


INVESTMENT POLICY

1.0 GENERAL POLICY

The 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.

Section 102(4)(c) 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 such a policy:

"105: Investment policy

A policy adopted under Section 102(4)(c) must state the local authority's policies in respect of investments, including –

(a) The objectives in terms of which financial and equity investments are to be managed; and

(b) The mix of investments; and

(c) The acquisition of new investments; and

(d) An outline of the procedures by which investments are managed and reported on to the local authority; and

(e) 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 Chief Financial Officer reports on all investments at every Ordinary Council meeting.

The Council is required to use the special consultative procedure in adopting its Policy although it may be adopted as part of its long term council community plan (LTCCP). Once adopted the policy can only be changed as an amendment to the LTCCP.

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 – share holdings held for strategic purposes
- Property
- Forestry
- Internal loans
- Liquid financial instruments

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

The Council holds equity investments in the NZ Local Government Insurance Corporation as part of the Council's membership.

The 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 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. Refer to section 4.2 on use of sale proceeds on disposition of operational assets.

The Council aims to receive a rate of return on its equity investments that is higher than the official cash rate.

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.

The Council approval is required for the sale and purchase of all property investments.

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 Financial investments

In investing in financial instruments the Council's primary objective is the minimisation of the risk of capital loss.

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.

Normally, financial investments are held to maturity date. In the unusual circumstance where investments are liquidated prior to maturity, approval is obtained from the Chief Financial Officer. Proceeds from the redemption of 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 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.

The Council aims to achieve a rate of return on its financial investments that is higher than the official cash rate.

(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 credit rating of A-1 for short term and A+, for long term investments (see the Counter party Exposure Limits Section).

Within its credit constraints contained above the Council seeks to:

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

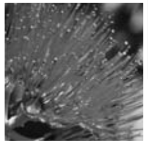
The following principles capture the objectives outlined above and form the key assumptions of the operating parameters contained in Counter party Exposure Limits:

- Credit risk is minimised by placing maximum limits for each broad class of non-government issuer and by limiting investments to local authorities, registered banks, state owned enterprises (SOE) and corporates within prescribed limits.
- Liquidity risk is minimised by ensuring that all investments are capable of being liquidated in a readily available secondary market. The Council's 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 Counter party Exposure Limits, the Council invests in the following instruments:

- Government securities
- Registered bank securities
- Approved corporate, local authority and SOE securities
- A full list of approved instruments and their definitions are contained within Appendix I.

(c) Interest rate risk management

- The Council's 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 Chief Financial Officer.
- 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 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 fund's capital value is preserved and funded from interest income on a quarterly basis by reference to the change in Statistics New Zealand "All Group Consumer Price Index". Any excess revenue is used to specifically fund harbour development
- that the Council prefers fixed interest investments with regular interest payments.

1.8 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 the 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.

1.9 Foreign exchange

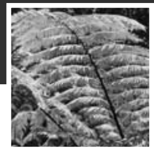
Council does not invest or enter into incidental arrangements within or outside New Zealand in currency other than New Zealand currency.

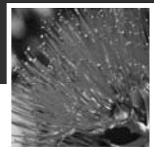
1.10 Counter party exposure limits

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 and the selection of quality investments.

More specifically, the Council minimises its credit exposure by:

- Transacting with entities that have a strong or better Standard & Poor's, Moody's or equivalent credit rating
- Limiting total exposure to prescribed amounts and portfolio limits
- Ensuring investments are liquid and able to be sold into a readily available secondary market
- Monthly monitoring of compliance against set limits.






The following table summarises credit requirements and limits:

INSTITUTION	MINIMUM S&P SHORT TERM CREDIT RATING	MINIMUM S&P LONG TERM CREDIT RATING	TOTAL EXPOSURE LIMIT FOR EACH COUNTER PARTY
Government	A1+	AA+	Unlimited
Registered Bank On balance sheet exposures	A-1	A+	$5 million
Off balance sheet exposures	A-1	A+	$10 million
Strongly rated Corporates, Local Authorities and SOE's (on balance sheet exposures only)	A-1	A+	$1 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. Counter parties exceeding limits are reported to the Council.

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

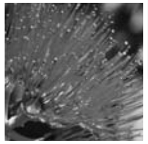
(a) On balance sheet

Total amounts invested with that counter party.

(b) Off balance sheet

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) 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 Reserve Bank of New Zealand on behalf of the government. They are usually available for terms of up to a year, with 90 day terms generally preferred by investors. They are discounted instruments held primarily for bank balance sheet liquidity management purposes.

1.2 Government stock

Government stocks are registered securities issued by the RBNZ on behalf of the government. They are available for terms ranging from one to twelve year maturities. Government stock has 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 Registered Banks

2.1 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 with the expectation that they will be held to maturity. Term deposits are not negotiable instruments and termination prior to maturity date can involve penalty interest costs.

2.2 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 without suffering the penalty interest costs common to term deposits.

3.0 Corporates

3.1 Promissory Notes (also known as Commercial paper)

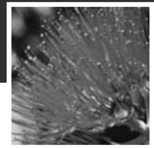
Promissory Notes are issued by borrowers who usually have a credit rating and standing in the market that is sufficient to enable the Notes to be issued without endorsement or acceptance by a bank. Promissory Notes are issued with maturities ranging from 7 days to over one year. The common maturities are for 30 and 90 days. The face value of the note is repaid in full to the investor, on maturity.

3.2 Corporate bonds

Corporate Bonds are financial instruments issued by companies, banks, local authorities and SOE's that have a strong credit rating. These bonds are registered securities. There are two types of bond: the medium term note (MTN) and the floating rate note (FRN).

The MTN has a fixed coupon payment that is paid semi annually to the holder of the security. They are priced on a semi annual yield basis and are issued at a discount/premium to face value. The interest on the FRN is set on a floating rate basis, usually off the 90 day BKBM bid rate. Corporate bonds are negotiable and can be bought and sold in the secondary market.






APPENDIX II - APPROVED INTEREST RATE RISK MANAGEMENT INSTRUMENTS

Approved risk management instruments include:

- Forward rate agreements on bank bills.
- Interest rate swaps of less than 18 months.
- 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 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 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.