TREASURY MANAGEMENT POLICY

INCORPORATING

Investment and Liability Management Policies

In accordance with Sections 104 & 105 of the Local Government Act 2002

CONTENTS

1.0 INTRODUCTION

Taupo District Council ("Council") undertakes borrowing (liability management) and investment activities, which in total are referred to as treasury activity. Council's treasury activities are carried out within the requirements of the Local Government Act 2002, its related amendments and other relevant local authority legislation.

This Treasury Management Policy provides the policy framework for all of Council's borrowing and investment activities and defines key responsibilities and the operating parameters within which borrowing, investment and related risk management activities are to be carried out.

Key borrowing and investment objectives form the basis of the policies. These objectives, while consistent with corporate best practice, are subject to overall Council objectives, as stated in the Annual Plan and Long Term Plans (LTP).

This Treasury Management Policy document will be reviewed and updated on an annual basis.

This policy covers:

- LIABILITY MANAGEMENT
  Council's borrowing activity is largely driven by its capital works programme, mainly related to its infrastructure assets. Council's liability management policy is discussed in Section 3 of this document.

- INVESTMENTS
  Council manages a portfolio of investments comprising equity investments, airport, property, forestry and financial investments. Council's investment policy is discussed in Section 4 of this document.

Council acknowledges that there are various financial risks such as interest rate risk, currency risk, liquidity risk and credit risk arising from its treasury activities.

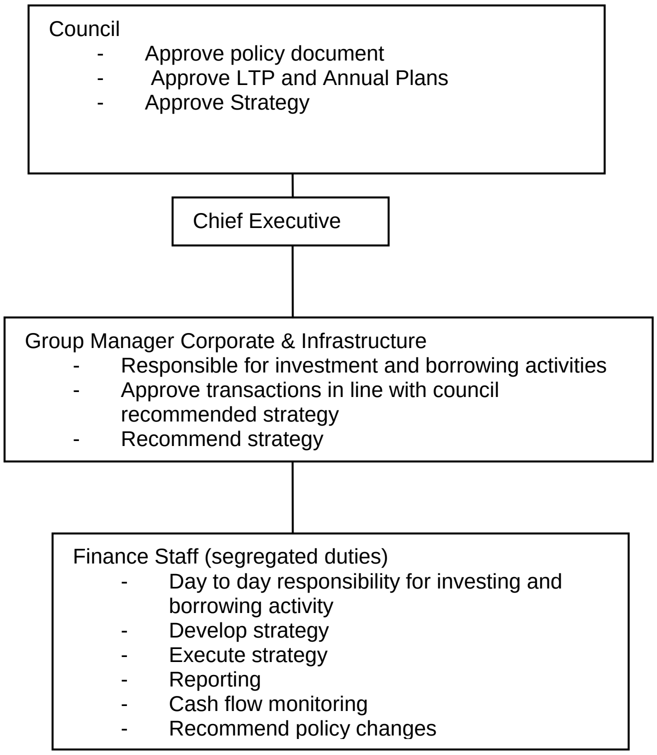
Council is a risk adverse entity and does not wish to incur additional risk from its treasury activities.

Council's accounting function in relation to its treasury activities is a risk management function focused on protecting Council's budgeted interest costs and revenues and stabilising Council's cash flows. Council does not undertake any treasury activity that is unrelated to its underlying cash flows or is purely speculative in nature.

2.0 MANAGEMENT STRUCTURE, RESPONSIBILITIES AND DELEGATED AUTHORITIES

2.1 FINANCIAL SERVICES ORGANISATIONAL STRUCTURE

The organisation chart for treasury activity is as follows:



2.2 DELEGATED AUTHORITIES

Delegated authorities are summarised at the end of each section of the liability management and investment policy (sections 3.0 and 4.0).

2.3 LEGISLATIVE REQUIREMENTS

The Liability Management and Investment Policies of the Treasury Management Policy are in compliance with the requirements of the Local Government Act 2002 (LGA 2002).

3.0 LIABILITY MANAGEMENT POLICY

3.1 PURPOSE

Council borrows for the following primary purposes:

- General debt to fund Council's capital works primarily on infrastructure assets. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to Council's assets and investments.
- Short term debt to manage timing differences between cash inflows and outflows, and to maintain Council's liquidity.
- Specific debt associated with significant "one-off" projects and non-financial investments from time to time.
- Borrowing through hire purchase, credit, deferred payment or lease arrangements in the ordinary course of Council business.

3.2 LOCAL GOVERNMENT ACT 2002 REQUIREMENTS

Section 104. The Liability Management Policy required to be adopted under section 102(2)(b) must state the local authority policies in respect of liability management, including:

(a) Interest rate exposure (section 3.5).

(b) Liquidity (section 3.7).
(c) Credit exposure (section 3.6).
(d) Debt repayment (section 3.8).
(e) Specific borrowing limits (section 3.9).
(f) The giving of security (section 3.10).

3.3 OBJECTIVES

The objectives of the Liability Management Policy are consistent with corporate best practice and will take into account Council's annual and strategic plans, its long-term financial strategy and future LTP. The key Liability Management objectives in relation to borrowings are to:

- Prudently manage Council's borrowing activities to ensure the ongoing funding of Council.
- Borrow only under Council approved facilities and as permitted by this policy.
- Minimise borrowing costs.
- Minimise risk due to adverse interest rate movements.
- Maintain operational controls and procedures to protect Council against financial loss, opportunity cost and other inefficiencies.

3.4 BORROWING MANAGEMENT AND INTERNAL CONTROLS

Council approves policy parameters in relation to borrowing activities.

Council approves, by resolution, the borrowing requirement for each financial year in the annual plan or LTP or by later resolution during the year.

Council considers the impact on its borrowing limits (section 3.9) as well as the size and the economic life of the asset that is being funded and its consistency with Council's long term financial strategy or LTP.

A resolution of Council is not required for hire purchase, leased, credit or deferred purchase of goods if:

- the period of indebtedness is less than 365 days; or
- the goods or services are obtained in the ordinary course of operations on normal commercial terms for amounts not exceeding in aggregate $250,000.

Council's Chief Executive has overall responsibility for the operations of Council.

The Group Manager Corporate & Infrastructure has the responsibility for the formulation and implementation of specific borrowing and interest rate risk strategies consistent with the objectives of this policy. Implementation of borrowing and interest rate risk management strategies is controlled by the Liquidity, Credit and Interest Rate guidelines.

Council's borrowing activities are managed centrally through its accounting function. The accounting function is broadly charged with the following responsibilities:

- Manage Council's borrowing programme to ensure funds are readily available at margins and costs favourable to Council.
- Raise authorised and appropriate borrowing, in terms of both maturity and interest rate strategies.
- Manage the impact of market risks such as interest rate risk and liquidity on Council's borrowing by undertaking appropriate hedging activity in the financial markets.
- Minimise adverse interest rate related increases on ratepayer charges and maintain overall interest costs within budgeted parameters.
- Provide timely and accurate reporting of treasury activity and performance.

Council's systems of internal controls over borrowing activity include:

- Adequate segregation of duties among the core borrowing functions of deal execution, confirmation, settling and accounting/reporting.

- There are a small number of people involved in borrowing activity, however the risk from this is further minimised by the following processes:
  - a documented discretionary approval process for borrowing activity.
  - regular management reporting and review.
  - regular operational risk control reviews by an independent audit function.
- Organisational, systems, procedural and reconciliation controls to ensure:
  - all borrowing activity is bona fide and properly authorised.
  - reviews in place to ensure Council's accounts and records are updated promptly, accurately and completely.

Council is prohibited from borrowing in a foreign currency.

3.5 INTEREST RATE EXPOSURE

Interest rate risk management refers to managing the impact that movements in interest rates can have on Council's cash flows. This impact can be both favourable and unfavourable. Council's ongoing borrowing requirement gives rise to direct exposure to interest rate movements.

3.5.1 FIXED/FLOATING PROFILE

Council is exposed to interest rate repricing risk on the maturity of existing debt that is refinanced, as well as issue yield risk on planned new debt.

The debt portfolio will comprise a mix of fixed-rate and floating-rate borrowings subject to the following:

- Council maintains a mix of both fixed and floating rates, as appropriate, to ensure a degree of flexibility and also to take advantage of lower floating rates when appropriate.
- floating rate debt is defined as debt that is subject to interest rate re-pricing within twelve months.
- up to 50% of total debt may have a floating rate profile. Approval by Council is required for any floating rate exposure beyond this level and term.
- any fixed rate debt beyond 10 years requires the prior approval of Council
- An appropriate hedged/floating rate mix determined in the approved borrowing strategy.

3.5.2 INTEREST RATE RISK MANAGEMENT CONTRACTS

Interest rate risk will be managed by using interest rate risk management contracts that allow the re-profiling of the portfolios:

- hedging up to 100% of repricing risk on existing fixed rate debt and issue yield risk on planned new debt within the next twelve month period.
- Converting fixed rate borrowing into floating rate or hedged borrowing and floating rate borrowing into fixed or hedged borrowing.

The following interest rate risk management instruments are approved by Council:

- Interest Rate Swaps
- Forward Rate Agreements
- Interest Rate Options on approved underlying instruments, e.g. on Interest Rate Swaps or bonds.
- Interest Rate Collar Strategy, but only where the ratio of the face value and interest rate exposure on bought to sold legs is 1:1.

3.6 CREDIT EXPOSURE

Council hedging can only be undertaken with approved Registered Banks, as per section 4.6.3.

Credit exposure will be managed by:

- Ensuring gross external debt as a percentage of annual operating income does not exceed 250% for up to 3 years at the commencement of any financial year; and
- Compliance with the borrowing limits outlined in 3.9

3.7 LIQUIDITY POLICY

The objective of the Liquidity Policy is to ensure adequate financial resources are available to Council to meet all obligations as they arise.

The purpose of the Liquidity Policy is to analyse Council's cash flows, in both short and long-term for all perceived requirements and contingencies, and arrangement of suitable sources of liquid resources.

3.7.1 Policy

Liquid resources are defined as:

- Unencumbered financial assets which can readily be converted to cash in a short space of time
- Un-drawn committed or standby facilities which can be accessed in a suitable timeframe.

There are three aspects to liquidity management:

- Short-term operational liquidity management, to be monitored and controlled through daily cash management activities;
- Long-term operational liquidity management, to be monitored and controlled through long-term financial planning;
- Contingency crisis management, to be monitored through the long-term and short-term planning process and arrangement of liquidity sources sufficient to meet worst case scenarios.

Council requires a minimum level of surplus liquidity to meet unexpected cash expenditure or revenue shortfall. Liquidity should be flexible enough to manage the rate payment cycle.

3.7.2 Committed Bank Facilities

To ensure the ongoing funding of Council and to manage funding risk (and hence liquidity), it is important that Council obtain committed bank facilities to ensure that sufficient funds can be called upon when required. This form of borrowing would usually be secured through the issuing of a security stock certificate under the Debenture Trust Deed. Committed borrowing facilities plus term debt will be maintained at a minimum of 10 per cent above the existing net debt amount including working capital. This is deemed to include the value and terms of credit from suppliers including leases, hire purchase and deferred payment agreements.

A list of authorised counterparties is required. This list is approved by the Chief Executive Officer and any additions or deletions to this list require approval.

3.8 DEBT REPAYMENT

Repayment of debt (interest and principal) is governed by:

- Affordability of debt servicing costs.
- Intergenerational equity principles (debt will be repaid over the life of the asset or 25 years whichever is the lesser).
- Maintenance of prudent debt levels and borrowing limits.
- Council repays borrowings from general or special funds.

3.9 BORROWING LIMITS

The Council is able to borrow through a variety of market mechanisms including issuing stock and debentures, direct bank borrowing or accessing the short and long term capital markets directly. Council may also borrow internally from the TEL investment portfolio.

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

- Total net interest expense[1] on gross external debt will not exceed 20% of annual operating income.
- Ratio of gross external debt to equity will not exceed 15%.

[1] Refers to gross external interest expense, excluding interest owing on internal loans (after interest rate risk management costs/benefits)

- Net cash flows from operating activities (excluding interest expense) exceeds total net interest expense[1] by 2 times

Council will adhere to the borrowing limit that is reached first, and provides the lowest level of debt.

3.10 SECURITY

All loans are secured by the issuing of security or debenture stock certificates under the debenture trust deed which has a charge over the rates of the district and/or Council assets

Formal security over either the separate general and special rates of the district or Council assets requires prior Council approval.

3.11 BORROWING MECHANISMS

In developing strategies for new borrowing (in relation to source, term, size and pricing) Council takes into account the following:

- Available and Council approved sources, terms and types of borrowing.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates, margins and total cost relative to term and nature of the borrowing.
- The market's outlook on future interest rate movements as well as Council's own.
- Legal documentation and financial covenants.
- Requirements of the New Zealand Local Government Funding Agency Limited Investment (see Appendix 1)

3.12 GUARANTEES

Council provides guarantees to banks for loans between the bank and non-profit bodies advances where Council considers the guarantee to be beneficial to the community in accordance with Council's policies on loan guarantees.

Financial statements are received annually. Should the guarantee be called upon, Council takes immediate steps to recover the money.

Guarantees require the prior approval by way of Council resolution.

3.13 LEASES

Council utilises finance leases (as opposed to an operational lease i.e. renting) as a means of financing some office equipment.

3.14 DELEGATIONS

The delegated authority in respect of the Liability Management policy is as follows:
Council:

- Approve liability management policy.
- Alter liability management policy.
- Approve borrowing strategy.
- Approve borrowing programme for the year through the Annual Plan or LTP.
- Approve borrowings other than in accordance with the Annual Plan or LTP.
- Approve interest rate risk management instruments.
- Approved seal register signatories
- Approve charging assets as security over borrowing.

Chief Executive

- Delegates Treasury Management to the Group Manager Corporate & Infrastructure

Group Manager Corporate & Infrastructure:

- Recommend borrowing strategies.

- Raise new loans in accordance with Council approved borrowing programme, and carry out debt negotiations in accordance with strategy and policy.
- Authorise use of Council approved interest rate risk management instruments in line with strategy.

Financial Staff

- Execute approved borrowing and borrowing interest rate risk management strategies

3.15 PERFORMANCE MEASUREMENT

The performance of the borrowing activity will be measured against pre-determined benchmarks:

- Adherence to policy and in particular the borrowing limits.
- Unplanned overdraft costs – specifically that daily bank balances are within limits.
- Comparison of actual monthly and year to date interest costs vs budget borrowing costs.
- Comparison of actual monthly borrowings with budgeted borrowings.
- Comparison of actual financial ratios to budgeted financial ratios as per the Annual Plan and LTP.

3.16 REPORTING

Reporting to Council

- Annual review of Liability Management Policy
- Monthly Treasury Report
- Six monthly Borrowing strategy (recommend to Council)
- Annual Report

3.17 REVIEW

Liability Management Policy

- Annual review

4.0 INVESTMENT POLICY

4.1 PURPOSE

Council holds financial investments sufficient to match reserve accounts created by Council resolution and as a result of short term cash flow surpluses. Council also manages investments in equities, property, council controlled organisations (e.g.Taupo Airport Authority) and forestry.

4.2 LOCAL GOVERNMENT ACT 2002 REQUIREMENTS

Section 105. The Investment Policy required to be adopted under section 102(2)(c) must state the local authority policies in respect of investments, including:

(a) The mix of investments (section 4.5 - 4.11)
(b) The acquisition of new investments (section 4.6 - 4.11)
(c) An outline of the procedures by which investments are managed and reported on to the local authority (section 4.4, 4.6 – 4.11, 4.14 - 4.17)
(d) An outline of how risks associated with investments are assessed and managed (section 4.6 – 4.11)

4.3 OBJECTIVES

The objectives of this investment policy are consistent with corporate best practices and will take into account the requirements of Council's Annual Plan and LTP. The key investment policy objectives are to:

- Prudently manage Council's investment assets in the interests of the Council's district and its inhabitants and ratepayers, only for lawful purposes and so as to safeguard against loss.
- Manage investments in accordance with the Local Government Act 2002 and the Trustee Act 1956; administer, manage and account for its funds and exercise the care, diligence, and skill that a prudent person of business would exercise in the managing the affairs of others.
- Maximise investment income within a prudent level of investment risk. Council recognises that as a responsible public authority any investments that it does hold should be of relatively low risk. It also recognises that lower risk generally means lower returns.
- Invest only in approved securities and asset classes as permitted by this policy. Accordingly, only creditworthy counterparties are acceptable.
- Ensure investments are maintained at an appropriate level of liquidity to enable the provision of cash flow when required.
- Minimise potential risk due to adverse interest rate movements.
- Regularly review the performance and credit worthiness of all investments.
- Maintain operational controls and procedures to best protect Council against financial loss, opportunity cost and other inefficiencies.

4.4 INVESTMENT MANAGEMENT AND INTERNAL CONTROLS

Council approves policy parameters in relation to investment activities.

The Treasury Management Group (TMG), consisting of members of Council management, regularly review treasury reports to ensure compliance with policies, procedures and risk limits and has overall responsibility for setting strategies in relation to financial investment activity.

In making any investment decisions the TMG considers:

- the desirability of diversifying investments;
- the nature of existing investments;
- the risk of capital loss or depreciation;
- the potential for capital appreciation;
- the likely income return;
- the length of the term of the proposed investment;
- the marketability of the proposed investment during, and on the determination of the term of the proposed investment;
- the effect of the proposed investment in relation to tax liability; and
- the likelihood of inflation affecting the value of the proposed investment.

Council's Chief Executive has overall responsibility for the operations of Council. The Group Manager Corporate & Infrastructure has financial management responsibility over Councils' investments. Operational management is detailed in sections 4.6 - 4.11.

Council's systems of internal controls over investment activity include:

- Adequate segregation of duties among the core investment functions of deal execution, confirmation, settling and accounting/reporting. There are a small number of people involved in investment activity, however the risk from this is further minimised by the following processes:
  - a documented discretionary approval process for investment activity.
  - regular management reporting and review.
  - regular operational risk control reviews by an independent audit function.

- Organisational, systems, procedural and reconciliation controls to ensure:
  - all investment activity is bona fide and properly authorised.
  - reviews in place to ensure Council's accounts and records are updated promptly, accurately and completely.
- Overall assessment of performance of funds management [fund manager portfolio and internally managed portfolio] by investment advisors.

4.5 INVESTMENT PORTFOLIO

An investment is an asset held by Council that provides service potential or future economic benefit to Council. Investments include property, forestry, ownership in council related trading entities and financial assets. A financial asset is any asset that is cash or the contractual right to receive cash including the financial investment instruments.

Council invests in the following assets:

- Financial investments incorporating a term greater than 90 days (section 4.6)
- Equity investments (section 4.7)
- Council controlled trading organisations (CCTOs) - Airport investment (section 4.8)
- Property investments incorporating (section 4.9)
- Forestry investments (section 4.10)
- Liquidity investments (less than 90 days) (section 4.11.)

4.6 FINANCIAL INVESTMENTS

Council maintains cash and fixed interest financial investments for the following primary reasons:

- Invest amounts allocated to special reserves.
- Invest surplus cash and working capital funds
- Provide ready cash in the event of a natural disaster. This cash is intended to assist reinstatement and to finance short-term needs between the disaster and the reinstatement of normal income streams.
- Invest Taupo Electricity Limited (TEL) and Taupo Generation Limited (TGL) sale proceeds known as the TEL investment portfolio (additional detail is provided in section 4.6.4)

The following are approved financial investments:

- Government investments (treasury bills, government stock)
- Registered bank investments (call and term deposits, registered certificates of deposit), subject to Counterparty Exposure Limits (section 4.6.3).
- Local authority investments subject to Counterparty Exposure Limits (section 4.6.3).
- SOE investments subject to Counterparty Exposure Limits (section 4.6.3).
- Corporate investments (corporate bonds, promissory notes) subject to Counterparty Exposure Limits (section 4.6.3).

4.6.1 ACQUISITION/DISPOSITION AND REVENUE

Interest income from financial investments is credited to general funds or special reserves and is included in the Statement of Financial Performance.

Proceeds from the disposition of financial investments are used for operational and capital expenditure purposes or for the purpose for which they have been established, as approved in the Annual Plan or LTP.

4.6.2 MANAGEMENT PROCEDURES

Financial investments are managed by the Group Manager Corporate & Infrastructure with day to day management centrally through its accounting function. The accounting function is broadly charged with the following responsibilities:

- Develop six monthly investment strategy by reviewing on a regular basis, cash flow forecasts incorporating plans for approved expenditure and strategic initiatives, evaluating the outlook for interest rates and the shape of the yield curve, and where applicable, seeking appropriate financial advice.
- Develop and maintain professional relationships with the financial markets.
- Manage Council's investments within its strategic objectives and ensure that surplus cash is invested in liquid and creditworthy instruments.
- Manage the impact of market risks such as interest rate risk and liquidity on Council's investments and currency risk on investments by undertaking appropriate hedging activity in the financial markets.
- Minimise adverse interest rate related increases on ratepayer charges and maintain overall revenues within budgeted parameters.

- Manage the overall cash and liquidity position of Council's operations.
- Provide timely and accurate reporting of treasury activity and performance for management, and the Council.

4.6.3 INVESTMENT RISK

CREDIT RISK - COUNTERPARTY EXPOSURE LIMITS

Council's primary objective when investing is the protection of its capital. Accordingly, only creditworthy counterparties are acceptable. Creditworthy counterparties are selected on the basis of their Standard and Poor's (S&P) rating except for unrated Local Authorities secured by charge over rates, which are governed by individual counterparty limits.

More specifically, Council minimises its credit exposure by:

- Ensuring all investment, cash management, interest rate risk management and any foreign exchange transactions are undertaken with entities (excluding Government) that have a strong or better (A1 for short term, A+ for long term) Standard and Poor's (S&P) credit rating, except for unrated Local Authorities secured by charge over rates, which are governed by individual counterparty limits.
- Limiting total exposure to prescribed amounts and portfolio limits.
- Rigorous six monthly monitoring of compliance against set limits.

Council approval is required to add to or delete from the counterparty exposure limits. The following table summarises credit requirements and limits:

Institution	Minimum S&P Short Term Credit Rating[3]	Minimum S&P Long Term Credit Rating[4]	Total Exposure Limit for each counterparty	Portfolio Limit (% of Total Portfolio)
Government	n/a	n/a	Unlimited	100%
Registered Bank - On balance sheet exposures - Off balance sheet exposures	 A2 A2	 A- A-	 $35 million $10 million	80%
Strongly Rated Corporates, Local Authorities and SOEs (on balance sheet exposures only)	A2 (n/a for Local Authorities)	A- (BBB for SOE's, n/a for Local Authorities)	$10 million [Face Value]	75%

If any counterparty's credit rating falls below the minimum specified in the above table then all practical steps are taken to reduce the credit exposure to that counterparty to zero as soon as possible.

Exposures to each counterparty are computed as follows:

On-Balance Sheet:

- Total principal invested with that counterparty.
- International Equities currency exposure on foreign currency hedging converted on the day at the spot rate.

Off- Balance Sheet

- Credit exposure on interest rate contracts computed by multiplying face value of outstanding transactions by an interest rate movement factor of 5%, per calendar year or part thereof.

[3] Short term refers to securities with a remaining maturity of 12 months or less

[4] Long term refers to securities with a remaining maturity of more than 12 months

INTEREST RATE RISK
Interest rate risk refers to the impact that movements in interest rates can have on Council's cash flows. Council's financial investments give rise to direct exposure to interest rate movements. Interest rate risk is managed by Council as part of its overall investment strategy.

The following interest rate risk management instruments are approved by Council:

- Interest Rate Swaps
- Forward Rate Agreements
- Interest Rate Options on approved underlying instruments, e.g. on Interest Rate Swaps or bonds.
- Interest Rate Collar Strategy, but only where the ratio of the face value and interest rate exposure on bought to sold legs is 1:1.

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

LIQUIDITY RISK
Liquidity risk management refers to the timely availability of funds to Council when needed, without incurring penalty costs.

Because of Council's credit rating criteria, all investments would be readily saleable in the secondary market, which addresses Council's liquidity requirements, even though there may a pricing risk if there was a forced sale in adverse market conditions.

The average duration[5] of the total investment portfolio would normally be between 2 and 3 years.

4.6.4 TEL INVESTMENT PORTFOLIO
The TEL portfolio is managed in line with a separate Investment Strategy Statement (ISS) for that Fund (Appendix 3) but with additional guidelines as follows:

- A strategic asset allocation as follows with the percentage allocation to each asset class to vary as much as plus or minus 25% (or in the minus aspect such lesser amount as appropriate where the stated allocation is less than 25%) depending on market conditions:
  -
  - International Equities 15%
  - Australasian Equities 10%
  - Diversified Fixed Interest 50%
  - Property 15%
  - Cash 10%

The key objective in the management of the TEL Fund is to provide income to meet the level of District rate subsidy set by Council without diminishing the value of the Fund.

Additionally the following requirements for the TEL portfolio are specified:

- An appropriate level of investment diversification across securities will be maintained.
- The fund risks will be managed in a prudent manner.
- An appropriate level of investment risk is determined and accepted by Council .
- Purely speculative investments will be prohibited.
- Consistent with the stated objectives, Council demonstrates a preference for more conservative investment choices and a more stable flow of investment income.
- The fund structure allows flexibility to accommodate changes in Council's requirements and the investment environment.
- All aspects of the investment process and functions will be reviewed regularly.
- The fund is managed from day to day within the Investment policy parameters.

[5] Duration is a mathematically calculated term representing the average of the time weighted cash flows of the investment, discounted at current yields.

- Because the fund is managed in a manner that reflects its potential utilisation as a disaster recovery fund in the event of a natural disaster in the Taupo District, the TEL portfolio must conform to the Council's policy requirements with regard to liquidity and credit criteria.

4.7 EQUITY INVESTMENTS

INTERNATIONAL EQUITIES AND NEW ZEALAND EQUITIES

Council maintains international equities for the following primary reasons:

- Invest (TEL) investment portfolio.
- Diversify the TEL Investment portfolio to enable the objective return to be achieved over the long term.

4.7.1 ACQUISITION/DISPOSITION AND REVENUE

All income, including dividends is recognised in the Statement of Financial Performance forms part of special funds [TEL]. Any change in the strategic asset allocation for the TEL portfolio requires Council approval

Revenue earned from New Zealand equities outside the TEL fund is minimal. All income is recognised in the Statement of Financial Performance and forms part of general funds.

4.7.2 MANAGEMENT REPORTING AND PROCEDURES

The international equities may be managed by Fund Managers. In such cases monthly reports are provided by the Funds Manager to the Group Manager Corporate & Infrastructure and included in the monthly Treasury Report.

Annual Reports for the New Zealand equity investments are received and reviewed by Council.

4.7.3 INVESTMENT RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Council is exposed to translation risk arising from its foreign currency denominated international equity fund being translated onto the New Zealand dollar ("NZD") Statement of Financial Position. Council is also exposed to translation risk on any income or dividends declared and recognised in the Statement of Financial Performance.

4.7.4 NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED INVESTMENT (NZLGFA)

Council has invested in the NZLGFA to access additional funding streams (see Appendix 2)

4.8 COUNCIL CONTROLLED TRADING ORGANISATIONS (CCTO's) – TAUPO AIRPORT AUTHORITY INVESTMENT

Council has 50% ownership of the joint venture Taupo Airport Authority, with the other 50% owned by the Crown. Council has 100% ownership in Destination Lake Taupo Ltd and Data Capture Systems Ltd. Both these companies are non-trading. Council may establish or be jointly involved in the establishment of other CCO's in the future.

Council retains ownership of the airport because it is essential for the economic development of the Taupo district and is consistent with Council's Annual Plan and LTP.

4.8.1 ACQUISITION/DISPOSITION AND REVENUE

The airport and any other CCO investment is consolidated into the Council's annual report in line with generally accepted accounting practice. Any surplus generated by the CCO will be utilised by the CCO, except in the case that a dividend requirement is set out in the CCO SOI or other such determination. Proceeds from the disposition of the investment will form part of general or special funds.

Additions to or disposal of any CCO investment requires Council approval. .

4.8.2 MANAGEMENT REPORTING AND PROCEDURES

Council is responsible for the management of the airport through its appointment of the Airport Manager who reports to the Group Manager Corporate & Infrastructure. The Airport Manager reports to the Taupo Airport Authority Committee on a monthly basis. A half year financial report and an Annual Report are prepared by Council staff. The authority prepares an annual statement of corporate intent for approval of the joint venture partners.

Similar management reporting and accountability practices are also in place for other CCO interests.

4.8.3 INVESTMENT RISK
The primary objective for risk management of the airport is to maintain operational efficiency and safety. This is managed by regular Civil Aviation Authority audits.

4.9 PROPERTY INVESTMENTS

Council's property investments include:

- crown land vested in Council and Council owned reserve lands
- property owned by Council either for the development needs of the district or for investment purposes (land, buildings, ground leases and motor camps) .

Council's primary objective for crown owned land vested in Council and Council owned reserve land is for the social benefit of the Taupo district.

Council's primary objective for property owned for development needs or for investment purposes is that it is important for the economic, physical and social development of the Taupo district and secondly, to achieve an acceptable rate of return. Council generally follows a similar assessment criteria in relation to the acquisition of new property investments.

4.9.1 ACQUISITION/DISPOSITION AND REVENUE
Prior to acquisition of property for the development needs of the district or for investment purposes the property will be assessed as follows:

- Property for the development needs of the district - a financial and non financial assessment of economic, physical and social benefit to the district, the cost of owning the property and the cost of ownership and assessment.
- Investment property - a financial assessment including a calculation and assessment of the cost of ownership.
- Proceeds from the disposition of property investments are used for retirement of debt relating to such property, or allocated to general or special funds. All income from property investments is shown in the Statement of Financial Performance and forms part of general funds.

Any acquisition or disposition of property, other than investment property purchased within the asset allocation parameters of the TEL Investment Portfolio, requires Council approval.

4.9.2 MANAGEMENT REPORTING AND PROCEDURES
Council reviews the performance of its property investments on a six monthly basis, and ensures that the benefits of continued ownership are consistent with its stated objectives.

4.9.3 INVESTMENT RISK
Insurance cover is held for all property investments. A risk assessment is carried out prior to acquisition of a property investment.

4.10 FORESTRY INVESTMENTS

Council has a holding of forestry assets which are held as long term investments on the basis of their net positive discounted cash flows. The discounted cash flows take into account projected market prices, annual maintenance and logging costs.

4.10.1 ACQUISITION/DISPOSITION AND REVENUE
Proceeds from the disposition of forestry investments are applied firstly to the repayment of forestry encouragement loans raised to fund these assets. Surplus proceeds (after repayments of loans) from the disposition of forestry investments will be allocated to special funds .

Any disposition of these investments requires Council approval. Valuations are carried out in accordance with accepted accounting principles

4.10.2 MANAGEMENT REPORTING AND PROCEDURES

The forestry assets are managed under contract to Council and are overseen by the Group Manager Corporate & Infrastructure. An annual Forest Health report is provided by the Forest Managers.

4.10.3 INVESTMENT RISK

Professional Forest Managers are engaged to oversee the forests. Insurance cover is held for all forest investments.

4.11 CASH & WORKING CAPITAL MANAGEMENT

Cash management deals with the net balance in Council's main bank accounts. The accounting function is responsible for managing Council's cash surpluses and/or deficits.

Council maintains a Daily Balancing Report (bank reconciliation) and short term and long term cash flow projections which are updated monthly and which form the basis of its cash management activity. Generally cash management surpluses are available for periods less than 90 days.

Cash management instruments are limited to:

- Call deposits with registered banks.
- Corporate Commercial Paper with a maturity less than three months.
- Term deposits (less than three months) with registered banks.
- A target average daily balance of $0 to $100,000 is aimed for in the main bank account, with surplus transferred to call deposits.
- The use of interest rate risk management instruments on cash management balances is not permitted.

Cash and the counterparties on cash management instruments may only be invested with approved counterparties within the limits detailed in section 4.6.3.

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4.12 OTHER INVESTMENTS – LOANS AND MORTGAGE ADVANCES

Council has other investments in the form of water and wastewater lump sum loans. All existing loans will continue to be held on the same terms and conditions, unless there are obvious financial reasons suggesting a change.

A Council resolution is required to provide funding assistance in the form of water and wastewater loans.

On occasion Council may also approve loans to Trusts or other community based organisations where there is clear social or community benefit to be achieved from the lending. Often such lending might be made at significantly discounted or nil interest rates, again in recognition of the clear social and community benefit that is being provided.

4.13 DELEGATIONS

The delegated authority in respect of the Investment policy is as follows:

Council:

- Approve investment policy
- Alter investment policy
- Approve investment strategy
- Approve interest rate risk management instruments and subsequent additions and deletions

Chief Executive

- Open/close bank accounts
- Approve cheque signatories

Treasury Management Group (TMG)

- Review strategies in place and revise as appropriate
- Recommend alterations to the investment management policy
- Review performance
- Overviews management of Council's relationships with financial markets

Group Manager Corporate & Infrastructure:

- Implement day-to-day investment strategies in line with overall strategy developed by TMG
- Authorise use of Council approved interest rate risk management instruments in line with strategy and treasury policy
- Financial staff
- Execute approved investment, investment interest rate risk management and daily cash management strategies.

Financial staff

- Execute approved investment, investment interest rate risk management and daily cash management strategies,

4.14 PERFORMANCE MEASUREMENT

The performance of the investing activity will be measured against pre-determined benchmarks:

FINANCIAL INVESTMENTS

- Adherence to policy.
- Comparison of actual monthly and year to date accrued returns vs investing the entire treasury portfolio at the combined average of the 90 day bill rate and the three year investor swap rate, over the last two years.
- A maturity profile showing the average yield in each maturity band compared against the current market yields.

EQUITY INVESTMENTS

- Adherence to policy.

PROPERTY INVESTMENTS

For investment property:

- Adherence to policy.
- Comparison of actual gross and net income to budgeted gross and net income.
- Comparison of actual return to budgeted (and/or market) return (with market return able to be established from such measures as the Property Council's Investment Performance Index).
- Comparison of actual property sales to budgeted property sales.
- Comparison of actual property purchases to budgeted property purchases.

FORESTRY INVESTMENTS

- Adherence to policy.
- Comparison of actual annual cash flows to budgeted projected annual cash flows.

GENERAL

- Total return achieved by the TEL Fund compared to investment objectives and Annual Plan target.
- A quarterly review by Council's Investment Advisors of performance of the whole of Council's investment portfolio.
- Comparison of actual financial ratios to budgeted financial ratios as per the Annual Plan and LTP

4.15 REPORTING

Reporting to Council

- 3-Yearly review of Investment Management Policy
- Annual Statement of Corporate Intent (for CCO's)
- Monthly Treasury Report including commentary where significant changes in investment strategy are entered
- Annual Report (for Council and CCO's)

Reporting to the Group Manager Corporate & Infrastructure
- Monthly Fund managers report
- Daily balancing report (bank reconciliation)

4.16 REVIEW

Investment Policy
- 3-Yearly review.
- Quarterly review by investment advisors of whole portfolio performance.

Investment Advisors
- Annual review

4.17 APPENDIX 1

New Zealand Government Funding Agency Limited Investment

Despite anything earlier in this Treasury Management Policy, the Council may borrow from the New Zealand Local Government Funding Agency Limited (LGFA) and, in connection with that borrowing, may enter into the following transactions to the extent it considers necessary or desirable:

(a) Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA;

(b) Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself;

(c) Commit to contributing additional equity (or subordinated debt) to the LGFA if required;

(d) Subscribe for shares and uncalled capital in the LGFA; and

(e) 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.

4.18 APPENDIX 2

New Zealand Government Funding Agency Limited Investment

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

The Council's objective in making any such investment will be to:

(a) Obtain a return on the investment; and
(b) Ensure that the LFGA 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 lower than the return it could achieve with alternative investments.

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

APPENDIX 3

4.19 INVESTMENT STRATEGY STATEMENT (ISS) – TEL FUND

Council's 2012/22 long term plan (LTP) provides for continuing rates subsidy until 2019/20 while maintaining or increasing the capital value of the fund.

This ISS has been prepared for the Council as a Local Authority

The Council has established a unique asset allocation strategy taking into account contemplated assets, operating expenses and future distributions.

KEY INFORMATION

Name of Trust: Taupo District Council – TEL Fund

Governance is carried out by the Taupo District Council.

STATEMENT OF OBJECTIVES

The objectives of the Council have been established in conjunction with a comprehensive review of current and projected investment requirements. The objectives are:

OBJECTIVES

1) Maintain the purchasing power of the current assets and all future contributions. The objective is to maintain the level of services and programs in relation to the average cost increases.
2) Establish the investments to ensure sufficient liquidity and/or income to meet cashflows required for distribution.
3) Maximize return within reasonable and prudent levels of risk.
4) Maintain an appropriate asset allocation based on a total return policy that is compatible with a flexible spending policy, while still having the potential to produce positive real returns.

TIME HORIZON

The investment guidelines are based upon an investment horizon of greater than ten years. The Council intends to maintain the TEL fund's assets in perpetuity. Therefore, interim fluctuations should be viewed with appropriate perspective.

RISK TOLERANCES

The Council recognises and acknowledges some risk must be assumed in order to achieve the long-term investment objectives, and there are uncertainties and complexities associated with contemporary investment markets.

In establishing the risk tolerances for this ISS, the Council's ability to withstand short- and intermediate-term variability were considered. The Council's prospects for the future, current financial condition and level of funding suggest collectively some interim fluctuations in market value and rates of return may be tolerated in order to achieve confidence in longer-term objectives.

PERFORMANCE EXPECTATIONS

In general, the Council would like the Portfolio to earn at least a return of between 100 and 200 basis points higher than the 90 day bill rate. It is understood this average return will require targeted market risk exposure to: (1) retain principal value; and, (2) purchasing power; (3) adequately contribute to the annual cash flow distributions as required. Furthermore, the objective is to inflation proof the fund.

ASSET CLASS GUIDELINES

The Council believes that long-term investment performance, in large part, is primarily a function of sub-asset class mix. The Council has reviewed the long-term performance characteristics of the asset classes and sub-asset classes, focusing on balancing the risks and rewards.

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

The asset allocation is as set out below. The ISS allows the percentage allocation to each major asset class (that is Equities, Fixed Interest and Cash) to vary as much as plus or minus 25% depending upon market conditions. Asset allocation is also subject to potential change in an annual review process.

Asset Classes	**Strategic Allocation**	
	%	**%**
International Equities	15	
Large		7.5
Value		3.75
Small		3.75
Australasian Equities	10	
Large		5
Value		2.5
Small		2.5
Diversified Fixed Interest	50	
Property	15	
Cash	10	
	100%	

The TEL fund exposure limit to the total issue size of any product should not be greater than 2.5%.

REBALANCING OF STRATEGIC ALLOCATION

The percentage allocation to each major asset class may vary as much as plus or minus 25% depending upon market conditions. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the Portfolio. If there are no cash flows, the allocation of the Portfolio will be reviewed quarterly.

If the Council's TMG judges cash flows to be insufficient to bring the Portfolio within the strategic allocation ranges, the Council's TMG shall decide whether to effect transactions to bring the strategic allocation within the threshold ranges (Strategic Allocation).

DUTIES AND RESPONSIBILITIES

As a fiduciary, the primary responsibilities of the Council are:

1) Prepare and maintain this Investment Strategy Statement
2) Prudently diversify the Portfolio's assets to meet an agreed upon risk/return profile
3) Prudently select investment options

4) Control and account for all investment, record keeping and administrative expenses associated with the Portfolio
5) Monitor and supervise all service vendors and investment options
6) Avoid prohibited transactions and conflicts of interest.

INVESTMENT FIDUCIARY
The Council may retain an independent investment fiduciary as an objective, third-party to assist the Council in managing the overall investment process. The Fiduciary will be responsible for guiding the Council through a disciplined and rigorous investment process to enable the Council to meet the fiduciary responsibilities outlined above.

INVESTMENT MANAGERS
As distinguished from the Council and the Investment Fiduciary, who are responsible for managing the investment process, investment managers are responsible for making investment decisions (security selection and price decisions). The specific duties and responsibilities of each investment manager are:
1) Manage the assets under their supervision in accordance with the guidelines and objectives outlined in their respective Service Agreements, Prospectus or Trust Agreement.
2) Exercise full investment discretion with regards to buying, managing, and selling assets held in the Portfolios.
3) If managing a separate account (as opposed to a mutual fund or a commingled account), seek approval from the Council prior to purchasing and/or implementing the following securities and transactions:
    - Unregistered securities; commodities or other commodity contracts; and short sales or margin transactions
    - Securities lending; pledging securities.
    - Investments in the equity securities of any company with a record of less than three years continuous operation, including the operation of any predecessor
    - Investments for the purpose of exercising control of management.
4) Vote promptly all proxies and related actions in a manner consistent with the long-term interest and objectives of the Portfolios as described in this ISS. Each investment manager shall keep detailed records of the voting of proxies and related actions and will comply with all applicable regulatory obligations.
5) Communicate to the Council all significant changes pertaining to the fund it manages or the firm itself. Changes in ownership, organisational structure, financial condition, and professional staff are examples of changes to the firm in which the Council is interested.
6) Effect all transactions for the Portfolio subject “to best price and execution."
7) Use the same care, skill, prudence, and due diligence under the circumstances then prevailing that experienced investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like portfolios with like aims in accordance and compliance with and all applicable laws, rules, and regulations.
8) If managing a separate account (as opposed to a mutual fund or a commingled account), acknowledge co-fiduciary responsibility by signing and returning a copy of this ISS.

CUSTODIAN
Custodians are responsible for the safekeeping of the Portfolio’s assets. The specific duties and responsibilities of the custodian are:
- Maintain separate accounts
- Value the holdings
- 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, and change in value of each security and the overall Portfolio since the previous report.

INVESTMENT MANAGER SELECTION
The Council can manage its investments internally. Should the Council appoint external managers it will apply the following due diligence criteria in selecting each external money manager or mutual fund:
- *Regulatory oversight:* Each investment manager should be a regulated bank, an insurance company, a mutual fund organization, or a registered investment adviser

- *Correlation to style or peer group:* The product should be highly correlated to the asset class of the investment option. This is one of the most critical parts of the analysis since most of the remaining due diligence involves comparisons of the manager to the appropriate peer group
- *Performance relative to a peer group:* The product's performance should be evaluated against the peer group's median manager return, for 1-, 3- and 5-year cumulative periods
- *Performance relative to assumed risk:* The product's risk-adjusted performance (Alpha and/or Sharpe Ratio) should be evaluated against the peer group's median manager's risk-adjusted performance
- *Minimum track record:* The product's inception date should be greater than three years
- *Assets under management:* The product should have at least $75 million under management (Note: to be determined separately for international and Australian and New Zealand asset holdings.)
- *Holdings consistent with style:* The screened product should have no more than 20% of the portfolio invested in "unrelated" asset class securities - for example, a Large Growth product should not hold more than 20% in cash or fixed income
- *Expense ratios/fees:* The product's fees should not be in the bottom quartile (most expensive) of their peer group
- *Stability of the organization:* There should be no perceived organizational problems – the same portfolio management team should be in place for at least two years
- *Exit Strategy:* The investment manager must be able to prove a track record of implementation of exit strategy.

CONTROL PROCEDURES

Performance Objectives – External Managers

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

The Council is aware the ongoing review and analysis of the investment managers is just as important as the due diligence implemented during the manager selection process. The performance of the investment managers 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 quarterly, the Council will meet to review whether each manager continues to conform to the search criteria outlined in the previous section; specifically:

1) The manager's adherence to the portfolio's investment guidelines;
2) Material changes in the manager's organization, investment philosophy and/or personnel; and,
3) Any legal or other regulatory agency proceedings affecting the manager.

The Council has determined it is in the best interest of the Portfolio's participants that performance objectives be established for each investment manager. Manager performance will be evaluated in terms of an appropriate asset class market index (e.g. the S&P 500 stock index for large-cap U.S. equity manager) and the relevant peer group (e.g. the large-cap growth mutual fund universe for a large-cap growth mutual fund).

Asset Class	**Indices**	**Peer Group**
International Equities	International Equities	International Equities
Large	MSCI World Index	Large
Value	MSCI World Value Index	Value
Small	MSCI World Small Index	Small
Australasian Equities	Australasian Equities	Australasian Equities
Large	S&P/ASX Accumulated 100 Index	Large
Value	S&P/Citigroup Broad Market (BMI) Value Index	Value
Small	S&P/ASX Accumulated Small Ordinaries Index	Small
New Zealand	NZX-50 Index	New Zealand
Emerging Markets	MSCI Emerging Markets Index	Emerging Markets

Diversified Fixed Interest	1–5 yr Global Govt Bond Index Hedged	Short Term Bonds
Cash	90 Day Bank Bill Index	Cash

A manager may be placed on a Watchlist and a thorough review and analysis of the investment manager may be conducted, when:

1) A manager performs below median for their peer group over a 1-, 3- and/or 5-year cumulative period
2) A manager's 3-year risk adjusted return (Alpha and/or Sharpe) falls below the peer group's median risk adjusted return
3) There is a change in the professionals managing the portfolio
4) There is a significant decrease in the product's assets
5) There is an indication the manager is deviating from his/her stated style and/or strategy
6) There is an increase in the product's fees and expenses
7) Any extraordinary event occurs that may interfere with the manager's ability to fulfil their role in the future.

A manager evaluation may include the following steps:

1) A letter to the manager asking for an analysis of their underperformance
2) An analysis of recent transactions, holdings and portfolio characteristics to determine the cause for underperformance or to check for a change in style
3) A meeting with the manager, which may be conducted on-site, to gain insight into organisational changes and any changes in strategy or discipline

The decision to retain or terminate a manager cannot be made by a formula. It is the Council's confidence in the manager's ability to perform in the future that ultimately determines the retention of a manager.

Measuring Costs

The Council will review at least annually all costs associated with the management of the Portfolio's investment program, including:

1) Expense ratios of each investment option against the appropriate peer group.
2) Custody fees: The holding of the assets, collection of the income and disbursement of payments.
3) Whether the manager is demonstrating attention to "best execution" in trading securities.
4) Investment Management Entity - cost of management.

Investment Strategy Review

The Council will review this ISS at least annually to determine whether stated investment objectives are still relevant and the continued feasibility of achieving the same. It is not expected that the ISS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the ISS.