A- or better), with a sublimit of $60 million for investments. The counterparty credit risk is ascertained by summing the investments and the exposure to derivatives. The latter is calculated by multiplying the notional swap amount with the number of days times 3%.

In the light of a raising debt profile, the resulting need to enter into swaps as well as increasing deposits, the current policy is considered too rigid. It at times had prevented the Council from receiving the best possible return.

The updated Treasury policy bases the counter party calculation on the total revenue the council receives from rates and the water levy, therefore future rates increase will automatically increase the counter party credit limit. This auto adjustment will in turn reduce the need to adjust the policy limits in the near future.

In determining the usage of the above gross limits, the following product weightings will be used:

a) Financial investments (e.g. deposits, bonds) -100% of the principal value.

b) Interest Rate Risk Management* (e.g. swaps, FRAs) –Any positive month-end mark to market value (as provided by the treasury management system) plus: 3% of the notional principal for all interest rate hedging instruments.

c) Foreign Exchange instruments* (e.g. Forward Exchange Contracts) –Any positive month-end mark to market value (as provided by the treasury management system) plus 30% of the notional value of the instrument.

GWRC will not net off marked to market values against counterparties. Only positive marked to market values (from GWRC's perspective) will contribute to the counterparty calculation. Negative marked to market values will always have a value of zero for counterparty calculation purposes.

The calculated exposure (in dollar terms) will then be divided by the total of rates and levy revenue. This percentage needs to be under the maximum percentage which is stipulated by the updated Treasury Policy. The new counterparty credit limit thresholds are attached (**Attachment 3**)

3.3 Adjusting the funding Chart Maturity Bands

In recent years the New Zealand debt capital markets have grown in size and increased its depth significantly, and with a lower interest rate environment seeing term debt of up to 15 years. Previously debt issues beyond 5-7 years were not common. This change was reflected in a previous update to GW's treasury policy, allowing the council to enter into debt rising of up to 15 years.

However the funding risk management policy parameters were not updated at the time and have now become limiting, for example they presently prevent the council from borrowing any debt greater than 5 years. This means any new borrowing has to be made with a maturity of less than 5 years.

The updated policy makes some changes to the existing intra-band time frames and the complimentary policy limits within the time frames.

The existing policy is as follows:

- 0-3 years: 15%-60%
- 3-5 years: 15%-60%
- 5 years plus: 10%-60%

The new policy is recommended as follows:

- 0-3 years: 15%-60%
- 3-6 years: 15%-60%
- 6 years plus: 0%-60%

Additionally, no more than of 33% of total committed loans/bonds/FRN's and debt facilities are permitted to mature within an immediate 12 month period.

The proposed change is graphically illustrated in (**Attachment 4)** and shows the position before and after the change. As can be seen by widening of the band looks sensible.

4. The decision-making process and significance

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.

4.1 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.

5. 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 set out in Attachment 1 to this report.*

Report prepared by:	Report approved by:
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Attachment 1: Amended Treasury Risk Management Policy (marked up)
Attachment 2: Fixed Rate Debt Profile charts
Attachment 3: Counterparty credit limits
Attachment 4: Funding Maturity charts