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Westland District Council

Review of Liability Management Policy

November 2008

Introduction

- Section 102(4) (b) of the LGA requires a local authority to adopt a Liability Management Policy
- The Liability Management Policy is part of the LTCCP
- Council is required to review its policies from time to time to ensure they are still relevant and comply with the Act

Specific Changes

- Removed reference to specific annual resolution regarding loans as the adoption of the annual plan is now all that is required by the Act
- Proposed some alterations to borrowing limits
- Removed the reference to a particular bank as from time to time the loan portfolio should be reviewed and put out to the market to get the best rates
- A paragraph on credit risk management has been inserted to comply with the Act
- Fuller explanation provided on debt repayment
- A statement allowing council to internally fund projects, which has been the current practice, is provided for
- Removed the general information on types of loans or stock as this is not a requirement of the Act and doesn't add to the policy

Internal Loans

- Internal loans are common practice and have the benefit of reducing interest costs to the council
- Used when a council has surplus investment monies and rather than getting interest from bank council loans to specific project
- Journal is processed crediting interest to councils general fund and charging interest to the project
- The loan is repaid by the target group (eg water if a water project) over 20 years
- The general ratepayer does not miss out on their interest income being credited to reduce their rates
- Council must ensure it defines a target amount for liquid investments in its investment policy which can't be used for internal loans

Other examples of Small to Medium Councils with Internal Loans

Council	Population
Buller District	11,215
Central Hawkes Bay District Council	13,100
Central Otago	15,000
Clutha District	17,000
Grey District	14,000
Kaipara District	17,500
Waitomo	9,729

Capital and Debt Requirements per LTCCP(2006-2016)

$000s	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15
Water	430	4007	364	192	420	287	118	271	0
Wastewater	80	5107	107	0	0	230	0	241	0
Waste	1124	31	85	55	56	0	523	0	0
Capital Totals	1634	9145	556	247	476	517	641	512	0
Debt required	1634	4768	556	247	476	517	641	512	0

Forecast Debt Requirements per LTCCP (No debt repayment provided for)

$000s	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15
Debt required	1634	4768	556	247	476	517	641	512	0
Existing debt	5865								
Forecast Total debt	7499	10633	11199	11446	11922	12439	13080	13592	13592

How is this Debt to be Funded

- 2006 LTCCP provides for internal funding of projects rather than taking out external debt
- For management of debt purposes the council ratios should include the internal debt
- For audit purposes the internal debt is not accounted for but is netted off against investments
- Under the current scenario of debt provision some of the debt measurements can't be met and it is proposed to have more appropriate measurements

Westland Forecasts 10 Year Ratios as per current LTCCP

	Target 6/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15
Interest less rates income	35 %	9%	15%	19%	18%	18%	18%	18%	18%
Debt to Income	.8	.7	1 Exceeds ratio	1 Exceeds ratio	1 Exceeds ratio	1 Exceeds ratio	1 Exceeds ratio	1.1 Exceeds ratio	1.1 Exceeds ratio
Liquidity 1:1	1:1	1.8:1	1.8:1	1.8:1	1.8:1	1.8:1	1:1.7	1:1.7	1:1.7
Net income from operating exceeds	2 times	21	17	10	10	10	10	9	9

Examples of Ratios utilised by other Councils

Council	Per rateable property	Int as % of revenue	Int as % of rates	Net cashflows exceed gross annual interest	Liquidity	Liability/ Assets	Debt/ Equity	Debt/ income
Hurunui	$8000		20%	By 2 times	1.5:1	Less than 25%		
Buller			15%	By 2 times		Less than 20% (for infrastructure)		
Central Hawkes bay	$2000	10% (incl principal)	20% (incl principal)				5%	
Clutha	$1000		15%					
Central Otago	No defined measurements							
Westland			35%	By 2 times	1:1			.8

Proposed Changes to Ratios used in Policy

- Gross interest as percentage of rates reduce to 20%
- Debt to income ratio exceeded so take out this measurement
- Total debt per rateable property not to exceed $4000

Then must ensure

- Liability ratios appear in a quarterly report to Council so that compliance is measured regularly. Include internal borrowing in these ratios as this is prudent for Council to do so.

Recommendations

- That Council provide for these proposed changes to the Liability policy to be included in the draft LTCCP 2009-2019

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local government
procurement
alliance partnering
long term financial plan
asset management
waste management
governance
financial/feasibility modeling
economic development

LIABILITY MANAGEMENT POLICY

1. General Policy

Council exercises its borrowing powers within the Local Government Act 2002, S113 122. The borrowing programme is approved by Council when it approves the annual plan each year. Resolutions of Council are not required in the case of hire purchase, credit or deferred purchase of goods and services where:

- There is a period of less than 3 months indebtedness.
- The goods and services are obtained in the ordinary course of operations, on normal terms, for amounts not exceeding in aggregate an amount determined by resolution at Council i.e. approved financial delegations as documented in Councils Delegation Manual.

When borrowing is required it is generally used for the following main purposes:

- General debt to fund Council's balance sheet and from time to time liquidity requirements.
- To fund operational or infrastructural asset purchases that will benefit the Council and ratepayers over a long period of time.

Council may borrow through a variety of mechanisms comprising of the issue of stock, through accessing the capital markets or by direct bank borrowing.

When evaluating any new borrowing the Manager Finance or Accountant take into account the following in relation to source, term size, and pricing;

- The size and economic life of the project.
- The impact any new debt will have on the borrowing limits.
- Council s overall debt maturity profile.
- Interest rates prevailing relative to term for both stock issuance and bank borrowing.
- Management s view, after consultation with qualified advisors, of future interest rate movements.
- Term available from bank and stock issuance.
- Legal documentation and financial covenants required.

From time to time the Council may wish to replace external borrowing with internal funding or to use internal funds for new projects. Council would require a return on its internal funding because it would have lost the opportunity to invest externally in the market place.

Internally funded projects will be charged interest annually. The interest rate on internal borrowing will be the interest offered on 1st July for a 12 month investment. plus a credit margin of 0.25 which Council would normally pay for a facility.

2. Borrowing Limits

Council in managing borrowing adheres to the following limits:

- Gross interest expense on all borrowing will not exceed 20% of total annual rates income, being total general rates, penalties and targeted rates levied.
- Net cash inflows from operating activities exceed gross annual interest expense by two times.
- Liquidity ratio of 1:1 which measures the ability of Council to quickly generate cash from current assets in order to meet its current obligations.
- Total debt per rateable property not to exceed $4000

LIABILITY MANAGEMENT POLICY

3. Liquidity and Credit Risk Management

Council will avoid the concentration of debt maturity dates and the total amount of debt in so far as is practical, be spread evenly across the range of possible maturity dates.

Council will only enter incidental arrangements with creditworthy counterparts. Credit worthy counterparties are selected on the basis of their current Standard & Poors rating which must be A- or better.

4. Interest Rate Risk Management

Any borrowing done by Council gives rise to exposure to interest rate movements. Council's preference, to avoid adverse impact on interest rates, is to have a preference for a high percentage of long term fixed rates.

The Manager Finance and Policy will manage the interest rate risk by ensuring a mix of fixed and variable rates are present in its debt portfolio.

The use of interest rate risk management instruments requires Council approval e.g. hedging.

The current loans for Westland Holdings Limited utilize interest swap instruments.

5. Security

Council will normally secure its borrowings against its rates revenue. Security may also be offered, with Council's approval, over specific Council assets.

Council can also offer security on infrastructure assets where special rating provisions apply.

6. Repayment

Repayments of Council borrowing are made from asset sale proceeds, sinking funds, renewal loans or from general funds.

Term of loan not to exceed the life of the asset to a maximum term of 20 years

Debt will be repaid as it falls due. Rates are collected quarterly for loan funding from these sectors for which the loans were raised and are credited quarterly to the bank loans outstanding.

7. Financial Guarantees

Financial guarantees can be made from time to time, by Council, to organisations, groups or bodies for recreational and community purposes. Before guarantees are approved the latest financial reports and cashflow projections are reviewed by management.

Appropriate conditions and controls will be established and documented, by Council, before the approval and provision of any financial guarantees.

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Westland District Council

Funding Depreciation

Sue Davidson

Depreciation issues

- What depreciation do we deduct as an expense in our accounts?
  - This is normally determined by NZ Society of Accountants
- What level of depreciation does Council want to fund from rates?
  - This has to meet balanced budget requirement or have good Council rationale and discussion with the public for adoption in annual or LTCCP plans

There two key questions:

- How much should the depreciation figure be?
- Depreciation is the systematic allocation of the consumption of an asset over its useful life
- Useful life is the period over which an asset is expected to be available for use by an entity
- Straight-line depreciation is used where the pattern of economic consumption does not materially differ from straight line, or where the pattern cannot be reasonably determined and demonstrated
- All asset useful life's should be reviewed whenever there is any expenditure to renew the asset (usually is a yearly basis)
- Therefore you should adjust the depreciation to reflect the right level of consumption (This isn't always done but in the future as we improve at asset management then life expectancy will improve and the allocation of depreciation needed to be expensed could be reduced)

What should the funds from depreciation be used for?

- Depreciation is a 'non-cash' expenditure item, if council funds (rates for) depreciation it provides a funding source
- Depreciation reserves are cash reserves that can be used to fund
  - Replacement
  - Renewals
  - New assets
  - Service loans/debt

Note: if you also service a loan for new asset or replacement of an asset by a targeted rate in addition to the depreciation funded in the general rate, then you are effectively double dipping from the ratepayer.

Examples of Treatment of Depreciation
Hurunui District Council

- State will only fund their share of roads and bridges depreciation
- States won't fund library depreciation as technology may make libraries obsolete in 50 years
- State water and sewer systems depreciation will not be cash funded as schemes less than 30 years old and nearly debt free. Concerned that ratepayers paying twice through cash contributions and then again for depreciation.
- States for water and sewer will continue to fund upgrades and replacements through loans and rates and that ratepayers know when replacement will be required and that the rates will increase at the time to pay for the loan repayment
- Consulted on this topic and sought submissions
- Forecast Income statement showed surplus
- Clear audit report

Example of Treatment of Depreciation
Wellington City Council

- States not financially prudent to fund all of depreciation, transport assets, Living Earth joint venture, Clearwater sewerage treatment plant
- Will not fund depreciation where, at the end of its useful life, it will be funded by a third party or will not be replaced
- Will not fund depreciation where the third party has a contractual obligation to maintain the service potential and Council will already effectively be funding this through fees
- Forecast Income statement shows surplus over 10 years
- Clear audit opinion

Example of Treatment of Depreciation
Wairoa District Council

- State wont fund
  - Community Halls and buildings on reserves 6k
  - Parks and reserves 64k
  - Cemeteries 2k
  - Camping Ground 6k
  - Staff Housing 5k
  - Fire Appliances 19k
  - LTNZ portion of subsidised roading 1235k
  - AFFCO portion of the costs of running the treatment plant 140k
- No rationale is provided in the LTCCP
- Forecast income statements show balanced budget
- Clear audit report

Example of Treatment of Depreciation Timaru District Council

- State last revaluation of assets 2005 and not proposing to revalue in future
- Depreciation increased by 1.4m and decided to phase in over 3 years
- Balanced budget statement states there will be a deficit due to not funding depreciation resulting from the revaluation of assets
- States unaffordable for ratepayers to take increase from depreciation in one year
- Forecast income statement shows loss in 2006/07
- States financially prudent not to balance budget and service levels will not be decreased
- Qualified audit report but, due to not including inflation. The depreciation treatment was not mentioned

Westland District Council
Current Policy on Funding Depreciation

- All assets are depreciated per NZ Society of Accountants standards and detailed policy produced in annual report
- All depreciation is fully funded apart from roading which is based on the renewal program cost rather than depreciation cost
- Depreciation is used to fund renewals and capital items
- Depreciation has not been used to fund loan repayments

Details of Depreciation 08/09

Activity	Amount	Any Rationale for not fully funding depreciation
Library	42601	
Safer Community Council	4250	
Community Halls	22231	
Parks	12800	
Land and Buildings	49695	
Public Toilets	12500	
Pools	14280	
Cemeteries	1123	

Details of Depreciation 08/09

Activity	Amount	Any Rationale for not fully funding depreciation
Community Service	40360	
Governance	1300	
Transportation	2199000	NZTA subsidy taken into account
Water	312740	
Wastewater	160502	
Stormwater	195004	
Waste	4700	
Rural Fire	4500	

Proposed Policy to be written up

- Depreciation reserves are cash reserves that can be used to fund
  - Replacement
  - Renewals
  - New assets
  - Service loans/debt
- Specific areas Council will not fund are
  - Roading assets where NZTA funds part of the purchase of the asset and this is not expected to alter in the future
  - Other areas Council discussed today and will propose for consultation

Recommendation

- That Council provide for the proposed changes change to policy and prepare a depreciation policy based on today's discussion for inclusion in the draft LTCCP

FIN 2

NBS

NELSON BUILDING SOCIETY

4 November 2008

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GM	HWM	MPR	MO	MAC	MF	MPA	CSO	ENG	
					✓				

Audit and Finance Committee
Westland District Council
36 Weld Street
Hokitika 7810

Dear Committee members

We confirm that NBS has applied for participation in the recently announced Crown Retail Deposit Guarantee Scheme (CRDGS).

NBS is New Zealand's oldest Building Society, and has successfully traded through challenging economic times in the past. Our inclusion in the Government scheme will give further comfort to our existing Investment customers and confidence to all prospective Investment customers.

NBS currently manages Investment funds for two other District Councils and would be pleased to offer you the same excellent service and market-leading Investment rates.

A substantial increase in investment funds here will firmly entrench our Greymouth Branch in the marketplace and place us in a position to be able to consider sponsorship assistance for community-focussed projects.

We see this partnership being mutually beneficial to Westland District Council, the local community and NBS.

Please contact me at any time to clarify any questions you may have about this offer.

Nelson 111 Trafalgar Street, T: 03 548 2164, F: 03 548 8900. Richmond 207 Queen Street, T: 03 543 9391, F: 03 543 9390.
Motueka 185 High Street, T: 03 528 1111, F: 03 528 0092. Murchison 32 Waller Street, T: 03 523 1000, F: 03 523 9565.
Greymouth 74 Mackay Street, T: 03 768 9016, F: 03 768 7084. Westport 192 Palmerston Street, T: 03 788 8177, F: 03 789 7180.
Post PO Box 62, Nelson. Freephone 0800 101 700. Email info@nbs.co.nz www.nbs.co.nz

Yours faithfully

Karen Atkinson
Manager
NBS Greymouth

FIN2

NBS

13 November 2008

Quecha Horning
Westland District Council
36 Weld Street
Hokitika 7810

GM	HWM	MPR	MO	MAC	MF	MPA	CSO	ENG	
					✓				

Dear Quecha

As discussed in our phone conversation yesterday, I have enclosed some additional information in support of our request that Westland District Council give Nelson Building Society (NBS) the opportunity to quote for the management of Councils Investment funds. I have also included my original letter for you information.

Find enclosed:

1. NBS Annual Report 2008
2. NBS Prospectus No 33
3. Copy of the press release announcing the assignment of a BB Credit Rating by Fitch Ratings, a leading global rating agency
4. Copy of the press release on the launch of the New Zealand Savings Institutions Assoc of which NBS is a member
5. Information on Amendments to the Crown Retail Deposit Guarantee Scheme. NBS is now 'approved' under the scheme.

NBS is administered by a Trust Deed, which contains strict financial controls. This monitoring is undertaken by Trustees Executors Ltd on a monthly basis. Trustees Executors Ltd is a division of the Sterling Grace Group, a longstanding historical institution.

NBS has remained strong in the recent challenging economic times due to our strict financial controls, conservative lending policies and the experience of our Management team, achieving a Total Asset Growth of 3.3% to $231.7M year-to-date.

Please contact me at any time to clarify any questions you may have regarding this information.

Yours faithfully

Karen Atkinson
Manager
NBS Greymouth