Council Meeting Agenda - 9 June 2021

Meeting will be held in the Council Chamber, Level 2, Philip Laing House, 144 Rattray Street, Dunedin

Members:

Cr Andrew Noone, Chairperson	Cr Carmen Hope
Cr Michael Laws, Deputy Chairperson	Cr Gary Kelliher
Cr Hilary Calvert	Cr Kevin Malcolm
Cr Michael Deaker	Cr Gretchen Robertson
Cr Alexa Forbes	Cr Bryan Scott
Hon Cr Marian Hobbs	Cr Kate Wilson

Senior Officer: Sarah Gardner, Chief Executive

Meeting Support: Liz Spector, Governance Support Officer

09 June 2021 12:00 PM

Agenda Topic — Page

1. APOLOGIES

No apologies were noted at the time of publication of the agenda.

2. CONFIRMATION OF AGENDA

Note: Any additions must be approved by resolution with an explanation as to why they cannot be delayed until a future meeting.

3. CONFLICT OF INTEREST

Members are reminded of the need to stand aside from decision-making when a conflict arises between their role as an elected representative and any private or other external interest they might have.

This report is to approve Council joining the Local Government Funding (LGFA) and to determine the preferred method of membership (guaranteeing or non-guaranteeing). Subject to Council's decision on joining the LGFA approval is also sought to authorise staff to undertake consultation on that proposal and revise the Treasury Management Policy (TMP).

5. CLOSURE

4.1. LGFA Funding Proposal

Prepared for:	Council
Report No.	CS2132
Activity:	Governance Report
Author:	Nick Donnelly, General Manager Corporate Services
Endorsed by:	Nick Donnelly, General Manager Corporate Services
Date:	9 June 2021

PURPOSE

[1] To approve Council joining the Local Government Funding Agency (LGFA) and determine the preferred method of membership (guaranteeing or non-guaranteeing). Subject to Council's decision on joining the LGFA approval is also sought to authorise staff to undertake consultation on that proposal and revise the Treasury Management Policy (TMP).

EXECUTIVE SUMMARY

[2] Historically Council has had no external debt and has internally funded activities that required debt funding. This internal debt has been funded via reserves.

[3] The Long-Term Plan 2021-31 proposes the use of external debt to replace the core of Council's internal debt. This will enable reserves to be repaid, provide a cheaper source of funding and improve cash management.

[4] At its meeting on 24 February 2021 Council approved staff to commence the process of joining the LGFA.

[5] A draft consultation document will be prepared based on the information provided in this proposal and the proposal to join the LGFA will be consulted on as required under the Local Government Act 2002.

[6] Three borrowing options have been considered and are analysed in this proposal:

a. Join the LGFA as a guaranteeing member.
b. Join the LGFA as a non-guaranteeing member.
c. Not join the LGFA.

[7] Option a. Join the LGFA as a guaranteeing member is the preferred option.

[8] The Treasury Management Policy (TMP) has also been revised to include the borrowing limits required under the LGFA and to include the LGFA as a permitted investment. A copy of the revised TMP is attached.

RECOMMENDATION

That the Council*:*

1) ***Receives*** *this report.*

2) ***Approves*** *the proposal to join the Local Government Funding Agency as a guaranteeing member.*

3) ***Approves*** *the amendments to the Treasury Management Policy****.***

4) ***Endorses*** *formal consultation, as required under the LGA 2002, on the proposal to join the Local Government Funding Agency and the revised Treasury Management Policy.*

5) ***Appoints*** *the co-chairs of the Finance Committee, Councillors Malcolm and Calvert to constitute a hearings panel to hear any submitters that wish to be heard, deliberate on the submissions received and make a recommendation to Council on joining the LGFA following completion of the consultation.*

6) ***Notes*** *that the proposed level of external borrowing included in the draft Long-Term Plan 2021-31 is $25 million for the 5 years until June 2026 and then reduces $2 million per annum to $15 million at June 2031.*

BACKGROUND

[9] Council currently has no external debt but does fund some activities via internal debt. This is primarily in flood and drainage and transport activities. This internal lending is provided from other Council reserves.

[10] Over recent years the level of internal debt has increased together with general reserves also being utilised to fund increasing levels of budgeted and unforeseen (unbudgeted) expenditure. This has resulted in Council’s operating cashflow being almost fully exhausted prior to the latest annual rates strike in September 2020.

[11] Cashflow forecasts for the 2020-21 financial year and LTP 2021-31 indicate working capital cashflow will be insufficient to fund expenditure through to the next rates strike in September 2021. Council could manage the short term cashflow deficit via a temporary overdraft facility as it did in 2020 (although the facility was not utilised in 2020).

[12] The LTP 2021-31 proposes to replace internal debt with external debt. This will allow reserves to be replenished and realign their cash balances to the underlying position.

[13] Historically Council has used internal funding in preference to external debt. This is because, for a number of years, Council maintained significant cash reserves (in excess of $50M following rates strike). The interest cost of providing internal debt has been aligned to the cash returns Council has received on financial investments (term deposits and the fixed interest portion of the managed fund). This has typically provided a funding cost lower than externally sourced debt.

[14] Current debt funding costs are now significantly lower than historic levels, particularly through the LGFA, and there is now a benefit in utilising external debt rather than internal.

[15] All external debt including borrowings from the LGFA will be secured by a charge over Council’s rates

ABOUT THE LOCAL GOVERNMENT FUNDING AGENCY

[16] The LGFA is a Council Controlled Trading Organisation ("CCTO") established by a group of local authorities and the Crown in 2011. Of the 72 member councils to date, 67 are borrowers 63 are guarantors and 30 are shareholders.

[17] The LGFA has an S&P Global Ratings ('S&P') long term rating of 'AA+'.

[18] Borrowers must meet certain financial covenants to be able to borrow from the LGFA.
- Net debt shall not exceed 175% of revenue.
- Net interest shall not exceed 20% of revenue.
- Net interest shall not exceed 25% of rates revenue.
- Liquidity shall be not less than 110%.

[19] Differential pricing applies depending on the credit standing of the borrower and on the borrower's level of participation

[20] All borrowers are required to contribute 2.5% of the total amount borrowed as capital, known as Borrower Notes. These can be converted to equity at the discretion of the LGFA. The exception to the 2.5% contribution is Commercial Paper where it does not apply.

[21] Because of the potential for the Borrower Notes to convert to equity, all councils must go through the special consultative process before joining the LGFA. This is because of the LGA 2002 requirements relating to a council's holding of an equity stake in a Council Controlled Organisation or a CCTO.

[22] A joint and several guarantee applies whereby all participating borrowers will be liable in the event of a default by any of the borrowers. The exception to this is - if a local authority borrows less than $20.0 million, it is not compulsory to participate in the guarantee, but it is limited to borrowing a maximum of $20.0 million from the LGFA and it will be charged an additional 0.10%, except for Commercial Paper where the 0.10% add on does not apply.

[23] As a guaranteeing borrower ORC will be subject to the joint and several guarantee whereby the debts of the agency are guaranteed in proportion to each individual council's rating base. ORC's share of the guarantee would be 0.41%. This would mean that if the LGFA made a call of $100 million, ORC would need to contribute $410,000.

[24] In relation to the potential liability, there are a number of factors that significantly lessen the possibility that the guarantee would be called, and these include:
- The financial position and credit rating of the LGFA.
- The LGFA's access to significant amounts of liquidity.
- Ability to call on shareholder Councils uncalled capital and borrower notes prior to the guarantee.
- Initial and ongoing credit analysis by the LGFA prior to lending.
- Oversight of the LGFA by the Office of the Auditor General, Audit New Zealand and the Department of Internal Affairs.

- Under the Local Government (Financial Reporting and Prudence) Regulations Act 2014, councils are required to report annually on debt and interest performance benchmarks.

[25] As at 13 May 2020 the LGFA had lent $11.9 billion to local authorities and has raised $13.5 billion.

[26] In terms of its capital base, on a risk adjusted basis, LGFA has a similar level of capital to the major banks operating in New Zealand. Its capital position is as follows:

- Equity of $79.0 million as at December 2020. This is up from $25.0 million in 2012 when the LGFA began operating.
- LGFA is currently generating significant profits ($10.6 million in the 2019/20 financial year).
- There is $20.0 million of uncalled capital that could be called.
- There was $221.1 million in Borrower Notes that could be converted into equity as at December 2020.
- As at 21 May 2021 the LGFA's liquidity portfolio totalled $1.6 billion.
- LGFA's implied capital adequacy ratio was around 12.4% as at December 2020 with the objective of increasing it to 15.0% over time.

BORROWING OPTIONS

[27] Council has several options in the way that it will raise the debt it has forecasted. These options are:

- Participate in the LGFA scheme as a guaranteeing-borrower
- Participate in the LGFA scheme, as a non-guaranteeing borrower.
- Not participate in the LGFA scheme – under this option Council could consider raising the required debt from a bank, issue bonds in its own name or withdrawal funds from its financial investments (the long-term managed fund).

[28] All local authorities are able to borrow from the LGFA, but different benefits apply depending on the level of participation. ORC is proposing that it will participate in the LGFA as a guaranteeing borrower.

[29] As a guaranteeing borrower ORC will not be subject to the restriction of borrowing a maximum of $20 million from the LGFA. Also, as a guarantor ORC will receive pricing that is 0.10% lower than what applies to non- guarantors.

[30] As a guaranteeing borrower ORC will be subject to the joint and several guarantee whereby the debts of the agency are guaranteed in proportion to each individual council's rating base. ORC's share of the guarantee would be 0.41%.

[31] The risk of the guarantee being called has been assessed as low. To date, the LGFA has never called on the guarantee. The LGFA maintains a strong liquidity position and should be able to absorb a default from most borrowers.

ADVANTAGES OF JOINING THE LGFA

[32] Estimated cost savings from using LGFA funding verses bank funding is shown below:

Start Period	End Period	Debt	Gross Savings	Annual Costs	Net Savings
1-Sep-21	30-Jun-22	$25 million	$165,479	$42,000	$123,479
1-Jul-22	30-Jun-23	$25 million	$199,452	$13,000	$186,452
1-Jul-23	30-Jun-24	$25 million	$200,000	$13,000	$187,000
1-Jul-24	30-Jun-25	$25 million	$199,452	$13,000	$186,452
1-Jul-25	30-Jun-26	$25 million	$199,452	$13,000	$186,452
1-Jul-26	30-Jun-27	$23 million	$183,496	$13,000	$170,496
1-Jul-27	30-Jun-28	$21 million	$168,000	$13,000	$155,000
1-Jul-28	30-Jun-29	$19 million	$151,585	$13,000	$138,584
1-Jul-29	30-Jun-30	$17 million	$135,627	$13,000	$122,627
1-Jul-30	30-Jun-31	$15 million	$119,671	$13,000	$106,671
		Total	**$1,722,214**	**$159,000**	**$1,563,214**

[33] Pricing assumptions:

- Bank line fee of 0.35% and a margin of 1.05% (all up 1.40%).
- Average LGFA margin of 0.60% (based on ORC joining as an unrated guarantor).
- Pricing difference is therefore 0.80% (1.40% vs 0.60%).
- Bank facility is based on a 3-year tenor.
- LGFA tenor is based on a debt portfolio with tenors ranging from 3 months to 7 years and an average tenor of 4.1 years, thus giving the LGFA portfolio a longer duration.
- To calculate the net savings the following costs are factored in - set up legal costs of $29,000 which are included in the first years' costs, and annual costs of $5,000 for the Trustee $4,000 for the Registry and audit fees of $4,000, these totalling $13,000.

[34] The LGFA provides benefits around access to funds:

- Immediacy of funding – LGFA funding can be accessed on a continuous basis either through the scheduled tender process or on a bespoke basis whereby borrowers can access funds within two days of giving notice to borrow.
- Flexibility and duration of funding tenors – currently the LGFA offers funding from one month out to April 2037. Borrowers can nominate whether the funding is in a floating or fixed rate term. This is beneficial from an overall interest rate risk management perspective. At present it is doubtful if ORC could access bank funding for more than a 5-year term and if it did so, the cost would be considerably higher.
- Increased certainty of funding – the LGFA is able to offer increased certainty of funding because of its credit rating (and consequent appeal to investors), its standby funding facility from the Debt Management Office and the pre-funding that it carries out in the normal course of its operations. Bank debt is subject to the banks willingness to provide debt and in some cases even when it is willing to provide funding the pricing may be unreasonably high.
- Ease of issuance – once the initial setup process to join the LGFA has been completed it is a relatively straightforward procedure to source LGFA debt which does not involve excessive management time and documentation.

PROPOSAL

[35] Council is proposing to join the LGFA as a guaranteeing member.

[36] Historically Council has had no external debt and has internally funded activities that required debt funding. This internal debt has been funded via reserves.

[37] The Long-Term Plan 2021-31 includes the use of external debt to replace the core of Council's internal debt. This will enable reserves to be repaid, provide a cheaper source of funding and improve cash management.

[38] Joining the LGFA doesn't mean Council is obliged to borrow from the LGFA. Council can still choose not to borrow from the LGFA or not to borrow externally at all. Joining the LGFA provides Council additional flexibility and certainty in how it manages its funding requirements.

[39] Three borrowing options have been considered and are analysed in this proposal:

a. Join the LGFA as a guaranteeing member (preferred).
b. Join the LGFA as a non-guaranteeing member.
c. Not join the LGFA.

[40] Council's Treasury Management Policy (TMP) has also been revised to include the borrowing limits required under the LGFA and to include the LGFA as a permitted investment in the event borrower notes convert to equity.

OPTION 1 – JOIN THE LGFA AS A GUARANTEEING MEMBER (PREFERRED)

[41] Under this option Council can borrow up to the maximum amount allowed under the borrowing covenant of 175% of revenue. Based on the LTP 2021-31 that would allow Council to borrow approximately $130 million in 2021/22 rising to $220M in 2030/31.

[42] In the LTP Council is proposing to borrow $25 million for the first 5 years with this estimated to decrease by $2 million pa from 2025-26 to $15 million in 2030/31.

[43] In order to borrow more than $20 million Council is required to be a guaranteeing member.

[44] Borrowing from the LGFA is approximately 0.80% cheaper than bank funding meaning Council is expected to save around $1.5 million over the 10 years of the LTP.

[45] As a guaranteeing member Council will receive lending 0.10% lower than it would as a non-guaranteeing member. This option provides the most favourable financing costs.

[46] As a guaranteeing member Council will be subject to the joint and several guarantee where the debts of the LGFA are guaranteed by the members in proportion to each Council's individual rating base.

OPTION 2 – JOIN THE LGFA AS A NON-GUARANTEEING MEMBER

[47] Council borrowing as a non-guaranteeing member is limited to $20 million. Council is proposing to borrow more than this amount. Even if a lower amount was borrowed

initially, Council's future borrowing would be limited to $20 million and in the event a higher amount was sought later Council would need to become a guaranteeing member at that point. That would necessitate undertaking the consultation process and delay the availability of that funding until that process was completed.

[48] Funding under this option would be 0.10% higher but Council would not be subject to the joint and several guarantee.

OPTION 3 – DON'T JOIN THE LGFA

[49] Council could choose to not join the LGFA. Under this option long term external debt could still be sourced from non LGFA lenders or if not some level of short-term debt funding will still be required to manage cashflow requirements throughout the year.

[50] If Council doesn't join the LGFA other funding sources are:

- Bank lending.
- ORC issuing bonds in its own name.
- Withdrawal from long-term managed fund.

[51] None of the above options are preferred:

- Bank lending is more expensive than LGFA funding and unless adequate funding lines are maintained funding may not be immediately available or accessible at all.
- Bond issuance by ORC is estimated to cost at least 30 basis points more than the LGFA however it is also likely to necessitate Council obtaining a credit rating which will add time and cost to the process. Effectively this is duplicating what the LGFA already does collectively and would be inefficient and more expensive.
- Withdrawal from the managed fund is not recommended as the managed fund is currently earning returns significantly greater than the borrowing rates offered by the LGFA. The managed fund is also intended to maintain a level of return to offset general rates which will be diminished if these funds are withdrawn and used to fund internal debt.

TREASURY MANAGEMENT POLICY

[52] Council must amend its TMP to include the LGFA as a permitted investment and to include the LGFA borrowing limits.

[53] The borrowing limits included in the amended TMP are a standard requirement for borrowing from the LGFA.

[54] The LGFA needs to be included as a permitted investment in the event borrower notes are converted to equity.

[55] These changes have been made and the revised TMP is attached. This will be included in the consultation material.

CONSIDERATIONS

Strategic Framework and Policy Considerations

[56] Joining the LGFA supports Council's strategic direction and provides cash and funding necessary to implement the activities outlined in the Long-Term Plan 2021-31.

[57] The TMP requires amendment to allow the LGFA to be a permitted investment activity. LGFA borrower notes are required to be held and these may convert to equity.

[58] Borrowing limits in the TMP are being aligned to those required by the LGFA.

Financial Considerations

[59] Use of external debt has been included in the draft LTP 2021-31. Debt levels outlined in this proposal are consistent with those proposed in the LTP.

[60] Financial considerations of each option have been outlined in this paper.

Significance and Engagement Considerations

[61] Under s.56 of the Local Government Act 2002 (LGA 2002) consultation is required via a special consultative process (s.82 of the LGA 2002) before Council can establish or become a shareholder in a CCTO. join the LGFA.

[62] Council could become a shareholder in the LGFA in the event borrower notes converted to equity.

Legislative and Risk Considerations

[63] Legislative requirements around consultation have been outlined in this paper.

[64] An external legal advisor (Buddle Findlay) has been engaged to establish a debenture trust deed, appoint a Trustee and Registry and to prepare the accession documents and certificates.

[65] There is risk associated with the use of external debt and there also risk associated with the ongoing use of internal debt. These risks have been outlined in the proposal options.

[66] Primary risk considerations are credit risk, interest rate risk, cashflow risk and risk around joining as a guaranteeing member.

Climate Change Considerations

[67] There are no climate change considerations.

Communications Considerations

[68] There are no communications considerations.

NEXT STEPS

[69] The consultation documentation will be completed, and consultation undertaken.

[70] Consultation will include the option for submitters to be heard. Hearings will be scheduled to follow the close of the consultation period.

[71] Once consultation is complete Council can formally approve joining the LGFA and sign the accession documents and certificates.

[72] Assuming Council joins the LGFA the initial amount to be borrowed including debt structuring will be finalised prior to drawdown.

ATTACHMENTS

1. Treasury Management Policy - Draft June 2021 - marked up [**4.1.1** - 47 pages]

TREASURY MANAGEMENT POLICY

Incorporating

LIABILITY MANAGEMENT POLICY AND INVESTMENT POLICY

~~September 2019~~June 2021

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1. Introduction

The Local Government Act 2002 requires local authorities to adopt a Liability Management Policy and an Investment Policy. The Otago Regional Council's ("Council") prepared policies have been combined into one document called the Treasury Management Policy.

The Liability Management Policy is designed to provide a framework for prudent debt management and sets out how Council may wish to use debt as a funding mechanism.

The Investment Policy is designed to ensure that the financial resources of the Council are managed in an efficient and effective way. It sets out how Council can utilise funds from the sale of assets~~,~~ and what should be done with the investment income ~~and so on~~.

Council has set up a structure of responsibilities and reporting lines to ensure the appropriate management and accountability of the liability management and investment~~ing~~ management activities.

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2. Structure

2.1 *Treasury and Investment Organisational Structure*

The organisation chart for the treasury and investment activity is as follows:

2.2 *Treasury and Investment Responsibilities*

The key responsibilities of the above positions are as follows:

Council
The primary responsibilities of Council are planning, policy and governance.

- Approve and adopt the Liability Management and Investment Policies.
- Review at least on a three yearly basis the Liability Management and Investment Policies, and approve any revisions or amendments as required.
- Approve by resolution all external Council borrowing.
- To encourage the appointment of Audit and Risk Subcommittee members with the relevant experience and competencies to achieve the stated objectives.
- To ensure that the roles and responsibilities of all parties are documented and clearly defined.
- Reviewing and assessing budgets during the budget review process.
- Appointment of Investment Managers.

- Reviewing investment performance and investment reports periodically throughout the year and at year end.
- Approve any transaction that falls outside the guidelines of the IP and Statement of Investment Policy and Objectives ("SIPO").

Finance and Corporate Committee

The Council has established the Finance and Corporate Committee and has delegated such powers and duties to the Committee as the Council sees fit. The Finance and Corporate Committee operates as per the Council's constitution. Members serving on the Finance and Corporate Committee are appointed by the Council. The Audit and Risk Subcommittee is a subcommittee of the Finance and Corporate Committee.

Audit and Risk Subcommittee

The Council has established the Audit and Risk Subcommittee and has delegated such powers and duties to the Committee as the Council sees fit. The Audit and Risk Subcommittee operates as per the Council's constitution. Members serving on the Audit and Risk Subcommittee are appointed by the Council.

- To provide guidance and leadership on the appointment, management, monitoring and review of appropriate Investment Managers.
- Reviewing all matters concerning the SIPO, considering any changes or amendments to the SIPO and making appropriate recommendations
- Regularly reviewing the Investment Managers reports, and reporting exceptions.
- Ensuring that all parties overseeing, advising and managing ORC's investments disclose any potential conflicts of interest. In the event that conflicts of interest arise the policies and procedures for managing these are to be clearly defined, although, in principle, such conflicts should be avoided.
- Ensuring that an appropriate SIPO is developed and maintained.
- Ensuring that contracts for investment advisory/management, custodial and consultancy services are reviewed at least every three years.
- To recommend the appointment and removal of Investment Managers as appropriate.
- Ensuring investment portfolios are prudently diversified to meet the agreed risk/return profile.
- Approving the asset classes and sub-asset classes to be included in any investment portfolios.
- Ensuring that all service agreements and contracts are in writing and are consistent with fiduciary standards of care.
- To ensure that the practices and policies set out in the SIPO are adhered to.
- To follow formal criteria to monitor, evaluate and compare the investment performance results achieved against relevant benchmarks and objectives on a regular basis.
- To confirm on an annual basis that best practice with respect to execution, brokerage, money sweep facilities, foreign currency spreads, transaction costs and management fees is being applied.

General Manager Corporate Services and CFO

- Responsible for setting investment, borrowing and risk management strategy in conjunction with the Finance Manager and the Manager Projects.
- Responsible for recommending the level of cash available for investment and that held for working capital purposes.
- Recommend to Council amendments to the Liability Management and Investment Policies as required.
- ~~Recommend to Council the most appropriate source and terms for borrowing as and when required.~~
- Manages the funding and liquidity activities of the Council.
- Determines the level of future core debt is to be used for interest rate risk management purposes.
- Maintains lender relationships with the banks and the capital markets including the LGFA.
- Monitors and reviews the ongoing treasury risk management performance of the Council to ensure compliance with the policy parameters.
- Review internal audit reports and approve as appropriate any recommendations made.
- Administering and attending to the day-to-day financial matters associated with the management of investment portfolios, including serving as the primary point of contact for the Investment Manager(s).

Finance Manager – Expenditure and Reporting

- Responsible for all activities relating to the daily implementation and maintenance of the Liability Management and Investment Policies.
- To control and account for all investment, recordkeeping and administrative expenses associated with management of the funds.
- Prepares quarterly treasury reports.
- To report at least annually to the Audit and Risk Sub-committee 'Total cost of Delivery' being the sum of:
  - Investment Advisory Fees,
  - Custodial Fees,
  - Administration Fees, and
  - Total Fund Fees – made up of; annual management fees (including annual management fees of underlying investments), performance-based fees (including performance based fees of underlying investments), and any other fees and costs.
- Assist in determining the most appropriate sources and terms for borrowing and investing.
- Negotiate investment and borrowing transactions.
- Responsible for keeping the General Manager Corporate Services & CFO informed of significant treasury activity and market trends.
- Responsible for reviewing/approving the weekly cashflow and cash management transaction requirements completed by the Accountant.

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- Responsible for confirming adherence to Liability Management and Investment Policies, through internal audit reviews, to be performed on an annual basis. Reports findings to the General Manager Corporate Services & CFO.
- Assist in identifying amendments to the investment, borrowing and risk management strategy, which may require amendment of the Liability Management and Investment Policies.

Senior Accountant / Accountant

- Prepare and manage Council's cashflow and cash requirements.
- Report to the Finance Manager on the weekly cashflow position and resulting cash management transactions required.

Council may also appoint an Independent Treasury Advisor ("ÏTA") to advise on the management of the treasury risks.

3. Liability Management Policy

3.1 General Liability Management Policy

The Council, on such terms and conditions as it considers appropriate and by resolution, exercises its borrowing powers pursuant to the Local Government Act 2002.

Council may borrow for the following primary purposes:

- Fund special one-off type projects.
- Fund expenditure for items of an intergenerational nature.
- Short term borrowing to manage timing differences between cash inflows and outflows.

Council can borrow from external sources utilising the following borrowing mechanisms.

- Committed bank facilities.
- The capital markets using Commercial Paper ("CP"), Floating Rate Notes ("FRN") and Fixed Rate Bonds ("FRB''), also referred to as Medium Term Notes ("MTN")
- The Local Government Funding Agency using standby facilities, CP, FRNs and FRBs, also referred to as MTNs.

~~through a variety of market mechanisms including the issue of stock and debentures, direct bank borrowing or through accessing the short and long-term capital markets directly.~~

When evaluating new borrowings, the Council will take into consideration the following:

- The impact on its borrowing limits (refer Section 3.5).
- The impact on its interest rate exposure limits (refer Section 3.2).
- The available terms of borrowing including interest rates, level and timing of repayments and security.
- The size and economic life of the asset / project being funded.
- The level and timing of earnings which may flow from the asset / project.
- The advantages and disadvantages of various borrowing mechanisms including the relevant margins under each borrowing source.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue / rollover time.
- Consistency with the Council's long-term financial strategy.
- Legal documentation and financial covenants.
- The Council cannot borrow ~~offshore~~ in foreign currencies.

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3.2 *Interest Rate Exposure Policy*

~~Interest rate risk refers to the impact that movements in interest rates can have on the Council's cashflows.~~

~~Given the purposes for which the Council will borrow, Council tends to weight its borrowing to long term fixed interest securities. It may be appropriate from time to time (depending on Council's outlook on interest rates) to choose borrowing mechanisms which have a floating interest rate, but the level of such borrowing must not exceed the maximum floating rate exposure allowed, as set out below:~~

- ~~**Up to 30% of the total borrowings may have a floating interest rate.**~~

~~The Council may use the following interest rate protection tools to assist in the management of interest rate exposure:~~

- ~~Forward rate agreements.~~
- ~~Interest rate swaps and swap options.~~
- ~~Purchase or sale of interest rate options products including caps, floors, bond and bill options.~~
- ~~Interest rate futures contracts.~~

Interest rate risk management has the objective of managing Council's interest rate exposures in order to:

- Give a sufficient level of certainty to Council's funding costs while, at the same time, allowing Council to participate if interest rates and credit spreads move favourably.
- Control variations in interest expense for the debt portfolio from year to year, taking into consideration relevant budgetary assumptions.
- Recognise Council's exposure to the local and international economies and maintain sufficient flexibility in its interest rate risk management profile to enable TDH to respond as appropriate.

Hedging controls relate to the level of core debt. Core debt is defined as the level of current and projected future debt as determined by the CFO. Core debt projections should be supported by appropriate budgetary analysis.

Council will maintain fixed interest rate cover for core debt within the control limits detailed in the table below. Fixed rate debt is defined as all debt that has at least one more rate reset outstanding (typically quarterly) or has more than three months to maturity in the case of a fixed rate term loan. Compliance with these parameters is at the discretion of the CFO if core debt is less than $10.0 million. Any hedging in excess of 8 years must be approved by the full Council.

The following interest rate risk management parameters apply if debt is greater than $10~~5~~.0 million:

Fixed Rate Hedging Percentages		
	Minimum Fixed Rate Amount	Maximum Fixed Rate Amount
0-2 years	4~~5~~0%	100%
2-4~~5~~ years	20~~5~~%	80%
4~~5~~-8~~10~~ years	0%	60%

The approved interest rate risk management instruments are as follows.

- Fixed interest rate swaps, including forward starting swaps.
- Interest rate options – includes caps, swaptions and collars. For a collar the amount of the sold option must match the amount of the purchased option.
- Fixed Rate Term Loans.

Options that hedge floating rate debt with an exercise rate greater than 1.50% above the equivalent period fixed interest rate at the time of inception cannot be included as part of the fixed rate cover percentage calculation. For example, a two year cap at 2.00% would only count as a fixed rate hedge if the underlying two year swap rate at the time of inception was higher than 0.50%.

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3.3 *Liquidity and Funding Risk Management*

~~Council ensures funds are available for the repayment of debt by:~~

- ~~Matching expenditure closely to its revenue streams and managing cashflow timing differences to its favour.~~
- ~~Avoiding concentration of debt maturity dates.~~
- ~~Ensuring funds are available through committed bank facilities.~~

Liquidity risk is the risk that an unforeseen event or miscalculation in the required liquidity level may lead to Council being unable to meet its day to day obligations.

Liquidity risk management has the objective of ensuring that adequate liquid assets and funding sources are available at all times to meet both the short and long-term commitments of TDH as they arise, in an orderly manner. The two main sources of liquidity requirements are for working capital and material adverse business events.

To manage liquidity risk Council must maintain a liquidity percentage of 110% above the projected peak borrowing requirement over the following twelve months e.g if debt was $25 million, the Council must maintain liquidity of at least $2.5 million. Liquidity is defined as external debt plus committed loan facilities plus liquid investments divided by external debt.

Appropriate cash flow reporting mechanisms must also be maintained to monitor Council's estimated liquidity position over the next twelve months.

~~To minimise the risk of large concentrations of debt maturing or being reissued at times of unfavourable interest rates, the Council ensures debt maturity is spread widely over a range of maturities (managed through the use of detailed cashflow forecasting). Specifically, Council ensures that:~~

Funding risk is defined as an inability to secure access to external lines of credit sufficient to enable the Council to achieve its strategic short term and long term objectives where the financial requirements to achieve those goals exceed the funds being generated from operating activities. Funding risk covers both working capital requirements and core debt.

- The Council must approve all new debt funding facilities and/or revision to the parameters of existing debt funding facilities.
- To ensure that all of the Council's debt is not exposed to excessive refinancing risk at any one time, no more than 40% of all debt facilities should mature within a rolling twelve month period. Compliance with this provision is not required if total external debt is less than $10.0 million.
- The CFO must renegotiate/replace maturing bank funding facilities on a timely basis. Specifically, the CFO must obtain an indicative letter of offer no later than three months before the maturity of any bank facility.

- ~~**No more than 50% of total borrowing is subject to refinancing in any one financial year, if debt is greater than $10.0 million.**~~
- ~~**Committed funding facilities of not less than 110% of projected core debt over the ensuing twelve months shall be maintained.**~~

3.4 Credit Risk Management

~~While the Council will only borrow from reputable financial institutions, there are no minimum credit rating requirements imposed by the Council on its lenders. Also, there is no limit on the level of borrowing to which the Council may commit from any one lender.~~

The management of counterparty credit risk in relation to the Council' borrowing and interest rate risk management activities has the objective of minimising financial loss through the default of a financial counterparty, usually a financial institution, due to the financial insolvency of the counterparty, the inability of the counterparty to perform due to country decree, or any other circumstance such as an adverse market event. The purpose of counterparty credit limits is to limit the loss that the Council may incur if a counterparty was to default or be unable to meet its obligations.

The Council's exposure to counterparty credit risk will be managed by entering into financial market transactions and funding arrangements with only approved counterparties. Approved counterparties are defined as follows:

- An approved counterparty must be a New Zealand Registered Bank or financial institution with a long term credit rating of 'A-' or above by Standard & Poor's ("S&P"), or the Moody's Investors Service ("Moody's) or Fitch Ratings ("Fitch") equivalents.

3.5 External Borrowing Limits

In managing its borrowings, the Council will adhere to the following limits (based on the Council's latest financial statements):

- **Net ~~Interest~~ interest expense will not exceed ~~20~~25% of total rates per annum.**
- **Net ~~Interest~~ interest expense shall not exceed ~~25~~20% of total revenue.**
- **Net ~~Debt~~ debt shall not exceed 175% of total revenue.**
- **Liquidity shall not be less than 110%.**

3.6 Local Government Funding Agency

The Council may borrow from the New Zealand Local Government Funding Agency ("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.
- Provide guarantees of the indebtedness of the LGFA.
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required.
- Subscribe for 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.

3.7~~6~~ Security

It is Council policy to offer security for its borrowing by way of a charge over its rates. In the normal course of business, Council policy is not to offer security over any of the other assets of the Council. However, in special circumstances and if it is considered appropriate, Council may resolve to offer such security on a case by case basis.

3.8~~7~~ Repayment

The Council repays borrowings from rates, surplus funds, investment income, proceeds from the sale of investments and assets, or from specific sinking funds.

3.~~8~~9 Internal Debt Management

When considered appropriate, the Council uses accumulated reserves as a borrowing mechanism, thereby reducing the level of external borrowings. The following operational guidelines apply to the use of reserves for funding rather than external borrowings:

- Interest is charged on the month end loan balances.
- The interest rate charged is equivalent to what Council would earn if it had been invested.
- Reserves available for internal borrowing are limited to 50% of total reserves.

4. Investment Policy

4.1 General Investment Policy

Guiding Principles

The guiding principles which govern ORC's equity and financial market investment activities are as follows:

- ORC's time horizon is long term, i.e. it is greater than 15 years, and it intends to hold investments for the long term.
- There is a positive relationship between risk and return, higher expected returns means higher risk.
- Every investment has an associated level of risk. This risk is best mitigated by diversification.
- Investors who have a Strategic Asset Allocation ("SAA"), and a Statement of Investment Policy and Objectives ("SIPO") which they follow, generally outperform investors who do not.
- Frequent trading, completely liquidating all investments, or allocating all investments to one specific sector which is predicted to outperform is speculation, not investment.
- Periodic rebalancing back to SAA target weights is likely to enhance investment returns over the long term.
- Periodic review of IP and the SIPO is likely to ensure that any material changes in circumstances are captured and reflected in the management of the portfolio. Reviews should occur not less than three yearly.

Objectives

Council's primary objective when investing is the protection of its initial investment. Accordingly, the risk profile of all investment portfolios must be conservative (see Appendix 1).

Within the approved credit limits contained in Appendix 1, the Council also seeks to:

- Maximise investment returns.
- Manage potential capital losses due to interest rate movements, currency movements and price movements.
- Maintain the real value of investment assets in perpetuity.
- Ensure that the real value of distributions can be maintained.
- Maintain intergenerational equity between current and future ratepayers of Otago Regional Council.

4.2 Risk Tolerance

The Council recognises and acknowledges that some risk must be assumed in order to achieve the long-term investment objectives.

Risk tolerance is affected by three factors:

- Capacity to accept risk,
- Willingness to accept risk, and
- Required rate of return.

Capacity to Accept Risk

ORC's capacity to accept risk is a function of its investment time horizon, prospective future contributions, current financial condition, level of funding requirements and reserve facilities.

Time Horizon

ORC is expected to exist in perpetuity. The investment time horizon of ORC is therefore long term. This increases capacity to accept risk.

Financial Capacity

ORC's current financial condition and level of funding requirements imply reasonable capacity to tolerate short to medium term volatility in the value of its investments. This increases capacity to accept risk.

Based on the combination of time horizon and financial circumstances, ORC's overall capacity to accept risk is assessed as **Medium to High**.

Willingness to Accept Risk

ORC is a risk averse entity. The Council seeks, where possible, to minimise volatility or risk. Notwithstanding this risk aversion, the Council, Finance and Corporate Committee and Audit and Risk Subcommittee, acknowledge that investing solely in capital stable investments exposes the Council's asset base to the risk of inflation and is willing to accept some risk in order to increase expected return, subject to ORC's capacity to accept risk.

Required Rate of Return

Careful consideration of cash flow requirements is essential to determine the required rate of return. In order to achieve the desired level of contributions to cash flow, while maintaining the real value of ORC's capital over time, the real (i.e. inflation adjusted) required return for ORC must be greater than the spending rate.

Based on a spending rate of $2,000,000 per annum and an assumed investment asset base of $40,000,000 to $50,000000, inflation expectations of 2.0% per annum, a return of 2.0% to 3.0% may be sufficient to meet ORC's objectives.

Otago Regional Council

4.3 Investment Mix

The Council has a significant portfolio of investments that may be comprised of the following:

- Strategic equity investments.
- Strategic property investments.
- Kuriwao Endowment.
- Short Term Liquidity.
- Long Term Fixed Interest
- Long Term Investment Portfolio
- Investment in Irrigation Schemes
- Local Government Funding Agency

4.4 Strategic Equity Investments – Port Otago

Nature of Investments and Rationale for Holding

The Council owns 100% of Port Otago Limited.

Port Otago is a significant strategic asset held by the Council on behalf of the regional community, with its activities complementing and supporting the economic development of the region.

Review of Holding

The Council will from time to time review the equity held in Port Otago Limited, and may, if considered strategically appropriate, amend the percentage shareholding held.

Disposition of Revenue

Port Otago Limited has consistently paid a dividend to the Council. The company's Statement of Corporate Intent produced annually, specifies the level of dividend that will be paid. These dividends are to be used to subsidise general rate funding. Special dividends received may be used towards special projects of a one-off nature.

Risk Management

The Council's investment in Port Otago Limited is not without risk. Dividends receivable are driven by the level of profitability that Port Otago can continue to generate, and ultimately, the value of the Council's investment in the company.

The Council's risk management procedures include:

- Appointing external directors with appropriate expertise to Port Otago Limited's Board of Directors.
- Reviewing / approving on an annual basis Port Otago Limited's Statement of Corporate Intent.
- Regular reporting to Council as specified in the Company's Statement of Corporate Intent.

Management Reporting Procedures

Management reporting issues have been noted under risk management issues above.

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4.5 Property Investment

Nature of Investment and Rationale for Holding

The Council owns investment properties within Dunedin City, the land having been gifted to the Council. The land is leased on commercial terms.

Council considers that holding this investment is in the interests of residents and ratepayers, because the return by way of rentals is at commercial rates.

Review of Holding

The Council will from time to time review the investment properties, and may, if considered strategically appropriate, reduce the holdings.

Disposition of Revenue

Revenue earned from investment properties is used to subsidise general rate funding.

Proceeds from the sale of investment properties would be allocated to the Asset Replacement Reserve.

Risk Management

The risk in respect of holding investment property is evaluated as low given the location of the property and its current and long-term use. A valuation of the property is carried out on an annual basis by an Independent Registered Valuer, with gains or losses in value being taken directly to the property revaluation reserve.

Rental income earned from investment properties is considered low risk, due to the fixed and long-term nature of the lease agreements. Lease rental is negotiated at the time that the leases expire, with independent and expert advice being obtained on the market conditions.

Management Reporting Procedures

Returns from investment properties are monitored on a regular basis.

On an annual basis, the market value of the investment properties is recorded and reported on in the Council's financial statements.

4.6 Kuriwao Endowment

Nature of Investments and Rationale for Holding

This land was vested in the Council by the Otago Regional Council (Kuriwao Endowment Lands) Act 1994 ("the Act"). The Otago Regional Council leases the land to private individuals.

Disposition of Revenue

The Act allows the Council to sell the land if it so desires but stipulates that sales proceeds and any earnings from those proceeds must be used for the benefit of the Lower Clutha district.

In accordance with the Act, rental income from the leases is also used for the benefit of the Lower Clutha district, and is used primarily for catchment works in that district.

Risk Management

The risk in respect of holding investment property is evaluated as low given the location of the property and its current and long-term use.

Rental income earned from endowment land is considered low risk, due to the fixed and long-term nature of the lease agreements. Lease rental is negotiated at the time that the leases expire, with independent and expert advice being obtained on the market conditions.

Management Reporting and Procedures

Returns from the leased land are monitored on a regular basis.

The value of the land is recorded and reported on in the Council's financial statements.

4.7 Short Term Liquidity

Nature of Investment and Rationale for Holding

This type of investment will be in the form of cash deposits held for various periods from "on call" to 365 days or longer. It will be held for working capital purposes, emergency funds and as an investment when deemed appropriate.

Deposition of Revenue

Revenue earned on cash holdings is added to the reserve balance that the cash holdings relate to, e.g. Emergency Response Reserve. When earned on general cash held from rate takes and other external funding sources it is used to subsidise general rates.

Risk Management

Investments are to be held with financial institutions as approved by the General Manager Corporate Services and CFO, and in accordance with the limits set out in Appendix 1.

- No more than 30% of cash is to be invested at any one time with any one institution, unless this is the diversified cash management portfolio managed by a fund manager when 100% can be invested (see Appendix 1).

Management Reporting

Cash holdings are managed as part of the Council's daily operational procedures (refer section 5).

4.8 Long Term Investment Portfolio

Nature of Investment and Rationale for Holding

The Council has established a Long-Term Investment Portfolio in order to assist with the subsidising of rates and maintaining intergenerational equity between current and future ratepayers.

Council considers that holding this investment is in the interests of residents and ratepayers, because the opportunity to earn higher investment returns through income and capital growth than is achievable through short term liquidity or long-term fixed interest provides a greater chance of maintaining the real value of ORC's asset base in the face of inflation.

Review of Holding

The Council will from time to time review the Long-Term Investment Portfolio, and may, if considered strategically appropriate, reduce or increase the amount of funds allocated to the Long-Term Investment Portfolio.

Disposition of Revenue

Revenue earned from the Long-Term Investment Portfolio is used to subsidise rate funding.

Risk Management

The Council's investment in the Long-Term Investment Portfolio is not without risk. The income and capital growth likely to be achieved from the Long-Term Investment Portfolio will vary and may not meet Council's expectations in any one quarter or year.

The Council's risk management procedures include:

- Appointing an independent Investment Manager with appropriate expertise to manage the Long-Term Investment Portfolio.
- Requiring the Investment Manager to adhere to a SIPO which defines the nature of the investment management mandate including restrictions, exclusions and minimum reporting requirements.

- Requiring the Investment Manager to report compliance with the SIPO.
- Requiring the Investment Manager to report formally against appropriate benchmarks quarterly, and peer group at least annually.
- The Council will conduct a formal review of incumbent Investment Managers not less than three yearly. This may result in a tender process for the Investment Management of the Council's Long-Term Investment Portfolio.

Management Reporting and Procedures

Long-Term Investment Portfolio returns, and portfolio characteristics are monitored on a quarterly basis against relevant benchmarks and compliance reporting criteria established in the SIPO.

On an annual basis, portfolio returns are benchmarked against an appropriate peer group.

4.9 Investment in Irrigation Schemes

Nature of Investment and Rationale for Holding

This type of investment would be in the form of equities in irrigation schemes. Such investments could only be entered into where an equity holding by Council will enable a scheme to proceed, if committed supply contracts alone are not sufficient to enable this, **and** where an equity holding will enable wider community benefits in water management.

Any consideration of an equity investment will only occur after normal corporate loan and equity funding had been diligently explored by the developers of the irrigation scheme, and reasons for rejection identified.

Any proposed investment in an irrigation scheme must be consulted on before proceeding with the investment.

Disposition of Revenue

Revenue earned from equity investment in irrigation schemes is to be used to subsidise general rates.

Proceeds from the sale of equities will be allocated to the general reserve.

Risk Management

Investment in Irrigation Schemes is assessed as having a high risk. Returns on this type of equity investment may not be earned until such time as the investment is sold, or may not be at levels that may be returned on other types of investment.

Further there is a risk that there will be no readily available option for selling the investment, should the Council wish to do so.

The Council's risk management procedures include:

- Requiring a full business plan that shows a commercial return on investment, and a real opportunity to sell the investment.
- Being entitled to having a representative on the Board of the irrigation scheme company.
- Requiring regular reporting to Council of the activities and progress of the scheme, and the uptake of shares by farmers joining the scheme.

Investments are to be held in accordance with the limits set out in Appendix 1.

Management Reporting

The value of equity investment in irrigation schemes is to be recorded and reported annually in the Council's financial statements.

4.10 Local Government Funding Agency

Council may invest in shares and other financial instruments of the 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 become and remain viable, meaning that it continues as a source of debt funding for the Council.

Because of this dual objective, the Council may invest in LGFA shares in circumstances in which the return on that investment is potentially higher 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.

5. Cash Management

The finance department is responsible for managing the Council's cash surpluses and deficits as they arise. These may arise due to a mismatch of daily receipts and payments.

Council maintains weekly cashflow forecasts. These cashflows determine the level of cash required for working capital purposes, any surpluses available for investment, and any deficits that may require short-term borrowing. Any cash to be invested for longer than 12 months is covered by sections 4.7 and 4.8 of this policy document.

The following operational guidelines apply to the cash management processes:

- **Cashflow surpluses will be invested in accordance with section 4.7 of this document.**
- **A committed bank overdraft facility will be maintained, to meet interim cash and liquidity requirements.**

Dedicated cash held in respect of special rating districts or special funds will accumulate interest on those funds to an amount equivalent to that earned by the Otago Regional Council on its cash deposits.

Otago Regional Council

APPENDIX 1:

Approved Credit Ratings and Limits

Approved Credit Ratings

S&P Rating	Maximum Percentage of NZ Fixed Interest Asset Class
AAA to BBB-	100%
A+ to BBB-	55%
BBB+ to BBB-	15%
Sub-investment Grade/Unrated	0%
Government	100%
Equities in Irrigation Schemes*	10%

* Subject to consultation and Council approval as per section 4.9

Individual Security Guidelines

S&P Rating	Individual Security Maximum Percentage of NZ Fixed Interest Asset Class
AAA	15%
AA	10%
A	10%
BBB	5%
Sub-investment Grade/Unrated	0%
Equities in Irrigation Schemes*	10%

* Subject to consultation and Council approval as per section 4.9

Note the above table provides guidelines for assessing an individual security. Section 4.7 of the Investment Policy sets the risk management limit on maximum issuer exposure for Short Term Liquidity and Section 4.4 of the SIPO provides diversification guidelines to manage maximum issuer exposure for the Long-Term Investment Portfolio.

APPENDIX 2:

Otago Regional Council

Statement of Investment Policy and Objectives

Revised
September 2019

Contents

1. Purpose

The purpose of this Statement of Investment Policy and Objectives (SIPO) is to provide the policy framework for Otago Regional Council (the Council) to effectively supervise, monitor and evaluate the management of the investment activities of the Council.

The SIPO defines the key responsibilities and the operating parameters within which the investments and their ongoing management are to operate. The SIPO should at all times encourage the use of methodologies and processes that reflect industry best practice, encompass the principles of good corporate governance, and reflect the corporate vision of Otago Regional Council.

2. Objectives

2.1 Introduction

The Local Government Act 2002 requires local authorities to adopt an Investment Policy to ensure that the financial resources of the Council are managed in an efficient and effective way.

2.2 Objectives

Otago Regional Council's primary investment objectives are:

- To protect and maintain the purchasing power of the current investment assets and all future additions to the investment assets.
- To maximise investment returns within reasonable and prudent levels of risk.
- To maintain an appropriate asset allocation in order to make distributions as required while preserving the real value of the Council's capital from the effects of inflation.

2.3 Time Horizon

The investment guidelines are based upon an investment horizon of greater than seven years. Therefore, interim fluctuations should be viewed with appropriate perspective.

2.4 Risk Tolerance

The Otago Regional Council is a risk-averse entity but some risk must be assumed in order to achieve the long-term investment objectives of the portfolio, given there are uncertainties and complexities associated with investment markets. It is the express desire of the Council to minimise portfolio volatility through the adoption of prudent portfolio management practices. Overall, a conservative investment approach is to be adhered to.

2.5 Performance Expectations

Otago Regional Council aims to earn a net real return on the portfolio of 2.3-3.1% per annum after investment management costs and inflation (assumed to average 2.0% per annum), on average over five years.

The Council recognises that the target rate of return is a long term one and will not be achieved in every measurement period.

2.6 Risk Summary and Selection of Asset Allocation

The table below summarises the Council's level of risk tolerance as measured by the three risk factors:

Risk Measure	Level of Risk
Capacity to accept risk	Medium to High
Willingness to accept risk	Low to Medium
Required rate of return	Inflation plus 2.3% - 3.1% (net)

Over the long term, the average rate of investment return is related to the level of risk within the portfolio, as illustrated in the table below:

Estimated Rate of Return (net of fees) Inflation plus:	Estimated Gross Return	Level of Investment Risk	Growth Asset Strategy
1.5% - 2.3%	6.0% - 6.5%	Low	20% to 40%
2.3% - 3.1%	6.5% - 7.2%	Low to medium	40% to 60%
3.1% - 3.8%	7.2% - 7.8%	Medium to high	60% to 80%
3.8% - 4.3%	7.8% - 8.1%	High	80% to 90%

Returns above are per annum. The table comprises estimates based on standard portfolio and custodial fees and assumes a tax rate of 0%. Estimated gross returns increase as the portfolio allocation to growth assets increases. Actual returns may be higher or lower than those detailed above.

Based on ORC's required rate of return, capacity and willingness to accept risk, it is recommended that a portfolio incorporating 40% to 60% growth assets is adopted which is suitable for a low to medium level of risk. Aim is to achieve 50% income assets ,50% growth assets.

2.7 Policy Setting and Management

The Council may from time to time approve/amend the policy parameters set in relation to Otago Regional Council's investment activities. These changes will be minuted and incorporated into the SIPO and the dates of the changes noted.

3. Duties and Responsibilities

3.1 The Council

The primary responsibilities of the Council are planning, policy and governance.

The Council will take cognisance of the prudent person and duty of care rules as set out in the Trustee Amendment Act 1988.

As fiduciaries, the primary responsibilities of the Council are:

- To state in a written document the Council' attitudes to risk, expectations, objectives and guidelines for the investment of their assets.
- To review this SIPO on a regular basis.
- To ensure Otago Regional Council's investment assets are prudently diversified to meet the agreed risk/return profile.
- To establish formal criteria to select, monitor, evaluate and compare the investment performance results achieved by the investment adviser and the overall portfolio against agreed benchmarks, peer groups and Otago Regional Council's objectives on a regular basis.
- To avoid prohibited transactions and conflicts of interest.
- To encourage effective communications between the Council and parties involved with investment management decisions.
- To encourage the appointment of Audit and Risk Subcommittee members with the relevant experience and competencies to achieve the stated objectives.
- To ensure that the roles and responsibilities of all parties are documented and clearly defined.
- Appointment of Investment Managers.
- Reviewing investment performance and investment reports periodically throughout the year and at year end.
- Approve any transaction that falls outside the guidelines of the SIPO.

3.2 The Audit and Risk Subcommittee

The Council has established the Audit and Risk Subcommittee and has delegated such powers and duties to the Committee as the Council sees fit. The Audit and Risk Subcommittee operates as per the Council's constitution. Members serving on the Audit and Risk Subcommittee are appointed by the Council.

- To provide guidance and leadership on the appointment, management, monitoring and review of appropriate Investment Managers.
- Reviewing all matters concerning the SIPO, considering any changes or amendments to the SIPO and making appropriate recommendations.
- Regularly reviewing the Investment Managers reports, and reporting exceptions.
- Ensuring that all parties overseeing, advising and managing Otago Regional Council's investments disclose any potential conflicts of interest. In the event that conflicts of interest arise the policies and procedures for managing these are to be clearly defined, although, in principle, such conflicts should be avoided.
- Ensuring that an appropriate SIPO is developed and maintained.
- Ensuring that contracts for investment advisory/management, custodial and consultancy services are reviewed at least every three years.
- To recommend the appointment and removal of Investment Managers as appropriate.
- Approving the asset classes and sub-asset classes to be included in any investment portfolios.
- Ensuring that all service agreements and contracts are in writing and are consistent with fiduciary standards of care.
- To ensure that the practices and policies set out in the SIPO are adhered to.
- To follow formal criteria to monitor, evaluate and compare the investment performance results achieved against relevant benchmarks and objectives on a regular basis.
- To confirm on an annual basis that best practice with respect to execution, brokerage, money sweep facilities, foreign currency spreads, transaction costs and management fees is being applied.

3.3 Custodian

Custodians are responsible for the safekeeping of Otago Regional Council's investment assets. The specific duties and responsibilities of the custodian are to:

- Value all investment assets.
- Collect all income and dividends owed to the portfolio.
- Settle all transactions (buy/sell orders) initiated by the Investment Manager.
- Provide monthly reports that detail transactions, cash flows, securities held and their current value. The report should also detail the change in value of each security and the overall portfolio since the previous report.
- Maintaining separate accounts.

3.4 Investment Advisor

The Council may retain an objective, third-party investment adviser to assist the Council in managing the overall investment process. The adviser will be responsible for guiding the Council through a disciplined and rigorous investment process to enable the Council to prudently manage their fiduciary duties and responsibilities. The investment adviser will:

- Provide advice on appropriate strategic asset allocation, security and fund manager selection.
- Periodically monitor the SIPO and its appropriateness, (in conjunction with the Council).
- Specify and advise on asset and sub-asset class allocation strategies.

3.5 Investment Manager

The Council will appoint an investment Manager to manage the assets under their supervision in accordance with the guidelines and objectives outlined in the SIPO and in their service agreements. The investment Manager will:

- Periodically review the custodial arrangements and make recommendations.
- Provide instructions to each fund manager with respect to the lodging or withdrawing of funds placed.
- Oversee and monitor the performance of the fund managers.
- Appoint and remove fund managers.
- Deliver quarterly reports to the Council which detail the following:
  - Portfolio valuation,
  - Fixed Interest Portfolio duration,
  - Compliance reporting,
  - Portfolio Performance Summary for the portfolio and by asset class,
  - Performance against benchmarks,
  - Asset transactions summary, and
  - Cash transactions.
- Make available appropriate personnel to attend meetings as agreed between the Council and the adviser.
- Report to the Council annually as to the total expenses incurred and tax paid in managing Otago Regional Council's investment portfolio.
- Communicate to the Council all significant changes pertaining to the portfolio it manages or the adviser's firm itself. Changes in ownership, organisational structure, financial condition and professional staff are examples of changes to the firm in which the Council are interested.
- Use the same care, skill, prudence and due diligence under the prevailing circumstances that an experienced investment professional, acting in a like capacity and fully familiar with such matters, would use in like activities for like portfolios with like aims in accordance with all applicable laws, rules and regulations.
- Ensure that "expected" and "modelled" returns for asset classes are based on sound return and risk premium assumptions.
- Outline expected returns and risk, or volatility, within the selected strategies.
- Recommend a Custodian to hold and report on investment assets.
- Rebalance individual investments and asset class groups to within agreed benchmarks as described in the rebalancing policy contained in the SIPO.
- To effect all transactions for the portfolio at the best price.
- Regularly report on compliance exceptions with the SIPO.
- Disclose any potential conflicts of interest and steps taken to mitigate such conflicts.

3.6 Fund Managers

Fund Managers are utilised by the Investment Manager to manage a part of the Long-Term Investment Portfolio.

- To manage an allocated part of the portfolio on terms and conditions consistent with their mandate.

4. Investment Policy and Implementation

4.1 Asset Class Guidelines

Long-term investment performance is primarily a function of strategic asset allocation and asset class mix.

History shows that while interest-generating investments, such as fixed interest portfolios, have the advantage of relative stability of capital value, they provide little opportunity for real long-term capital growth due to their susceptibility to inflation. On the other hand, equity investments have a significantly higher expected return but have the disadvantage of much greater year-on-year variability of return. From an investment decision-making point of view, this year-on-year variability may be worth accepting, provided the time horizon for the equity portion of the portfolio is sufficiently long, (10 years or greater).

Authorised Investments

The following investments, within New Zealand and internationally, are authorised by the Council:

- Cash – term deposits, cash on call, cash funds.
- NZ fixed interest – NZ Government, local authority and NZ State-Owned Enterprise bonds, corporate bonds, fixed interest funds.
- International fixed interest – either direct, if appropriate or via managed funds.
- Listed property companies, property funds and direct property investments.
- Equities, either via managed funds or directly.

Excluded Investments

The following investments are not permitted:

- Preference shares.
- Leveraged investments.
- Options.
- Futures (excluding those employed as risk management strategies by fund managers).
- Commodities contracts.
- Precious metals.
- Hedge funds.
- Unlisted equity securities.
- Private equity investments.
- Illiquid investments.
- Investments in Council Controlled Organisations (other than those described in Section 4.4 of the Investment Policy).

4.2 Asset Allocation

Academic research offers considerable evidence that the strategic asset allocation decision far outweighs security selection and market timing in its impact on portfolio variability and performance. On this basis the Council prefer to adopt a strategic asset allocation and passive strategy over an active and/or tactical asset allocation strategy.

The asset allocation benchmark is to be:

Asset Class	Target Allocation	Acceptable Range	
		Minimum	Maximum
Cash	5%	0%	25%
NZ Fixed Interest	35%	25%	45%
International Fixed Interest	10%	5%	15%
Defensive Total	**50%**	**40%**	**60%**
NZ Property	5%	2%	8%
NZ Equities	15%	10%	20%
Australian Equities	15%	10%	20%
International Equities	15%	10%	20%
Growth Total	**50%**	**40%**	**60%**
Total	**100%**		

Note target allocation is 50% income assets and 50% growth assets.

4.3 Rebalancing Guidelines

The percentage allocation to each asset class may vary depending upon market conditions.

The SAA has upper and lower limits for each asset class as set out in the table above. The limits are based on the following guidelines:

- Plus or minus 5% for an asset class comprising 20% or more of the SAA,
- Plus or minus 25% of the allocation to a single asset class, where that asset class comprises less than 20% of the SAA (e.g. an asset class comprising 4% of the SAA would have limits of plus or minus 1%).
- The result of the above formulas are then rounded to the nearest full percentage (minimum is round down and maximum is rounded up).

To remain consistent with asset allocation guidelines, the Investment Manager(s) will periodically review the portfolio and each asset class. If the actual weighting has moved outside the tolerances described above, the Investment Manager(s) shall rebalance the portfolio back towards the recommended weighting. This rebalancing is to be completed as required, at least annually, and reported to the Audit and Risk Sub-committee.

Rebalancing tends to involve buying underperforming assets at relatively lower prices, and selling relatively higher priced assets.

4.4 NZ Fixed Interest Investment Guidelines

4.4.1 Portfolio Objectives for Direct NZ Fixed Interest

To gain a diversified exposure to the New Zealand Fixed Interest market through investing in direct securities with the following objectives identified below:

- Provide access to the market in a cost-effective manner,
- Provide a stable income and capital preservation (in nominal terms) over a full market cycle,
- Reduce overall volatility of a strategically diversified portfolio, and
- Provide a high level of transparency.

4.4.2 Portfolio Construction Guidelines

a. Diversification

The portfolio should be constructed to achieve appropriate diversification (in the constraints of the NZ market) relative to:

- New Zealand fixed interest issuers,
- The industries/sectors the issuers are involved with,
- The individual issue and overall portfolio duration, and
- Overall credit risk exposure of a portfolio.

The level of the diversification will be governed by the size of the fixed interest portfolio.

Credit ratings will have an impact on the level of diversification. Securities with lower credit ratings require a higher level of diversification.

b. Number of Securities

To achieve sufficient levels of diversification, a minimum of 15 securities where the size of the NZ Fixed Interest portfolio is more than $1,000,000, and 10 securities where the size of the NZ Fixed Interest portfolio is less than $1,000,000, is required. Where appropriate diversification cannot be achieved due to the size of the portfolio or availability in the market, surplus funds may be directed to money market instruments until availability improves.

c. Duration

The portfolio should be diversified across all durations to minimise the adverse effects of reinvestment risk on maturity. Otago Regional Council should be aware if the duration of their portfolio deviates from the benchmark duration by more than 1 year.

d. Liquidity

Although Otago Regional Council invests into the direct New Zealand fixed interest market with a "buy and hold" philosophy, over time its needs may change and greater levels of liquidity may be required.

The more liquidity is required, the more government and liquid (i.e. senior debt issues of $150m or greater) corporate securities should be included in the portfolio.

e. Exposure Levels by Credit Rating

Guidelines for maximum security exposure levels for individual securities are set by credit rating. The following criteria should be considered when making decisions on exposure levels within a portfolio:

- Consideration should be given to excessive exposure to any single issuer,
- Consideration should be given to other asset class exposures Otago Regional Council may have to an issuer,
- The portfolio should be distributed across credit ratings, and

The following table presents a set of guidelines that need be used when constructing a portfolio.

Guidelines:

S&P Rating band (or Moody's or Fitch equivalent)	Overall maximum % of Income Assets
AAA to AA-	100%
A+ to A-	55%
BBB+ to BBB-	15%
Sub-Investment Grade / Unrated	0%
Government	100%

A maximum of 5% of floating rate/annual resettable securities is permitted in a portfolio. Where possible, the following maximum individual security guidelines should be followed to gain diversification whilst ensuring sound credit quality within portfolios.

Maximum Individual Security Guidelines:

S&P Rating band (or Moody's or Fitch equivalent)	Individual security maximum % of Income Assets
AAA	15%
AA	10%
A	10%
BBB	5%
Sub-Investment Grade / Unrated	0%

Note that the above table provides guidelines for assessing an individual security. Although there is no maximum issuer exposure specified, diversification guidelines described under the "Diversification" heading are to be followed.

f. Perpetual Securities

Given the equity structure (including potential imputation credits) of perpetual securities, this class of fixed interest is not to be used.

g. Structured credit

Due to the complexity of structured credit instruments and the lack of sophisticated monitoring systems required to provide ongoing assessment, Otago Regional Council should not include this type of investment in its NZ fixed interest portfolio. It is considered that the required fixed interest exposure can be adequately achieved by investing in securities with simple structures which possess typical fixed interest characteristics.

h. Ratings Downgrade

If a security is downgraded, the mandatory guidelines table should be revisited to ensure that the new rating falls within the ratings framework. A decision must be made by the Council in light of the downgrade as to the future holding of the security (which could potentially be outside the guidelines).

i. Reinvestment

Recommendations to reinvest the proceeds from a maturity should take into account all of the above portfolio construction guidelines.

Where it is uneconomical to gain a direct exposure to NZ or international fixed interest, investment may occur via a recommended managed fund in order to gain an appropriate level of diversification.

4.5 International Fixed Interest

4.5.1 Portfolio Objectives for International Fixed Interest

The inclusion of international fixed interest has the benefit of increasing diversification and reducing volatility by providing exposure to a greater range of issuers, credit ratings and yield curves than is achievable through domestic fixed interest.

4.5.2 Portfolio Construction Guidelines

Given the quantum of the allocation to international fixed interest this asset class must be invested in through one or more Collective Investment Vehicles (CIVs). CIVs must invest in diversified portfolios of fixed interest securities and have exposure limits, minimum credit ratings and policies and procedures acceptable to the Council.

International fixed interest investments must be 100% hedged to the New Zealand dollar.

4.6 Property Investment Guidelines

4.6.1 Portfolio Objectives for Property Investment

To provide an exposure to the New Zealand listed property sector.

4.6.2 Portfolio Construction Guidelines

For direct New Zealand property investments, the following rules shall apply:

- Investment in property entities that are listed on the New Zealand Stock Exchange.
- Investments in partly paid shares in respect of shares of the type referred to above are permitted following a formal submission from the Investment Manager and Audit and Risk Subcommittee approval.
- Not more than 25% of this asset class to be invested in any one entity.

4.7 New Zealand Equity Investment Guidelines

4.7.1 Portfolio Objectives for New Zealand Equity Investment

To provide a combination of capital growth and income via a broad exposure to the New Zealand equity market.

4.7.2 Portfolio Construction Guidelines

For direct New Zealand equity investments, the following rules shall apply:

- Investment in companies listed on the New Zealand Stock Exchange.
- Investments in partly paid shares in respect of companies of the type referred to above are permitted following a formal submission from the Investment Manager and Audit and Risk Subcommittee approval.

Exposure limits for direct New Zealand equity investments (based on the dollar value of the NZ Equities sector of the Long-Term Investment Portfolio) are set out below:

Security Type	Minimum percentage of NZ equities	Maximum percentage of NZ equities
Companies not represented in the Benchmark	0%	20%
Individual company in the Benchmark	0%	Benchmark weight +/-8%
Individual company not in the Benchmark	0%	4%

4.8 Australian Equity Investment Guidelines

4.8.1 Portfolio Objectives for Australian Equity Investment

To provide a combination of capital growth and income via a broad exposure to the Australian equity market.

4.8.2 Portfolio Construction Guidelines

For direct Australian equity investments, the following rules shall apply:

- Investment in companies listed on the Australian Stock Exchange.
- Investments in partly paid shares in respect of companies of the type referred to above are permitted following a formal submission from the Investment Manager and Audit and Risk Subcommittee approval.

Exposure limits for direct Australian equity investments (based on the dollar value of the Australian Equities sector of the Long-Term Investment Portfolio) are set out below:

Security Type	Minimum percentage of Aust equities	Maximum percentage of Aust equities
Companies not represented in the Benchmark	0%	20%
Individual company in the Benchmark	0%	Benchmark weight +/- 8%
Individual company not in the Benchmark	0%	4%

4.9 International Equity Guidelines

4.9.1 Portfolio Objectives for International Equity Investment

To provide an exposure to investments in the international equities sector.

4.9.2 Portfolio Construction Guidelines

For direct international equity investments, the following rules apply:

- Investment in international equities will be through one or more CIVs.
- International equity investments must be hedged in accordance with the requirements contained in Foreign Currency Management.
- CIVs in international equities must hold a broadly diversified portfolio of equity securities, be consistent with underlying benchmarks, be managed according to appropriate policies and procedures and impose reasonable exposure limits.
- Ensure that any investment is sufficiently liquid to enable exit from the investment at any time.

4.10 Foreign Currency Management

Historically, fluctuation of the New Zealand dollar against other major currencies has been significant and has resulted in additional portfolio volatility.

To minimise the risks associated with currency fluctuations the following policies apply:

- Holdings of international fixed interest investments are to be fully hedged back to NZ dollars at all times.
- When investing in international equities either directly or via managed funds, a neutral currency position is the preferred strategy however, 0% to 100% of the international equities being hedged back to NZ dollars is permitted at any one point in time. Any change to the actual hedging level should be disclosed to the General Manager Corporate Services & CFO and Audit and Risk Subcommittee and may require the Council's approval/endorsement.

4.11 Tax Policy

Any investment strategy employed needs to take into account Otago Regional Council's tax status, although this should not be to the detriment of the long-term strategic asset allocation.

Any tax leakage is to be quantified by the investment adviser and reported to the Council annually.

Otago Regional Council

5. Monitoring and Evaluation

5.1 Performance Objectives

The Council acknowledges fluctuating rates of return characterise the securities markets, particularly during short time periods. Recognising that short-term fluctuations cause variations in performance; the Council intends to evaluate investment performance from a long-term perspective.

The Council is aware the ongoing review and analysis of the investment options is just as important as the due diligence process. The performance of the investment options will be monitored on an ongoing basis and it is at the Council's discretion to take corrective action by replacing a manager if they deem it appropriate at any time.

On a timely basis, but not less than annually, the Council will meet to review whether the investment adviser and the investment options selected continue to conform to the criteria outlined in the SIPO, specifically:

- Adherence to the asset allocation levels set with rebalancing occurring within the agreed parameters and in a timely fashion.
- Adherence to the agreed investment philosophy and constraints;
- The adherence of individual investments to investment guidelines;
- Material changes in the investment options, organisation, investment philosophy and/or personnel; and
- Any legal or other regulatory agency proceedings affecting the investment options.

5.2 Benchmarks

The Council has determined that performance objectives should be established for each investment option and for the overall investment portfolio. Investment Manager performance will be evaluated in terms of an appropriate market index and the relevant peer group. These are to be agreed to between the Council and the Investment Manager. Asset classes and relevant benchmarks:

Asset Class	Index
Cash (on call and securities less than 1 year to maturity)	S&P/NZX 90 Day Bank Bill Index
New Zealand Fixed Interest	S&P/NZX Corporate A Grade Bond Index
International Fixed Interest - $NZD Hedged	Barclays Capital Global Aggregate Bond Index (NZD Hedged)
New Zealand Property	S&P/NZX All Real Estate Industry Group Index (Gross)
New Zealand Equities (Excluding NZ Listed Property)	S&P/NZX 50 Index (Gross)
Australian Equities	S&P/ASX 200 Accumulation Index (Unhedged)
International Equities	MSCI All Country World Index (Unhedged)
NZ Government Bonds	S&P/NZX NZ Government Stock Index

5.3 Compliance

The Council and Audit and Risk Subcommittee are aware that the ongoing review and analysis of investments is just as important as the due diligence process. Performance will be monitored on an ongoing basis and it is at the Audit and Risk Subcommittee's discretion to take corrective action by recommending the replacement of an Investment Manager at any time. The Council may direct the Audit and Risk Subcommittee to take such action if it deems this is required.

Specifically, the following will be confirmed and reported to the Audit and Risk Subcommittee:

- Performance reporting as described in roles and responsibilities above.
- Adherence to the SAA and rebalancing within approved limits occurring in a timely fashion.
- Adherence to agreed investment philosophy and constraints.
- Adherence to investment guidelines.
- Material changes in the investment organisation, investment philosophy and/or personnel.
- Any legal or other regulatory proceedings affecting the Investment Manager's organisation and/or reputation.

5.4 Watch List Procedures

An investment option and/or Investment Manager may be placed on watch list and a thorough review and analysis may be conducted when:

- Performance is below median for their peer group over a one, three and/or five-year cumulative period;
- The three-year risk adjusted return falls below the peer group's median risk-adjusted return;
- There is a change in the professionals managing the investment;
- There is an indication the investment option and/or investment adviser is deviating from the stated style and/or strategy;
- There is an increase in fees and expenses;
- Any extraordinary event occurs that may interfere with the investment option and/or Investment Adviser's ability to prudently manage investment assets.

This process is delegated to the investment adviser and/or a nominated third party and they will report to the Council at least annually.

5.5 Measuring Costs

The total portfolio delivery costs should be fair and reasonable. The appointed Investment Manager should offer a fee-only service with all commissions returned to Otago Regional Council.

The investment adviser is to report to the Council annually on the breakdown and the total costs of delivery including:

- Administration/custodial reporting fees;
- Management expense ratios for managed fund investments;
- Advisory fees;
- Other brokerage or fees.

6. Review of the Statement of Investment Policy and Objectives

The Council will review this SIPO at least annually to determine whether the stated investment objectives are still relevant and it is feasible that they will be achieved. It is not expected that the SIPO will change frequently. In particular, short-term changes in the financial markets should not require adjustment to the SIPO.

Approved by Otago Regional Council:

Signature **Position** **Date**

Copy to Investment Manager:

Copy sent by **Date**