POLICIES

Investment Policy 2020

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Commences: 3 September 2020
Review: 1 September 2023

WHAKATĀNE District Council

www.whakatane.govt.nz

1.0 GENERAL POLICY

Council recognises its fiduciary responsibility as a public authority and any investments that it holds should be at an appropriate level of risk, giving preference to conservative investment policies and avoiding speculative investments. The Council is a risk averse entity and does not wish to incur additional risk from its treasury activities.

Section 102 of the Local Government Act 2002 (the "Act") requires the Council to adopt an Investment Policy (the "Policy"). Section 105 of the Act outlines the contents of Council's policies in respect of investments, including:

- The mix of investments; and
- The acquisition of new investments; and
- An outline of the procedures by which investments are managed and reported on to the local authority; and
- An outline of how risks associated with investments are assessed and managed.

The Council recognises its custodial responsibility and reviews the performance and purpose of all investments on an annual basis. The General Manager Finance and Corporate Services reports on all investments quarterly at the Risk and Assurance Committee meeting.

In its investment activities the Council is guided by the Trustee Act of 2019 (effective 30 January 2021). When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others.

1.1 Investment Mix

An investment asset is an asset owned by the Council for the delivery of Council services and includes and is not limited to land, buildings and infrastructure. A non-operational asset is owned by the Council that is not an investment asset. From time to time, the Council holds the following investment assets:

- Equities
- Property
- Forestry
- Internal loans
- Treasury financial instruments

Council will keep under review its approach to all major investments and the credit rating of approved financial institutions.

The Council will review its policies on holding investments at least once every three years.

1.2 Use of Sale Proceeds on Disposition of Operational Assets

Net proceeds from the sale of an Operational Asset are returned to the relevant operational account and utilised as follows:

- If there was debt attributable to the asset, payment of that debt is the first call upon any proceeds of sale (that is the cash value less any costs relating to the sale).

The proceeds of sale (that is the cash value less any costs relating to the sale) following the retirement of any debt will be used for the purposes of:

- The retirement of debt in relation to assets; or

- The funding of the purchase of new assets (as scheduled within a relevant Asset Management Plan); or
- The purchase of strategic assets; or
- Transferred to an appropriate reserve; or
- The funding of one off operational expenses.

The proceeds will not be used to fund general operational expenditure.

1.3 Equity investments

Equity Investments are held for various strategic, economic development and financial objectives as outlined in the LTP.

Council holds equity investments in Civic Financial Services Ltd (formerly the NZ Local Government Insurance Corporation),Bay of Plenty Local Authority Shared Services Ltd (BOPLASS) and NZ Local Government Funding Agency (LGFA) as part of the Council's membership. Council may also invest in other equity investments, including investments held in CCO/CCTO and other shareholdings.

Council also has a 50:50 joint equity venture with the Crown (Ministry of Transport – Air Transport division) in the ownership of the Whakatane Airport. This investment is held for the strategic purpose of providing public access to emergency and scheduled air services to the Eastern Bay of Plenty. The Council controls the operation of the airport and the results of operations are consolidated by equity method into the Council's financial accounts. The Whakatane Airport Annual report is reviewed and adopted by the Council prior to 30 September.

Income from the Council's equity investments, including dividends, is included within general income. Dividends received from investments not controlled by Council are used firstly to repay debt in relation to that investment, then unless otherwise directed by Council, used to reduce other Council debt. Refer to section 1.2 on use of sale proceeds on disposition of operational assets.

The Council seeks to achieve an acceptable rate of return on all its equity investments consistent with the nature of the investment and their stated philosophy on investments.

The sale or purchase of all equity investments requires the prior approval of the Council.

1.4 Property investments

The Council owns harbour endowment land that is currently leased to commercial tenants. Historically there were strategic and commercial reasons for holding this land, but the Council is now considering the option of selling a number of sites to leaseholders. Where appropriate the Council will consult with Iwi on property disposal and acquisitions.

The Council owns a number of other properties. Each year, the Council reviews the performance of all its property investments to ensure that the benefits of continued ownership are consistent with stated objectives.

All rental income received from the harbour endowment land is recorded in the Harbour Activity Account. Other property income is recorded as general funds or credited to the appropriate reserve account.

Council approval is required for the sale and purchases of all property investments and are managed to ensure compliance with statutory requirements.

Property purchases are supported by registered valuations and where appropriate a full business case analysis. Council will not purchase properties on a speculative basis.

1.5 Forestry investments

The Council owns forestry assets. These assets are held as a long-term commercial investment to assist in maximising the return on the land. Income is included in general revenue. Any sale or purchase of forestry assets requires the prior approval of the Council. Refer to section 1.2 on use of sale proceeds on disposition of operational assets.

1.6 Treasury financial investments

In investing in treasury financial instruments Council's primary objective is the protection of its investment capital.

For the foreseeable future the Council will be in a net borrowing position although the Council holds funds from time to time as its cash flows dictate as well as those derived from its reserves and other funds. Investments are therefore made for the following primary reasons:

- to invest surplus cash and working capital funds.
- to invest monies allocated to general and specific reserves, and debt redemption reserves.
- to invest Harbour Property Fund sale proceeds (refer Section 1.4 of this policy).

General, specific, and debt redemption reserves, and the Harbour Property Fund are invested in liquid, short term investments or internally lent to fund activity centre infrastructure projects. The Council allocates funds between those investments that emphasise capital protection, are liquid and have regular interest payments. Accordingly, Council may only invest in approved creditworthy counterparties. Creditworthy counterparties are covered in Section 1.13. Credit ratings are monitored and reported annually to Council.

Council may invest in approved financial instruments as set out below. These investments are aligned with Council's objective of investing in high credit quality and liquid assets.

Treasury financial investments are held to maturity date. In the unusual circumstance where investments are liquidated prior to maturity, approval is obtained from the General Manager Finance and Corporate Services. Proceeds from the redemption of treasury financial investments are used in accordance with the terms of the original purpose of the reserve or fund, or in accordance with a resolution of the Council.

Interest income from treasury financial investments is credited to general funds, except for income from investments for specific reserves, debt redemption reserves, and the Harbour Property Fund, where interest is credited to the particular reserve or fund.

Council recognises that as a responsible public authority any investments that it does hold should be low risk. It also recognises that lower risk generally means lower returns.

(a) Financial investment objectives

The Council's primary objective is to preserve the capital value of investments. Accordingly, investment is restricted to creditworthy institutions (counter parties) that must have a minimum short-term credit rating of A-1 and a long-term credit rating of A from Standard & Poors (or equivalent recognised agency) (see the Counterparty Exposure Limits Section).

Within its credit constraints contained above the Council seeks to:

- Ensure investments are liquid
- Diversify the mix of financial investments
- Optimise investment return within Policy parameters.
- Manage potential capital losses due to interest rate movements if investments need to be liquidated before maturity

The following principles capture the objectives outlined above and form the key assumptions of the operating parameters contained in Counterparty Exposure Limits:

- Credit risk is minimised by placing maximum limits for each broad class of non-government issuer and by limiting investments to the LGFA and registered banks within prescribed limits.
- Liquidity risk is minimised by managing maturity terms to future expenditure requirements and ensuring that all investments are capable of being liquidated.
- Treasury investments are restricted to a term of no more than three months (unless linked to pre-funding debt management activity).
- The Council's treasury financial investments are structured to provide sufficient funds to meet Council's cash flow and capital expenditure obligations as they fall due.

(b) Approved investment instruments

Within the constraints of the Counterparty Exposure Limits, the Council invests in the following instruments:

- Government securities.
- LGFA securities and borrower notes.
- Registered bank securities.

A full list of approved instruments and their definitions are contained within Appendix I.

(c) Interest rate risk management

The Council's treasury financial investments give rise to a direct exposure to a change in interest rates, impacting upon the financial return and potentially the capital value of its investments.

A key part in the management of financial investments is the formulation of an interest rate strategy. An interest rate strategy is approved by the General Manager Finance and Corporate Services.

Once approved the interest rate risk management strategy is implemented by:

- Using risk management instruments to protect investment returns and to change the interest rate profile.

The use of interest rate risk management instruments requires the approval of the Council. Approved risk management instruments are outlined in Appendix II.

1.7 Harbour property fund

The Council holds the net proceeds from the sale of harbour property land in a separate fund for the long-term benefit, management and development of the District's Ports and associated lands. The fund is considered separately from other financial investments discussed in Section 1.6 of the Investment Policy.

The Harbour Property Fund (HPF) is managed in line with a separate Statement of Investment Policy and Objectives (SIPO) document. External fund managers may be appointed in the knowledge of and operate the portfolio according to, the investment guidelines outlined in the SIPO.

The Council will be responsible for the following:

• Setting the Fund's Investment Strategy, including the level of risk and investment performance objectives, and investment policies.
• Determining the appropriate number of investment managers, and selecting and changing those managers as appropriate after having taken advice from the Investment Consultant.
• Reviewing the SIPO on a biennial basis, including the Investment Strategy, policies and manager configuration, and instructions to the Investment Consultant.
• Ensuring that the level of redemptions from the Fund is consistent with the Fund's

objective to maintain equity, in terms of amounts available for distribution, between present and future generations.
• Providing cash flow information to the Investment Consultant with respect to future deposits and redemptions.
• Appointing the Investment Consultant.

Financial instruments and credit restrictions for funds under management in the HPF are separate to that within the Investment Policy as per the Council approved SIPO.

The fund's investment objectives are to:

- preserve the capital value of the fund.
- maintain the real capital value of the fund with regard to inflation.
- invest in instruments that provide a constant income stream.

Specific investment policies relating to this fund are:

- that the inflation adjusted capital value of the fund will not be withdrawn.
- that the funds may be invested to offset the Councils internal borrowing.

1.8 New Zealand Local Government Funding Agency Limited

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

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.

Because of these dual objectives, the 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 alternative investments.

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

1.9 Acquisition of new investments

With the exception of treasury financial investments, new investments are acquired if an opportunity arises and approval is given by the appropriate Council committee, based on advice and recommendations from Council officers. Before approving any new investments, the Council gives due consideration to the contribution the investment will make in fulfilling Council's strategic objectives, and the financial risks of owning the investment. The authority to acquire financial investments is delegated to the General Manager Finance and Corporate Services.

1.10 Investment management and reporting procedures

Council's investments are managed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed through the Daily Cash Position Report, and long-term cashflow through the annual Rolling Cashflow Forecast. To maintain liquidity, Council's investment maturities are matched with Council's known cash flow requirements.

The performance of Council investments is regularly reviewed to ensure Council's strategic objectives are being met. Both performance and policy compliance are reviewed through regular reporting.

1.11 Debt redemption reserves

The Council no longer sets up sinking funds for new loans but may establish specific Debt Redemption Reserves for each new borrowing. As Council is a net borrower for the expected life of the reserve, the funds are utilised for internal loan purposes and managed within the internal borrowing policy.

1.12 Foreign exchange

The Council does not invest or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

1.13 Counter party exposure limits

The Council ensures that all investment and interest rate risk management activity is undertaken with institutions that have a strong credit rating. This is to ensure that the amounts owing to the Council are paid fully and on due date. Default or credit risk is minimised through a combination of portfolio diversification.

More specifically, the Council minimises its credit exposure by:

- Transacting with entities that have a short-term and long-term credit rating from Standard & Poors (or equivalent recognised agency) of at least A-1 and A respectively
- Limiting total exposure to prescribed amounts
- Ensuring investments are liquid
- Monthly monitoring of compliance against set limits

The following table summarises credit requirements and limits:

COUNTERPARTY	MINIMUM S&P SHORT/LONG TERM CREDIT RATING	INVESTMENTS MAXIMUM PER COUNTERPARTY	RISK MANAGEMENT INSTRUMENTS MAXIMUM PER COUNTERPARTY	TOTAL EXPOSURE LIMIT FOR EACH COUNTER PARTY
NZ Government	N/A	Unlimited	N/A	Unlimited
Local Government Funding Agency	A-1 / AA-	Unlimited	N/A	Unlimited
NZ Registered Bank	A-1 / A	$40 million	$40 million	$40 million

Approval is required from the Council for any alterations to these limits.

If any counter party's credit rating falls below the minimum specified in the above table, all practical steps are taken to reduce the credit exposure to that counter party to zero as soon as possible. Counterparties exceeding limits are reported to the Council.

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

(a) On balance sheet

Total amounts invested with that counterparty, i.e. transaction principal * weighting 100%.

(b) Interest rate and foreign exchange rate risk management instruments:-

- 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 x maturity (years) x 3%.
- Credit exposure on foreign exchange is computed by multiplying the face value amount by the (square root of the maturity (years) x 15%)

APPENDIX I - APPROVED FINANCIAL INVESTMENT INSTRUMENTS

1.0 NEW ZEALAND GOVERNMENT

1.1 Treasury Bills

Treasury bills are registered securities issued by the Debt Management Office (DMO) on behalf of the government. They are usually available for terms of up to a year, with 90 or 180 day terms generally preferred by investors. They are discounted instruments held primarily for bank balance sheet liquidity management purposes.

1.2 Government bonds

Government bonds are registered securities issued by the DMO on behalf of the government. They are available for terms ranging from one to twelve year maturities. Government bonds have fixed coupon (interest) payments every six months. It is quoted on a semi annual yield basis and is priced on a discounted cashflow basis. It is readily negotiable in a secondary market.

2.0 NZ LOCAL GOVERNMENT FUNDING AGENCY

2.1 Commercial Paper (also known as Promissory Notes)

Commercial paper (CP) is issued by borrowers who usually have a credit rating and standing in the market that is sufficient to enable the CP to be issued without endorsement or acceptance by a bank. In this instance the LGFA being highly credit rated. Commercial paper is issued with maturities ranging from 7 days to over one year. The common maturities are for 30 and 90 days. Council is restricted to investing in CP with maturities of no more than 90 days. CP is generally preferred over term deposits because investors can sell them prior to maturity without suffering the penalty interest costs common to term deposits.

2.2 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.

2.3 Bonds

With a medium term note (MTN) a fixed coupon payment is made semi-annually to the holder of the security. They are priced on a semi-annual yield basis and are issued at a par/premium or discount to face value. Floating rate notes (FRN) are bonds where interest is paid quarterly at a margin over the bank bill bid rate. LGFA bonds are negotiable and can be bought and sold in the secondary market.

3.0 NEW ZEALAND REGISTERED BANKS

3.1 Call and Term deposits

Call and term deposits are funds accepted by the bank on an overnight basis (call) or for a fixed term. Interest is usually calculated on a simple interest basis. Term deposits are for a fixed term that is held to maturity. Term deposits are not negotiable instruments and termination prior to maturity date is only achievable with 31 days notice.

3.2 Registered Certificates of Deposit (RCD)

RCDs are securities issued by banks for their funding needs or to meet investor demand. They are registered at the RBNZ or held 'on behalf of' by the dealing bank. Details of registration include the name of the investor, face value and maturity date. Ownership can only be transferred by electronic transfer. RCDs are priced on a yield basis and issued at a discount to face value or on a grossed up basis. They are generally preferred over term deposits because investors can sell them prior to maturity.

APPENDIX II - APPROVED INTEREST RATE RISK MANAGEMENT INSTRUMENTS

Approved risk management instruments include:

- Forward rate agreements on bank bills
- Investor interest rate swaps
- Purchased investor swaptions
- Purchased interest rate option products on bank bills (purchased floors)
- Interest rate collar type option strategies (one for one basis only). 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 in isolation (i.e. repurchased) otherwise both sides must be closed out simultaneously.

The sold option leg of the collar structure must not have a strike rate "in-the-money".

Glossary of terms for interest rate risk management mechanisms are set out in Appendix III.

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. Credit exposure on these financial instruments is restricted by specified counter party credit limits.

The following interest rate risk management Instruments are NOT permitted for use:

- Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.
- Structured interest rate option strategies where there is any possibility of the Council's total interest income increasing in a declining interest rate market or where Council's total interest cost is increasing faster than the general market rate.
- Interest rate futures contracts, mainly for administrative ease.

Additions to and deletions from this list are approved by the Council.

APPENDIX III - GLOSSARY OF TERMS FOR TREASURY MANAGEMENT

Term	Definition
Amortising Swap	An interest rate swap contract that has a reducing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an amortising swap is the weighted average maturity, not the final maturity date.
Accreting Swap	An interest rate swap contract that has an increasing principal or notional amount over the term of the contract period. The appropriate market swap rate from which to price an accreting swap is the weighted average maturity, not the final maturity date.
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	Basis risk is the financial risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other.
Benchmark	An agreed market related yardstick that investor returns, funding costs or average exchange rate achieved are compared against for performance measurement purposes.
Bid–Offer Spread	The exchange points (FX) or basis points (interest rates) difference between the bid and offer rate when quoted by a bank is known as the “bid-offer spread”. Banks make their profits from dealing at their own bid and offer prices, thus earning the spread.
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.
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.
Bond FRA	A tailored contract to buy or sell a bond (Government or Corporate) at a fixed interest rate at some specified future date. The Bond FRA contract rate will differ from the current physical market bond yield, depending on the slope of the interest rate yield curve.
Bond Option	The right, but not the obligation by the owner/holder of the option to buy or sell bonds (Government or Corporate) at a predetermined interest rate at a specified future date. The buyer pays a “premium” in cash up-front to

reduce risk and have insurance-type protection, the seller or grantor of the bond option receiving the premium for assuming the risk.

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.

Caplet — A series of call options (caplets) which exist for each period the cap agreement is in existence.

Certificate of Deposit "CD" — A debt instrument (normally short term) issued by a bank to borrow funds from other banks/investors.

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.

Collar — Two option contracts linked together into the one transaction or contract. A borrower's collar is normally a bought "cap" above current market rates and a sold "floor" below current rates. Over the term of the collar contract, if rates go above the cap the borrower is protected and pays an interest cost no more than the cap rate. Likewise, if market rates fall below the floor, the borrower pays the floor rate and does not participate in the lower market rates. Also called a "cylinder".

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.

Commoditised — When a financial market or instrument becomes so popular and "plain vanilla" that there is no longer any difference in the prices quoted by participants in the market.

Convexity — A measure of the degree of curve or slope in an interest rate yield curve.

Convertible Bonds — A debt instrument issued to investors by a borrower that has a fixed interest rate for a period and then converts (under a strict pricing formula) to shares in the issuing company.

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.

Cover	A term used to describe any action of entering financial instruments that reduces risk or puts protection in place against adverse future price movements.
Credit Default Swap	A credit default swap (CDS) is a credit derivative between two counterparties, whereby one makes periodic payments to the other and receives the promise of a payoff if a third party defaults. The former party receives credit protection and is said to be the "buyer" while the other party provides credit protection and is said to be the "seller". The third party is known as the "reference entity". CDS resemble an insurance policy, as they can be used by debt owners to hedge, or insure against credit events such as a default on a debt obligation. However, because there is no requirement to actually hold any asset or suffer a loss, credit default swaps can also be used for speculative purposes.
Counterparty 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 (normally a finance company) borrows for a longer term at a fixed rate. Also a legal instrument provided as security to a lender.
Delta	“Greek” letter that measures how the price of an option (premium) changes given a movement in the price of the underlying asset/instrument.
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.
Digital Option	An option contract that provides a predetermined payout based on an agreed and contracted market price path.
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.

Embedded Option	An option arrangement that may be exercised by a borrower at a future date, but the determining conditions are buried or "embedded" in a separate debt or financial instrument.
Eurodollar	The borrowing and depositing of a currency outside its domestic financial markets.
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.
Exchange - Traded	A currency, debt or financial instrument that is quoted and traded on a formal exchange with standardised terms, amounts and dates.
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.
Floorlet	A series or string of floor options which exist for each period the floor agreement is in existence.
Forward Rate Agreement	A contract ("FRA") whereby a borrower or investor in Bank Bills or Government Bonds agrees to borrow or 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.
Futures	Exchange-traded financial and commodity markets which provide forward prices for the underlying asset, instrument or commodity. Futures

contracts are standardised in amount, term and specifications. Futures markets are cash-based, transacting parties do not take any counter party credit risk on each other. Deposits and margin-calls are critical requirements of all futures markets.

Gamma	"Greek" letter used in option pricing that measures how rapidly the delta of an option changes given a change in the price of the underlying asset/instrument.
Hedging	The action of 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.
High-Yield Bonds	Corporate bonds issued by borrowing companies that are non-prime i.e. have a low or no credit rating. The margin or credit spread above Government bond yields is high (>300 basis points) to compensate the investor into the bond for the higher credit and liquidity risk.
Implied Volatility	Used in option pricing. To estimate the future volatility of the underlying asset or instrument, the option pricing models use historical volatility (expressed as percentage) as a key variable to calculate the option premium amount. The movement in option prices is therefore a good indicator of future market volatility, as volatility is "implied" in the option price.
Index Linked Bonds	Debt instruments that pay an interest coupon or return that is wholly or partially governed by the performance of another separate index e.g. a share market index, or the gold price.
ISDA	International Swaps and Derivatives 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.
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.

LIBOR	London Inter-bank Offered Rate, the average of five to six banks quote for Eurodollar deposits in London at 11:00am each day. The accepted interest rate-fixing benchmark for most offshore loans.
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.
Loan Stock	See definition Appendix I
"Long" Position	Holding an asset or purchased financial instrument in anticipation that the price will increase to sell later at a profit.
Look-back Option	An option structure where the strike price is selected and the premium paid at the end of the option period.
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.
Moody's	A rating agency similar to Standard & Poor's.
Netting	Method of subtracting currency receivables from currency payables (and vice versa) over the same time period to arrive at a net exposure position.
Open Position	Where a Council has purchased or sold an asset, currency, financial security or instrument unrelated to any physical exposure, and adverse/favourable future price movements will cause direct financial loss/gain.
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 pre-set 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.
Perpetual Issue	A loan or bond that has no final maturity date.
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.
Proxy Hedge	Where there is no forward or derivative market to hedge the price risk of a particular currency, instrument or commodity. A proxy instrument or currency is selected and used as the hedging method as a surrogate. There needs to be a high correlation of price movements between the two underlying prices to justify using a proxy hedge.
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.
Repurchase Agreement (Repo)	A sale and repurchase agreement has a borrower sell securities for cash to a lender and agrees to repurchase those securities at a later date for more cash. The repo rate is the difference between borrowed and paid back cash expressed as a percentage. For example, the RBNZ in open market operations buys securities from financial institutions who agree to buy them back at a cost of OCR plus margin.
Reverse Repo	The same repurchase agreement from the buyers' perspective, i.e. the seller executing the transaction would describe it as a 'repo', while the buyer in the same transaction would describe it as a 'reverse repo'
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.
"Short" Position	Selling of an asset or financial instrument in anticipation that the price will decrease or fall in value to buy later at a profit.
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	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.
Structured Options	An option instrument where the relationship/profile to the underlying referenced asset or liability is not linear i.e.1:1
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.
Swaption Collar	The simultaneous position of entering into 2 option contracts on 2 interest rate swaps linked together into one transaction. A swaption collar performs similarly to a ‘collar’ where from a borrower’s perspective a top-side position above current market rates and a bottom-side position below current market rates are entered into. On maturity of the options and depending on current interest rates relative to the strike levels on the swaps will determine if either swap is transacted.
Station	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.
Vega	Another “Greek” letter that is the name given to the measure of the sensitivity of the change in option prices to small changes in the implied volatility of the underlying asset or instrument price.
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.
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.
Zero Coupon Bond	A bond that is issued with the coupon interest rate being zero i.e. no cash payments of interest made during the term of the bond, all interest paid on the final maturity date. In effect the borrower accrues interest on interest during the term, increasing the total interest cost compared to a normal bond of paying interest quarterly, half-yearly or annually.