Treasury Management Policy

CITY OF PROSPECT

Reference Number:	TRIM Reference: CR22/35180
Type:	Council Policy
Responsibility:	Director Corporate Services
Responsible Officer (s):	Manager Financial Services
Initial Adopted Date:	August 2000
Last Review Date:	24 August 2021
Next Review Date:	3 Years - August 2024
Legislation:	Local Government Act 1999 (SA) Local Government (Financial Management) Regulations 2011
Related Documents:	City of Prospect Delegations Register Code of Conduct for Council Employees Corporate Governance Framework

1 Purpose

The Treasury Management Policy (the policy) sets the principles and procedures to ensure appropriate management of Councils cash, cash equivalents, investments and borrowings to fund Councils recurrent, project and capital expenditure. This is considered in the context of its Annual Budget and Long Term Financial Plan (LTFP).

2 Legislative Requirements and Corporate Policy Context

2.1 Borrowings

The *Local Government Act 1999:*
Section 44: Delegations
Section 48: Prudential requirements for certain activities
Section 122: Strategic Management Plans
Section 134: Borrowing and related financial arrangements
Section 135: Ability of a Council to give security

The Local Government Financial Management Regulations 2011
Regulation 5: Long Term Financial Plans
Regulation 7: Budgets

2.2 Investments

The *Local Government Act 1999*: Section 47: Interests in companies
Section 139: Investment powers
Section 140: Review of investments

3 Interpretation

For the purpose of this policy:

Bank corporations which are authorised under the *Banking Act 1959* (*Cth*) including banks, building societies and credit unions.

Borrowing cash is received from another counterparty in exchange for future payment of the principal, which normally includes interest and other finance charges.

Cash Advance Debenture
a loan where principal amounts can be repaid at any time and the calculation of interest payable is based on the amounts of principal outstanding.

Counterparty
an opposite party in a financial transaction.

Credit Foncier Debenture
a loan for a fixed term with regular repayments comprising principal and interest, such that at the end of the term the total principal would have been repaid. Usually the interest rate is fixed for the period of the loan, but can be variable.

Debt the amount of money owed by the debtor as a result of a transaction with Council.

Deposits placement of cash either at call or for a fixed term that is not held in an operating account or invested in the investment pools.

Debenture is a type of debt instrument; in local government normally secured against the future of rates income of a Council. They can be either *Cash Advance or Credit Foncier.*

Financial Sustainability
where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services.

Fixed Interest
where the interest rate for a loan is unchanged over the term of the loan.

Interest Cover Ratio
the extent to which a Councils operating revenues (excluding the Natural Resource Management Levy) are committed to net interest expenses.

Inter-Generational Equity
the concept of spreading both the costs of large assets or the benefits of financial windfalls over the medium to long term so that not just a single generation of rate payers either incur or benefit the impacts of such events

Investment the placement of centrally managed Council investment funds in assets or items with the intent of generating income, return or appreciation in value.

Local Government Finance Authority (LGFA)
provides financial investment and borrowing services exclusively to South Australian Councils and Local Government Bodies. In accordance with Section 24 of the Local Government Finance Authority Act, 1983 it is guaranteed by the State Government Guarantee.

Management staff employed by the Council, noting that the responsible officer for this policy is the Manager Financial Services.

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 a Council subsidiary, inventories and assets held for sale.

Net Financial Liabilities Ratio
the extent to which net financial liabilities of a Council could be met by its operating revenue (excluding the Natural Resource Management Levy)

New Borrowings

the creation of a new borrowing facility whether it be a *Credit Foncier Debenture* or a *Cash Advance Debenture*. This does not include the management of pre-existing facilities.

Treasury Management

how cash, cash equivalents, borrowings and loans are managed in the short, medium and long terms to allow Council to managed operations and to ensure its financial liquidity.

Variable Interest

where the interest rate for a loan fluctuates over the life of the loan.

4 Policy

This policy establishes a framework to ensure sound treasury management, including how cash, cash equivalents and all financial borrowings and investments will be managed over the short, medium and long term to fund Council operations. Council will monitor and compare financial indicators to Local Government Association (LGA) recommendations to help achieve this.

4.1 Inter-Generational Equity

A key challenge Council faces is the need to address principles of Inter-Generational Equity. This is the concept of spreading both the costs of large assets or the benefits of financial windfalls over the medium to long term so that not just a single generation of ratepayers either incur or benefit the impacts of such events.

Borrowing is a useful mechanism for spreading the costs of assets over the time frame that those assets are to provide services to ratepayers, thus ensuring to a large extent that the ratepayers who benefit from the assets pay for their consumption. A loan term of between 15-20 years achieves a balance between this inter-generational equity principal and interest costs.

Conversely investments can also spread the benefits of one-off windfalls, for example the sale of a major Council asset, over many financial years, thus assisting with inter-generational equity.

4.2 Core Considerations

This Policy establishes a decision framework to ensure that funds are appropriately managed, these include

- interest rate, liquidity and investment credit risks are acknowledged and responsibly managed,
- net interest costs associated with borrowing are minimised on average over the longer term,
- net interest income from investments is maximised over the term of the investment product, and
- returns on surplus funds are maximised whilst safeguarding those funds from any losses.

Accountability for the treasury management function is the responsibility of the Manager Financial Services.

4.3 Borrowings

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).

There are many types of borrowings and Council will consider these when borrowing to minimise net interest costs on average over the longer term and to manage interest rate movement risks.

Council will manage its cash holistically within the constraints of its overall financial strategies and targets outlined in the LTFP. Council does not match borrowings with specific projects but rather will only borrow when it requires cash as a result of timing differences between cash inflows and outflows.

Council may borrow through any market mechanism under Section 134 and Section 135 of the Local Government Act 1999 but will not directly issue its own debt.

Future movements in interest rates are uncertain in direction, timing and magnitude. Council recognises the importance of balancing risk management and costs and in an effort to minimise risk and net interest costs may utilise various borrowing mechanisms:

- Fixed Interest borrowings
- Variable Interest borrowings

Council's loan portfolio may have a mix of fixed and variable borrowings. In order to spread its exposure to interest rate movements, Council will aim to have a variety of maturity dates on its borrowings. Council will be mindful of these issues when making borrowing decisions and will consider the mix of fixed and variable terms and interest rates. In order to ensure flexibility in changing circumstances, Council will not set range limits for the mix of fixed and variable borrowings.

When borrowing Council will consider these financial indicators:

- Interest Cover Ratio
- Net Financial Liabilities Ratio

Council does not place a physical monetary limit on the level of borrowings it may hold however places an upper limit through its key financial indicators.

All borrowings must be made exercising care and diligence and consider the following:

- the reason for requiring additional cash,
- level of borrowings required,
- Council's overall debt maturity profile and mix,
- an assessment of future interest rate movements,
- the period over which the cash is likely to be required and subsequently repaid, and
- cost of making and maintaining the borrowing.

As there is usually a material margin between borrowing and investment rates, Management recognises that costs can be reduced by structuring its loan portfolio so that surplus cash inflows can be applied in the first instance to reduce the level of borrowings that would otherwise be necessary.

In addition, Council may need to access debt where timing of receipts does not match timing of payments. For this reason Council may incorporate variable interest or short-term borrowings into its portfolio.

The length of the loan with considered by Management on a case-by-case basis.

When a new loan is being considered a recommendation may be presented to the Audit Committee with a list of current loans including details of loan type, balance outstanding, term and interest rates to enable an informed decision to be made about the proposed borrowing. To proceed the Audit Committee must approve the recommendation.

Final approval will be sought from Council.

4.4 Investments

Cash that is not immediately required for operational needs and cannot be applied to reduce existing borrowings or avoid the raising of new borrowings will be invested in accordance with this Policy and Sections 47, 139 and 140 of the Local Government Act 1999.

4.4.1 Investments undertaken in the normal course of Council operations

After taking into account the cash required to fund the daily operations of Council, and all borrowings that can be repaid have been then surplus cash will be invested will be invested in a 24hour facility with the LGFA while maintaining a prudent cash balance at the bank.

Where Management consider that that there is a high probability that a surplus cash position will not be required within a 3 - 6 month period then the surplus will be invested in a 90 day, or equivalent facility, with the LGFA.

4.4.2 Investments undertaken outside in the normal course of Council operations

When a surplus cash position occurs that is not required to meet daily operations and not envisaged by management to be required in the next 6 months then this surplus cash can be invested in

- Deposits with the LGFA,
- Bank interest bearing deposits, with the current Bank providing banking services to Council,
- State/Commonwealth Government Bonds, or
- Bank accepted/endorsed bank bills.

The length of the investment with considered by Management on an investment-by-investment basis.

Any investment outside of the normal course of Council business will be presented with a recommendation to the Audit Committee.
They will be provided with a list of current investments including details of investments type, balance outstanding, term and interest rates to enable an informed decision to be made about the proposed investment. To proceed the Audit Committee must approve the recommendation.

Final approval will be sought from Council.

4.4.3 Investment Process and Investment Counterparty Requirements

All investments must be made exercising care and diligence and considering the following:

- the likely yield and term of the investment
- the period in which the investment is likely to be required
- the cost of making and maintaining the investment
- an assessment of future interest rate movements
- an assessment of future cash flow requirements
- the Government guarantee on the investment

All investment counterparties must have a Standard & Poor's rating or at least AA-. Should the investment counterparty be downgraded then where possible efforts should be made to withdraw from the deposits as soon as practicable.

All Councils financial borrowings and investments will be held in Australian dollars.

No fewer than three written quotations should be obtained for each investment.

4.5 Reserves

Reserves are an allocation of Council's accumulated surplus. Council may establish various equity accounts called 'Reserves' to identify accumulated surpluses that will be used for specific future purposes. Separate bank accounts will not be established for reserves unless legally required to do so.

There are three types of reserves:

- Required by Accounting Standards (eg Asset Revaluation Reserve)
- Statutory reserves (eg open space & car parking contributions);
- Council discretionary reserves (eg Renewal and Replacement Reserve).

Refer to Appendix 1 for further discussion on treatment of reserves.

There are very few circumstances where a Council is legally required to quarantine cash. In order to receive contributions, Council is legally required to hold a Reserve for Open Space contributions and a car parking reserve under the PDI Act. These Reserves are not required to be 'cash backed' by a separate bank account.

Where cash is required to be expended for specific purposes, but is not required to be kept in separate bank accounts, Council will use such cash to increase its investments, reduce its borrowings or to defer raising additional borrowings.

As an example, Council will use cash earmarked to be held in a Reserve as part of its overall financing strategies.
Council can use this cash to 'finance' other activities and thereby reduce its borrowing costs (because of the margin between borrowing and investment rates) until they are required for the original purpose. Borrowings would only be raised when additional cash is required.

This does not prevent Council from raising Council rates for the purpose of allocating money to a reserve.

An example of this has been Council raising rates to smooth out the impact of future asset management spending requirements and allocating them to the Renewal and Replacement Reserve.

Whilst the allocation will occur, the Reserve will not necessarily be fully cash backed, as it would be more appropriate to use this cash to fund other expenditure and/or defer borrowings.

Borrowings would then be taken out in the future when the cash is required. It is important to note that whilst not 'cash backed', any reserves will be represented by net assets in the Statement of Financial Position.

4.6 Valuation and Measurement

- The City of Prospect shall comply with the Australian Accounting Standards.
- Investment returns are calculated as gross returns, including interest earned, premiums and discounts.
- Investments will be carried at market valuations.

4.7 Annual Review, Reporting and Financial Ratio Monitoring

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

4.7.2 Annual Report
Each year a report will be prepared by Management that summarises the performance of each investment and borrowing and the performance of the investment portfolio as a whole relative to this policy document.

The report will include:

- for each Council investment and borrowing – the name of the financial institution, the quantum of funds invested, the interest rate, the maturity date and the interest earned or paid;
- the proportion of fixed interest rate and variable interest rate borrowings at the end date of the reporting period along with key reasons for significant variances compared with the targets specified in this policy;
- full details and explanation of any instances of deviation from this policy during the year.

4.7.3 Financial Ratio Monitoring
Finance will monitor the Interest Cover Ratio and Net Financial Liabilities Ratio and report to the Audit Committee as part of the LTFP and budget preparation process.

5 Review

5.1 This Policy will be reviewed once per Council term or as required by legislation.

6 Access to the Policy

The Policy is available for public inspection on Council's website www.prospect.sa.gov.au and from Customer Services at the Civic Centre, 128 Prospect Road, Prospect SA 5082.

7 Further Information

7.1 For further information about this policy please contact:

Director Corporate Services
City of Prospect
128 Prospect SA 5082
t. 8269 5355
e. admin@prospect.sa.gov.au

Appendix 1: Treatment of Reserves

The definitions of the Reserves outlined in 4.5 are set out below. None of these Reserves are cash backed but are represented by net assets in the Statement of Financial Position.

1. Required by Accounting Standards

The Asset Revaluation Reserve is a Reserve that is required by the Australian Accounting Standards. The purpose of this Reserve is to record asset revaluation increments and decrements.

2. Statutory Reserves

Sections 50 and 50(b) of the Development Act 1993 dictates that money received under these sections of the Act needs to be immediately accounted for in a special account established for the purposes of these sections and applied by the Council for the purpose and interest of acquiring or developing land as open space or for the purpose of purchasing land for, or planting, significant trees.

Reserve accounts are established for this purpose but the money is not required to be kept in a separate bank account.

3. Council Discretionary Reserves

3.1 Creating the Reserves

Council has a number of discretionary Reserves to which transfers may be made for specific purposes. Under the guidance of the Treasury Management Policy these Reserves will still have amounts transferred to them, but may not necessarily be cash backed at year end. Following the principles contained within this Policy, excess cash will be used to increase investments or to reduce or defer borrowings. Borrowings will only be taken out when required. This means that money will only be borrowed when there is insufficient cash to cover the expenditure required from those Reserves.

3.2 Using the Reserves

When the decision is made to apply the amounts set aside in the Reserve for a specific purpose, any available cash and investments should be used as the first option. Borrowings should only be used where there is insufficient cash and investments available. This is a cheaper alternative when comparing the net cost of the interest expense associated with borrowing with the investment interest received from any cash backed Reserves.