LIABILITY MANAGEMENT POLICY

1.0 GENERAL POLICY

To provide appropriate parameters in which Council will manage its borrowing activities and external liabilities to ensure compliance with the provisions of the Local Government Act 2002.

Section 102(4)(b) of the Local Government Act 2002 (the "Act") requires the Council to adopt a liability management policy (the "Policy"). Section 104 of the Act outlines the contents of such a policy:

"104: Liability management policy

A policy adopted under section 102(4)(b) must state the local authority's policies in respect of the management of both borrowing and other liabilities, including –

(a) interest rate exposure; and
(b) liquidity; and
(c) credit exposure; and
(d) debt repayment; and
(e) specific borrowing limits; and
(f) the giving of securities."

The Council is required to use the special consultative procedure in adopting its Policy although it may be adopted as part of its Long-term Council Community Plan (LTCCP). Once adopted the Policy can only be changed as an amendment to the LTCCP.

The Policy is to be consistent with the LTCCP and annual plans. It is to achieve the lowest possible net borrowing costs obtainable within the Policy parameters by pro-actively managing funding and interest rate exposures. Benefits from favourable interest rate movements are to be maximised while proactive measures are to be taken to minimise the effect of significant adverse interest rate movements.

2.0 SPECIFIC POLICIES

(a) General borrowing

The Council approves a borrowing programme by resolution during the annual planning process.

The Council's infrastructural and community assets generally have long economic lives and provide long-term benefits for the community. The use of debt is seen as an appropriate and efficient mechanism for promoting intergenerational equity between current and future ratepayers in relation to the Council's assets and investments.

Whakatane District Council will use term borrowing to fund capital works providing assets where:

- The benefits of such expenditure are received over terms greater than one financial year.
- The term of the borrowing is related to the expected economic life of the assets purchased or created (where assets are deemed to have a life in excess of 25 years, the maximum term of borrowing will be 25 years).

The Council raises debt for the following primary purposes:

- General debt to fund the Council's capital works which are primarily infrastructure assets;
- Short term debt to manage timing differences between cash inflows and outflows and to maintain the Council's liquidity;
- Borrowing through hire purchase, credit, deferred payment or lease arrangements in the ordinary course of the Council's business.

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

- The period of indebtedness is less than 91 days (including rollovers); or
- The goods or services are obtained in the ordinary course of operations on normal terms for amounts not exceeding in aggregate, an amount determined by resolution of the Council.

(b) Specific borrowing limits

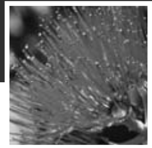
In managing borrowing, the Council adheres to the following limits:

- Net interest expense of all borrowings not to exceed 15% of annual income.
- Net debt as percentage of Annual Income not to exceed 150%.
- Term debt and a liquidity buffer are maintained at an amount of 110% of projected peak net debt levels over the next 12 months.
- Income is defined as earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue.
- Net debt is defined as total external debt less liquid cash or cash equivalents.

(c) Borrowing mechanisms

The Council is able to borrow through a variety of market mechanisms including, issuing fixed or floating wholesale and retail loan stock, commercial paper (CP), or direct bank borrowing. (Refer Appendix I). The Council is also able to internally borrow.






Any borrowing through the retail investor market must have the prior approval of Council.

Alternative funding mechanisms such as leasing are evaluated with financial analysis in conjunction with traditional on-balance sheet funding. The evaluation should take into consideration, ownership, redemption value and effective cost of funds.

The internal debt portfolio is used as an input into determining the Council's external debt requirements. The Council's internal funding mechanisms are discussed in Section (e).
In assessing strategies for new borrowings in relation to source, pricing, size and term, delegated staff take into account the following:

- The impact of new debt on borrowing limits;
- Relevant margins and total cost under each borrowing source;
- The Council's overall debt maturity profile, to avoid concentration of debt at reissue/rollover time;
- Prevailing interest rates relative to term for both stock issuance and bank borrowing and the Council's view of future interest rate movements;
- Available terms from bank and the debt capital markets;
- Legal documentation, financial covenants, security requirements.

The Council is able to use a mixture of short term facilities (which generally have lower credit margins) as well as longer term facilities to achieve an effective borrowing mix, balancing the requirements of liquidity, flexibility and cost.

A borrowing strategy is determined on a six monthly basis which is approved by the Chief Financial Officer.

(d) Liquidity and credit risk management

The Council's ability to readily attract cost effective borrowing is largely driven by its ability to maintain a strong balance sheet as well as its ability to rate, manage its image in the market and its relationship with bankers and brokers.

Where possible the Council seeks a diversified pool of borrowing and ensures that bank borrowings are only sought from approved strongly rated New Zealand registered banks.

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

The Council minimises its liquidity risk by:

- Matching expenditure closely to its revenue streams and managing cash flow timing differences to its favour;
- Maintaining its financial investments in liquid investments;
- Ensuring where debt redemption reserves are maintained to repay borrowing, that these investments are held for maturities not exceeding the borrowing repayment date (see Section (h) of this Policy);
- Avoiding concentration of debt maturity dates (refer below). So funds are available when needed.

There is sufficient available operating cash flow and committed bank facilities to meet cash flow requirements between rates instalments as determined by the Finance Department.

The liquidity buffer is maintained from either available committed bank facilities and/or liquid negotiable financial investments. Investments have a maturity of no more than 3 months.

To minimise the risk of large concentrations of debt maturing or being reissued in periods where credit margins are high for reasons within or beyond the Council's control, delegated staff ensure debt maturities are generally spread widely over a band of maturities. Specifically, total committed funding in respect to all loans and committed facilities is controlled by the following system:

PERIOD	MINIMUM	MAXIMUM
0 to 3 years	20%	60%
3 to 5 years	20%	60%
5 years plus	0%	60%

Committed bank facilities are to have a maturity of no more than 3 years.

A maturity schedule outside these limits requires specific Council approval.

The Chief Executive has the discretionary authority to re-finance, rollover and re-negotiate existing debt on more favourable terms. Such action is reported to the Council at the earliest opportunity.

(e) Internal borrowing

The Council uses its reserves to internally fund new capital projects. The finance department is responsible for administering the Council's internal loan portfolio. Loans are set up within the portfolio based on planned loan funded capital projects as approved by the Council resolution as part of the Annual Plan and the LTCCP.

The primary objective in funding internally is to use reserves and external borrowing effectively, by establishing a portfolio that provides funding to internal activity centres. This creates operational efficiencies through not paying fees/margins and other costs associated with raising funds from financial institutions.




In addition to external borrowing the following specific reserves are used for internal borrowing purposes:

- Special Fund Reserves
- Harbour Property Fund
- Debt Redemption Reserves
- Rate Account surpluses.

(f) Interest rate risk management

The borrowing programme exposes the Council to interest rate movements. Interest rate risk refers to the impact that movements in interest rates can have on the Council's cash flows, Annual Plan and LTCCP forecasts.

Generally, given the long-term nature of the Council's assets, intergenerational factors and the desire to avoid an adverse impact on rates, the approach is to have a percentage of debt at a fixed interest rate.

The primary objective of interest rate risk management is to reduce uncertainty due to interest rate movements through fixing of funding costs. Both objectives are to be achieved through the active management of underlying interest rate exposures.

The Council debt/borrowings should be within the following fixed/floating interest rate risk control limit:

RISK CONTROL LIMIT	
MASTER FIXED/FLOATING	
Minimum Fixed Rate	Maximum Fixed Rate
55%	95%

"Fixed Rate" is defined as an interest rate repricing date beyond 12 months forward on a continuous rolling basis.

"Floating Rate" is defined as an interest rate repricing within 12 months.

The percentages are calculated on the rolling 12 month projected net debt level.

Net debt is the amount of total debt less liquid cash or cash equivalents. This allows for prefixing in advance of projected physical draw downs of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to comply with the policy minimums and maximums.

The fixed rate amount at any point in time must be within the following maturity bands:

FIXED RATE MATURITY PROFILE LIMIT		
PERIOD	MINIMUM COVER	MAXIMUM COVER
1 to 3 years	20%	60%
3 to 5 years	20%	60%
5 to 10 years	10%	60%

The implementation of the fixed rate framework assumes dealing lines are available from the Council's dealing bank(s).

Any swap beyond 10 years requires approval from the Council.

(g) Security

The Council generally does not offer assets other than a charge over rates or rates revenue as security for general borrowing programmes and interest rate risk management instruments. Security is offered through the Charge Document over the Council's rates. Internal loans are provided on an unsecured basis.

From time to time, with prior Council approval, security may be offered by providing a charge over one or more of the Council's specific assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds (e.g. an operating lease, or project finance);
- The Council considers a charge over physical assets to be appropriate.

(h) Debt repayment

The Council repays borrowing from general funds, specific debt redemption reserves and renewal loans allocated to that borrowing. The Council ensures that sufficient funds are available for repayment of debt and other obligations at the time of maturity.

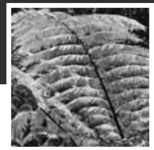
Where a loan is raised for a specific purpose and the funds are no longer required, the funds may be held in a special fund until the funds can be applied against a future borrowing.

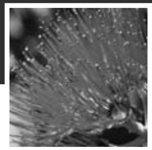
(i) Contingent liabilities

The Council, from time to time, provides financial guarantees to local organisations, groups or bodies for recreational and community purposes.

In determining whether a guarantee is to be approved, the Council considers the social benefits provided to the community and the following:

- The potential for loss of capital;
- Where the Council assumes the asset in the case of default, the ongoing operating costs or completion costs of the asset;
- The nature of the organisation including its management, financial stability, cash flow forecasts and membership.
- The total value of guarantees at any one time will not exceed 3% of the total annual rates, levied during that year.






Total loan guarantees held at any time shall be taken into account when calculating the Council's maximum borrowing limit.

As a condition of the guarantee, the guarantor's annual financial statements are to be promptly given to Council. Should the guarantee be called upon, the Council will take immediate steps to recover the money.

(j) Foreign exchange

The Council's policy is to identify, define, recognise and record these risks by their respective types or category and then to manage each risk under predetermined and separately defined policies/risk control limits for each risk category.

It is prudent practice to pre-hedge potential adverse foreign exchange rate movements on capital imports from the time the Capex budget is approved by the Council. There is a risk that the net NZD cost could increase substantially from Capex budget time to the actual placement of the purchase order. It would be expected that the payment currency and payments schedule are known at the time of the purchase order and sale/purchases contract signed with the equipment supplier.

Capital and Operational Expenditure: Imported Items/ services.

The Council is exposed to foreign exchange risk on imported capital expenditure and operational expensed items/ services:-

- **Contingent risk:** this applies from the time the annual capital expenditure (Capex) and operational expenditure (Opex) budget is approved to the time specific Capex and Opex items are approved during the course of the year. This also includes the time from specific approvals to the time contracts are finalised.
- **Full risk**: at the time the expenditure is approved and legal commitments are made

Foreign Exchange Risk Control Limits

Capital and Operational Expenditure: Imported items/services – All individual items/ services greater than NZD100,000 must be hedged at all times in accordance with the following risk control limits:-

CAPITAL AND OPERATIONAL EXPENDITURE – FOREIGN EXCHANGE RISK CONTROL LIMITS		
TIME – POINT	EXPOSURE COVERED BY FORWARD EXCHANGE CONTRACTS/COLLARS	EXPOSURE COVERED BY PURCHASED FOREIGN EXCHANGE OPTIONS
1. Budget approved by Council – (Medium Probability)		Up to a maximum 50%
2. Specific item approved – (High probability)		Up to a maximum 100%
3. Contract confirmed – (Undoubted Risk)	Minimum 100%	

The use of foreign exchange risk management instruments are approved by the Council.

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

APPENDIX I - APPROVED BORROWING MECHANISMS

1.0 Bank Borrowing

1.1 Overdraft

Overdraft facilities are calculated on a simple interest basis with interest calculated daily and paid in arrears. Overdraft facilities are usually for a term of up to one year and are priced off the bank's indicator rate. Most organisations use these facilities to borrow on an overnight basis.

The lending bank sets the indicator rate (which includes a liquidity and credit margin) at the time of negotiating the facility along with a line fee (expressed in basis points or percentage points per annum). This rate is usually set for the term of the facility.

1.2 Committed and uncommitted bank facilities

Committed bank facilities are calculated on a simple interest basis with interest paid in arrears (at the end of the borrowing period). Committed bank facilities are usually for a term of up to three years but may be for as long as five years. Most facilities allow for the borrower to draw up to the facility limit in various short term, 90 day tranches.

The lending bank sets the bank bill bid market settlement (BKBM Bid) rate at the time of lending along with the line fee (expressed in basis points or percentage per annum) and credit margin. This rate generally re-prices on a 90 day basis.

2.0 Local Authority Stock/Bonds

Local authority stock is registered and issued via tender or private placement to a range of investors. It can be issued into the wholesale or retail investor market. Stock is usually issued for maturities ranging from 90 days (CP) one to ten years (stock). Normally a fixed coupon payment, determined at the outset, is made semi annually to the holder of the security. A 90 day floating interest rate may also be determined. The stock is registered with the Council appointed registrar. The paper can be unrated or credit rated by a rating agency like Standard & Poors.

Private placement generally provides better rates for the Council as the relationship bank approaches their investor base for interest and both the Council and the investor are assured of anonymity. The relationship bank completes the documentation required. With a tender situation the issuing Council must provide an invitation to tender, an information memorandum, bid forms and a covering letter to all participants. The tender is widely advertised and market bids are obtained.

APPENDIX II - APPROVED INTEREST AND FOREIGN EXCHANGE RATE RISK MANAGEMENT INSTRUMENTS

I) Interest Rate Risk Management Instruments

The use of interest rate risk management instruments is approved by Council as part of this policy.

Interest rate risk management instruments approved for use, consistent with the policy contained in Section (f) are:

- Fixing through physical borrowing instruments – e.g. loan stock, debentures, bank term loan.
- Floating rate bank debt may be spread over any maturity out to 12 months. Bank advances may be for a maximum term of 12 months.
- Forward Rate Agreements (FRA) on bank bills and government bonds.
- Interest rate swaps including:
- Forward start swaps (start date less than 24 months);
- Amortising and accreting swaps;
- Swap extensions and shortenings.
- Purchase of interest rate options products on:
    - Bank bills (purchased caps and one for one collars)
    - Government bonds.
    - Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00% above the appropriate swap rate, cannot be

counted as part of the fixed rate cover percentage calculation.

- ◦ Interest rate collar type option strategies. However, 1:1 collar option structures are allowable whereby the sold option is matched precisely by amount and maturity to the simultaneously purchased option. During the term of the option, only the sold side of the collar can be closed out in isolation (i.e. repurchased) otherwise both sides must be closed out simultaneously. The sold option leg of the collar structure must not have a strike rate “in-the-money”

- The forward start date of the collar strategy is to be no more than 24 months, and the underlying cap, swap commences within this period.
- Purchased borrower swaptions only that mature within 18 months.

Additions to and deletions from this list are recommended by the Chief Financial Officer and approved by the Council.

A glossary of terms for interest rate risk management mechanisms are set out in Appendix III.

Any other financial instrument must be specifically approved by Council on a case-by-case basis and only be applied to the one singular transaction being approved. Credit exposure on these financial instruments is restricted by specified counter party credit limits (refer Investment Policy).

The following interest rate risk management instruments are NOT permitted for use:

- Interest rate options must not be sold outright. Selling interest rate options for the primary purpose of generating premium income is not permitted because of its speculative nature.
- Structured interest rate option strategies where there is any possibility of Council’s total interest expense increasing in a declining interest rate market or where Council’s total interest cost is increasing faster than the general market rate.
- Interest rate futures contracts, mainly for administrative ease.
- Interest rate risk management instruments in foreign currency (see s113 of the Act).

Foreign Exchange Rate Risk Management Instruments

The use of foreign exchange rate risk management instruments is approved by the Council as part of this policy.

Foreign exchange rate risk management instruments approved for use, consistent with the policy contained in Section (j) are:

- Foreign currency deposits
- Purchased currency options
- Forward foreign exchange contracts
- One for one collars
- Financial instruments other than those stipulated in Appendix II above require one-off Council approval prior to transacting.
- Foreign exchange options cannot be sold outright.
- The purchase price paid for an option (premium) is to be amortised (spread) over the period of cover and added to the actual average exchange rate achieved by Council.
- It is important that all significant tenders allow bidders the opportunity to select desired currencies and where possible allow for suppliers to transparently link price escalations to clear financial market references.