Treasury Management Policy

Keywords: Enter any Policy keywords

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Responsible Officer(s):	*General Manager Corporate and Community Services*
Council File Reference:	
Applicable Legislation:	*Local Government Act 1999* *Local Government (Financial Management) Regulations 2011*
Relevant Policies:	*Internal Controls Framework Policies*
Related Procedures:	*N/A*
Delegations:	*Chief Executive Officer*

1. Purpose:

1.1 This policy provides clear direction to management, staff and Council in relation to the treasury function. It underpins Council's decision-making regarding the financing of its operations as documented in its Annual Budget and Long-Term Financial Plan (LTFP) and associated projected and actual cash flow receipts and outlays. It outlines how required borrowings will be raised and how cash and investments will be managed to fund Council operations.

1.2 Council is committed to operating in a financially sustainable manner and maintains an up-to-date Long Term Financial Plan (LTFP) to assist in determining affordable service levels and revenue raising needs. This plan also provides projections of future cashflow availability and needs.

1.3 All investments and borrowings are to be made exercising care, diligence and skill that a prudent person of business would exercise in managing the affairs of other persons.

2. Scope:

2.1 This policy is applicable to all employees and all Elected Members.

2.2 The Treasury Management Policy establishes a decision-making framework to ensure that:

- Funds are available to support approved outlays;
- Interest rates and other risks (e.g. liquidity and investment credit risks) are acknowledged and responsibly managed; and

- The net interest costs associated with borrowing and investing are reasonably likely to be minimised on average over the longer term.

3. **Definitions:**

3.1. For the purpose of this policy:

Key Term/Acronym	Definition
Asset Renewal Funding Ratio	Capital expenditure on renewal or replacement of existing assets as a percentage of asset management plans allocation. Capital expenditure on renewal or replacement of existing assets / Asset Management Plan.
'Better Practice Model'	The framework of internal financial controls legislated for South Australian Local Government external audits. **Internal Control Policies** - As per Section 10A of the Local Government (Financial Management) Regulations 2011 For the purposes of section 125(2) of the Act, the policies, practices and procedures of internal financial control of a council must be in accordance with the Better Practice Model—Internal Financial Controls.
Borrowings	Cash received from another party in exchange for future payment of the principal, which would normally include interest and other finance charges.
Convertible Cash Advance Debenture (CAD)	A loan where principal amounts can be repaid at any time and calculation of interest payable is based on the amounts of principal outstanding i.e. an interest only loan. The principal is not required to be repaid until maturity.
'Credit Foncier Borrowings'	Are borrowings for a fixed period with regular repayments where each repayment includes components of both principal and interest, such that at the end of the period the principal will have been entirely repaid. Commercial credit foncier borrowings (including to local governments) usually have a fixed rate of interest.
'Financial Sustainability'	A Council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met and maintained without unplanned increases in rates or disruptive cuts to services.
Fixed Interest	A loan where the interest rate is unchanged over the term of the loan.

Key Term/Acronym	Definition
FSIP	Local Government Association Financial Sustainability Information Papers.
Inter-Generational Equity	When assessing investment and borrowing decisions, consideration should be given to the "generation of rate payers" who will derive the substantive benefits versus those who will ultimately pay (through Council rates and user charges).
Investments	The commitment of funds in order to receive later benefits, usually interest.
'LGFA'	Local Government Finance Authority
'Net Financial Liabilities'	Equals total liabilities less financial assets, where financial assets for this purpose include cash, investments, receivables and prepayments, but excludes equity held in Council business, inventories and land held for resale.
'Net Financial Liabilities Ratio'	indicates the extent to which net financial liabilities of a Council could be met by its operating revenue. Net Financial Liabilities/Total operating revenue.
Operating Surplus Ratio	Operating surplus before capital revenues as a percentage of total operating revenue Operating surplus / Total operating revenue.
Treasury Management	Is the management of investments and debt, in order to make the best possible use of funds, maintain financial sustainability, maximise the returns from investments, reduce the overall cost of borrowings, and mitigate operational and financial risk.
Variable Interest	A loan where the interest rate fluctuates over the life of the loan.
Useful Life	Is defined as the period over which an asset is expected to be available for use by the entity.

4. Principles

4.1 This policy provides clear direction to management, staff and Council in relation to the treasury function.

4.2 It underpins Council's decision-making regarding the financing of its operations as documented in its Annual Budget and Long-Term Financial Plan (LTFP) and associated projected and actual cash flow receipts and outlays. It outlines how required borrowings will be raised and how cash and investments will be managed to fund Council operations.

4.3 The decision-making framework ensures the following:

- Funds are available as required to support approved outlays;
- Interest rate and other risks (e.g. liquidity risks and investment credit risks) are acknowledged and responsibility managed~~)~~;

- Subject to Council's capital expenditure decisions, the gross level of debt is minimised; and
- On average over the longer term it is reasonably likely to minimise the net interest costs associated with borrowing and investing.

5. **Policy Statements:**

5.1. **Treasury Management Strategy:**

5.1.1 Council's operating and capital expenditure decisions are made based on the following:

- **Community Need** - Identified community need and benefit relative to other expenditure options;
- **Cost Effectiveness** - Cost effectiveness of the proposed means of service delivery;
- **Affordability** - Of proposals having regard to Council's long-term financial sustainability and key financial indicator benchmarks (including consideration of the cost of capital and the impact of the proposal on Council's Net Financial Liabilities and Interest Cover ratios);
- **Delivery and Maintenance of Assets** - Based on asset management plans**;**
- **Strategic Partnerships** - Where the "multiplier effect" will mean that more can be delivered supported by Council funds and contribution from partners e.g. federal or state government grants or commercial organisation contributions.

5.1.2 Whether a borrowing needs to be raised and if so the nature of it is a separate decision to the expenditure one and it is made in accordance with the criteria specified in this Policy.

5.1.3 The Council manages its finances holistically in accordance with its overall financial sustainability strategies and targets. This means Council will:

- **Retention of funds** - Not retain and quarantine money for a particular future purpose unless required by legislation or formal agreement with other parties;
- **LTFP/ABP Alignment** - Borrow funds in accordance with the requirements set out in its Long Term Financial Plan, Annual Business Plan and Annual Budget;
- **Liabilities** - Maintain sufficient funds to meet its liabilities;
- **Reporting** - Report on the performance and outcomes of the Council's investments and borrowings to the Audit and Risk Management Committee and to the Council at least annually.
- **Balanced Approach** - Recognise that on average the rate of return it can receive from investing money is less than the interest rate char~~n~~ged on borrowed funds;
- **Target** - Maintain target ranges for its Net Financial Liabilities ratio;
- **Cash Management** - Wherever possible apply any funds it has that are not immediately required to meet approved expenditure (including funds that are required to be expended for specific purposes and are not required to be kept in separate bank accounts), to reduce its level of borrowings or to defer and/or reduce the level of new borrowings that would otherwise be required;
- **Cash flow shortfalls** - Meeting immediate cash flow shortfalls initially by redeeming invested funds. Where there are no (or insufficient) funds invested they may be drawn down against Council's Convertible Cash

Advance Debenture (CAD) facilities at the LGFA approved in the short to medium-term in accordance with delegations; and

- **Operating Deficits** - Not borrow to fund long term operating deficits.

5.1.4 **Key Financial Indicators** - Council ensures long term financial sustainability using key financial indicators in its LTFP aligned with the Local Government Financial Management Regulations 2011 that require that a Council use three specific financial indicators. Council has the following targets:

- **Operating Surplus Ratio** - To achieve a positive operating surplus ratio on average over the life of the LTFP of between 0% and 5% (noting that the FSIP suggested target range is to achieve, on average over time, an operating surplus ratio of between 0% and 10% of total operating income);
- **Net Financial Liabilities Ratio** - Achieve a target of less than 100% of total operating revenue on average over the life of the LTFP (noting that the FSIP suggested range is between 0% and 100% of total operating income); and
- **Asset Renewal Funding Ratio** - Maintain an asset renewal funding ratio of ~~greater than or~~ ~~equal to~~ 100% of the Infrastructure and Asset Management Plan as a rolling average over the life of the LTFP (noting that the FSIP suggested range is between 80% and 120% with a rolling average of 100% of the level proposed in the Infrastructure and Asset Management Plan).

5.2 **Borrowings:**

5.2.1 Borrowings are not a form of income and do not replace the need for Council to generate sufficient operating income to service its operating requirements. Undertaking borrowings gives rise to both an asset (the cash it provides) and a liability (the obligation to repay the money borrowed plus interest).

5.2.2 Council may borrow through any market mechanism under Section 134 and Section 135 of the Local Government Act 1999 and will not directly issue its own debt. No borrowing will occur for the purpose of investing funds without approval of Council.

5.2.3 Council does not place a physical monetary limit on the level of borrowings it may hold, however, has an upper percentage limit in place through its financial targets (as per 5.1.4).

5.2.4 It further allows that council may enter financial arrangements for the purpose of managing, hedging or protecting against movement in interest rates or other costs of borrowing money.

5.2.5 The Act stipulates however that these arrangements must not be entered into without council first obtaining independent and impartial advice in relation to risk management policies, controls and systems of entering such an arrangement. To mitigate interest rate risk exposure Council will only seek to borrow funds from the following sources:

- Local Government Finance Authority of which it is a member.
- Either the National Australia Bank, the Commonwealth Bank of Australia, the Australian and New Zealand Banking Corporation and the Westpac Banking Group including its affiliates i.e. BankSA.

5.2.6 Council will consider its LTFP and future funding obligations when deciding on the use of the following:

- Credit Foncier (fixed term and interest);
- Fixed interest rate;

- Variable interest rate;
- Interest only loan; and
- Combination of credit types

5.2.7 **Annual Debt Limit:**

- On an annual basis, Council will consider its debt limit to ensure that funds are available as required to support approved outlays and to account for working capital requirements.
- The annual debt level will vary from the opening and closing debt disclosed in the Annual Business Plan and Budget due to the timing of receipt of funds from income and the timing of payments for the provision of goods and services.

5.2.8 **Interest Rate Exposures**

To ensure an adequate spread of interest rate exposures, Council will consider structuring its portfolio of borrowings to maintain a combination of both fixed and variable interest rate borrowings.

All borrowings are to be made exercising care, diligence and skill in the consideration of:

- Current risk profile;
- Current economic factors;
- The period over which the funds are likely to be required;
- Expected short and long term view of interest rate trends;
- Council's overall debt maturity profile and mix;
- Cost of funding;
- Cost differentials between fixed and variable facilities;
- Long term capacity for repayment of loans;
- The reason behind Council's cash shortfall; and
- The cost of making and maintaining the borrowing.

When Council considers any additional loans, it ~~should~~ will consider the current portfolio of borrowings, in particular the balance between fixed rate and variable rate loans and their maturity profile, before deciding on the nature of the loans to be used. To ensure flexibility in changing circumstances, Council will not set range limits for the mix of fixed and variable borrowings.

The portfolio of borrowings includes all current loans and the LGFA Cash Advance Debenture Facility line of credit to the maximum value.

5.2.9 **Fixed Interest Rate Borrowings**

Having regard to cost effectiveness, risk management criteria and flexibility, Council will restructure its portfolio of borrowings as old borrowings mature and new ones are raised.

To spread its exposure to interest rate movements, Council will aim to have a variety of maturity dates on its fixed interest borrowings over the available maturity spectrum and will typically have no more than one fixed interest rate borrowing maturing in any financial year.

In circumstance where Council needs to raise new fixed interest rate borrowings it will consider using medium to long term borrowings (3 years or more duration) that:

- Have a fixed interest rate;

- Require interest payments only;
- Allow the full amount of principal to be repaid (or rolled over) at maturity

Fixed rate loans can be either interest only or credit foncier.

Interest only loans are only permissible where Council wishes to borrow a set amount of funds for a known period and make interest payments during the term of the loan, with the principal amount repaid at maturity.

Credit foncier loans are suitable if Council wishes to borrow for a known period and make repayments of principal and interest during the term of the loan. Credit foncier borrowings by councils are typically at fixed interest rates. However, the Council can choose how frequently it wishes to make repayments, and the loan can be negotiated as a fixed rate for the term of the loan or as a floating rate which varies according to prevailing market rates.

5.2.10 **Variable Interest Rate Borrowings**

Council recognises that there is usually a significant margin between borrowing and investment rates. When this occurs Council can generate savings by structuring its portfolio of borrowings so that surplus cash can be used to reduce the level of borrowings, thereby minimising interest expense. This is more readily and effectively achievable with variable interest rate borrowings.

Council will make ~~extensive~~ use of a variable interest rate borrowing facility and or LGFA's Cash Advance Debenture facility. Such facilities require interest payments only and enable any amount of principal to be repaid or redrawn at call. The redraw facility will provide Council with access to liquidity and therefore eliminate the need to hold significant sums in liquid investments. It is important to note that these are approved borrowing facilities and not an overdraft.

These borrowing facilities will have all of the following features:

- A long-term maturity date;
- An interest rate that will vary from time to time (e.g. when there is a movement in official short-term interest rates);

The amount of principal outstanding at any time would not be repayable until maturity (The LGFA Cash Advance Debenture is an example of such a product)

This flexibility requires additional internal financial controls.

5.2.11 **New Borrowings:**

All new borrowings will be obtained through the LGFA in the first instance unless Council deem it appropriate to go to tender.

Prior to undertaking a new loan, a report must be presented to Council to approve the establishment of the loan and authorise the Chief Executive Officer and the Mayor to sign and affix the common seal for the loan agreement.

When a new loan is being considered, Council will be provided with a comprehensive list of any loans in place, including details of loan type, balance outstanding, term and interest rates to enable an informed decision to be made about the proposed borrowing.

5.2.12 **Leases**

Where Council enters a lease this is in essence a borrowing transaction and should be considered holistically in accordance with Council's overall borrowing policy. An evaluation of lease versus debt will be performed to determine the best return to Council.

Disclosure of lease costs is to be provided in the annual financial statements in accordance with Australian Accounting Standards.

5.3 **Investments:**

5.3.1 Council funds that are not immediately required for operational needs and cannot be applied to either reduce existing borrowings or avoid the raising of new borrowings will be invested.

5.3.2 The balance of funds held in any operating bank account that does not provide investment returns at least consistent with 'at call' market rates shall be kept at a level that is no greater than is required to meet immediate working capital requirements.

5.3.3 All investments are to be held in the name of the Council, or an associated entity if the Council is holding funds on behalf of a Community Group.

5.3.4 Any funds invested will be lodged at call or having regard to differences in interest rates for fixed term investments of varying maturity rates, may be invested for a fixed term. The maturity date for a fixed term investment would not exceed a point in time where the funds otherwise could have been applied to cost-effectively either defer the need to raise a new borrowing or reduce the level of Council's variable interest rate borrowing facility.

5.3.5 When investing funds within the above criteria the investment type that delivers the best value to Council is to be selected having regard to investment returns, transaction costs and other relevant and objectively quantifiable factors.

5.3.6 Council will only seek to invest funds with the following:

- Local Government Finance Authority of which it is a member.
- Either the National Australia Bank, the Commonwealth Bank of Australia, the Australian and New Zealand Banking Corporation and the Westpac Banking Group including its affiliates i.e. BankSA.

5.3.7 Any other investment requires specific approval of Council. Council must be mindful of the requirements of the Local Government Act 1999, in particular, s139 (2)(b) which provides that Council must avoid investments that are speculative or hazardous in nature.

5.4 **Community Loans**

5.4.1 Community groups who are seeking to undertake capital works may approach Council to borrow funds on their behalf which the groups are to pay back to Council, as Council is able to access superior terms and borrowing conditions. Council also acts as guarantor for community groups seeking to borrow funds.

5.4.2 Council's Community Group Loans Policy provides a framework for Council to consider requests from community groups including sporting clubs, operating on Council owned property, seeking assistance by way of direct loan and/or loan guarantee under $500,000.

It should be noted that community loans reduce Council's overall borrowing capacity.

Financial Reserves

Financial reserves are maintained as equity-based reserves and are not cash backed.

6. Annual Review and reporting:

6.1 An annual review of the treasury management performance will be undertaken in accordance with section 140 of Local Government Act 1999.

6.2 At least once a year Council's Audit and Risk Committee shall receive a specific report regarding treasury management performance relative to this policy document.

The report shall highlight:

- for each Council borrowing and investment - the quantum of funds, its interest rate and maturity date, and changes in the quantum since the previous report; and,
- the proportion of fixed interest rate and variable interest rate borrowings at the end date of the reporting period and an estimate of the average of these proportions across this period along with key reasons for significant variances compared with the targets specified in this policy.
- budgeted borrowings versus actual borrowings.

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