Meeting of the Corporate and Strategic Committee

Date: Wednesday 13 June 2018

Time: 9.00am

Venue: Council Chamber
Hawke's Bay Regional Council
159 Dalton Street
NAPIER

Attachments Under Separate Cover

Crowe Horwath.
PART OF FINDEX

Item 6

Attachment 1

Hawke's Bay Regional Council

Internal Audit: Procurement & Contract Management Review

Audit Report
May 2018

Confidential
Prepared for: Melissa des Landes, Management Accountant

Prepared by: Phil Sinclair, Senior Partner – Audit & Assurance
Martyn Solomon, Associate Partner – Audit & Assurance

Audit | Tax | Advisory

Crowe Horwath.
PART OF FINDEX

Contents

Crowe Horwath.
PART OF FINDEX

1. Executive Summary

1.1 Objective and Scope

The objective of this review was to assess the Hawke's Bay Regional Council's ("the Council" or "HBRC") existing procurement procedures and strategies and to identify areas for improvement. The scope was extended to include a review of the adequacy of the policies, procedures and controls in place over contract management. In addition, we have provided a separate memorandum highlighting the implications, practicalities and challenges of implementing living wage conditions in Council's agreements with its contractors.

The review was conducted primarily by applying discussion, observation and review techniques with limited detailed testing being undertaken.

The detailed scope is included in Appendix 3.

1.2 Findings

Effective procurement and contract management activities support the HBRC strategy of receiving value for money over the life of the goods or service. The Office of the Auditor General ("the OAG") provides guidance on the policies and procedures that Council's should have in place for effective procurement and contract management. We identified a number of findings and recommendations to highlight where the Council can improve its practices.

Overall, we noted procurement policies were fit for purpose, however cases were identified where those policies had not been fully implemented or followed across the Council. We also noted that there were no contract management policies in place. In order to achieve consistent and effective procurement and contract management practices we have made the following recommendations:

- Procurement and contract management is currently de-centralised at HBRC. There is no centralised support or resource that provides guidance to staff on the procurement and contract management processes. The Council would potentially benefit from a dedicated procurement and contract management resource. This could be a full time, part time or outsourced position. In addition, a suite of policies and procedures should be developed that guides staff on the contract management process. Tools and templates would help significantly.

  The Council has recognised that there is currently a gap in this area and is considering the appropriateness of a dedicated procurement and contract management resource.
- There is a lack of management oversight on both procurement and contract management activities, with contract management planning, monitoring and reporting processes requiring improvement.
- There is a lack of contract management systems. We had difficulty locating supporting documentation when requested. There is a document management system where contracts are recorded, however this is not complete or accurate. HBRC should implement a contract management system that stores contracts centrally and has a contract register that stores key information.
- We reviewed the supplier set up processes to ensure robust controls are in place to prevent and detect fraud. We did not identify any significant issues but have identified some areas for improvement.

Crowe Horwath.
PART OF FINDEX

A summary of the risks identified for the three main areas of review and severity rating is included below. Refer to Appendix 1 for risk definitions. We remind Council that risk ratings need to be considered in the context of the engagement under review. Risk ratings are the impact the control weakness has on the ability of the process to achieve its objectives. Management will need to determine the action of recommendations in-light of their own risk assessments and priorities with other Council reports.

Area Audited	Findings summary		
	High	Moderate	Low
Procurement	2	6	2
Purchasing	0	3	3
Contract Management	3	4	0

The table below provides a high-level summary of the recommendation relating to the observation that we consider to be high risk. We have provided, in sections 2 to 4, more detailed findings and practical recommendations for improvement across the identified areas.

Attribute	Recommendation
Lack of evidence to support procurement decisions (see finding 3 on page 8)	▪ The Council had difficulty supplying documentation to support procurement decisions. The information was often not stored on the contract management system or able to be provided by staff. ▪ The Council should ensure all requirements of the HBRC Procurement Policy and HBRC Procurement Manual are considered in procurement planning. A template procurement plan will assist this. ▪ In addition, a procurement checklist should be implemented and include the key elements of the HBRC Procurement Policy and HBRC Procurement Manual. This should be signed as completed by the employee approving the procurement and stored on the contract management system.
Lack of tools and templates to assist employees in the procurement process (see finding 6 on page 11)	▪ Procurement at HBRC is the responsibility of departments, with limited support provided centrally. There is a lack of tools and templates to assist employees in the procurement process. In a de-centralised environment we would expect a suite of tools and templates such as procurement plans, tender documents and checklists to guide employees. The use of templates would ensure key requirements of the HBRC Procurement Policy and HBRC Procurement Manual were followed. ▪ HBRC should implement tools and templates to assist employees in the procurement process. This will ensure the relevant policies and procedures are followed. The tools and templates should be developed or reviewed by procurement and or legal professionals.

Crowe Horwath
PART OF FINDEX

Attribute	Recommendation
Lack of contract management policies and procedures (see finding 17 on page 22)	▪ Council wide contract management policies and procedures should be developed. The policies should include the headings identified in the adjacent findings. The Office of the Auditor General ("OAG") Procurement Guide 2008 provides guidance on the policies and procedures expected of public entities to manage contracts.
Contract register is incomplete and inaccurate (see finding 19 on page 24)	▪ Contract management systems can range in complexity from manual systems to integrated software solutions. The Council should: - review Contract Central to ensure the system can meet Council's requirements; - review the contract register and achieve expired contracts. This may include a post contract evaluation; - add additional fields as identified in the detailed finding below; and - current contract information should be updated to reflect the requirements. ▪ The above process should be based on the level of contract risk/value.
Lack of contract management plans (see finding 20 on page 26)	▪ The Council should develop contract management templates. In addition, the Council should require all contracts that meet certain defined risk thresholds to prepare a contract management plan. ▪ The contract management plan should be consistent with your contract management policies and procedures and provide the key information that will be recorded on the contract register. ▪ Details of the expected contents of a contract management plan are provided in the detailed finding below.

1.3 Basis and Use of this Report

This report has been prepared in accordance with our Scoping Document dated 25 February 2018 (Procurement and Purchasing) and 3 April 2018 (Contract Management) and subject to the limitations set out in Appendix 4 - Basis and Use of the Report. The report is written on an exceptions basis and therefore only areas requiring management consideration and action are included in this report.

We have separated our findings into four sections:

- Procurement;
- Purchasing;
- Contract Management.

Crowe Horwath.
PART OF FINDEX

2. Findings and Recommendations: Procurement

1. No centralised function to provide support and assistance		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Procurement is de-centralised at HBRC. There is no centralised resource that provides guidance to staff on the procurement process. There is an HBRC Procurement Policy ("the Policy") and HBRC Procurement Manual ("the Manual") that employees are required to follow. It is the responsibility of the respective departments to manage the procurement process from tendering through to project completion (contract management). Financial delegations were the key reference point for staff when they required support or approval in the procurement process. However, from our discussions with Management, there were varying levels of understanding on their procurement roles and responsibilities. The Council has recognised that there is currently a gap in this area and is considering the appropriateness of a dedicated procurement and contract management resource. **Risk** There is a risk that staff do not have the required skills, experience or knowledge to run an effective procurement process. This may result in the Council losing its ability to gain procurement efficiencies. In addition, this may lead to legal challenge if the correct legal process has not been followed (see finding 3 below for an example).	HBRC should review its current procurement structure and consider the benefits of a centralised specialist or dedicated resource. This may be a full time or part time position. If responsibility continues to rest with departments, these employees need training relevant to their position. This will ensure they have the required procurement competency to run an effective procurement process and a knowledge of the key requirements of the Policy and the Manual.	HBRC plans to review the options of having a centre of excellence for procurement. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Review will be initiated in current financial year.

The relationship you can count on

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

2. Lack of Management oversight		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
In a de-centralised environment, Management require oversight within their departments and across the business. We interviewed three Executive Team Members, who had varying degrees of knowledge on the number of contracts within in their departments. There was also varying degrees of understanding of procurements happening within other departments. In addition, there is limited procurement reporting to the Executive Team and the Council. We understand that reporting is on an exception basis. As a result, this reduces Managements oversight on procurement activities. Procurement reporting would provide an overview of large value, high risk or complex procurements. It would also provide valuable insights into the activities of other departments. **Risk** There is a risk that significant procurements are being made with limited oversight from a Council wide perspective. There is may lead to examples where procurement efficiencies have not been gained. For example, where different business units have been procuring from the same supplier without the other business units knowledge or departments using multiple suppliers for the same goods and services.. With the combined purchasing power this could have led to cost savings.	Regular procurement reporting should be provided to the Executive Team. This should include large value, high risk or complex procurements. In addition, any upcoming significant tenders should be outlined.	It is proposed that procurement will become a monthly agenda item at weekly executive meetings, plus any large procurements will be discussed on an ad hoc basis. **Responsible Person** Executive **Date of Implementation** Q1 2018/2019

Crowe Horwath.
PART OF FINDEX

3. Lack of evidence to support procurement decisions		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
The Council had difficulty supplying documentation to support procurement decisions. The information was often not stored on the contract management system or able to be provided by staff. Section 4.4 of the Manual "Deviations from Competitive Process" states that where there have been deviations from a competitive process that this is appropriately documented. We tested two procurements that deviated from a competitive process and one did not have sufficient documentation. We have explained Deviations from Competitive Process further in finding 4 below. Section 7.1 of the Policy "Buying Local" supports purchasing from local suppliers. Our testing identified two examples where local suppliers were not used. Only one had sufficient documentation showing why a local supplier was not used. Section 7.3 of the Policy "Sustainability" states that HBRC is committed to purchasing goods, works and services that are environmentally sustainable. We could not see any evidence of how sustainability was considered in the selection of suppliers. It is important to note that in three out of seven procurements reviewed we were unable to confirm any of the above as sufficient documentation could not be provided. Risk When rationale for decisions are not documented and stored appropriately, the Council may not be able to support a decision if challenged. This may lead to legal or reputational damage.	The Council should ensure all requirements of the Policy and Manual are considered in procurement planning. As recommended in finding 6 a template procurement plan will assist this. In addition, a procurement checklist should be implemented and include the key elements of the Policy and Manual. This should be signed as completed by the employee approving the procurement and stored on the contract management system.	Council will implement a template that will be checklist based with room for storing back up documentation for decision making. These will then be stored in contract management system/database. Policy to include a section on buying local and sustainability to be considered in procurement decision making. If neither are to be factored in to decision making for procurements over $10,000 backing documentation has to be provided. Council is aware of inconsistencies with usage of contract management system and is working on verifying a solution to this. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Review will be initiated in current financial year.

The relationship you can count on

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

4. Deviations from competitive process lacks important information		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Section 4.4 of the Procurement Manual "Deviations from Competitive Process" outlines the type of situations where direct procurement purchasing may be considered. Section 4.7 of the OAG good practice states that a public entity should also have procedures in place to ensure that: ▪ the rates are reasonable and consistent with the market rates for items of a similar nature; ▪ it does regular reviews to ensure the reasonableness of prices, including randomly inviting quotations at appropriate time intervals; ▪ the required goods or services are not split into components or a succession of orders to enable orders to be placed without seeking competitive prices; and ▪ fairness and equity are assured This information is not included in the Manual. As described in finding 3 We tested two procurements that deviated from a competitive process and one did not have sufficient documentation. **Risk** When rationale for decisions are not documented and stored appropriately, the Council may not be able to support a decision if challenged. This may lead to legal or reputational damage.	The information identified in the adjacent finding is included in the Manual. Where a direct procurement is used, the Manual must be followed and all requirements documented in the procurement plan and stored on the contract management system. Direct procurements are often areas where Councils can be challenged by rate payers or suppliers. This highlights the importance of having a robust procurement process which clearly outlines the rationale for deviating from a competitive process.	Council is currently reviewing its procurement policy and will incorporate s4.7 of OAG good practice into the revised policy. Documentation is to be collated and stored in line with contract management review findings. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Review will be initiated in current financial year.

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

5. Lack of procurement training		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
We understand procurement training had been provided to staff in 2017, however this was not compulsory. With a decentralised approach, this leads to the risk that staff undertaking procurement activity may not have the appropriate knowledge, skills and experience. The OAG good practice guide is clear that *"a public entity should ensure that each employee or agent involved in a procurement process has the required skills for the type and level of procurement"* Section 3 of the Procurement Policy *"Procurement Capability and Oversight" states that "HBRC will assign appropriately experienced employees to manage its procurement activities. HBRC will provide training and supervision to employees to support good practice in procurement and purchasing activities. Where required for specific procurement activities, additional specialist expertise may also be employed by HBRC."* From the interviews held, it is evident that there may be gaps in employee's procurement knowledge, skills and experience and that further training may be required. **Risk** As the finding shows there may be gaps in employee's procurement skills and experience. This may lead to poor procurement outcomes for the Council.	Management should receive training to ensure they have the appropriate skills for the role. Training should be provided where any gaps are identified. This recommendation is relevant for all staff involved in procurement. In addition, an overview of the Policy and Manual should be included in staff induction. The recommendation is also applicable to contract management.	Procurement policy and manual is to be included in staff induction for those employees that are likely to have procurement activities in their roles. **Responsible Person** HR Manager/HR Advisor **Date of Implementation** Within current calendar year.

The relationship you can count on

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

6. Lack of tools and templates to assist employees in the procurement process		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
As explained in finding 1 above, procurement is the responsibility of departments, with limited support provided centrally. There is a lack of tools and templates to assist employees in the procurement process. In a de-centralised environment we would expect a suite of tools and templates such as procurement plans, tender documents and checklists to guide employees. The use of templates would ensure key requirements of the Policy and Manual were followed. As part of our testing we reviewed six procurements that required a detailed procurement plan (as per Section 3.2 of the Procurement Manual). Two out of six had sufficient procurement plans. The Council were unable to provide plans for the remaining four. Section 3.4 of the Procurement Manual has clear guidance on the information required for a detailed procurement plan. This could be developed into a template to guide staff. We see the use of templates and tools as important where there is no centralised function to provide support. **Risk** As the finding shows, there is a risk that the Policy will not be followed. This may result in the Council losing its ability to gain efficiencies in the procurement process.	HBRC should implement tools and templates to assist employees in the procurement process. This will ensure the relevant policies and procedures are followed. The tools and templates should be developed or reviewed by procurement and or legal professionals.	Council is currently creating a procurement plan that is to be followed for all future procurements. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Plans and templates to be developed by end of calendar year.

The relationship you can count on

Crowe Horwath. PART OF FINDEX

7. Lack of procurement strategy		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
The Council's procurement strategy is included in Section 4 "Procurement Strategy" of the Manual and states that *"the procurement strategy should be about achieving the best value outcome for the client"*. While the best value outcome for the client is important for local authorities, the primary objective should be the best value outcome for the Council. Section 3 of the OAG good practice guide states that "*the Council should have a knowledge of the type, value and risk associated with the goods or services it procures. Regardless of the size and function a public entity should know:* ▪ *what goods and services it procures;* ▪ *how much it spends by category type and on individual procurements;* ▪ *its main suppliers and the volume and value of the procurements; and* ▪ *the main markets it procures in".* Furthermore, the public entity should include guidance in its policies and procedures on how it will develop and implement its procurement strategy. The guidance should cover: ▪ who will have overall responsibility for procurement planning; ▪ who will be involved in the planning process and when they will be involved; and ▪ how the procurement strategy will be linked with the Councils broader strategic planning processes. This information is not included in the Policy or Manual. **Risk** If the procurement strategy is not clearly identified, the policies and procedures may not provide the best approach to meeting Council's intended strategy.	The Council should develop a procurement strategy that includes the key information included within the finding. This could be a separate strategy or included with the current procurement policies and procedures.	All procurements over $10,000 are to include assessment of s3 of OAG good practice guide. Documentation of strategy to be included in procurement planning documents. Narrative of s4 of internal policy to be reconsidered. **Responsible Person** Group Manager Corporate Services **Date of Implementation** To be included as part of internal procurement update

8. No formal process to declare conflicts of interest in the procurement planning phase		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Section 6.2 of the Policy "Conflicts of Interest" refers the reader to Council's Conflict of Interest Policy. The Conflict of Interest Policy places responsibility on employees to disclose all actual, potential or perceived conflicts of interest. The Conflict of Interest Policy or the Policy does not specifically address conflicts of interest in the procurement process. None of the procurements reviewed had specifically declared that there were no conflicts of interest. We noted one contractor who was a past employee. Our observations across the local government sector is that past employees who contract to Councils can create a perceived conflict of interest. In these cases, it is important that a robust procurement process has taken place and that conflicts of interest are declared. **Risk** There is a risk that a conflict of interest is not disclosed. This could lead to reputational or legal damages.	Section 3.2 of the Procurement Manual sets out that all procurements over $10,000 require a procurement plan. Within the procurement plan a section should be included where all employees involved in the procurement process declare conflicts of interest.	Conflict of interest will be incorporated into procurement template. Any conflicts required to be disclosed, along with steps taken to assess level of conflict and any actions required. This is to be signed off and filed with remainder of procurement documentation. **Responsible Person** Group Manager Corporate Services **Date of Implementation** To be included as part of internal procurement update.

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

9. Lack of clarity for when to engage legal advice		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
The Manual states that *"for major procurements, professional and/or legal advice should be sought before proposal or tender documents are issued to the market."* This does not provide clear guidance on when legal advice should be sought. Section 3.42 of the OAG good practice guide states that *"the guidance should also set out the circumstances when the public entity should seek legal advice or assistance in preparing the contract. Legal advice will often be required in a procurement process, particularly for high risk, complex, or strategic procurements. The public entity should consider this advice early in the planning stage, since it may need to develop specific documentation, including a draft contract, to accompany the procurement documents."* **Risk** Staff may be unsure of when to use legal advice. This may lead to legal challenge.	When to seek legal advice should be specifically stated within the Manual. This should include the type of major or complex procurements where legal advice should normally be sought. We would expect a brief explanation in the procurement plan on why legal advice was not used in major or complex procurements, especially when a non-standard contract was used. This is particularly important given the decentralised nature of procurement and lack of custom built and designed procurement plans and tender documents.	Requirement to use legal advice to be written in to revised procurement manual along with any exceptions for deviation. In either case, documentation is required to be attached as evidence. In addition, HBRC will perform a review of a legal supplier to provide advice in this area. **Responsible Person** Group Manager Corporate Services **Date of Implementation** To be included as part of internal procurement update.

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

10. Opportunities for improvement in the Procurement Policy		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**

The Procurement Policy was adopted in 2015. The policy was based on the OAG best practice guide and included legal input into its development. We performed a review against the OAG best practice guide and did not identify any significant issues. We have identified opportunities for improvement which have been included in the recommendations.	▪ The Policy should be made publicly available. Publishing an unambiguous procurement policy and following that policy reduces the risk of challenges to the decision-making process and may reduce the cost of procuring. It also helps retain credibility with suppliers. Clear processes can help ensure that the procurement policy is consistently followed.
	▪ Organisational policies and procedures are more effective when they are up to date and easily available to all staff who need to access them. For these reasons, the Councils procurement policies and procedures should include:
	  ▪ a process for regularly reviewing the policies and procedures, and assigning responsibility for updating them;
	  ▪ version control to identify the most recent version;
	  ▪ a process for educating staff, including any agent that the Council uses to procure on its behalf, about the policies and procedures; and
	  ▪ the need to retain a copy of updated policies and procedures so that a copy of the policies and procedures that applied at the time of the procurement is available if the procurement is subsequently challenged.
		Once Council has completed its policy review, this will be published on its website.
		
		This policy will now form part of the induction process for all staff likely to be involved in procurement decisions.
		
		Responsible Person
		Group Manager Corporate Services
		
		Date of Implementation
		After internal procurement update completed and resolution passed.

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

3. Findings and Recommendations: Purchasing

11. Segregation of duties risk		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
HBRC performs a monthly review of the supplier master-file change report. The purpose of the review is to ensure changes are bona-fide and supported by appropriate documentation. The master-file review is completed by the Team Leader Finance who can also make changes (such as bank accounts). This creates a segregation of duties risk as the Team Leader Finance could review her own changes. **Risk** There is a risk that the Team Leader Finance could change a supplier's bank account to her own and a payment made.	Good practice would be for the employee reviewing the supplier master-file change report to have no change access to the supplier master-file. This is not always practical in smaller organisations where employees are required to perform multiple roles within a process. We understand that the Team Leader Finance is the back-up if the Accounts Payable Officer is not available. In this instance, we recommend that a senior finance member reviews the master-file change report for any changes made by the Team Leader Finance.	Master File also to be signed off by qualified accountant such as management accountant or corporate accountant. **Responsible Person** Qualified accountant who does not have access to alter master file. **Date of Implementation** Immediately

The relationship you can count on

16

Crowe Horwath.
PART OF FINDEX

12. Flexi purchase card use policy not being followed		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
The Council has recently implemented a purchase card programme. In August 2017, a 'flexi purchase card policy' was adopted that sets out the requirements for use. We reviewed a sample of eight transactions and identified two examples where the policy was not being followed. ▪ $1,100 purchase of vouchers for 11 staff ($100 each). Section 3.5 of the policy states that *"flexi purchase cards must not be used for purchase of vouchers"*; and ▪ $659 was spent on accommodation. Section 3.7 of the policy states that *"flexi purchase cards must not be used for the bookings of flights or accommodation; these must be booked through HBRC reception.*	HBRC purchase card holders are reminded of the key requirements of the policy. It should be ensured that robust monitoring and approval processes are in place for purchase card expenditures to ensure non-compliance is identified and actioned.	It is noted that Flexi Purchase Cards were introduced initially as a trial run. Those who have breached the policy have been spoken to and a reminder email has been sent out to all staff to reinforce the policy. Monthly checks of Flexi Card transactions will also be conducted to ensure compliance with policy. **Responsible Person** Team Leader Finance **Date of Implementation** Immediately.

The relationship you can count on

17

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

13. Emergency policy overly prescriptive		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
The Policy defines an emergency procurement as *"defined under the Civil Defence Emergency Management Act 2002, as amended or superseded by other legislation. In an emergency, departures from normal procurement and payment process will be acceptable if it is necessary in order for HBRC and the Hawke's Bay CDEM Group to respond the emergency effectively".* The Policy then sets out the line and level of authority and control. The Policy is quite prescriptive in terms of its definition. The definition would not technically cover the Havelock North Drinking Water Enquiry as an example. In addition, the Policy does not provide guidance on the quality assurance and review process. **Risk** There is a risk that urgent procurements are not covered by the emergency policy and restrict the Councils ability to respond to urgent events.	HBRC should consider broadening its emergency policy to address urgent procurement. Relevant criteria may include when: ▪ life, property, or equipment is immediately at risk; or ▪ standards of public health, welfare, or safety need to be re-established without delay, such as disaster relief. The guidance should also set out what quality assurance and self-review needs to be put in place. Points to cover could include: ▪ were the staff used in the procurement process appropriately qualified and trained? ▪ were the prescribed criteria and procedures followed? ▪ was the outcome satisfactory, and what lessons can be learned? ▪ did the public entity's management systems identify procurement requirements in a timely way?	Council will review its current definition and amend in its revised procurement policy. Council will incorporate the prescribed guidance into the review. **Responsible Person** Group Manager Corporate Services **Date of Implementation** To be completed as part of internal procurement policy update.

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

14. Bank account verification processes could be improved		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Bank verification checks over the set-up of new suppliers are a key control to prevent fraud. To confirm bank accounts are bona-fide, an e-mail from the supplier or the bank account identified on the supplier's invoice are considered sufficient. This is no longer considered best practice. We are aware of recent frauds where e-mails have been 'spoofed' so the message appears to have come from a supplier. In addition, we are aware of cases where cyber-criminals have hacked into the supplier's creditors listing, sent a fake invoice (that appears the same as the suppliers) and changed the bank account to their own on the invoice. There are no additional checks to confirm the supplier's details such as calling the supplier to confirm the change. **Risk** There is an increased risk of fraud if bank accounts are accepted in e-mails or taken from invoices.	We have the following recommendations: ▪ verified bank documentation should be the only acceptable supporting documentation; ▪ council staff should phone the new supplier to confirm the bank account details. The phone number should be sourced from the yellow pages, website or an independent source; and ▪ the employee engaging the new supplier should declare that they do not have a conflict of interest with the supplier. We have seen good examples at other Councils where a 'new supplier form' is used to record basic supplier details, including the employee declaring no actual, potential or perceived conflict of interest with the supplier.	For every change in bank account details, bank account details will now no longer suffice. Accounts Payable will request bank deposit slip or call supplier. **Responsible Person** Accounts Payable Officer **Date of Implementation** Immediately

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

15. Lack of awareness of fraud related schemes		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
As explained in finding 14 above, cyber-criminals are becoming increasingly sophisticated. Accounts Payable staff were not aware of these fraud schemes. In addition, we understand that regular fraud training is not provided. **Risk** There is a risk that staff will inadvertently make payments to cyber-criminals.	Regular training should be provided to finance staff and departmental managers responsible for approving expenditure on the latest trends in fraud and cyber-crime. This could be run by senior finance staff.	Council will review its training in this area and will ensure relevant staff are given awareness of cyber crime developments. Council will also request that IT develop a real life test to create awareness of sample emails sent by cyber criminals. **Responsible Person** Group Manager Corporate Services **Date of Implementation** End of calendar year

16. User access levels unable to be identified		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
HBRC was unable to provide a report from the NAV system which identifies the user access levels of employees. For example, the Council was unable to identify which employees can make changes to the supplier master-file. **Risk** There is a risk that employee have inappropriate access and could be creating false suppliers that would not be identified.	HBRC works with the software company to provide a report that outlines the users and their ability to make changes. The Council should then review the report on scheduled periodic basis to ensure all user access levels are appropriate.	Staff have since created a report internally which identifies access levels of various NAV functionalities including change rights versus read only. **Responsible Person** Team Leader Finance **Date of Implementation** Completed

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

4. Findings and Recommendations: Contract Management

17. Lack of contract management policies and procedures		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
There are no Council wide contract management policies and procedures. Within the Policy and the Manual, there are record keeping requirements that require contracts to be set up under Contract Central in HerBi. The Resource Management Group have created procedures for preparing contracts, preparing open tender and closed tender contracts, and contract forms and types. Important aspects of leading practice contract management policies are missing: ▪ Contract management plans (see finding 20); ▪ Roles and responsibilities; ▪ Risk management (see finding 22); ▪ Managing supplier performance; ▪ Monitoring supplier performance; ▪ Reporting requirements; ▪ Contract administration; ▪ Record keeping; ▪ Managing relationships; ▪ Use of external/legal advice; ▪ Managing contract disputes; ▪ Contract variations; and ▪ Contract evaluation (see finding 21). **Risk** A lack of policy and procedure may lead to inconsistency in contract management activities. This can reduce the level of oversight and monitoring abilities of the Council.	Council wide contract management policies and procedures should be developed. The policies should include the headings identified in the adjacent findings. The Office of the Auditor General ("OAG") Procurement Guide 2008 provides guidance on the policies and procedures expected of public entities to manage contracts.	To be incorporated into procurement review and inserted into procurement policy as appropriate. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Policy to be adopted by end of 2018 calendar year.

The relationship you can count on

22

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

18. Lack of contract management support and guidance		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Like procurement, contract management is de-centralised at HBRC. There is no centralised function to provide support and guidance. It is the responsibility of the respective departments to manage the contract performance and compliance. **Risk** There is a risk that the supplier/provider does not meet contractual obligations (performance/compliance) and this is not identified by Council. This may result in Council not receiving value for money for the works or service.	HBRC should review its current contract management structure and consider how support can be provided to the organisation. In addition, HBRC should consider what tools and templates can be implemented to support employees in the contract management process. This could include: ▪ designing procedures that align to contract management policies (see finding 17); ▪ contract checklist that ensures policies and procedures have been adhered to (i.e. delegations enforced, contract management plan approved, all relevant information stored on the contract central etc.); ▪ contract management plans (see finding 20); ▪ contract templates; and ▪ contract evaluation templates (see finding 21).	This will be incorporated into procurement review. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Support and guidance to be formalised by end of 2018 calendar year.

Item 6

Attachment 1

Crowe Horwath.
PART OF FINDEX

<table>
<tr><th colspan="2">19. Contract register is incomplete and inaccurate</th><th>Rating of finding: High</th></tr>
<tr><th>Finding</th><th>Recommendations</th><th>Agreed Management action(s)</th></tr>
<tr><td rowspan="5">The Council had difficulty supplying documentation to support procurement decisions. An example was the inability to provide a variation order for a current contract.

Furthermore, the information was often not stored on Contract Central or able to be provided by staff. Council staff had little confidence that the contract register was complete and accurate.

The Council has a contract register that is driven from Contract Central. The register shows 518 contracts. Based on the expiry date it appears that 394 have expired. The contract register provides information on the contract name, contract number, contract group, expiry date and contract description but lacks key aspects of a leading practice contract register. This includes:
- Contract expiry/roll over dates;
- Contract value;
- Supplier details;
- Key performance indicators;
- Contract obligations;
- Risks and risk ratings;
- Service levels;
- Milestones;
- Contract reviews;
- Responsibilities;
- Variations; and
- Contract evaluations.

We understand that Contract Central can add additional fields to include the above information.

Contract Central is essentially a storage system, rather than a contract management system. The contract register should be complete and accurate which can provide a foundation for effective monitoring and reporting requirements.</td><td rowspan="5">Contract management systems can range in complexity from manual systems to integrated software solutions. The Council should:
- review Contract Central to ensure the system can meet Council's requirements;
- review the contract register and achieve expired contracts. This may include a post contract evaluation;
- add additional fields as identified in the adjacent findings; and
- current contract information should be updated to reflect the requirements.

The above process should be based on the level of contract risk/value.</td><td>All new contracts will be required to be entered into a register with all required supporting documentation. Contracts will be reviewed for risk and will be updated or archived accordingly.</td></tr>
<tr><th>Responsible Person</th></tr>
<tr><td>Group Manager Corporate Services</td></tr>
<tr><th>Date of Implementation</th></tr>
<tr><td>September 2018</td></tr>
</table>

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

19. Contract register is incomplete and inaccurate		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
Risk When the register is not complete or accurate there is limited oversight on contracts and contract performance.		

Crowe Horwath.
PART OF FINDEX

20. Lack of contract management plans		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
The OAG Procurement Guide 2008 includes an expectation that each contract will have a contract management plan in place. The extent of the monitoring and management activities should reflect the value and risk associated with the goods or services. There are no contract management plans that we are aware of. **Risk** There is a risk that contract management activities are not planned effectively to monitor performance and compliance.	The Council should develop contract management templates. In addition, the Council should require all contracts that meet certain defined risk thresholds to prepare a contract management plan. The contract management plan may include: ▪ a list of individuals and their responsibilities; ▪ identification of the contract details for each party's contract/relationship manager; ▪ the nature and extent of engagement with the supplier/provider; ▪ key stakeholders (internal and external) and how these relationships will be managed; ▪ a schedule of risks that have been identified and that are being monitored and managed; ▪ performance management framework; ▪ the process by which contractual obligations are to be achieved (deliverables); ▪ milestone dates, including review of the contract and the lead time needed for re-tender/proposal or renewal; ▪ the content, frequency, and distribution of reporting within the Council (including reporting to Executive on important service statistics); ▪ a schedule of meetings and any standard agenda items; ▪ documentation reviews and updates (e.g. contract management and quality plans, health and safety plans, traffic management plans, qualifications or certifications, insurance policy documents); ▪ details of the process and authorities for approving variations to contracts (including delegations); ▪ dispute resolution; and ▪ contract completion.	Review will be incorporated into procurement/contract management review. Template for contract management plans for any whole of life contracts over $50,000 to be developed and incorporated into process. **Responsible Person** Group Manager Corporate Services **Date of Implementation** September 2018

The relationship you can count on

Item 6

Attachment 1

Crowe Horwath
PART OF FINDEX

20. Lack of contract management plans		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
	The contract management plan should be consistent with your contract management policies and procedures and provide the key information that will be recorded on the contract register.	

Crowe Horwath.
PART OF FINDEX

21. Contract evaluation		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
The Local Government Act 2002 section 17A requires the Council to review the cost-effectiveness of current arrangements for meeting the needs of communities within its district or region for good-quality local infrastructure, local public services, and performance of regulatory functions. The extent of the review should reflect the value and complexity of the contract. There is no formal contract evaluation process on the completion of a contract. The OAG Procurement Guide 2008 provides the following guidance on evaluations: ▪ assessment of the alignment of the contract with the Council's objectives; ▪ assessment of whether the contract represented value for money, taking into consideration the full contract cycle costs; ▪ assessment of the supplier's performance including levels of service, contract management activities, and reporting; ▪ assessment of whether the extent of the Council's monitoring and management activities are appropriate relative to supplier performance, risk and the cost of activities; ▪ assessment of whether there are other options available in the market that may not have been available when the contract was last tendered; ▪ assessment of options under the contract (renewal terms), guidance including the Rules of Sourcing (guidance for Councils) and the Council's own procurement policies; and ▪ assessment of the costs, risks and benefits of a re-tender process. We understand there is no formal plan or process to ensure the section 17A requirements are met. **Risk** There is a risk that Council is not identifying issues with current contracts or applying learnings across the organisation.	A contract evaluation process should be implemented. This may include: ▪ evaluating contract performance; ▪ documenting lessons learned; and ▪ update policies or procedures, where required. The OAG requirements in the adjacent findings should be included in the contract evaluation. The Council should develop a template that includes the requirements. The contract evaluation should be stored on the contract register.	A contract evaluation process will be developed and implemented in line with other templates and plans. Level of detail required will be commensurate with value of contract. **Responsible Person** Group Manager Corporate Services **Date of Implementation** July 2019

The relationship you can count on 28

Crowe Horwath.
PART OF FINDEX

22. No process to assess contracts for risk		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
Contract risk management allows the Council to prioritise contracts and apply resources relevant to the contract risk. Contract risk could be based on value, complexity, health and safety or public interest. There are no procedures in place relating to contract risk management. **Risk** There is a risk that appropriate resources are not applied to contracts that present a significant risk to the Council. There is limited oversight of this where contracts are not rated for risk.	Council should develop a contract risk framework and include in their policies and procedures. Risks should be assessed and documented within the contract management plan (see finding 21) In addition, risk ratings should be documented on the risk register and significant risks summarised. This will provide a useful basis for contract reporting.	Contract risk assessment will be incorporated into contract management plan to be developed. **Responsible Person** Group Manager Corporate Services **Date of Implementation** September 2018

Crowe Horwath.
PART OF FINDEX

23. Lack of organisation oversight on contract management activities		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Like procurement, there is a lack of oversight on contract management activities within the organisation. Executive Team Members had varying levels of oversight on contract management activities within their departments. We believe this is a result of: ▪ no contract management reporting within the organisation.; and ▪ no process to monitor contract compliance or performance. **Risk** There is a risk that contracts are not being appropriately managed to ensure Council is receiving value for money.	Regular reporting should be provided to the Executive on high risk contract performance. The Executive should know how many contracts within their department, the risk profile and current performance. The Council should consider forming a contract management/procurement committee at Management level. Their role should provide strategic direction, drive performance and ensure policies and procedures are followed. Council contract management policies and procedures should include performance measurement. Contract management plans should include: ▪ the objectives of the contract; ▪ performance measures and targets to ensure the contract meets the objectives; ▪ the format and frequency of reporting by the contractor of their performance against agreed service levels, performance measures and contract deliverables; ▪ scheduled performance evaluations (on a regular basis and relative to the risk of the contract); ▪ reporting within the Council to the appropriate level of management depending on the risk of the contract; ▪ requirement to act on any variations between expected and actual performance; and ▪ escalation routes and procedures to escalate ongoing issues within the Council to ensure appropriate actions are taken (penalties, retaining retentions, termination of contract etc.). In determining performance measures to be included in the contract and contract management plan, it should be ensured that all performance measures are meaningful and quantifiable. Applying the SMART acronym (Specific, Measurable, Achievable, Relevant, Time-Bound) in developing performance objectives can assist in the development of quantifiable objectives.	In line with action point #2, it is proposed that this will become a monthly agenda item at weekly executive meetings. **Responsible Person** Group Manager Corporate Services **Date of Implementation** Q1 2018/2019

The relationship you can count on

Crowe Horwath
PART OF FINDEX

Appendices

Appendix 1: Classification of Internal Audit Findings

Risk ratings are based on the use of professional judgement to assess the extent to which deficiencies could have an effect on the performance of systems and controls of a process to achieve an objective.

Rating	Definition	Guidance	Action required
High	• Issue represents a control weakness, which could cause or is causing major disruption of the process or major adverse effect on the ability of the process to achieve its objectives.	• Material errors and departures from the organisation's policies and procedures • Financial management / accountability / probity concerns • Non-compliance with governing legislation and regulations may result in fines or other penalties • Collective impact of many moderate or low issues	• Requires significant senior management intervention and may require significant mobilisation of resources, including external assistance. • Ongoing resource diversionary potential. • Requires high priority to immediate action
Moderate	• Issue represents a control weakness, which could cause or is causing moderate adverse effect on the ability of the process to meet its objectives.	• Events, operational, business and financial risks that could expose the organisation to losses that could be marginally material to the organisation • Departures from best practice management procedures, processes	• Requires substantial management intervention and may require possible external assistance. • Requires prompt action.
Low	• Issue represents a minor control weakness, with minimal but reportable impact on the ability to achieve process objectives.	• Events, operational and business risks that could expose the organisation to losses which are not material due to the low probability of occurrence of the event and insignificant impact on the operating capacity, reputation and regulatory compliance • Departures from management procedures, processes, however, appropriate monitoring and governance generally mitigates these risks.	• Requires management attention and possible use of external resources. • Requires action commensurate with the process objective.

Crowe Horwath
PART OF FINDEX

Appendix 2: List of Interviewees

Name	Role
Melissa des Landes	Management Accountant
Manton Collings	Corporate Accountant
Liz Lambert	Group Manager External Relations
Graeme Hansen	Group Manager Asset Management
Jessica Ellerm	Group Manager Corporate Services
Viv Moule	Human Resources Manager
Mark Heaney	Client Services Manager
Wayne Wright	Manager Resource Use
Barbara Mear	Team Leader Finance
Luana Lord	Accounts Payable Officer

Crowe Horwath.
PART OF FINDEX

Appendix 3: Detailed Scope

Procurement and Purchasing

The scope of the audit will cover three key areas of procurement and purchasing practice as follows:

- A benchmark of the Council's policies and procedures with regard to procurement contract tendering, selection and awarding against relevant sections of the following good practice guidelines and rules:
  - The NZ Government Rules of Sourcing
  - The OAG's good practice guide Procurement guidance for public entities.
  - The NZ Government Guide to Mastering Procurement.
  - Our own experience with local government and other public-sector entities.

- A review of a sample of major procurement activities will be undertaken to assess compliance with the Council's policies and procedures covering tendering, supplier selection and the completion of contract documents and will include:
  - Assessing whether appropriate procurement planning has been undertaken to identify the optimum solutions for the Council and the local economy considering the size, complexity and risks of the proposed procurement.
  - Assessing whether quoting and tendering methods, policies and procedures have been adhered to and decisions made in line with delegated authorities.
  - Assessing whether appropriate considerations of environmental sustainability are taken into account in procurement decisions.
  - Assessing whether support of the local economy and local community is appropriately considered in procurement decisions.
  - Assessing whether tender evaluations have been performed appropriately and in line with expectations, including sustainability considerations.
  - Assessing the procedures in place to identify, manage and monitor potential conflicts of interest in the procurement process.
  - Assessing whether exemptions applied or other exceptions to standard policy have been appropriately documented, justified and approved.
  - Assessing whether formal agreements are in place or purchase orders with appropriate terms and conditions have been approved and issued prior to the commencement of procurement activities.
  - Assessing whether documentation of all stages of the procurement process has been appropriately obtained and retained to ensure transparency and integrity of the procurement, tender evaluation and contractor selection processes.

- A review of procurement processes for lower value/direct purchases including:
  - Assessing the policies and procedures for the creation, management and review of supplier lists (e.g. all of government, registered suppliers, pre-qualified suppliers and panel of suppliers).
  - A review of purchase order requirements and monitoring of adherence to those requirements including delegated levels of authority.
  - Review of the use and monitoring of procurement cards and emergency procurement practices.

- Assessing the processes in place to identify, manage and monitor potential conflicts of interest in the procurement process.

Living wage considerations

The Council's remuneration policies ensure that all employees are paid at a minimum the nationally determined living wage. We have been requested by management to extend the scope of our review to consider and provide advice on the implications and practicalities of implementing living wage conditions in its agreements with contractors.

We will provide a memorandum highlighting the implications, practicalities and challenges of implementing such an approach.

Contract Management

The scope of the audit will incorporate the following steps:

- Assess the adequacy of documented policies and procedures.
- Assess the adequacy and appropriateness of the organisational structure for contract management and procurement.
- Assess the processes to ensure qualified, trained staff are involved in contract management.
- Assess the adequacy of the storage of contracts.
- Assess the adequacy of the contract management system to record and manage key contract requirements:
  - expiry dates;
  - risk assessments;
  - milestones;
  - key performance indicators; and
  - project evaluation and completion.
- Assess the adequacy of the contracts register.
- Assess the contract management systems ability to provide useful performance and financial information.
- Assess the adequacy of contract management reporting.
- Assess the adequacy of contract management and governance oversight.

Crowe Horwath.
PART OF FINDEX

Appendix 4: Basis and Use of this Report

This report is prepared on the basis of the limitations set out below:

- Our procedures were performed according to the standards and guidelines of The Institute of Internal Auditors' International Professional Practices Framework. The procedures were not undertaken in accordance with any auditing, review or assurance standards issued by the External Reporting Board (XRB).
- Because of the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they were not performed continuously throughout a specified period and any tests performed were on a sample basis.
- Any projection of the evaluation of the control procedures to future periods is subject to the risk that the systems may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.
- The matters raised in this report are only those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the weaknesses that exist or improvements that might be made. We cannot, in practice, examine every activity and procedure, nor can we be a substitute for management's responsibility to maintain adequate controls over all levels of operations and their responsibility to prevent and detect irregularities, including fraud. Accordingly, management should not rely on our report to identify all weaknesses that may exist in the systems and procedures under examination, or potential instances of non-compliance that may exist.
- Recommendations for improvement should be assessed by management for their full commercial impact, before they are implemented.
- This Report is not to be used by any other party for any purpose nor should any other party seek to rely on the opinions, advice or any information contained within this Report. In this regard, we recommend that parties seek their own independent advice. Crowe Horwath disclaims all liability to any party other than the client for which it was prepared in respect of or in consequence of anything done, or omitted to be done, by any party in reliance, whether whole or partial, upon any information contained in this Report. Any party, other than the client for which it was prepared, who chooses to rely in any way on the contents of this Report, does it so at their own risk.

The information in this Report and in any related oral presentation made by Crowe Horwath is confidential between Crowe Horwath and the client for which it was prepared and should not be disclosed, used or duplicated in whole or in part for any purpose except with the prior written consent of Crowe Horwath. An Electronic copy or print of this Document is an UNCONTROLLED COPY.

Crowe Horwath

Contact Us

Phil Sinclair
Senior Partner – Audit & Assurance
phil.sinclair@crowehorwath.co.nz

Martyn Solomon
Associate Partner – Audit & Assurance
martyn.solomon@crowehorwath.co.nz

Crowe Horwath
211 Market Street
Farming House, Level 1
Hastings 4122
Tel +64 6 872 9200
www.crowehorwath.co.nz

Crowe Horwath
PART OF FINDEX

Hawke's Bay Regional Council

Memorandum on the implications of the implementation of a Living Wage requirement for contractors

9 May 2018

Confidential

Prepared for: Melissa des Landes, Management Accountant

Prepared by: Phil Sinclair, Senior Partner – Audit & Assurance
Martyn Solomon, Associate Partner – Audit & Assurance

Audit | Tax | Advisory

Contents

Crowe Horwath.
PART OF FINDEX

1 Background

1.1 Purpose of memorandum

Hawke's Bay Regional Council pays all of its staff (excluding a small number of students and other casuals) at a minimum the current New Zealand 'living wage' of $20.20 per hour.

In response to a petition from GoBus bus drivers submitted by Cr Bailey to the 20 September 2017 Corporate & Strategic meeting, staff were asked to review and report on the council's procurement policy and the implications of that policy on the wage rates paid by GoBus to its drivers. In connection with this request to staff, the scope of our internal audit on Procurement and Purchasing was extended to consider implications surrounding a requirement for Council to pay contractors the living wage.

This memorandum details implications and risks the Council should consider prior to the implementation of a living wage requirement for contractors.

1.2 The Living Wage in New Zealand

In New Zealand, the first Living Wage campaign was launched in 2012 in Auckland and in Wellington followed by other local networks around the country. Supporting organisations joined forces around a statement of commitment to a Living Wage. The definition of the living wage was formalised as:

> *"A living wage is the income necessary to provide workers and their families with the basic necessities of life. A living wage will enable workers to live with dignity and to participate as active citizens in society. We call upon the Government, employers and society as a whole to strive for a living wage for all households as a necessary and important step in the reduction of poverty in New Zealand."*

In April 2013 an incorporated society was formed called Living Wage Movement Aotearoa NZ with a governance body and membership comprising around 200 faith based religious groups, unions and community/secular groups

The living wage is set by the Family Centre Social Policy Research Unit and in 2017 is $20.20 per hour. The 2018 hourly rate, to apply from 1 September 2018, is $20.55

A significant amount of material exists on the benefits and disadvantages of introducing a living wage, often dependent on the authors or sponsors of the material published.

However, to provide a high level summary of the benefits, Birmingham City Council in the UK in its Living Wage Policy summarises the intentions of the living wage as follows:[1]

> *"The Living Wage is intended to recognise the dignity of work and the importance for individuals, families and society of people being able to earn a living. The idea is rooted in notions of contribution, reciprocity and community.*
>
> *For employees, the Living Wage Foundation's Living Wage means no longer having to work multiple jobs, getting some sleep and being able to provide for and spend time with their family.*
>
> *For employers, it means higher staff morale, better quality work, improved rates of retention, lower rates of sickness and absence, and reputational gain. For local authorities, it can mean more money being spent by local employees in the local economy."*

[1] Birmingham Living Wage Policy v2 March 2017

Crowe Horwath.
PART OF FINDEX

2 Applicability of the New Zealand Living Wage

2.1 Calculation of the New Zealand Living Wage

The 2018 living wage was prepared for Living Wage Movement Aotearoa NZ by the Family Centre Social Policy Research Unit in March 2018. The calculation of $20.55 per hour was made on the following basis[2]:

Table 13. 2018 itemised Living Wage Estimate

Expenditure items	Estimate $	Information source
01 Food	212.00	Otago nutrition survey
03 Clothing and footwear	48.45	HES
04.1 Actual rentals for housing	332.00	MBIE rent bond database
04.5 Household energy	72.14	Fuel poverty study
05 Household contents and services	39.13	HES
06 Health	23.45	MoH, Pharmac & HES
07 Transport	131.56	Ministry of transport
08 Communication	31.28	Broadband and mobile phone providers
09 Recreation and culture	92.12	HES minus 09.2 major equipment
10 Education	44.80	NZCER primary and ECE survey
11 Miscellaneous goods and services	72.00	HES
13 Other expenditure	70.00	HES adjusted as per 2012
Weekly total	1,169	Apparent small disparities in totals are due to rounding.
Annual total net	60,784	
Annual total gross	64,059	
Hourly rate	$ 20.53	

The following assumptions are made with regard to the calculation:

- The expenses are calculated based on a household of two adults and two children with 1.5 incomes earned.

  The following is noted with regard to this assumption:

  - A report issued by the Treasury in 2013[3] (hereafter "Treasury Report") identified that 63% of 'families' earning less than $18.40 (the proposed living wage at that date) were single adults without dependents (as the HES considers all children over 18 as a separate 'family' this number also included those living with their parents). A further 16% of families were two adults with no dependents.
  - Whilst this does mean the remaining 21% are indeed families with dependent children, it would potentially be of benefit for the Council to understand the demographic nature of the employees of its contractors prior to enforcing a living age requirement on those contractors.

- The living wage is calculated on a national rather than regional basis and does not take into account differences in regional living costs.

[2] Report of the Measurement Review for a New Zealand living wage, March 2018

[3] Treasury Report: Analysis of the Proposed $18.40 Living Wage, September 2013

Crowe Horwath. PART OF FINDEX

The following is noted with regard to this assumption:

- Whilst the living wage calculation is not based entirely on the Household Expenditure Statistics (issued by Statistics NZ), the Household Expenditure Statistics: Year ended 30 June 2016 shows the following regional variations in gross household expenditure costs:

Av. weekly household expenditure $	NZ Total	Auckland	Wellington	Rest of the North Island	Canterbury	Rest of the South Island
Total gross expenditure	1,304.6	1,555.0	1,283.7	1,139.1	1,290.4	1,132.3
% of NZ Total	100.0	119.2	98.4	87.3	98.9	86.8

- It is of note that living wages in countries such as the USA, Canada and the UK are determined on a regional basis.
- A review by Palmerston North City Council dated 17 February 2018 determined a living wage for Palmerston North at $17.50 per hour. Whilst the motivation and methodology behind this calculation could be challenged, the concept of a regional living wage has some merit.
- The calculation of a Hawke's Bay Living Wage could be considered in this respect if it is determined that contractors should receive a living wage.

2.2 Benefits to employees

Whilst the purpose of this report is not to consider the benefits that arise to individual low paid workers and society in general from the implementation of a living wage policy for contractors, whilst acknowledging that some low paid workers and their families would without doubt benefit considerably from the implementation of a living wage, the following should be considered with any decision made relating to the employees of contractors.

- Wellington City Council noted the following in a report to the Governance, Finance and Planning Committee on 26 May 2015 (hereafter "Wellington City Council Report"):

  "To assess whether it would be feasible to introduce a living wage to any external contracts, officers completed a case study of a cleaning contract as these contractor employees form a representative group of low wage workers that would be impacted by the living wage.

  The study found increases of approximately 15% on the direct contractor employee portion of the contract cost would be required to increase staff costs up to Council's current living wage level.

  The case study also found that the impact on a contractor employee's total income as a result of increasing their wage to the living wage varies considerably depending on the contractor employee's family status. The proportion of the uplift that could be expected to end up in the contractor employee's hand varied between 0% and 83%. In the case of a sole parent with one child working 20 hours a week, none of the uplift would go to the employee. It would entirely be offset against the government contribution.

  The study concluded that in an average scenario, where the Council was required to fund 100% of the contractor wage cost increase for the uplift to a living wage, approximately $46 in every $100 would go the contractor employee, with the balance cross-subsidising central government."

- The 2013 Treasury Report also considers this by stating:

  "The people who would benefit most would be those who currently receive no means tested support from government, i.e. teenagers and young single people, older single adults, and those over 65. Those who would receive the lowest additional assistance would be those who receive welfare support that abates as incomes rise."

In addition to this, the benefits may be restricted to staff working on council contracts, which may also create the following implications:

- A Literature Review on the Effects of Living Wage Policies prepared by Auckland Council in August 2013 states the following with regard to this:

  "Because living wages are often targeted primarily (if not exclusively) at local government contractors, they may be less "price sensitive." In other words, employers who hold contracts with the city may be able to pass on higher living wage costs through to the city and ultimately the tax or rate payers. Because living wages may cover only those employees of a firm that are working on a public contract, employers may be able to reallocate workers within the organisation. They may be able to shift more highly skilled and educated employees over to public contracts."

- This view is corroborated by Living Wage Movement Aotearoa NZ which has stated[4]:

  "Even though it would be good if the contractor decides to spread the living wage to all of its Wellington workforce, there is nothing in the law that prevents a contractor from paying one wage at the WCC and another at another site. In fact, in both cleaning and security (including car parking enforcement) the national collective agreements specifically acknowledge that this will happen."

2.3 Benefits to contractors

A review of both NZ and overseas literature indicates various benefits that arise from the implementation of the living wage. These include:

- Reduced employee turnover resulting in improved productivity
- improved longer-term training and development programmes
- The attraction of more highly skilled job applicants
- Contractors reviewing operating processes to increase efficiency and productivity and reduce downtime.

However, a number of points should be made in respect of these benefits:

- It is of note that much of the literature relates to experiences in larger cities where turnover rates are typically high (reductions in turnover of staff have often been recorded where turnover was initially at rates of over 40%). The relevance of this to the Hawke's Bay Region should be considered.
- The attraction of more highly skilled job applicants assists the contractor but is not necessarily of benefit to the low-paid unskilled workers the living wage is designed to protect.

It is of note that at KPMG UK, where a living wage to all direct and fulltime employees and on-site contractors has been rolled out, ongoing monitoring of the effectiveness of the living wage policy with each contractor is undertaken with the following (abridged) performance measures assessed[5]:

[4] The Living Wage in the People-Centred, Smart Capital of Aotearoa/New Zealand, 2013

Crowe Horwath.
PART OF FINDEX

KPMG Living Wage performance data collection framework (abbreviated version)

Quantified impacts (expressed in percentages, with comparatives)

- Staff turnover, absenteeism, change in employee numbers, employee and wage transfers to Living Wage contracts, change in cost of service.

Other impacts (to be answered Yes/No – with further details requested)

- Has presence, or lack of Living Wage, affected any reputational gains or losses for the company?
- Have there been changes in working conditions for Living Wage employees?
- Have there been changes in workload for Living Wage employees?
- Has there been career progression for employees?
- Has paying the Living Wage had an impact on employee relations?
- Has paying the Living Wage had an impact on performance and productivity?
- Has paying the Living Wage had an impact on employee morale?
- Number of contracts gained/lost/secured since previous year – and which of these were Living Wage?

Michael Kelly, Head of Living Wage at KPMG, stated the following with regard to this:

> *"If you start from the premise that the whole change management programme is just a pay differential program you are at a loss even before you have got going….organisations should treat going Living Wage as a change management programme; phase it over a reasonable term 1 or 2 years."*

In this respect, it would be seen as necessary to continue to monitor the benefits contractors are receiving through paying the living wage, rather than running the risk of those suppliers deciding not to propose for contracts restricted to living wage contractors.

[5] Living Wage Employers: evidence of UK Business Cases by Andrea B. Coulson and James Bonner on behalf of the University of Strathclyde, in partnership with the Living Wage Foundation, 2015

Crowe Horwath.
PART OF FINDEX

3 Legal implications

Potential legal risks arise with consideration of the compulsory implementation of a living wage for contractors. Under the Local Government Act 2002, sections 10 and 17A are potentially relevant.

The following sections are applicable:

- 10 (1) (b) The purpose of local government is to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective for households and businesses.
- 17A Delivery of services (1) A local authority must review the cost-effectiveness of current arrangements for meeting the needs of communities within its district or region for good-quality local infrastructure, local public services, and performance of regulatory functions

With regard to these concerns, a legal opinion dated 27 September2013 from Dr Matthew Palmer, a public law specialist states:

> *"My opinion is that the Local Government Act does not prohibit a local authority or Council Controlled Organisation from paying its employees, or requiring its contractors to pay their employees, a living wage. My opinion is based on material that explains the economic justification of a living wage in terms of associated productivity gains. Pursuing such a policy would be consistent with the purpose of local government which includes cost-effectiveness and provision of good quality services. In particular, I consider that it would be valid for a local authority to exercise its power to set remuneration policy under the Local Government Act by adopting a living wage policy."*

However, despite this opinion the Wellington City Council Report noted the following concerns:

> *"There are legal issues in requiring a living wage to be paid to employees of a contractor. Under the Local Government Act 2002 (LGA) the purpose of local government is to meet the needs of communities for 'good quality' public services (and infrastructure and regulatory services) in a way that is most "cost effective" for households and businesses. Unless the Council can be assured that the additional cost of paying a living wage to the employees of contractors to Council can be justified in terms of additional benefits to Council (for example improved quality or effectiveness) the Council is at risk of acting outside the powers of the Local Government Act, and therefore at risk of legal challenge by judicial review.*
>
> *The converse position is that there is scope for the employees of contractors to be paid a living wage on a case by case basis where the additional cost can be justified in terms of identifiable benefits (i.e. improved quality or effectiveness) to the Council.*
>
> *Officers do not recommend that Council implement a living wage in Council contracts on either a blanket basis or a case by case basis. However, if the issue is to be pursued, it is recommended that Council proceed with caution and only on a contract by contract basis, supported by legal advice that any particular proposal (ie contract) fits within the Council's statutory powers and the legal test set out above."*

It is also of note that in April 2017, Greater Wellington Regional Council (GWRC) also voted to introduce the Living Wage for council staff. However, with regard to the inclusion of contractors, the GWRC Chair, Cr Chris Laidlaw, noted:

> *"However, there are still many important questions to be answered before the Council can consider extending the Living Wage to include the employees of its contractors, such as cleaners and caterers.*

Crowe Horwath. PART OF FINDEX

> *At the recent mayoral forum I asked Local Government New Zealand to seek, on behalf of the local government sector, a legal opinion on whether and in what circumstances the living wage can be paid by a local authority.*
>
> *The issues involved extend well beyond what we as a council can achieve on our own. As a sector, we need legal clarity in which to apply the living wage with no dispute about the legitimacy of its introduction by councils who wish to do so,"*

This legal opinion is still outstanding.

4 Cost Implications

The following statement was noted in the Wellington City Council Report:

> *"Some contractors have noted potential positive outcomes from the implementation of a living wage policy, on the basis Council would bear the cost, but equally cited numerous challenges and issues that would need to be addressed."*

The clear indicator here is that cost of the implementation of the living wage to contractors would expect to be borne by the Council.

In this respect, the Council should ensure it is aware of the cost implications of extending the living wage requirement to either individual or all existing contracts prior to any decision to implement the living wage.

The following would need to be taken into consideration:

- Quantification of the direct costs of increasing wages below the living wage to the living wage.
- Quantification of the 'relativity' costs of increasing the wages of more senior or qualified staff that currently earn at or around the living wage to a higher level to reflect their more senior or qualified status.
- The fact that the ability to negotiate wage rates and control rate increases would be lost by way of an external party determining a new living wage on an annual basis.
- Whilst there is a potential expectation amongst contractors that the Council would bear the increased costs, competitive tendering procedures for contractors could well lead to contractors bearing some of the cost or looking to improve the operational efficiency of the services they provide.

From a reputational standpoint, the improved image of the Council as a living wage employer and its ability to promote other employers in the region to do likewise to improve standards of living in the region could be offset by rates increases seen as penalizing other low paid workers in the region to subsidise those fortunate enough to work on HBRC contracts.

Crowe Horwath.
PART OF FINDEX

5 Experiences of other Councils

The following is noted with regard to other NZ Councils that have implemented a living wage policy:

5.1 Wellington City Council

As noted above, in May 2015, Wellington City Council resolved to instruct officers to consider on a case by case basis the value to Council in terms of improved quality and/or effectiveness of requiring service providers to implement a living wage to work undertaken for Council.

The Council noted that its preference was to require service providers to implement a living wage where that could be justified in terms of improved quality and/or effectiveness.

This decision was subject to a challenge by the Wellington Chamber of Commerce with the Chamber of Commerce noting an intention to bring judicial review proceedings against the Council decision.

Agreement was subsequently reached with the Council agreeing to consult with the Chamber of Commerce and other interested parties prior to extending the living wage to contract other than the cleaning and security contracts, which were the initial contracts under review by the Council that led to the challenge from the Chamber of Commerce.

Wellington City Council has included the following with regard to the living wage in its 2017/18 Annual Plan:

> *"In 2017/18 we will raise the minimum wage paid by the Council and its council-controlled organisations to the official NZ Living Wage. This will rise to $20.20 on 1 July 2017.*
>
> *In addition to this, the Council will commit to a staged implementation of the Living Wage on relevant contracts for regular and ongoing core services, to be processed on a case-by-case basis. In 2017/18 the Council's primary focus will be on cleaning and sanitation services. We will also examine which of these services could best be delivered through an inhouse model. We will seek to obtain living wage accreditation within the 3 years."*

5.2 Greater Wellington Regional Council

GWRC has instructed its officers to consider how the living wage can be factored into its procurement process. The council sees it as one of a set of criteria to be applied to its purchasing decisions alongside other important criteria such as good environmental practice. The council also voted to encourage council controlled organisations to become living wage employers, when GWRC and other living wage councils make up 51 percent of the shareholding.

Cr Chris Laidlaw, the GWRC chair noted that before voting for the motion on introducing the living wage the council sought the views of a range of stakeholders.

> *"To be honest the feedback has been mixed. While nearly everyone we spoke to understands the struggles those earning the minimum wage face some questioned why ratepayers should have to foot the bill when this appears to be a problem that central government should be stepping in to help solve.*
>
> *We look forward to continuing the engagement with Living Wage Aotearoa, local and central government, our many contractors and of course our ratepayers. This is a complex issue and today's vote is only the start of the discussion on the Living Wage and the types issues it is intended to address."*

5.3 Auckland Council

Auckland Council introduced a living-wage policy in June 2017 that will be phased on to all staff, including those in CCOs by October 2019. The policy excludes contractors, volunteers and trainees.

5.4 Christchurch City Council

In August 2017, Christchurch City Council approved the introduction of a living wage to apply to Council staff with the skills and experience to work unsupervised. It did not include contractors or council-controlled organisations, although staff have been asked to report back on options to extend it to Council-owned organisations and to review procurement policies to include the Living Wage.

6 Implementation of the Living Wage

6.1 Definition of Contractors

In applying a living wage to contractors, consideration needs to be made as to which contractors are selected and to what extent those contractors can be required to implement the living wage. As noted in the Wellington City Council Report:

> *Implementing a living wage for external Council contracts is significantly more complex. The variety of Council contracts from roading projects, to cleaners, to telephone and stationery contracts mean that it would not be possible to provide a generic application of a living wage related policy to all Council contracts and contractors.*
>
> *On the basis of the case study, officers have concluded that the viability of the Council being able to dictate that lower paid employees, working through a contractor, receive a higher wage depends heavily on the features of the contractual relationship, the specific nature of the service provided and the elasticity of the market for the service being provided."*

In order to create a manageable definition of contractors, Birmingham City Council in the UK has provided the following wording in its Living Wage Policy to distinguish between contractors and suppliers:

> *"The City Council will therefore require, to the extent permitted by law, that any contractor, including subcontractors, who supplies an employee (other than an intern or apprentice) who provides a service or completes works, involving 2 or more hours of work in any given day in a week, for 8 or more consecutive weeks on:*
>
> - *Council premises; and/or*
> - *Property owned or occupied by the Council; and/or*
> - *Land which the Council is responsible for maintaining or on which it is required to work*
>
> *will pay employees the Birmingham Living Wage in respect of their time working on a Council contract or grant funded service.*
>
> *Where the 8 consecutive week threshold is achieved the payment of the Birmingham Living Wage will be made in respect of all of those weeks and any additional weeks worked by such employees.*
>
> *The following qualifications apply to the above:*

- *Grants for the purchase of capital assets are exempt from this policy*
- *Contracts and grants solely for the supply of goods are exempt from this policy."*

Examples of this definition have also been found in the commercial sector whereby SSE PLC which since 2014 has required that all new eligible contracts tendered would include a Living Wage clause, and require the contractor to pay any person who works on an SSE site for two hours or more, for at least eight consecutive weeks, to be paid at least the Living Wage.

These examples provide an effective mechanism for differentiating between suppliers and contractors.

6.2 Timeframes for Implementation

Timeframes for the implementation of a living wage policy to contractors are generally seen to be dependent on the termination date of existing contracts.

In its accreditation flowchart, Living Wage Aotearoa New Zealand states the following with regard to contractors:

> *"Ask your contractors to implement the Living Wage.*
>
> *OR*
>
> *Provide a commitment that contracts will be renewed at the Living Wage rate and work with Living Wage Aotearoa NZ to set milestones towards this for the licence."*

Additionally, following Wellington City Council's vote in 2013 to support in principle a Living Wage Council and a Living Wage Capital, Living Wage Aotearoa New Zealand stated with regard to the implementation of the living wage to contractors at Wellington City Council[6]:

> *"There are seven main contractors delivering services currently who would be impacted by living wage implementation. The affected areas of service are catering, parking, security, roading, refuse/recycling, facility maintenance and cleaning. Given the extent and size of the contracts and long terms (some are for five years), the implementation would take place over a number of years.*
>
> *The framework will need to include a timetable for the contracts that are due for tender."*

In this respect, it is acknowledged by Living Wage Aotearoa New Zealand that implementation for contractors is dependent on the termination dates of existing contractual agreements.

6.3 How to Select Contractors

Whilst the approach described in section 6.2 above provides an effective approach to distinguishing between contractors and suppliers, there is a conflict in policy with the Wellington City Council Report suggesting individual consideration of each service and contract for applicability compared to the Birmingham City Council blanket approach to all contractors receiving the living wage. Consideration would be required to determine an appropriate approach for HBRC to follow.

Pilot Schemes undertaken at the City of Edinburgh Council[7] have seen contractors required to provide living wage and non-living wage proposals for work (this approach is not necessarily preferred by Living

[6] The Living Wage in the People-Centred, Smart Capital of Aotearoa/New Zealand, 2013

[7] City of Edinburgh Council Finance and Resources Committee Meeting, 14 January 2016

Crowe Horwath.
PART OF FINDEX

Wage Aotearoa New Zealand[8]). In the pilot scheme, one of the living wage proposals was cheaper than three of the five non-living wage proposals.

The Pilot Schemes also included adding a weighting to the evaluation process for inclusion of the living wage. Whilst only undertaken on single cases, the results of the pilots indicated a 5% weighting was not sufficient to sway contractors towards the living wage but a 30% weighting was.

HBRC would need to consider the approach it would wish to pursue in its Procurement Policy. Additionally, the selection of contracts and contractors may also need to consider All of Government supply contracts, NZTA procurement rules, the Public Transport Operation Model (PTOM) and HBLASS commitments.

7 GoBus specific considerations

7.1 Hawke's Bay Regional Council GoBus contract

For Hawkes Bay Regional Council, in particular with regard to the GoBus contract which has been the key driver in consideration of a living wage for contractors, that contract was awarded to GoBus Ltd in September 2015 and, as required by PTOM, is for a nine-year period. The contract commenced on 1 August 2016 and will end on 31 July 2025.

As noted by HBRC officers with regard to that contract in the Corporate and Strategic Committee Meeting of 11 December 2017:

> *"As HBRC already has a contract in place with GoBus for a further 8 years, higher wage rates could only be required through a variation to the contract. Contract variations are usually in relation to levels of service and are negotiated according to rates already specified and evaluated in the tender.*
>
> *The legal implications of this 'other' type of variation would need to be examined carefully, both in relation to PTOM and because of possible legal challenge from unsuccessful tender applicants.*
>
> *There would also be financial implications from such a variation, both for the NZ Transport Agency (which provides 51% of the funding for the bus service) and HBRC.*
>
> *These legal and financial implications would need to be extensively investigated if pertinent changes were made to HBRC's procurement policy."*

7.2 Other Council recent experiences

Strike action by bus drivers has recently caused disruption in Auckland, the Waikato Region and in 2017 in the Bay of Plenty.

With regard to the Bay of Plenty, it is noted that NZ Bus will pay drivers in the Western Bay of Plenty the living wage when it takes over the Western Bay of Plenty bus contracts in December 2018 at the expiry of the current contracts.

Bay of Plenty Regional Council Public Transport Committee Chair Lyall Thurston confirmed that last year the Committee and Regional Council made a conscious decision to include higher driver pay as part of the evaluation criteria for the tender. He stated:

[8] The Living Wage in the People-Centred, Smart Capital of Aotearoa/New Zealand, 2013, page 20

Crowe Horwath.
PART OF FINDEX

> *"This came about for a number of different reasons, including clear feedback from members of our local community and comparing what bus drivers were paid in other parts of New Zealand. Seeking higher rates of pay as part of the evaluation criteria was one way that we could respond to this feedback and comparative data. However, we also made this decision because it was simply the right thing to do,"*

According to Thurston, 60 percent of the evaluation criteria was based on price and 40 percent was based on "quality" criteria, such as experience, track record, vehicle resources and driver's wages. He said they had been "particularly taken" with the pay offered by NZ Bus[9].

7.3 Public Transport Operating Model (PTOM) investigation

A Government response to the report of the Transport and Industrial Relations Committee on its **Inquiry into the future of New Zealand's mobility** was presented to the House of Representatives on 15 February 2018. The response stated the following:

> *"Public Transport in New Zealand is provided through the Public Transport Operating Model (PTOM). PTOM is a mix of legislative and operational policy tools used to plan, procure, and deliver public transport services in New Zealand.*
>
> *Work is being progressed on an investigation into PTOM to explore its effects on wages, salaries and employment conditions in the first half of 2018, with a full evaluation of PTOM scheduled for 2019. The review of the Total Mobility Scheme will be planned to coincide with the PTOM evaluation."*

The outcome of this review may provide a national solution to the issue of bus driver pay.

8 Conclusion

Whilst the intention to provide a living wage to all staff and contractors would provide a clear and substantial benefit to some low-income families, a number of challenges remain which could have financial, legal and reputational impacts for the Council.

In particular the ongoing lack of certainty over the legality of enforcing a living wage requirement on contractors is preventing other Councils from proceeding with living wage requirements for contractors and is an area which should potentially be resolved prior to considering the costs and benefits of the remaining implications highlighted in this memorandum.

With regard to the current concerns relating to the pay rates for bus drivers in the Hawkes Bay Region, it is of note that a central government review of the Public Transport Operating Model is currently underway.

[9] http://www.scoop.co.nz/stories/BU1804/S00346/first-union-upbeat-about-living-wage-for-bus-drivers.htm

Crowe Horwath.
PART OF FINDEX

Appendix: Basis and Use of this Report

This report is prepared on the basis of the limitations set out below:

- Our procedures were performed according to the standards and guidelines of The Institute of Internal Auditors' International Professional Practices Framework. The procedures were not undertaken in accordance with any auditing, review or assurance standards issued by the External Reporting Board (XRB).
- Because of the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they were not performed continuously throughout a specified period and any tests performed were on a sample basis.
- Any projection of the evaluation of the control procedures to future periods is subject to the risk that the systems may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.
- The matters raised in this report are only those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the weaknesses that exist or improvements that might be made. We cannot, in practice, examine every activity and procedure, nor can we be a substitute for management's responsibility to maintain adequate controls over all levels of operations and their responsibility to prevent and detect irregularities, including fraud. Accordingly, management should not rely on our report to identify all weaknesses that may exist in the systems and procedures under examination, or potential instances of non-compliance that may exist.
- Recommendations for improvement should be assessed by management for their full commercial impact, before they are implemented.
- This Report is not to be used by any other party for any purpose nor should any other party seek to rely on the opinions, advice or any information contained within this Report. In this regard, we recommend that parties seek their own independent advice. Crowe Horwath disclaims all liability to any party other than the client for which it was prepared in respect of or in consequence of anything done, or omitted to be done, by any party in reliance, whether whole or partial, upon any information contained in this Report. Any party, other than the client for which it was prepared, who chooses to rely in any way on the contents of this Report, does it so at their own risk.

The information in this Report and in any related oral presentation made by Crowe Horwath is confidential between Crowe Horwath and the client for which it was prepared and should not be disclosed, used or duplicated in whole or in part for any purpose except with the prior written consent of Crowe Horwath. An Electronic copy or print of this Document is an UNCONTROLLED COPY.

Contact Us

Phil Sinclair
Senior Partner – Audit & Assurance
phil.sinclair@crowehorwath.co.nz

Martyn Solomon
Associate Partner – Audit & Assurance
martyn.solomon@crowehorwath.co.nz

Crowe Horwath
211 Market Street
Farming House, Level 1
Hastings 4122
Tel +64 6 872 9200
www.crowehorwath.co.nz

HAWKE'S BAY REGIONAL COUNCIL

FINANCE AUDIT & RISK SUB-COMMITTEE

Wednesday 06 June 2018

Subject: LIVING WAGE IMPLICATIONS MEMORANDUM

Reason for Report

1. To provide the Sub-committee with the Crowe Horwath Living Wage memorandum for review and consideration.
2. Staff are requesting feedback from the Sub-committee, in the form of recommendations to the Corporate and Strategic Committee, then on to Council, about the potential inclusion of 'living wage' considerations in Council's procurement policy.

Background

3. In response to a petition from First Union submitted in October 2017, the Corporate and Strategic Committee agreed, at its meeting on 11 December 2017, to align a review of the living wage with the planned Procurement internal audit review. The agreed scope of the Living Wage review was to assess the possible implications of promoting the living wage for contractors and more specifically for GoBus drivers.
4. Council's internal auditor, Crowe Horwath, was engaged to provide a memorandum (attached) on the implications of requiring contractors to pay the Living Wage.
5. Staff have reviewed the findings and have provided some general commentary, along with commentary specific to the GoBus contract.

Living Wage Analysis

6. HBRC recently confirmed that it pays all of its own staff the living wage, however has not consciously made this a permanent commitment by way of internal remuneration policy.
7. In order for businesses to pay their staff the living wage, there is a question of who would absorb these costs. If businesses are operating at low margins, then the cost would likely be passed on to their customers through raising prices which may impact on their ability to be competitive.
8. If the subsequent cost increases were passed on to HBRC, this could give rise to section 17a issues where HBRC is required to "provide cost effective services to the ratepayer". This could also be seen as penalising other low paid workers in the region to subsidise those fortunate enough to work on HBRC contracts. For example, a self-employed worker on a low income (who does not provide services to HBRC) would have their rates bill increase to pay for the benefit of other workers.
9. The breaking of contracts to introduce a living wage requirement for contractors and suppliers may have legal and financial implications that may outweigh the benefits. A challenge could be raised by unsuccessful suppliers who may have included paying staff the living wage in their original tendering documents but were unsuccessful due to price.

National Approach

10. A small number of other Councils have decided to begin implementing the living wage selectively. Those councils are in larger cities with a higher cost of living than Hawke's Bay (Wellington, Auckland and Christchurch).
11. Statistics NZ provides information on cost of living by region, however the living wage is not indexed to reflect those regional variations. As an example, the cost of living for an

average household is approximately $416 per week (or 36%) lower for those in the regions than those living in Auckland.

12. In light of this, Palmerston North City Council recently requested a review to determine a "Palmerston North" living wage, which has currently been set at $17.50 an hour. This reflects a lower cost of living in Palmerston North than in major centres.

13. These Councils have also only implemented the living wage under certain criteria, often only for their direct staff – which HBRC currently has in place. A summary of each is outlined below:

Auckland Council

13.1. Policy updated to include living wage payments to staff and CCOs only. Policy excludes contractors, volunteers and trainees.

Wellington City Council

13.2. Resolved to consider implementing the living wage on a case by case basis however this decision was subject to challenge by Wellington Chamber of Commerce (WCoC) noting an intention to bring judicial review proceedings against the Council decision. This is due to belief that a higher cost of cleaning contracts did not represent prudent use of ratepayer resources.

13.3. After several months of negotiations between the WCoC, Wellington City Council agreed that when a significant contract is under renewal, there is a commitment to pay the living wage via a phased implementation, on selected contracts only and in consultation with WCoC.

Greater Wellington Regional Council

13.4. Has agreed to pay living wage for staff only. Has requested Local Government New Zealand provide a legal opinion on this area, of which the results are still outstanding.

13.5. Sees living wage as one set of criteria in purchasing process alongside others, such as environmental practices.

13.6. Notes that ratepayers are likely to foot the bill and that this appears to be a problem that central government should step in and resolve.

Christchurch City Council

13.7. Has agreed to pay living wage to staff with the skills and experience to work unsupervised. No comment provided by CCC on contractors/suppliers.

GoBus Contract

14. The GoBus contract currently sits under the national PTOM (Public Transport Operating Model). PTOM was introduced in 2013 with the intention of driving down bus fares for its users (bus fares currently offset approximately 50% of total operating costs, the remainder is made up by local government and NZTA).

15. It is noted that the Hawkes Bay GoBus contract expiry date is not until 2025. A review of this contract now could bring about legal challenge from other suppliers who missed out on the tender, along with potential litigation from commerce groups as evidenced in Wellington.

16. Bay of Plenty's (BOP) bus contract came up for renewal last month in April and it is noted that the winning tender agreed to pay the living wage in its contract. It should be recognised that the winning tenderer was not GoBus, and the recent winning supplier for BOP was a failed tender for the Hawke's Bay contract. BOP procurement notes that the living wage was a "factor" in its decision making, rather than a requirement. It is also noted that this service cost an additional $2m per annum – although this cost is made up of a number of factors.

17. Other Councils have only implemented living wage in contracts up for renewal. The review of unexpired contracts has not been conducted due to challenges outlined in the memorandum. In the case of GoBus there is an added dimension to this, including the NZTA 51% funding agreement which is also party to the contract, along with consideration of how this will impact on bus fares.
18. On this basis, a theoretical retender may mean that GoBus may lose the contract and the drivers could possibly be out of jobs altogether. This is not factoring in legal challenge costs which subject to any damages paid out, would likely go to GoBus owners and not the drivers. The ratepayer would be required to foot this bill.
19. It should be highlighted that GoBus drivers are also paid several dollars *above* minimum wage and wages for drivers are reviewed annually at a rate in line with or above inflation. The GoBus CEO has defended its recent pay negotiations, insisting workers have just been given a pay increase "recently those drivers received a very generous increase from the company, well in excess of inflation". GoBus drivers are now also paid at time and a half for work on Sundays, and at a rate above the Palmerston North hourly 'living wage' rate.
20. Staff have reviewed the GoBus tender documents and note several complexities due to the NZTA requirements and recommend that specific legal advice is obtained before looking any further at opening up the contract.

Central Government Action

21. There is a currently a review being conducted nationally regarding the PTOM which the GoBus contract was formed under. This review will include the assessment of wages for bus drivers. If Council were to make changes in line with a PTOM review overhaul, it is unlikely that there would be any legal implications due to following of national policy.
22. Specifically, The Ministry of Transport has contracted an independent consultancy firm to review the PTOM model and the effect this has on worker's conditions and wage rates. HBRC was contacted by the Ministry recently and advised that the consultancy firm will be in contact to request information on conditions and wage rates for bus drivers in our region.
23. Staff intend to report back to the Finance, Audit & Risk sub-committee with updates and results that arise from this review.

Decision Making Process

24. Council and its committees are required to make every decision in accordance with the requirements of the Local Government Act 2002 (the Act). Staff have assessed the requirements in relation to this item and have concluded:
    - 24.1. The decision does not significantly alter the service provision or affect a strategic asset.
    - 24.2. The use of the special consultative procedure is not prescribed by legislation.
    - 24.3. The decision does not fall within the definition of Council's policy on significance.
    - 24.4. The decision is not inconsistent with an existing policy or plan.

Given the nature and significance of the issue to be considered and decided, and also the persons likely to have an interest in the decisions made, Council can exercise its discretion and make a decision without consulting directly with the community or others having an interest in the decision.

Recommendations

That the Finance, Audit and Risk Sub-committee:

1. Receives and notes the Crowe Horwath ***"Living Wage"*** memorandum and staff report.
2. Accepts the commentary provided by HBRC Executive staff in response to the Crowe Horwath memorandum.

The Finance, Audit and Risk Sub-committee recommends that the Corporate and Strategic Committee:

3. Agrees that the decisions to be made are not significant under the criteria contained in Council's adopted Significance and Engagement Policy, and that the Committee can exercise its discretion and make decisions on this issue without conferring directly with the community and persons likely to be affected by or to have an interest in the decision.
4. Recommends that Council:
   - 4.1. Participates in and continually monitors results of the Public Transport Operating Model review and/or any central government policy changes that necessitate the reassessment of the GoBus contract to align with legislation and its own internal policies accordingly.
   - 4.2. Requests that staff amend Council's procurement policy to give weighting to contractors who are paying the living wage, alongside other important factors such as environmentally friendly business practices and overall affordability, in Tender evaluation processes.
   - 4.3. Requests that Council's procurement policy is published on the HBRC website (in line with the Procurement Review recommendations from Crowe Horwath).

Authored by:

Melissa des Landes
MANAGEMENT ACCOUNTANT

Manton Collings
CORPORATE ACCOUNTANT

Approved by:

Jessica Ellerm
GROUP MANAGER CORPORATE SERVICES

Attachment/s

1 Living Wage Memo

Crowe Horwath

Item 6

Attachment 4

Hawke's Bay Regional Council

Internal Audit: Water Management

Internal Audit Report

May 2018

Confidential

Prepared for: Finance, Audit & Risk Sub-Committee

Prepared by: Phil Sinclair, Senior Partner - Audit & Assurance
Martyn Solomon, Associate Partner - Audit & Assurance

Audit | Tax | Advisory

Contents

Crowe Horwath
PART OF FINDEX

1. Executive Summary

1.1 Objective and Scope

The objective of this review was to assess the policies, procedures and controls in place at the Hawke's Bay Regional Council ("HBRC") over key water management to meet the objectives of the Hawke's Bay Regional Resource Management Plan and the requirements of section 5(2) of the Resource Management Act.

The reviewed covered the three waters services delivered to communities as recognised in the OAG Water Management Work Programme dated October 2017 and focused on the monitoring and enforcement of consents held by territorial authorities in the region (Hastings District Council, Napier City Council, Wairoa District Council and Central Hawke's Bay District Council) that authorise:

- The taking of water to supply the community with drinking water.
- The discharging of waste (including human and industrial trade waste).
- The discharge of storm water.

The review was conducted primarily by applying discussion, observation and review techniques with limited detailed testing being undertaken.

The detailed scope is included in Appendix 2.

1.2 Introduction

Effective water management systems are necessary to protect the natural resources that the Hawke's Bay region relies upon for its physical, economic, social and cultural wellbeing. The scope of work for this engagement focused on the monitoring, enforcement and reporting of consents issued to territorial authorities within the region. This responsibility largely lies within the Resource Use Team at the HBRC. The team supports the HBRC's vision of "A region with a vibrant community, a prosperous economy, a clean and healthy environment, now and for future generations".

For the understanding of the details in our report, we consider it is important to outline the roles and responsibilities of the various Council areas that have responsibility towards water management:

Consents Team
The Consents Team is responsible for issuing resource consents. The team base their resource consent decisions on the requirements of the Hawke's Bay Regional Management Plan, the requirements of the Resource Management Act 1991 and other key legislation, to ensure policies and standards have been considered and appropriately included within resource consents.

Science Team
State of the Environment Monitoring ("SoE") is performed by the Science Team. SoE monitoring is required by the Resource Management Act 1991 to monitor various environmental 'domains'. They are not specifically testing for water quality to satisfy the purposes of the territorial authorities.

Crowe Horwath.
PART OF FINDEX

Resource Use Team
The Resource Use Team is responsible for the compliance and monitoring of resource of consents. The compliance and monitoring requirements are driven by regulation contained in or arising from the resource consents issued as result of the HBRC Resource Management plans and the Resource Management Act. The Resource Use Team manage over 4,300 consents of which 329 have been issued to territorial authorities. There have been 64 issued to territorial authorities for water take and discharge (waste & stormwater).

The compliance monitoring programme plays a vital role in ensuring that appropriate resources are allocated to activities by determining the monitoring frequency and intervention method required, based on the risk to the environment of that activity. The controls over the monitoring of consents has been the focus of our review.

1.3 Conclusions

We have highlighted our significant findings below:

Communication and collaboration
Communication and collaboration, both internal and external, are fundamental to the effective water management in the region. We have identified areas for improvement or where relationships can be formalised.

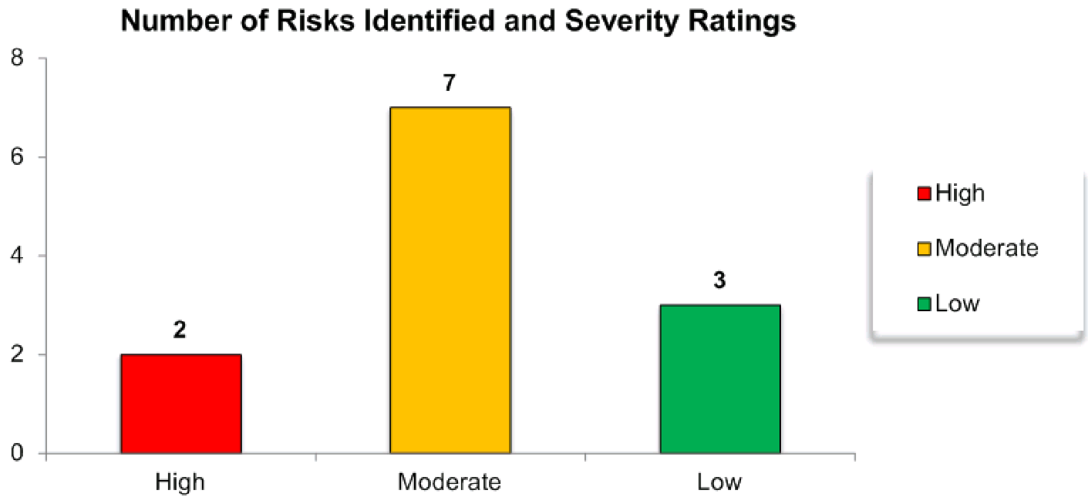
A Hawke's Bay Joint Working Group has been set up to collaborate matters around drinking water in Hawke's Bay. Representatives include HBRC, Hastings District Council, Napier City Council, Hawke's Bay DHB and drinking water assessors. Wairoa and Central Hawke's Bay District Council have been invited but have not attended to date. We recommend HBRC to encourage these councils to attend and consider how information can be shared with them.

We noted areas of good collaboration between HBRC and other Regional Councils. There is a group called The Compliance and Enforcement Special Interest Group ("CESIG") which meets regularly to discuss sector issues and challenges. The group performs peer reviews on the compliance and enforcement process where officers spend two to three days at other Councils assessing their processes. Additionally, every other year the group also undertakes peer reviews of other Councils' Dairy Monitoring Reports with an aim to improve the consistency throughout Regional Councils in the dairy farm resource consent process.

Risk monitoring programme
HBRC has recently implemented a risk monitoring programme. The risk monitoring programme applies risk-based criteria to identify the monitoring frequency of a consent which is based on the risk to human health and the environment. The risk monitoring programme is yet to be formally adopted, although it is largely applied in practice. We view the risk monitoring programme as an important control to manage, monitor and mitigate the significant number of consents held by the Council effectively. The Council should define its monitoring frequency appropriately to align with the resources available.

IRIS will improve efficiencies
We understand a new document management system (IRIS) will be implemented later in 2018 and will replace the current Daisy system. IRIS has been developed specifically for Regional Councils in New Zealand. IRIS is designed to manage the consent lifecycle and incorporates the regulatory role, particularly around the RMA. We understand IRIS will significantly improve a number of process such as recording and reporting.

A summary of the risks identified and severity rating is included below. Refer to Appendix 1 for risk definitions.



The table below provides a high-level summary of the recommendations relating to the observations that we consider to be high risk. We have provided, in sections 2 to 5, more detailed findings and practical recommendations for improvement across the identified areas. A high-level summary of results of our audit is provided in Appendix 3.

Attribute	Recommendation
Uncertainty over the responsibilities towards the National Environmental Standard for Sources of Human Drinking Water Standards **(Finding 1 on page 7)**	The Hawke's Bay Joint Working Group should establish the responsibilities for protecting sources of human drinking water from becoming contaminated within the Hawke's Bay region and develop appropriate procedures for managing, monitoring and reporting on impact of activities on drinking water sources.
Risk monitoring programme to be formally adopted **(Finding 3 on page 9)**	HBRC should formally adopt the risk monitoring programme. This should include the monitoring frequency that is appropriate to the risk appetite of the Council. In addition, the monitoring frequency should be achievable with the resources available. Management should be accountable for meeting the monitoring programme and if resources are not sufficient the additional risk (if any) of a consent not being monitored needs to be assessed, and communicated appropriately.

Crowe Horwath.
PART OF FINDEX

1.4 Basis and Use of this Report

This report has been prepared in accordance with our Scoping Document dated 24 January 2018 and subject to the limitations set out in Appendix 5 - Basis and Use of the Report. The report is written on an exceptions basis and therefore only areas requiring management consideration and action are included in this report.

We have separated our findings into four sections:

- Testing and Monitoring;
- Testing Results;
- Compliance and Enforcement; and
- Reporting.

Crowe Horwath.
PART OF FINDEX

2. Findings and Recommendations: Testing and Monitoring

1. Uncertainty over the responsibilities towards the National Environmental Standard for Sources of Human Drinking Water Standards		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
The Science Team is responsible for the State of the Environment Monitoring ("SoE") which is required by the Resource Management Act 1991 ("RMA") to monitor various environmental 'domains'. The National Environmental Standard for Sources of Human Drinking Water ("NES") is a regulation made under the RMA that sets requirements for protecting sources of human drinking water from becoming contaminated. The NES requires regional councils to ensure that the effects of activities on drinking water sources are considered in decisions on resource consents and regional plans. SoE monitoring does not specifically monitor the quality of drinking water within drinking water supply zones. The responsibility to monitor the quality of drinking water (to ensure it is safe for human consumption) rests with territorial authorities that supply drinking water. HBRC is responsible for managing and monitoring the effect of activities on the environment, whereas territorial authorities are responsible for monitoring the quality of drinking water at their point of take and within their supply network. The NES requires that the impact of activities on drinking water sources is managed. There is currently some uncertainty whose responsibility this is. The Hawke's Bay Joint Working Group are working through this issue. The groups roles and responsibilities are explained further in Finding 7 below. **Risk** There is a risk that the effects of activities on drinking water sources are not being adequately monitored and managed and subsequently the quality of drinking water is impacted.	The Hawke's Bay Joint Working Group should establish the responsibilities for protecting sources of human drinking water from becoming contaminated within the Hawke's Bay region and develop appropriate procedures for managing, monitoring and reporting on impact of activities on drinking water sources.	It is noted that this requires a multi-barrier approach and that all Joint Working Group parties understand their roles. Regional Plan provisions will include provisions for source protection zones. The Consents Team implements a Practice Note for the NES for Sources of Drinking Water when issuing consents It is noted that Territorial Authorities hold the responsibility for the provision of safe drinking water in their communities. **Responsible Person** Group Manager – Strategic Development & staff (plan changes) **Date of Implementation** As and when plan changes are notified

The relationship you can count on

Item 6

Attachment 4

Crowe Horwath
PART OF FINDEX

2. No set process for documenting and recording findings		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
When Monitoring Officers collect evidence in the field, they document and record information in diaries. The information documented is not always subsequently recorded on the consents file. We have seen some examples of good practice for dairy consents where templates are used and recorded on the consents file. We understand that the new IRIS document management system will have the ability for all information to be recorded on tablets which will be uploaded live to the system. The IRIS consenting system has been developed specifically for Regional Councils in New Zealand. IRIS is designed to manage the consent lifestyle and incorporates the regulatory role, particularly around the RMA. IRIS will replace the current Daisy document management system later in 2018. **Risk** When information is not stored centrally, there is a risk that if challenged, the Council may not be able to provide sufficient information to back up a decision.	HBRC should adopt a standard procedure for how information is documented and stored. We understand there has been successful roll out of IRIS to other Regional Councils. HBRC should work with other Regional Councils to understand the benefits of the system.	Management acknowledges that staff practice needs to improve with regard to attaching notes to electronic files. IRIS will incorporate the ability to document and record findings, and will have added functionality such as observation tags. **Responsible Person** Group Manager - Regulation **Date of Implementation** IRIS Implementation Date

The relationship you can count on

8

Crowe Horwath.
PART OF FINDEX

3. Risk monitoring programme to be formally adopted		Rating of finding: High
Finding	**Recommendations**	**Agreed Management action(s)**
At the time of our review there were over 4,300 resource consents issued by HBRC. The large number of consents requires a robust risk assessment process to prioritise resources to monitor compliance with consents effectively. HBRC have introduced a risk monitoring programme that assesses the likelihood of an event occurring and the risk to human health and the environment (including cultural, social and economic effects). The risk based monitoring programme allows Council to make informed regulatory decisions to ensure its compliance and enforcement activities focus on the biggest risks to the environment and human health and target those businesses and people least likely to comply. The risk monitoring programme is a process developed by the Resource Use Manager and has not been formally adopted. Each consent is rated: ▪ Priority 1: Must be monitored once a year ▪ Priority 2: Should be monitored once a year ▪ Priority 3: Would be good to be monitored once a year if time permits after monitoring priority 1 & 2 consents. The definitions of what risks and considerations that make a priority rating have not been documented. This is currently based on the judgement of the Resource Use Manager. **Risk** There is a risk that consents will not be rated appropriately and consequently not monitored at the correct frequency. This may lead to significant non-compliance not being identified.	HBRC should formally adopt the risk monitoring programme. This should include the monitoring frequency that is appropriate to the risk appetite of the Council. In addition, the monitoring frequency should be achievable with the resources available. Management should be accountable for meeting the monitoring programme and if resources are not sufficient the additional risk (if any) of a consent not being monitored needs to be assessed, and communicated appropriately.	It is recognised that priorities are judgement based but in accordance with the risk guidelines outlined in the Regional Sector Compliance Framework document. HBRC will document criteria for each priority level to ensure transparency and consistency in risk based approach used **Responsible Person** Group Manager – Regulation **Date of Implementation** Q1 2018/19

Crowe Horwath.
PART OF FINDEX

4. Lack of resources to effectively monitor consents		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
As described in finding 3 above the risk monitoring programme identifies the level of monitoring frequency required based on the risk rating. This could include multiple visits annually or none. Each year the consents are prioritised based on monitoring frequency. This may mean that a consent rated priority 3 may never be monitored. There is no process which ensures these consents are reviewed on a rolling basis. **Risk** If consents are not monitored in accordance with the risk monitoring programme, significant non-compliance may not be identified and issues resolved.	HBRC should ensure that the Resource Use Team is appropriately resourced to implement the risk monitoring programme. We understand that additional FTE have been requested for the 2018/19 financial year. In addition, if it is not possible to monitor all consents in accordance with the risk monitoring programme this needs to be communicated appropriately and the risk accepted.	It is noted that HBRC is currently equipped to monitor all priority 1 consents. Management have requested additional FTE in new LTP which will ensure additional monitoring of more consents. **Responsible Person** Group Manager - Regulation **Date of Implementation** Advertising of additional resource will commence post LTP sign off.

Crowe Horwath.
PART OF FINDEX

5. Lack of formal staff development programmes and succession planning		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
To provide context to the monitoring and enforcement of consents held by territorial authorities it was necessary to gain a high-level understanding of the consenting process. The Consents Team are responsible for ensuring the objectives of the Hawke's Bay Regional Management Plan, the requirements of the RMA and other key legislation, policies and standards have been considered and appropriately included within resource consents. The RMA allows the community to make decisions on their own environment which is managed through regional and district resource management plans. Decisions on resource consents are made with consideration of these plans, national direction and the objectives in the RMA. It is therefore important that staff are sufficiently experienced, qualified and competent to perform their role effectively. We understand there is an informal approach to staff development and staff performance appraisals. The recruitment process is the key tool used to ensure staff are sufficiently experienced and qualified. There is also on-going mentoring from senior staff members. Along with training and development, succession planning is an important tool to ensure there is a breadth and depth of talent to move into more senior positions. This allows for a smooth transition on the departure of a senior staff member. We understand that there is an informal approach taken towards succession planning. **Risk** There is a risk that staff do not remain current with relevant legislation and best practice. As a result, poor decision could be made.	The Consent Team should implement a formal professional development process for senior staff. Plans should incorporate: ▪ the minimum training requirements for each role; and ▪ requirements for setting, completing and reporting training. HBRC implements a formal succession planning process for the Consent Teams. This should include: ▪ Identification of roles that require succession plans; and ▪ For each role identification of current employees who are: - ready; - ready 1-3 years; and - ready 5 years+ Development plans should be in place for these roles. This recommendation is also relevant to the Resource Use Team.	Individual Performance and Development plans, including KPIs, will be in place for staff by 1 July 2018. In current reorganisation proposal that has been implemented there is implicit knowledge of formal successional hierarchy. It is also noted that consents and compliance staff do currently receive regular training relevant to their roles, and HBRC has recognised the **Responsible Person** Group Manager - Regulation **Date of Implementation** 1 July 2018

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

3. Findings and Recommendations: Testing Results

6. Monitoring Officer reports not reviewed		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
As part of our review we selected a sample of 15 consents across all four territorial authorities that covered both discharge (waste and storm water) and water take consents. The samples were chosen to identify the higher risk consents and identify potential examples of non-compliance. Our key findings are documented below: ▪ 6 consents were fully compliant. ▪ 9 consents were rated as either significant non-compliance, non-compliance or unable to be assessed. Appropriate action had been taken to address the issues of non-compliance. This included the use of 2 abatement notices. ▪ No issues were identified regarding the documentation of results. ▪ There was no evidence of review by the Team Leader. The Team Leader noted that he had reviewed some of the reports, however there was no way to confirm this. HBRC recently adopted a practice where all monitoring officer reports must be reviewed and signed off by the Team Leader before they are issued to the consent holder. This practice was adopted in December 2017. Previously, Monitoring Officers could provide reports directly to the consent holder without review. The driver for change was the outcome of the Havelock North Enquiry. The Team looked closely at their monitoring process and found examples where enforcement tools were not appropriately applied. In addition, territorial authorities were afforded more flexibility, and at times, follow up processes were lacking. Our testing procedures did not identify any examples where appropriate follow up had not taken place. There were two examples of when abatement notices were issued where information had not been provided in the required timeframe.	The Team Leader should sign off within the document management system (Daisy or its replacement IRIS) that the Monitoring Officer's report has been reviewed. The review should ensure that: ▪ the condition ratings are accurate; ▪ the level of documentation is sufficient; and ▪ any non-compliance has appropriate follow up. A report should then be able to be run from Daisy/IRIS to show all monitoring reports issued and identify any that had not been reviewed.	Management note that reviewing of all reports was implemented in December 2017 and was occurring at the time of the audit. All reports are reviewed by Team Leader – Compliance, and every six months Manager – Resource Use completes a random review of a number of reports in addition. **Responsible Person** Manager – Resource Use **Date of Implementation** This was implemented in December 2017.

The relationship you can count on

Item 6

Attachment 4

6. Monitoring Officer reports not reviewed		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Risk There is a risk that incorrect decisions could be made and monitoring reports could be issued directly to consent holders without appropriate review.		

Crowe Horwath.
PART OF FINDEX

7. Consent reporting to be improved		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Monitoring Officers manage their allocated consents on an MS Excel spreadsheet. All consents are risk rated and the work programme is designed to focus on the most significant risks first. On completion of a monitoring review the Daisy document management system is updated. Reporting is completed at an overall level that shows the number of consents monitored versus the number budgeted. There is no reporting that shows consents monitored by risk or sector. **Risk** There is reliance on staff completing their work effectively throughout the year. As regular reporting is limited there is a risk that issues may not be identified in a timely manner and rectified.	HBRC should complete reporting at a monitoring officer level that provides an overview of consents monitored based on the priority (risk) rating of the consent. This allows issues to be identified at an early stage, providing HBRC the ability to rectify any issues. We understand IRIS will have the ability to provide this reporting.	Regular work performance reporting occurs at several levels including Staff member – Team Leader, Staff member – Section Manager and Team Leader – Section Manager. OPAL 3 allows for formal reporting on numbers. IRIS will allow for enhanced reporting, such as reporting on consent by risk type. **Responsible Person** Group Manager - Regulation **Date of Implementation** IRIS Implementation

Item 6 **Attachment 4**

The relationship you can count on

14

Crowe Horwath.
PART OF FINDEX

8. IRIS to improve follow up process		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
When non-compliance with a consent is identified or further information is sought, the Council communicates a date to the consent holder for when information is required. Staff then use prompts in Microsoft Office as a reminder to follow up with the consent holder. There is no functionality within Daisy to provide automated alerts. We understand this will be incorporated into IRIS. We did not identify any issues in our testing procedures. **Risk** There is a risk that Monitoring Officers do not follow up on information requests. As the dates are not stored in the consenting system, this reduces the oversight available to the team leader.	On the implementation of IRIS all actions dates should be documented in the system. This will allow useful reporting such as running reports that shows the number of consent reports that are outstanding past the due date. This is particularly important for lower risk consents that may not be reviewed and followed up. An administrator could easily communicate and follow up late reports with consent holders.	Management notes that IRIS implementation will improve ability to follow up on all levels of consents. **Responsible Person** Group Manager - Regulation **Date of Implementation** Implementation

The relationship you can count on

Crowe Horwath
PART OF FINDEX

4. Findings and Recommendations: Compliance and Enforcement

9. Hawke's Bay Joint Working Group does not include all Councils		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
After a significant outbreak of gastroenteritis in Havelock North in August 2016, a government inquiry was commissioned. The inquiry ("the Report of the Havelock North Drinking Water Report") noted that in order to achieve a systematic approach to ensuring safe and reliable drinking water, there was a need to strengthen interagency working relationships, collaboration and information sharing pertaining to drinking water. Subsequently, a Hawke's Bay Joint Working Group has been set up with representatives from HBRC, Hastings District Council, Napier City Council, Hawke's Bay DHB and drinking water assessors. The group facilitates collaboration on matters around drinking water in the Hawke's Bay region. The group has invited both the Central Hawke's Bay and Wairoa District Council's to attend, however they have not attended to date. Representatives from HBRC include members of the Science and Consents Teams. **Risk** There is a risk that learnings and information shared between the relevant stakeholders are not communicated to the Central Hawke's Bay and Wairoa District Councils. This may result in confusion over the roles and responsibilities for water management between the parties.	Central Hawke's Bay and Wairoa District Councils are encouraged to attend the group. If this is not possible, then an alternative collaboration/form of communication needs to be considered. The key messages need to be communicated to these Councils.	HBRC staff will suggest at next Joint Working Group meeting to cc CHB and WDC in future Joint Working Group emails/correspondence. May require more formal approach again at political level. **Responsible Person** Group Manager - Regulation **Date of Implementation** Prior to next Joint Working Group meeting

The relationship you can count on

10. Lack of formal relationship between Science and Resource Use Teams		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
Effective communication within HBRC is necessary to ensure all parties are kept up to date with any issues identified or changes to requirements. This includes the relationship between the Resource Use and Science Teams. We understand there is an informal relationship between the teams on what information is passed between the teams. There is no formal agreement or procedure between the two parties that outlines the team's information requirements where issues identified may impact the other's activities. We understand there are examples such as the contamination of the Ahuriri Estuary where the Teams, led by the respective Executive Managers are working to positive outcomes. The participation of the Managers has resulted in clear roles and responsibilities. **Risk** There is a risk that relevant information is not passed between the parties. This may hinder any opportunities to improve monitoring performance for both parties.	A formal communication agreement and procedure should be implemented. The agreement should clearly define communication protocols and clarify what information is relevant to each group. The agreement should be drafted by the relevant Managers and be endorsed by the Group Managers.	Management agree with findings and note that while communication has improved in recent times, a formal agreement will be developed. **Responsible Person** Group Manager – Regulation Group Manager – Integrated Catchment Management **Date of Implementation** By end of current calendar year.

Crowe Horwath.
PART OF FINDEX

11.Complaint reporting to be improved		Rating of finding: Low
Finding	**Recommendations**	**Agreed Management action(s)**
All complaints are logged into an incident management system. The complaints are assessed using a risk based process which identifies the required response time. There is however no reporting which compares the actual response times against the planned response times. **Risk** There is a risk that incidents are not being responded to in the required time. This may lead to negative environmental affects if complaints such as pollution risks are not dealt with timely.	A regular report (monthly) should be prepared which shows the actual response time against the planned response time. We understand the IRIS system will incorporate this ability as well as other enhancements that will improve oversight by team leaders and management on the responses to complaints/incidents	Management notes that IRIS will assist and enhance reporting **Responsible Person** Group Manager – Regulation **Date of Implementation** Iris Implementation

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

5. Findings and Recommendations: Reporting

12. Lack of regular reporting		Rating of finding: Moderate
Finding	**Recommendations**	**Agreed Management action(s)**
There are number of formal and informal communications mechanisms used within the Resource Use Team. There are regular scheduled meetings between the Resource Use Manager and his Team Leaders and between the Resource Use Manager and the Group Manager External Relations. Formal reporting is completed quarterly through the OPAL 3 performance management system. OPAL 3 has both internal key performance indicators and service performance measures. There is a detailed formal report that is prepared annually, however there is no regular formal reporting from the Resource Manager to the Group Manager External Relations. Performance, including any issues or concerns, are raised in the regular meetings. **Risk** There is a risk that key information is not reported to the Executive or Councillors.	The Resource Use Manager should formally report to the Group Manager External Relations. This could include: ▪ The number of consents being monitored by: - performance (significant non-compliance, non-compliance, compliant, not assessed etc.); - sector for those that present a significant risk to the health of the community (i.e. territorial authorities, dairy etc.); - risk rating; and - where due dates for information have been breached. ▪ The number of complaints; ▪ Enforcement actions taken; ▪ Identification of any significant issues; ▪ Identification of any trends; and ▪ Identified actions from the previous period, responsibility and timeframe. Where possible the results from the corresponding period in the prior year should be shown. Where there are significant variances from the prior year or expectations, explanations should be provided.	It is noted that Manager – Resource Use and Group Manager – Regulation meet on a weekly basis. It is noted that IRIS is going to make reporting available in real time and Manager – Resource Use will be able to generate a report that will include information in recommendations to bring to their weekly meetings. In addition to this it is noted that reporting is a regular item on the E&S committee (Operational Activity Update), driven by both staff and Councillors. It is acknowledged that staff are very proactive at reporting any issues for Councillors. **Responsible Person** Group Manager – Regulation **Date of Implementation** IRIS Implementation

The relationship you can count on

Item 6

Attachment 4

Crowe Horwath.
PART OF FINDEX

Appendices

Appendix 1: Classification of Internal Audit Findings

Risk ratings are based on the use of professional judgement to assess the extent to which deficiencies could have an effect on the performance of systems and controls of a process to achieve an objective.

Rating	Definition	Guidance	Action required
High	• Issue represents a control weakness, which could cause or is causing major disruption of the process or major adverse effect on the ability of the process to achieve its objectives.	• Material errors and departures from the organisation's policies and procedures • Financial management / accountability / probity concerns • Non-compliance with governing legislation and regulations may result in fines or other penalties • Collective impact of many moderate or low issues	• Requires significant senior management intervention and may require significant mobilisation of resources, including external assistance. • Ongoing resource diversionary potential. • Requires high priority to immediate action
Moderate	• Issue represents a control weakness, which could cause or is causing moderate adverse effect on the ability of the process to meet its objectives.	• Events, operational, business and financial risks that could expose the organisation to losses that could be marginally material to the organisation • Departures from best practice management procedures, processes	• Requires substantial management intervention and may require possible external assistance. • Requires prompt action.
Low	• Issue represents a minor control weakness, with minimal but reportable impact on the ability to achieve process objectives.	• Events, operational and business risks that could expose the organisation to losses which are not material due to the low probability of occurrence of the event and insignificant impact on the operating capacity, reputation and regulatory compliance • Departures from management procedures, processes, however, appropriate monitoring and governance generally mitigates these risks.	• Requires management attention and possible use of external resources. • Requires action commensurate with the process objective.

Appendix 2: Detailed Scope

The detailed steps to be taken under each of the three areas of review are provided below.

- **Testing and Monitoring** – Assessing whether:
  - The testing regimes in place and volume and quality of information collected to determine whether the objectives of the Regional Resource Management Plan are being achieved.
  - The testing covers specific water take zones bodies in the region that supply water to the public including high risk aquifers and bores.
  - The testing is specific to ensuring the health and safety of the community.
  - The testing measures a comprehensive set of physical, chemical, bacterial and biological variables at a suitable frequency, and these variables have been appropriately defined.
  - Testing of compliance with discharge permits is undertaken to an appropriate level.
  - Testing of compliance with storm water discharge consents is undertaken to an appropriate level.
  - Testing of compliance with water permits and allocation limits is undertaken to an appropriate level.
- **Testing Results** – Assessing whether
  - Drinking water and waste water quality monitoring results are available for analysis in a timely manner.
  - Significant changes in monitoring results or monitoring results that could affect the health and safety of the community are escalated to relevant staff members on a timely basis.
  - Responses to results are undertaken on a timely basis (cause of the problem identified, steps taken to prevent ongoing freshwater quality degradation etc.)
- **Compliance and Enforcement** – Assessing whether
  - The Council is able to monitor compliance with regional rules and resource consents effectively to reduce unnecessary risk to communities, support health and safety and avoid adverse effects on the environment.
  - The Council is working effectively with specific industry and agricultural sectors to achieve greater levels of compliance.
  - The Council is working effectively with territorial authority consent holders to resolve issues of non-compliance.
  - Complaints received and pollution incidents are responded to in a reasonable timeframe and repeat incidents are identified and monitored.
  - The Council is using enforcement tools strategically and consistently to bring about greater rates of non-compliance and to encourage better resource management practices.

Crowe Horwath.
PART OF FINDEX

- The Council has appropriate reporting systems for identifying repeat non-compliance and tracking resolution of compliance issues.

- **Reporting** – Assessing whether
  - Testing, compliance and enforcement actions are reported accurately and on a timely basis.
  - Reporting provides information on the current state and trends in water quality in a manner that can be clearly understood.
  - Reports identify actions required to respond to issues identified and tracking of the completion of those actions.

Crowe Horwath.
PART OF FINDEX

Appendix 3: High Level Summary of Results

Detailed results of tests performed are indicated below by a red or green icon. A red cross indicates that a finding relating to this area has been included in section 2 of this report.

Area Tested	Result	Finding Ref
Testing and Monitoring		
The testing regimes in place and volume and quality of information collected to determine whether the objectives of the Regional Resource Management Plan are being achieved.	✗	1,2,5
The testing covers specific water take zones bodies in the region that supply water to the public including high risk aquifers and bores.	✗	3
The testing is specific to ensuring the health and safety of the community.	✓	
The testing measures a comprehensive set of physical, chemical, bacterial and biological variables at a suitable frequency, and these variables have been appropriately defined.	✓	
Testing of compliance with discharge permits is undertaken to an appropriate level.	✗	4
Testing of compliance with storm water discharge consents is undertaken to an appropriate level.	✗	4
Testing of compliance with water permits and allocation limits is undertaken to an appropriate level.	✗	4
Testing Results		
Drinking water and waste water quality monitoring results are available for analysis in a timely manner.	✓	
Significant changes in monitoring results or monitoring results that could affect the health and safety of the community are escalated to relevant staff members on a timely basis.	✗	6,7
Responses to results are undertaken on a timely basis (cause of the problem identified, steps taken to prevent ongoing freshwater quality degradation etc.)	✗	8
Compliance and Enforcement		
The Council is able to monitor compliance with regional rules and resource consents effectively to reduce unnecessary risk to communities, support health and safety and avoid adverse effects on the environment.	✗	9
The Council is working effectively with specific industry and agricultural sectors to achieve greater levels of compliance.	✓	
The Council is working effectively with territorial authority consent holders to resolve issues of non-compliance.	✗	10
Complaints received and pollution incidents are responded to in a reasonable timeframe and repeat incidents are identified and monitored.	✗	11

The relationship you can count on

Crowe Horwath.
PART OF FINDEX

Area Tested	Result	Finding Ref
The Council is using enforcement tools strategically and consistently to bring about greater rates of non-compliance and to encourage better resource management practices.	✓	
The Council has appropriate reporting systems for identifying repeat non-compliance and tracking resolution of compliance issues.	✓	
Reporting		
Testing, compliance and enforcement actions are reported accurately and on a timely basis.	✓	
Reporting provides information on the current state and trends in water quality in a manner that can be clearly understood.	✗	12
Reports identify actions required to respond to issues identified and tracking of the completion of those actions.	✗	12

Crowe Horwath.
PART OF FINDEX

Appendix 4: List of Interviewees

Name	Role
Wayne Wright	Manager Resource Use
Malcolm Miller	Consents Manager – External Relations Group
Melissa des Landes	Management Accountant
Stephen Swabey	Manager Environmental Science
Iain Maxwell	Resource Management Group Manager
Keith Peacock	Team Leader Compliance
Liz Lambert	External Relations Group Manager

Appendix 5: Basis and Use of this Report

This report is prepared on the basis of the limitations set out below:

- Our procedures were performed according to the standards and guidelines of The Institute of Internal Auditors' International Professional Practices Framework. The procedures were not undertaken in accordance with any auditing, review or assurance standards issued by the External Reporting Board (XRB).
- Because of the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they were not performed continuously throughout a specified period and any tests performed were on a sample basis.
- Any projection of the evaluation of the control procedures to future periods is subject to the risk that the systems may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.
- The matters raised in this report are only those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the weaknesses that exist or improvements that might be made. We cannot, in practice, examine every activity and procedure, nor can we be a substitute for management's responsibility to maintain adequate controls over all levels of operations and their responsibility to prevent and detect irregularities, including fraud. Accordingly, management should not rely on our report to identify all weaknesses that may exist in the systems and procedures under examination, or potential instances of non-compliance that may exist.
- Recommendations for improvement should be assessed by management for their full commercial impact, before they are implemented.
- This Report is not to be used by any other party for any purpose nor should any other party seek to rely on the opinions, advice or any information contained within this Report. In this regard, we recommend that parties seek their own independent advice. Crowe Horwath disclaims all liability to any party other than the client for which it was prepared in respect of or in consequence of anything done, or omitted to be done, by any party in reliance, whether whole or partial, upon any information contained in this Report. Any party, other than the client for which it was prepared, who chooses to rely in any way on the contents of this Report, does it so at their own risk.

The information in this Report and in any related oral presentation made by Crowe Horwath is confidential between Crowe Horwath and the client for which it was prepared and should not be disclosed, used or duplicated in whole or in part for any purpose except with the prior written consent of Crowe Horwath. An Electronic copy or print of this Document is an UNCONTROLLED COPY.

Crowe Horwath

Contact Us

Phil Sinclair
Senior Partner – Audit & Assurance
phil.sinclair@crowehorwath.co.nz

Martyn Solomon
Associate Partner – Audit & Assurance
martyn.solomon@crowehorwath.co.nz

Crowe Horwath
Level 1, 211 Market Street,
Farming House
Hastings 4122
Tel +64 6 872 9200
www.crowehorwath.co.nz

Hawke's Bay Regional Council
159 Dalton Street
Napier 4110

Attention: Jessica Ellerm, Group Manager Corporate Services

5 June 2018

Treasury Policy Recommendations

Dear Jessica,

PricewaterhouseCoopers (PwC) has pleasure in providing this letter outlining its recommendations in relation to the Liability Management and Investment Policy documents (i.e. Treasury Policy) of Hawke's Bay Regional Council (HBRC). The review of these documents forms part of the deliverables outlined under our letter of engagement dated 21 May 2018.

Observations and recommendations

The review of Council's current Liability Management and Investment Policies (Policy) focussed on ensuring that the documents provided the necessary framework and controls in facilitating Council's external Investment Fund and appointment of an Investment Manager, as well as membership of the Local Government Funding Agency (LGFA) to meet its debt funding requirements as outlined in the 2018-28 LTP.

Further additions to the Policy have also been recommended to ensure that the document continues to represent best treasury management sector practice.

Key amendments and recommended changes to the Policy are discussed below.

PricewaterhouseCoopers, 113-119 The Terrace, PO Box 243, Wellington 6140 New Zealand
T: +64 4 462 7000, F: +64 4 462 7001, www.pwc.com/nz

Investment Policy

Responsible investment

Expanded to further articulate Council's decision-making process in relation to responsible and ethical investments.

External Investment Fund

The Investment Policy reflects the establishing of the Statement of Investment Policy and Objectives (SIPO). Outlines a set of Council responsibilities to ensure there are sufficient controls in place for the operation and management of activities relating to externally managed funds.

NZ Local Government Funding Agency Limited investments

A broad section is included whereby Council may invest in shares and financial instruments issued by the LGFA and may borrow to fund that investment. Approved investment instruments include borrower notes that Council incurs upon borrowing from the LGFA.

Treasury investments

An articulation of treasury investments is included, representing those investment funds that Council will invest in and manage internally. The rationale for Council maintaining these funds is described, as well as the responsibilities and requirements of the CFO in prudently investing these funds.

Investment parameters

For Council internally invested funds, to achieve the dual objectives of managing maturity and interest rate repricing risks, Council invests within the recommended limit system. The limits encourage a spreading of maturities to reduce concentrations, but also good practice is to match investments to the planned expenditure needs.

At all times, there must be at least 50% of the total investment portfolio invested with a maturity term no greater than one year. For liquidity management purposes, a minimum investment maturity requirement within a year aims to ensure that access to liquid funds is maintained to manage reasonably unforeseen expenditure requirements. Furthermore, the maximum term of investments has been restricted to three years, while Council's externally managed investments under the documented SIPO provide for longer investment horizons.

Specific investment criteria

A matrix of allowable cash and fixed interest investment instruments, as well as counterparty credit limits, is included. Note that no limits or parameters for equity or property investment assets have been contemplated, as these investments are managed through Council's SIPO document.

Specific limits for each investment category are included, restricting and diversifying the amounts invested. Minimum credit rating criteria, counterparty diversification requirements and a maximum percentage of the investment portfolio are controls that spread approved investment activity. The policy limits consider the New Zealand fixed interest market in terms of the market depth, liquidity and availability of fixed interest securities.

Capital protection objectives are met through the stated credit rating criteria that requires a minimum short-term and long-term credit rating from Standard & Poor's (or equivalent rating agency). Although investment categories range from a very strong credit rating of AAA to an investment grade rating of BBB+, the Policy differentiates counterparties by limiting the amount invested per counterparty and rating segment, together with a percentage of rates revenue at risk limit.

The counterparty limit system encompasses cash and fixed interest investments held internally by Council and those within the Investment Fund.

pwc

Disaster Damage Reserve

The portfolio weightings of domestic and international equities have been amended to more closely align with the strategic asset allocations contained within the SIPO document. We have suggested an increased allowable weighting in equities (from 30% to 45%) to support Council's stated objective to generate long-term capital appreciation for the Reserve.

Liability Management Policy

General policy and objectives

A sub-section is included encompassing the considerations Council should make when evaluating strategy for new borrowings. Also included are general objectives, as they play an important role in aligning Council's treasury management framework.

Local Government Funding Agency Limited

Allowable transactions that are consistent with borrowing through the LGFA are articulated within the Policy. Specifically, Council is able to contribute a portion of its borrowing back to the LGFA as an equity contribution, provide guarantees of the indebtedness of other local authorities to the LGFA, commit additional equity (or subordinated debt) to the LGFA if required and subscribe for shares and uncalled capital in the LGFA.

Guarantees/contingent liabilities and other financial arrangements

Parameters for the granting of guarantees by Council have been included, incorporating types of guarantees that may be granted, restrictions and the requirement to maintain sufficient funding to meet amounts guaranteed.

Specific borrowing limits

A table is included, which summarises the specific borrowing limits that Council adheres to, in conjunction with the LGFA's lending policy limits that Council will need to meet as a non-credit rated guaranteeing member borrower. The suggested Council limits need to be discussed and approved with Council.

We suggest the net external debt as a percentage of debt plus equity ratio is removed, consistent with the majority of the local government sector. The ratio is considered more appropriate for a corporate borrower, whereas Council's equity is largely non-realisable infrastructure and underground assets. The ratio is not an LGFA lending policy requirement.

A liquidity ratio requirement has been included to align with local government sector practice and alignment with LGFA lending policy. The definition of liquidity seeks to reflect liquid funds, that is, assets that are readily convertible to cash and committed bank facilities. Specific types of liquid assets are identified as well as the percentage values, which can contribute towards the ratio.

Liquidity and funding limits

The Policy includes risk control limits to manage the debt maturity profile of total committed debt funding in respect of all external debt and committed bank debt facilities.

The LGFA requires that no more than the greater of NZD 100 million or 33% of Council's borrowings from the LGFA matures within an immediate 12-month period.

Good liquidity and debt management practice is to forward manage upcoming debt maturities. Therefore, we have included the ability for Council to pre-fund upcoming debt maturities that are maturing in the next 12-month period.

To provide some flexibility around the maturing of the debt profile, a 90-day period of non-compliance to the debt funding limits is allowable should the period self-correct within this timeframe.

Security

The security section has been amended to recognise that Council's external borrowings and interest rate risk management instruments are secured by way of a charge over rates and rates revenue through the Debenture Trust Deed.

Approved financial instruments

A list of approved cash management, borrowing, investment and interest rate risk management instruments have been added. These instruments represent the typical instruments used by sector peers and are consistent with best treasury practice.

Interest rate risk management

Risk control limits are included to enable proactive management of interest rate risk on forecast external debt amounts. To best meet the objectives of interest rate certainty and spreading of interest rate repricing risks, we have recommended the 'corridor-style' interest rate risk management policy. With the use of approved interest rate instruments, Council fixes its interest rate position in the corridor between the minimum and maximum policy percentage parameters.

This style of Policy provides a simple view of the overall interest rate risk position, as well as being flexible, allowing Council to manage interest rate risk according to changing debt forecasts. Consistent with the 10 year LTP plan and Council's long-term borrowing through the LGFA, the 'corridor' style Policy has a longer term outlook for debt forecasts and interest rate management.

A 90-day period of non-compliance with the stated interest rate risk limits is allowable should the period self-correct within this timeframe. The inclusion of this Policy statement prevents restructures of the fixed interest rate portfolio for temporary breaches of policy parameters.

The Policy allows interest rate hedging up to 15 years, consistent with peer councils and with Council's longer term planning cycle and ability to borrow from the LGFA through to April 2033.

Importantly, how the approved interest rate management instruments are used and not used are included as a policy statement.

Foreign currency

The Policy articulates an approach to the management of foreign currency risks associated with the occasional purchase of foreign exchange denominated services, plant and equipment. All foreign currency exposures above NZD100,000 are to be hedged using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts are included as allowable risk management instruments.

Foreign currency management for the external Investment Fund is covered in the SIPO document.

Management responsibilities

A section is included to provide an overview of the treasury management structure of Council and articulates specific treasury management responsibilities. Based on the available personnel, we have endeavoured to segregate the treasury duties between approval, execution, checking and reporting treasury functions.

Operational risk, dealing authorities and limits, segregation of duties, and procedures and controls

To support effective internal controls, cross-checking and maintaining the segregation of duties in managing treasury risks, the Policy articulates Council's approach to mitigating operational risks.

The suggested delegations should be consistent with Council's existing delegations policy. Daily dealing limits have been introduced to ensure control around the day-to-day treasury activities.

Reporting

Requirement of reporting of treasury related activities is included, outlining types of reports, frequency, who prepares and recipients.

We are available to discuss the recommendations of this review of Council's Liability and Investment Management Policies as required.

Yours sincerely,

BA Johanson

Brett Johanson
Partner
Treasury Advisory
T: +64 4 462 7234

pwc

Disclaimer

This Letter has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

This Letter is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, we do not accept a duty of care to any third party in connection with the provision of this Letter and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, we do not accept liability of any kind to any third party and disclaim all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of Hawke's Bay Regional Council ("HBRC or Council"). Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this Letter are based on information available as at the date of the Letter.

We reserve the right, but will be under no obligation, to review or amend our Letter, if any additional information, which was in existence on the date of this Letter was not brought to our attention, or subsequently comes to light.

We have relied on forecasts and assumptions prepared by Council about future events which, by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

This Letter is issued pursuant to the terms and conditions set out in our engagement letter dated 21 May 2018 and the Terms of Business attached thereto.

Draft Funding and Financial Policies

Contents

Draft Investment Policy

1. General Policy Context

HBRC's Investment Policy is consistent with its objectives, Long Term Plan (LTP), Annual Plans and established in accordance with the following relevant legislation:

- Local Government Act 2002, in particular sections 102 and 105.
- Trustee Act 1956. When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and that they shall exercise care, diligence and skill that a prudent person of business would exercise in managing the affairs of others. Details of relevant sections can be found in the Trustee Act 1956 Part II Investments.
- Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.

2. Purpose

The purpose of the Investment Policy is to present HBRCs policies in respect to investments including:

- The mix of investments
- The acquisition of new investments
- An outline of the procedures by which investments are managed and reported to Council
- An outline of how risks associated with investments are assessed and managed.

3. Scope

HBRC has a significant portfolio of investments comprising of:

- Equity investments
- Property investments
- Forestry investments
- Treasury investments
- Externally managed investment funds

Investments bound by this Policy are all of HBRC's financial assets and reserves, which are held to produce a financial return within accepted risk parameters, and help achieve its strategic economic objectives, while collectively retaining their real capital value over the period of their ownership.

The real capital value is the current market value in New Zealand dollars (based on market or independent valuation) adjusted for movements in the CPI.

There are two investment categories that HBRC may invest in:

- **Financial Investments** – the purpose of financial investments is to provide annual cash income at budgeted amounts.
- **Blended Investments** – the purpose of blended investments are to invest in projects that may have a combined objective of providing some financial benefit as well as environmental or regional economic growth benefits. Blended investments are only to be invested in if the total investment portfolio can provide the annual cash income requirements of HBRC.

4. Objectives

The objectives of this Investment Policy are to:

- to manage investments to optimise returns in the long term whilst balance risk and return considerations
- to balance the mix of financial investments and blended investments
- obtain an acceptable ongoing annual cash income from the investment portfolio as a whole
- ensure sufficient cash is available (liquidity) as needed to assist with the funding of HBRC's ongoing operations and to meet known and reasonably unforeseen funding requirements, maintain long term gains in capital value of its investments for the benefit of future as well as current generations of ratepayers
- hold certain investments for strategic benefits as well as for the financial benefits to the region
- invest funds within an environment of control and compliance so as to protect HBRC's financial assets
- to minimise exposure to credit risk by investing in credit worthy counterparties
- to ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions
- develop and maintain relationships with financial institutions, credit agencies, LGFA, investment managers, investors and investment counterparties.

5. Responsible Investment

Investments will be made with judgment and care, under circumstances prevailing at the time which people of prudence, discretion and intelligence exercise in the professional management of financial assets.

HBRC does not make speculative investments (such as contracts for difference in prices over time of any commodity or asset and other financial derivatives) or any other investments not detailed within this Policy or Council's SIPO document. Council has adopted an ethical based investment strategy. This will involve companies and industries being reviewed for sustainability, socially responsible and ethical practices. Investments will be periodically reviewed against these principles; any contraventions discovered will lead to the prudent and timely divestment.

Its economic and financial objectives should be achieved by balancing potential risks. Prudent investment management requires managing investment risk and return by consideration of the mix of investments by investment class, and location.

In its financial investment activity, HBRC's primary objective is to protect the value of its assets. Accordingly investment may only be made in creditworthy counterparties having acceptable standing and credit ratings. Where investments are externally managed these activities are approved under a separate policy.

6. Ethical Investment

Where practical, investments will consider the ethical practices of the investment entity. HBRC's intention for its investment portfolio is to avoid direct involvement with industries that have a negative impact on society and the environment. This includes but is not limited to:

- Alcohol
- Tobacco
- Fossil fuels
- Military/weapons.

7. Externally Managed Funds

Where Council funds are to be managed externally by a suitably qualified Investment Manager, investment funds (Funds) are managed in line with a separate Statement of Investment Policy and Objectives (SIPO) document. An external Investment Manager will be appointed in the knowledge of and operate the portfolio according to, the investment guidelines outlined in the SIPO.

Council will be responsible for the following:

- Setting the Fund's Investment Strategy, including the level of risk and investment performance objectives, and investment policies.
- Selecting and changing the Manager as appropriate after having taken advice from the Investment Advisor.
- Formally reviewing the SIPO annually, including the investment strategy, policies and manager configuration, and instructions to the Investment Manager.
- Formally reviewing the SIPO every three years by an external independent Investment Advisor. The review includes the investment strategy, return objectives, policies and manager configuration, and instructions to the Investment Manager.
- Ensuring that the level of redemptions from the Fund is consistent with the Fund's objective to maintain its real capital value, and amounts available for distribution, between present and future generations.
- Providing cash flow information to the Investment Manager with respect to future deposits to, and redemptions from the Fund.
- Appointing the external Investment Advisor.

The strategic asset allocation and tactical ranges provided below are included within HBRC's SIPO document:

Sector	Benchmark %	Ranges %
NZ equities	15%	13% - 18%
International equities (fully hedged)	29%	25% - 34%
NZ property	3%	1% - 4%

International property (fully hedged)	3%	1% - 4%
Total growth assets	**50%**	**40% - 60%**
Cash and short term securities	5%	2% - 8%
NZ fixed interest securities	20%	15% - 24%

8. Mix of Investments

Equity Investments

HBRIC Ltd

Since its establishment on 1 February 2012, HBRC beneficially owns 100% of the shares in HBRIC Ltd, a company established to manage HBRC's corporate investments.

HBRIC Ltd is classified as a strategic asset in terms of Section 97 of the Local Government Act 2002.

A key requirement of HBRC is that HBRIC adopt an investment policy for the management of the investments that is consistent with, and reflects the purpose, objectives and requirements of this investment policy, which will remain the overriding policy document for all HBRC's investments, including any investment company and its assets.

HBRC sets a series of performance and strategic targets for HBRIC Ltd in an annual Statement of Objectives, which in turn is reflected in the company's annual Statement of Intent (SOI). The 2017-18 performance targets as set out in HBRC's Statement of Objectives for HBRIC Ltd are outlined in the following tables.

Hawke's Bay Regional Investment Company Initial Performance Targets (subject to annual SOI review) HBRIC Ltd Parent 2017-18	
Performance Indicator	**Target**
Net debt to net debt plus Equity	<10%
Interest cover (EBIT/Interest paid)	>3x
EBITDA/Total Assets	3%
Return on Shareholder's Funds	3%

Notes:

Hawke's Bay Regional Investment Company Initial Performance Targets (subject to annual SOI review) Consolidated 2017-18	
Performance Indicator	**Target**
Net debt to net debt plus Equity	<40%
Interest cover (EBIT/Interest paid)	>3x
EBITDA/Total Assets	9%
Return on Shareholder's Funds	5%

EBIT = Earnings Before Interest and Tax
EBITDA = Earnings Before Interest, Tax, Depreciation and Amortisation

These performance targets may change from year to year as a result of HBRC's annual review of its Statement of Objectives and the company's Statement of Intent and changing economic, market and financial circumstances.

As controlling shareholder HBRC appoints the directors of HBRIC Ltd and, as controlling shareholder, HBRC will have an expectation that the company's policies will support its strategic objectives.

Port of Napier Limited

As at 30 June 2017, HBRC beneficially owned 100% of the shares in PONL through HBRIC. HBRC's strategic objective is to continue to beneficially hold a majority of the shares of PONL as a key means of assisting economic development of the region. The investment is expected to be a significant source of non-rate revenue and has long term prospects for growth and development.

As controlling shareholder HBRC approves the appointment of the directors of PONL recommended by HBRIC Ltd.

Property Investments

Napier leasehold property

HBRC owns leasehold endowment property within and around Napier City. The portfolio was acquired in 1989 during the reformation of Local Government, and under the terms of each lease, the properties can only be sold to lessees. This means HBRC will retain ownership of each lease unless the lessor is willing to buy the freehold interest in the property at a value acceptable to both lessee and lessor.

HBRC intends to continue to sell freehold interests to lessors wherever an acceptable sale price can be achieved, and reserves the right to sell the annual cash flows arising from ongoing rents paid by lessors from time to time. With effect from 1 July 2013, HBRC sold the annual rentals due from this portfolio over the next 50 years (i.e. until July 2063) to ACC for a lump sum of $37.8 million. The underlying properties continue to be owned by HBRC and sales to lessors have continued, and may continue in the future, in the same way as they have done in the past.

Ground rents paid by lessors have been predominantly set at 5% or "fair annual ground rental" and reviewed every 21 years.

Wellington leasehold property

HBRC owns 12 leasehold properties in the suburbs of Kelburn and Thorndon in Wellington, which are not subject to endowment restrictions. These leases provide an annual return with leases renewed every 14 years. HBRC reserves the right to sell some or all of these properties and reinvest the proceeds in appropriate investment classes specified in this policy.

Other Property Investments

HBRC may invest in other property if they meet section 1 to 6 of this investment policy and the correct delegations are engaged.

Forestry Investments

HBRC has an existing forestry portfolio consisting off:

Site Name	Area (ha)	Assumptions
CHB	168	No material investment, maintenance only, no harvesting in LTP period
Mahia	36	No material investment, maintenance only, no harvesting in LTP period
Waihapua	213	No material investment, maintenance only, no harvesting in LTP period
Tutira	114	Harvesting proposed over the period from 2018/19 to 2022/23. Replanting after harvest
Tutira Manuka Honey	130	Maintenance continues with yearly honey income of $46,000 assumed
Tangoio	150	Harvesting proposed over the period from 2020/21 to 2021/22. Replanting after harvest

Return on the forestry investments are determined by the harvest revenue received.

Tangoio forestry is treated differently from all the other forestry investments as HBRC does not own the land but does have responsibility for the management and control of the forest. Any income received from harvest is kept on reserve to fund the continuing maintenance programme and is not available for the funding of general.

NZ LGFA Limited Investments

Despite anything earlier in this Investment Policy, the Council may invest in shares and financial instruments issued by the New Zealand Local Government Funding Agency Limited, and may borrow to fund that investment.

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

- obtain a return on the investment, and
- ensure that the LGFA has sufficient capital to become and remain viable as a source of debt funding for the Council.

Because of this dual objective, 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, Council may also subscribe for uncalled capital in the LGFA.

Treasury investments

Council maintains Treasury Investments for:

- investing money allocated to accumulated surpluses, Council-created special, and restricted reserves, and general reserves,
- investing funds allocated for approved future expenditure in strategic initiatives or support inter-generational allocations,
- Investing funds arising from pre-funding upcoming maturing debt amounts,
- investing surplus cash, to be used for operational and capital expenditure requirements and
- investing proceeds from asset sales.

Treasury Investments will be managed within Council by the CFO and will be prudently invested as follows:

- Investments which have the intention of supporting liquidity should be matched to meet future cash flow and capital expenditure projections.
- Interest income from financial investments is credited to general funds, except for income from investments for special funds, reserve funds and other funds where interest income may be credited to the particular fund.
- The CFO executes Council's investment strategy within approved policy limits by regularly reviewing cash flow forecasts (incorporating plans for approved expenditure and strategic initiatives).
- Council adopts a conservative risk position for these funds and only accepts investments that have a minimum risk of loss. Accepting that a low-risk portfolio may result in lower returns.
- Treasury Investments must be compliant with the Investment Parameters, Approved Financial Instruments and Counterparty Credit Limits sections of this Policy.

Term deposits

HBRC currently holds both investment and reserve funds on term deposits with approved banking institutions.

9. Investment Parameters

The following percentages are calculated on the total current investment portfolio managed internally by Council. These Policy limits concurrently apply to both the maturity term and the interest rate re-pricing profile of the investment portfolio (and should be reported separately where they differ):

Maturity Term	Minimum limit	Maximum limit
0 to 1 year	50%	100%
1 to 3 years	0%	50%

When cash flow projections are changed, the maturity profile may have to be adjusted to comply with the policy limits.

The Council must only invest in acceptable financial instruments and counterparties, as covered in the Approved Financial Instruments and Counterparty Credit Limits sections of this Policy.

10. Acquisition of Investments

New investments will be acquired from time to time within the investment classes specified in accordance with the policies and objectives recorded in this policy.

New investments will be made by HBRC, HBRIC and its officers in accordance with the management authorities and delegations summarised below.

Acquisition of new investments will be made after assessment of their benefits, alignment with strategic objectives, costs and risks in accordance with the assessment procedures approved by HBRC from time to time.

11. Disposal of Investments

Sale or liquidation of investments held for special purpose reserves may only occur when the funds are required for the particular purpose each reserve was established for by HBRC.

Any disposal of unrestricted assets requires the approval of Council, other than those made within delegated authority granted by HBRC.

HBRC regards Napier Port as a strategic asset and will retain beneficial control of it through its wholly owned investment company. In the event it contemplates reducing its interest in Napier Port from its present 100% shareholding to not less than 51% (i.e. still retaining control) by selling shares to a third party (or parties) or by changing how the Napier Port is managed and operated, it will comply with the provisions of Section 97(1)(b) of the Local Government Act 2002 where “a decision to transfer ownership or control of a strategic asset” is to be considered.

HBRC will use either the Annual or LTP process, or a separate Special Consultative Process, it deems appropriate at the time, to obtain the views of ratepayers and stakeholders on its proposed sale of shares before committing to it.

HBRC wishes to retain the right to use a limited amount of funds from the proceeds of the disposals of leasehold property for purposes other than reinvestment in the investment classes of this policy, where appropriate. Such purposes will be restricted to capital related projects, loans (including interest free loans), and servicing the costs of borrowings by HBRC used for these purposes and may be initiated by HBRC or other organisations in the region. When proposing such a course of action, HBRC will, subject to the exceptions stated below, adopt a special consultative process under the Act which will ensure a fully inclusive decision making process with the Hawke’s Bay regional community. This process is intended to extensively canvass the community’s views and seek their input into any such proposals.

There will be no requirement to carry out a special consultative process when:

- no more than $300,000 of sale proceeds will be used for any one project, or
- HBRC uses the sales proceeds to acquire land or enters into partnership for the development of further open space areas, particularly those that are in environments that are of high ecological or landscape value or extensively used by the public.

HBRC’s objective will be to indicate in either the LTP or relevant Annual Plan any proposals not covered by the above exceptions. There may be some occasions when the special consultative process for such initiatives may not always coincide with these HBRC planning processes and so may occur as standalone consultations.

12. Disposition of Income

Investment income other than that to be applied to reserve funds and in compliance with the provisions of Section 3(b) of the Endowment Act, will be included in the revenue account and used for the general purposes of HBRC.

13. Risk Assessment and Management

The risk profile of the investment portfolio is continuously assessed to ensure adherence to the following risk management rules:

- HBRC will not invest where there is a significant known risk of decreased asset value, except where it has identified potential advantages to the Hawke's Bay economy in pursuit of its economic development objectives that may arise from making particular investments and has assessed whether potential economic gains could more than offset any potential decreases in asset value.
- For prudent management, while retaining a flexible approach to future investment opportunities, no more than 33% of HBRC's total investment portfolio will be invested in any one investment, or institution or groups of institutions in the same investment class, other than in institutions which are Government guaranteed (in which instance up to 100% of the portfolio may be invested). This rule does not apply to existing investments in Napier Port and Napier endowment property and the investment company established by HBRC.
- HBRC may use financial derivatives to "hedge" against fluctuations in interest rates and equity indexes. In some instances HBRC matches foreign currency denominated purchases with forward exchange contracts to reduce the risk of exchange rates increasing the cost of its purchases.
- HBRIC and Napier Port (and subsidiary Council Controlled Organisations (CCTO's) yet to be formed) will from time to time use interest-rate swaps and forward exchange contracts to manage interest rate and currency risk, consistent with prudent treasury and risk management practices.
- HBRC will appoint external professional investment advisers to provide an overall assessment of investment markets using its market intelligence and independent monitoring, and, specifically, to manage the funds invested in HBRC's managed funds portfolio and HBRC's Disaster Damage Reserve.

14. Investment Classes

HBRC can invest in the following investment classes.

14.1 Investment Instruments

Investment instruments include bonds, debt securities, cash, bills, commercial paper and term deposits. International investments are managed within the external Investment Fund.

14.2 Investment Property

Investment property includes Napier endowment property and other unrestricted investment property assets. New Zealand and international property investments are managed within the external Investment Fund.

14.3 Forestry

This includes physical assets including trees and land for forestry and forest development.

14.4 Equities

This excludes the Port of Napier, but includes shares in publicly listed New Zealand and International Companies. Equites are managed through the external Investment Fund by an appointed Investment Manager.

New Zealand carbon units (or emission units) are purchased for the satisfaction of Council generated carbon liabilities.

14.5 Related Equity Investments

Equity investments in HBRIC, PONL, CCTOs, and other subsidiary companies established in accordance with this policy, including those established by HBRIC.

14.6 Equity Investments: Joint Ventures

Equity investments in joint ventures with external partners.

14.7 Loans and Mortgages

This includes mortgages to buyers of the freehold of Napier endowment property.

14.8 Investment Portfolios

Both professionally managed (external to HBRC) and internally managed investment portfolios of assets classes itemised in this Section, either by direct investment or through unit trusts or other structures.

14.9 Internal loans

Internal Loans for the development of infrastructure and property, plant and equipment assets.

15. Specific Investment Criteria

15.1 Investment Instruments

Investments made under this investment class are only made in alignment with the following parameters:

Issuer / counterparty	Instruments	Minimum short term credit rating	Minimum long term credit rating	Maximum exposure per counterparty (% of rates revenue[1])	Maximum exposure per counterparty Category (% of rates revenue[1])
New Zealand Government	Treasury bills, NZ government bonds, debt issued by entities explicitly guaranteed by the NZ Government	n/a	n/a	unlimited	100%
RBNZ registered banks	Term deposits	A-1	A+	50%	100%
	Bank bills	A-1	A+	30%	
	Bonds	A-1	A	20%	
	Interest rate risk management contracts	A-1	A+	15%	
LGFA	Borrower notes, bonds, CP	A-1	AA-	40%	40%
Local authorities –rated	Local authority bonds, CP	A-1	AA-	20%	50%
Local authorities – non rated	Local authority bonds, CP	n/a	n/a	5%	20%
Supranational	Bonds	n/a	Aa+	40%	40%
Other issuers including state owned enterprises, listed companies	Commercial paper,	A-1+	AA-	15%	25%
	Corporate bonds	A-2	BBB+	10%	

- Investments (such as bank deposits) – Transaction Notional × Weighting 100% (unless a legal right of set-off over corresponding borrowings exists whereupon a 0% weighting may apply)
- Interest Rate Risk Management (such as swaps, FRAs) – Transaction Notional × Maturity (years) × 3%.
- Individual counterparty limits are kept on a register and updated on a day to day basis with specific approvals made by the GMCS. Credit ratings should be reviewed by the FA on an ongoing basis and in the event of material credit downgrades; this should be immediately reported to the GMCS and assessed against exposure limits. Counterparties exceeding limits should be reported to the Council.

[1] Rates revenue is defined as general rates, targeted rates and uniform annual general charges and in the 2017 Annual Report was $17.66 million.

Approved Treasury Investment Instruments

Category	Instrument
Treasury Investments	Bank term deposits (senior) Treasury bills(senior) Commercial paper (CP) (senior) Bank certificates of deposit (RCDs) (senior) Local Authority bonds (secured) State Owned Enterprise (SOE) bonds (senior) Government and Supranational bonds (senior) Corporate bonds (senior) LGFA borrower notes Note: bonds are either fixed rate or floating rate.

15.2 Investment Portfolios (excluding the Disaster Damage Reserve)

Investment portfolios may invest in any of the investment classes indicated in this policy.

The portfolio must earn at least 4.5% cash return on the funds for the first year of the LTP and then a 5% cash return for the rest of the LTP in line with the financial strategy.

Fund managers have the responsibility to obtain these returns while taking into account the following considerations and requirements of this policy.

- Cash Return
- Liquidity
- Capital Gains
- Risk Balance – Location, Industry risk
- Diversification of investments
- Responsible Investment
- Ethical Investment

15.3 Disaster Damage Reserve

As a specific part of its Disaster Damage Reserve HBRC holds New Zealand Shares and quasi equity instruments (such as convertible notes) listed on the New Zealand Stock Exchange, as well international shares (held in diversified global funds which may be investment trusts, investment companies or unitised funds).

These investments are held to generate long term capital appreciation for the Reserve, while providing ready liquidity in order to meet any call on the Disaster Damage Reserve funds.

Investments in equities for the reserve are limited to an overall maximum of 45% of the Disaster Damage Reserve, and further limited to:

- New Zealand shares - up to 20% of the Reserve
- International shares - up to 35% of the Reserve (fully hedged)

15.4 Other Reserves

HBRC holds a number of reserves for which is holds investments for. These include asset replacement provisions, disaster damage management and land drainage and flood control schemes. These funds need to be readily realisable to meet their particular purposes. All of the returns for these reserves are retained within the individual reserves.

15.5 HBRC Cash Reserves

HBRC also needs to maintain a working capital balance to ensure it can meet its obligations as and when they fall due. It is therefore important to maintain a continuing “cash reserve” in this form at a level no less than $3 million.

15 Investment Management Responsibilities and Delegations

Investment management responsibilities and powers to delegate are summarised in the following table.

Investment Policy Investment Management Responsibilities and Delegations	
Responsible Entity	**Responsibilities**
Council / Corporate and Strategic committee	1. Approve the Investment Policy and review it, at least every three years, as part of the Long Term Plan (LTP) process. 2. Monitor compliance with the Investment Policy through the receipt of periodic reports and briefings. 3. Approve investments (in the instances where funding is required from HBRC) in HBRIC, PONL and any Council Controlled Trading Organisations (CCTOs), other subsidiary companies or trusts, including authorisations of use of investment funds and the terms and conditions of investment for these purposes. 4. As controlling shareholder, vote for the appointment of directors in HBRIC, PONL and any CCTOs or other subsidiary companies established to manage HBRC's investments in future. 5. Approve new investments to facilitate community infrastructure asset creation, whether by way of direct property ownership or by making loans to non-HBRC entities for this purpose. 6. Approve investments made outside this policy. 7. Authorise the Chief Executive to manage and invest HBRC's cash reserves, surpluses, and available working capital balances, in investment instruments specified in "Investment Classes" section of this policy, up to the limit of total cash balances available to the HBRC from time to time, and in accordance with the requirements of this Investment Policy. 8. Approve the investment strategy and distribution policy for the external Investment Fund. Review and approve the SIPO and appoint the Investment Manager and Investment Advisor. 9. Grant delegated authority to act on all other investment decisions and issues.
HBRIC Ltd	1. Approve new investments or divestments, including any made by its current and any future subsidiary companies, joint ventures or other investment vehicles, except where the new investment or divestment: (a) Is inconsistent with delivery of HBRC's strategic objectives (b) Significantly varies performance targets agreed through respective Statements of Intent (c) Requires HBRC to assist funding these investments by increasing its equity in its subsidiary, associate, joint venture or other investment vehicle, or provide loans or other financial assistance to them (d) Involves divestment of a strategic asset as defined under Section 97 of the Local Government Act 2002.
Chief Executive	1. Ensure compliance with this policy through the appointment and accountability of appropriate staff. 2. Exercise delegated authority to make and implement investment decisions in accordance with authority delegated by HBRC. 3. Monitor investment conditions and performance and recommend initiatives and changes to HBRC as circumstances require. 4. Grant delegated authority to implement investment decisions to senior staff as appropriate.

16. Reporting

Investment mix and performance is reported to HBRC for all investments through the following means.

1. Reporting annually

- For all equities, (including HBRIC, PONL, CCTOs and other subsidiary companies, and New Zealand and international shares):
  - Dividends and other payments received
  - Sales and acquisitions; gains and losses on disposal (if any)
  - Changes in capital values of the assets (based on market or independent valuation)
  - Financial and operating results
  - Economic impacts (if any) generated during year.
- For property investments (including the Napier endowment property):
  - Movements in rental renewals
  - Sales and acquisitions of leases and property over the year
  - Any transfers of leasehold properties between lessees
  - Gains and losses on disposal (if any)
  - Net income and change in capital values of the underlying assets (based on market or independent valuation)
  - Economic impacts (if any) generated during the year.

2. Reporting quarterly

- For all treasury investments:
  - Dividends, interest and other income received during the quarter
  - Sales and acquisitions; gains and losses on disposal (if any)
  - Changes in capital values of the assets (based on market or independent valuation)
  - Economic impacts (if any) generated during quarter.
- For all externally managed investment funds :
  - Fund valuation
  - Fund duration
  - Compliance reporting (including approved exceptions)
  - Performance summary for the Fund and by asset class
  - Performance against benchmarks
  - Fund income
  - Asset transactions summary
  - Cash transactions
  - Investment management fees
  - Custodial fees
  - Individual fund management fees
  - Brokerage and other transaction costs.

3. Individual issue papers submitted to HBRC dealing with matters of relevance (including changes in investment policy) to the investment portfolio that may arise during the year.

4. Additional requirements on HBRIC, PONL, CCTOs and other subsidiary companies reporting through HBRIC, including:

- Agreeing financial and other relevant strategic and performance targets for these businesses through an annual Statement of Intent
- Confirm appointment of directors having appropriate expertise to their boards
- Where requested, for HBRC's strategic planning purposes, review businesses strategic plans, annual budgets and financial forecasts for their medium and long term future operations
- Receiving 6 and 12 month reports on financial performance and position and operating results of these businesses
- Being briefed by the Chairperson of Directors and Chief Executive Officer of the businesses as required by the HBRC, but no less than twice a year
- Being consulted, and where necessary, making decisions as shareholders, at any time on new developments or significant departures from anticipated performance.

17. Review of Policy

This policy will be reviewed no less than every three years.

Draft Liability Management Policy

Introduction and Scope

The following Liability Management Policy has been prepared in accordance with the following relevant legislation:

- Local Government Act 2002, in particular Part 6 including sections 101, 102, 104 and 113. The policy covers Council management of all borrowing, as defined in section 112 of the Act, as well as management of other liabilities. Section 113 of the Act prohibits Councils' from borrowing or entering into incidental arrangements denominated in other than New Zealand currency.
- Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.

Commentary

- HBRC has large infrastructure assets with long economic lives yielding long term benefits for the community. The use of debt as a funding option is seen as an appropriate and efficient mechanism for promoting inter-generational equity between current and future community members in relation to such assets. In addition, debt may allow scheme or other projects to progress at an earlier stage than might otherwise be possible as it reduces the cash flow burden on beneficiaries and therefore increases affordability.

General Policy

In accordance with the Act, and by resolution, Councils' may borrow on such terms and conditions that they consider appropriate. HBRC uses short-term and long-term funding to achieve an effective borrowing mix and to balance the requirements of liquidity and funding risk management.

Council may borrow for any of the following primary purposes:

- Funds for the acquisition of any assets expected to have a useful economic life of more than 2 years
- Funds for specific one-off projects
- The acquisition of low risk investments
- Short term debt to manage timing differences between cash inflows and outflows and to maintain Council's liquidity position and, if necessary, to fund emergency expenditure.

In approving new borrowing, Hawke's Bay Regional Council (HBRC) will apply the following principles:

- Borrowings will be repaid over the economic life of the assets being funded, or such shorter period as determined, at its discretion
- Interest costs and principal repayments will be funded by the beneficiaries of the borrowings
- The extent of borrowings will be determined by the beneficiaries' ability and willingness to pay, as determined by consultation
- HBRC considers the impact on borrowing limits, and its consistency with the LTP.

In evaluating strategy for new borrowing (in relation to source, term, size and pricing), HBRC considers:

- available terms from banks, domestic capital markets and LGFA,
- the overall debt maturity profile to ensure concentration of debt is avoided at re-issue/rollover time,
- prevailing interest rates and credit margins relative to domestic capital markets, LGFA and bank borrowing,
- liquidity, funding and interest rate risk-management parameters as detailed in this Policy,
- legal documents and financial covenants, together with credit rating considerations, and
- the market and HBRC's outlook on future credit margin and interest rate movements.

General objectives

- Minimise HBRC's costs and risks in the management of its borrowings.
- Borrow funds and transact risk management instruments within an environment of control and compliance under the Policy to protect HBRC's costs.

- Maintain liquidity levels and manage cash flows within HBRC to meet known and reasonable unforeseen funding requirements.
- Arrange and structure appropriate funding for the HBRC at the lowest achievable credit margin from debt lenders. Optimise flexibility and spread of debt maturity within the funding risk limits established by this Policy.
- Monitor and report on financing/borrowing covenants and limits under the obligations of the HBRC's lending/security arrangements.
- Monitor, evaluate and report on treasury performance.
- To minimise liquidity and credit risk by dealing with credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- To ensure adequate internal controls exist to protect HBRC's financial assets and to prevent unauthorised transactions.
- Develop and maintain relationships with financial institutions, the LGFA and investors.

Local Government Funding Agency

HBRC has proposed, as part of the public consultation for this LTP, to join the LGFA Scheme, including borrowing from the LGFA and entering into the transactions relating to that borrowing.

In connection with LGFA borrowings, HBRC may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA. For example borrower notes.
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself.
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required.
- 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.
- Subscribe for shares and uncalled capital in the LGFA.

Debt Repayment

HBRC will repay borrowings from rates, surplus operating funds, proceeds from the sale of assets or investments, re-financing with new debt or from specific sinking funds.

Guarantees/contingent liabilities and other financial arrangements

HBRC may act as guarantor to financial institutions on loans or enter into incidental arrangements for organisations, clubs, Trusts, or Business Units, when the purposes of the loan are in line with HBRC's strategic objectives.

HBRC is not allowed to guarantee loans to Council Controlled Trading Organisations under Section 62 of the Local Government Act.

Specific Borrowing Limits

The following table summarises the specific borrowing limits that HBRC adheres to, in conjunction with the LGFA's lending covenants.

	HBRC	LGFA
Net external debt as a percentage of total revenue	<150%	<175%
Net interest on external debt as a percentage of total revenue	<15%	<20%
Net interest on external debt as a percentage of annual rates income	<20%	<25%
Liquidity (liquid assets, term debt and committed debt facilities as a percentage of existing total external debt)	>110%	>110%

- Revenue is defined as earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue.

- Revenue excludes non-government capital contributions (e.g. developer contributions and vested assets)
- Net debt is defined as total external debt less liquid funds.
- Liquid funds are cash and cash equivalents defined as being:
  - Overnight bank cash deposits
  - Wholesale/retail bank term deposits no greater than 30 days
  - Bank issued registered deposits no greater than 181 days
  - Allowable fixed interest bonds as per approved investment instruments
  - Bank term deposits linked to pre-funding of upcoming maturing term debt exposures

Debt will be repaid as it falls due in accordance with the applicable agreement. Subject to the debt limits, a loan may be rolled over or re-negotiated as and when appropriate.

Borrowing limits are measured on Council only, not the consolidated group.

Disaster recovery requirements will be met through the liquidity ratio and contingency reserves (e.g. Disaster Damage Reserve).

Liquidity and Funding limits

Liquidity risk management focuses on the ability to access committed funding at the that future time to fund the gaps. Council will maintain liquidity by:

- Matching average expenditure closely to revenue streams and managing cash flow timing differences to its favour
- Avoiding concentrations of debt maturity dates
- Maintaining operating cash balances (being less than 1-year investment timeframes) of not less than $3,000,000.
- Liquid funds (including cash and cash equivalents) and committed debt facilities must be maintained at an amount equal to at least 110% of current total external debt.

Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and borrowing margins) and maturity terms of existing facilities.

HBRC has the ability to pre-fund up to 12 months of forecast debt requirements including re-financings. Debt re-financings that have been pre-funded, will remain included within the funding maturity profile until their maturity date.

The GMCS has the discretionary authority to re-finance existing debt on more favourable terms. Such action is to be reported and ratified by the Council at the earliest opportunity.

The debt maturity profile of the total committed funding in respect to all external debt and committed debt facilities, is to be controlled by the following risk control limits:

Period	Minimum	Maximum
0 to 3 years	15%	60%
3 to 5 years	15%	60%
5 years plus	0%*	60%

**Should HBRC's external debt exceed $30 million, this minimum will increase to 15%.*

A funding maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this Policy. However, a maturity profile outside these limits for greater than 90 days will require specific Council approval.

Notwithstanding the $25 million external core debt threshold, at all times, the LGFA require that no more than the greater of NZD 100 million or 33% of HBRC's borrowings from the LGFA mature within an immediate 12-month period.

Security

HBRC's external borrowings and interest rate risk management instruments are secured by way of a charge over rates and rates revenue offered through the Debenture Trust Deed. Under the Debenture Trust Deed, HBRC's borrowing is secured by a floating charge over all HBRC rates levied under the Rating Act. The security offered by HBRC ranks equally or pari passu with other lenders to Council.

Other borrowing structures are possible, but HBRC does not normally offer assets, other than rates, as security. Under special circumstances, and if considered more appropriate, security may be offered over specific assets, but only with HBRC's prior approval.

Internal Debt Management

When considered appropriate, HBRC uses cash operating and reserve balances as internal borrowing sources, thereby reducing the level of external borrowings. The following guidelines apply to the use of internal borrowings:

- Interest will normally be charged on the average of opening and closing loan balances in each financial year
- The interest rate charged is the average rate of return achieved from short term investments during the financial year.

The reserves established to cover the funding of replacement operating property, plant and equipment and renewal of flood and drainage scheme infrastructure are treated as one reserve balance for the purposes of providing funds for the purchase of new assets. Therefore for the most part loans are only raised from external funding sources when the total reserve balance is low.

Approved financial instruments

Category	Instrument
Cash management and external borrowings	Bank overdraft Committed cash advance and bank accepted bill facilities (short term and long term loan facilities) Bonds (Fixed Rate or Floating Rate) either through the LGFA or domestic capital markets Commercial paper (CP) –
Interest rate risk management (for borrowing activity only)	Forward rate agreements ('FRAs') on bank bills Interest rate swaps including: • Forward start swaps (start date <24 months, unless linked to existing maturing swap/collar with notional amount amounts not exceeding maturing swap/collar) • Amortising swaps (whereby notional principal amount reduces) • Swap extensions and shortenings Interest rate options on: • Bank bills (purchased caps and one for one collars) Interest rate swaptions (purchased swaptions and one for one collars with matching notionals only)
Foreign exchange risk management	• Spot foreign exchange • Forward exchange contracts (including par forwards)

Interest Rate Risk Management

Interest rate risk refers to the impact that adverse movements in interest rates may have on Council's cash flows and interest expense.

The following interest rate risk control limits apply to external core debt:

Debt interest rate policy parameters		
(calculated on a rolling monthly basis)		
Debt period ending	**Minimum fixed**	**Maximum fixed**
Current	50%	100%
Year 1	45%	95%
Year 2	40%	90%
Year 3	35%	85%
Year 4	30%	80%
Year 5	25%	75%
Year 6	0%	70%
Year 7	0%	65%
Year 8	0%	60%
Year 9	0%	55%
Year 10	0%	50%
Year 11	0%	45%
Year 12	0%	40%
Year 13	0%	35%
Year 14	0%	30%
Year 15	0%	25%

- “Fixed Rate” is defined as all known interest rate obligations on core debt, including where hedging instruments have converted floating interest rate obligations into firm commitments.
- “Floating Rate” is defined as any interest rate obligation subject to movements in the applicable reset rate.
- The fixed rate percentages are calculated on the projected core debt level at month-end reporting dates.
- Core debt is the amount of total external debt for a given period. This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved debt forecasts are changed, the amount of fixed rate protection in place may have to be adjusted to ensure compliance with the Policy minimums and maximums.
- A fixed rate maturity profile that is outside the above limits, however self corrects within 90-days is not in breach of this Policy. Maintaining a maturity profile beyond 90-days requires specific approval by Council.
- Bank draw down advances may be for a maximum term of 12 months.
- Any interest rate hedge with a maturity beyond 15 years must be approved by Council. The exception to this will be if Council raises LGFA funding as fixed rate or an interest rate hedge is linked to floating rate LGFA debt that has a maturity date beyond 15 years.
- Interest rate options must not be sold outright. 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, one side of the collar cannot be closed out by itself, both must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate “in-the-money”.
- Purchased borrower swaptions must mature within 12 months.
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00 per cent above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation.

- The forward start period on swap/collar strategies to be no more than 24 months, unless the forward start swap/collar starts on the expiry date of an existing swap/collar/fixed rate debt instrument and has a notional amount, which is no more than that of the existing swap/collar/fixed rate debt instrument.

Foreign currency

HBRC has minor foreign exchange exposure through the occasional purchase of foreign exchange denominated services, plant and equipment.

All individual commitments over NZ$100,000 equivalent are hedged using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts are used.

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

All foreign currency hedging must be approved by the GMCS.

Foreign currency management of the external Investment Fund is managed within the SIPO.

Counterparty Credit Limits

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where Council is a party. The credit risk to the Council in a default event will be weighted differently depending on the type of instrument entered into.

External borrowing, cash and interest and foreign exchange risk management related transactions would only be entered into with organisations specifically approved by the Council.

Counterparties and limits can only be approved based on long-term credit ratings (Standard & Poor's or Moody's or Fitch) being A+ and above or short term rating of A-1 or above.

Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

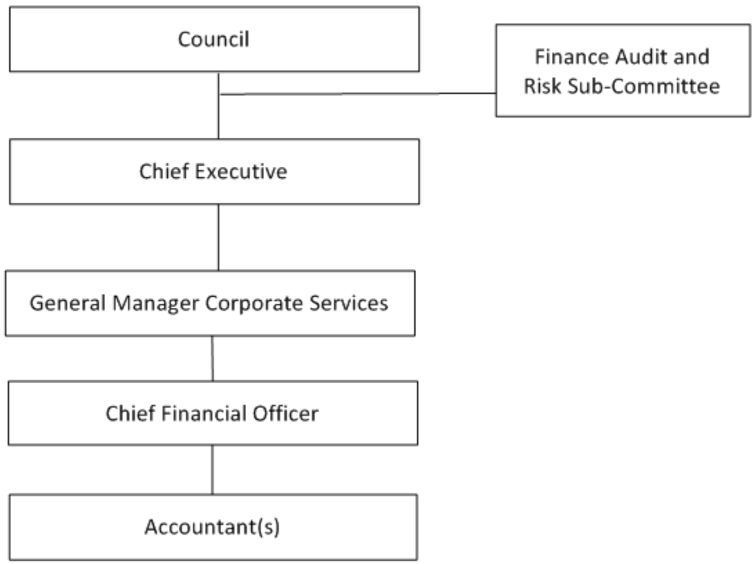
The matrix guide of counterparty credit limits can be found as part of the Specific Investment Criteria within the Investment Policy.

Review of Policy

This policy will be reviewed no less than every three years and amendments can be made through Council resolution any time within the three year period.

Management responsibilities

All of the Council's treasury management activities are undertaken by the Treasury function. The following diagram illustrates those individuals and bodies who have treasury responsibilities.



Council

The Council has ultimate responsibility for ensuring that there is an effective policy for the management of its risks. In this respect Council decides the level and nature of risks that are acceptable.

Council is responsible for approving these Liability Management and Investment Policies and any changes required from time to time. While the Policy can be reviewed and changes recommended by other persons, the authority to make or change Policy cannot be delegated.

In this respect, the Council has responsibility for:

- Approving the long-term financial position of the Council through the 10-year LTP and the Annual Plan
- Approving HBRC's SIPO document, including the investment strategy, return objective, policies, manager configuration, and instructions to the Investment Manager.
- Approving new debt funding via resolution of the Annual Plan
- Approving the Liability Management and Investment Policies, incorporating the following delegated authorities:
    - borrowing, investing and dealing limits and the respective authority levels delegated to the Chief Executive (CE), General Manager Corporate Services (GMCS), Chief Financial Officer (CFO) and other managers
    - risk management control limits
    - guidelines for the use of financial instruments.
- Delegating authority to the CE and other officers
- Reviewing and approving changes to the Liability Management and Investment Policies as well as the SIPO document every three years.

Council will also ensure that:

- Issues raised by auditors (both internal and external) in respect of any significant weaknesses in the Treasury function are resolved immediately
- Approval will be gained by the GMCS for any transactions falling outside Policy guidelines.

Finance Audit and Risk Sub-Committee ("FARC")

The FARC will oversee the implementation of the Council's borrowing and investment strategies and monitor and review the effective management of the treasury function, borrowing and investment activities.

The FARC will ensure that the information presented to the Council is accurate, identifies the relevant issues and is represented in a clear and succinct manner.

The FARC will discuss treasury matters on a quarterly basis.

Responsibilities are as follows:

- Recommending the Liability Management and Investment Policy and SIPO document (or changes to existing policy) to the Council
- Receiving recommendations from the GMCS and make submissions to the Council on all treasury matters requiring Council approval
- Recommending performance measurement criteria for externally managed funds
- Review all matters concerning the SIPO as well as providing guidance and leadership on the appointment, management, monitoring and review of the appropriate Investment Manager
- Monitoring quarterly performance of externally managed funds against benchmarks

Approving allowable financial instruments.

Chief Executive Officer ("CE)

While the Council has final responsibility for policy governing the management of Council's risks, it delegates overall responsibility for the day-to-day management of such risks to the CE. The Council formally delegates to the CE the following responsibilities:

- Ensuring Council's policies comply with existing and new legislation
- Approving the bank signatories
- Approving new counterparties and counterparty limits as defined within this policy and recommended by the GMCS
- Approving the opening and closing of bank accounts.

General Manager Corporate Services ("GMCS")

The CE formally delegates the following responsibilities to the GMCS:

- Approving new borrowing undertaken in line with Council resolution and approved borrowing strategy
- Approving re-financing of existing debt
- Approving all treasury deal tickets (borrowing, investment and risk management instruments) within delegated authority
- Approving treasury transactions in accordance with policy parameters outside of the CFO's delegated authority
- Authorising the use of approved risk management instruments within discretionary authority
- Receiving advice of breaches of Policy and significant treasury events from the CFO.

Chief Financial Officer ("CFO")

The GMCS formally delegates the following responsibilities to the CFO:

- Recommending policy changes to the FARC for evaluation.

- Ongoing risk assessment of borrowing and investment activity, including procedures and controls
- Receive quarterly reporting from the Investment Manager(s) and Investment Advisor
- Proposing any new funding requirements falling outside the Annual Plan and LTP to the FARC for consideration and submission to the Council
- Designing, analysing, evaluating, testing and implementing risk management strategies to position Council's interest rate risk profile to be protected against adverse market movements within the approved Policy limits
- Investigating financing alternatives to minimise borrowing costs, credit margins and interest rates, making recommendations to FARC as appropriate.
- Reviewing and making recommendations on all aspects of the Liability Management and Investment Policy to the FARC including dealing limits, approved instruments, counterparties, and general guidelines for the use of financial instruments.
- Negotiating bank funding facilities.
- Managing bank, LGFA, Investment Manager, Trustee, Custodial and other financial institution relationships.
- Executing treasury transactions in accordance with approved limits. In the absence of the CFO, the GMCS will execute treasury transactions.
- Completing deal tickets for treasury transactions.
- Overseeing a triennial review of the Liability Management and Investment Policy, treasury procedures and all dealing and counterparty limits.
- Managing the long-term financial position of the Council in accordance with Council's requirements.
- Ensuring that all borrowing and financing covenants/limits to lenders are adhered to.
- Ensuring management procedures and policies are implemented in accordance with this Policy.
- Monitoring and reviewing the performance of the Treasury function in terms of achieving its objectives .

Accountant(s)

The CFO formally delegates the following responsibilities to the Accountant(s):

- On a continuing basis, monitoring and updating credit ratings of approved counterparties.
- Recommending changes to credit counterparties to the CFO.
- Monitoring treasury exposure on a regular basis, including current and forecast cash position, treasury investment portfolio, interest rate exposures and borrowings.
- Checking compliance against limits and preparing reports on an exceptions basis.
- Preparing treasury reports.
- Delivering weekly reports to the CFO covering cash/liquidity, investment portfolio, debt funding portfolio and interest rate risk position.
- Forecasting future cash requirements.
- Check the written evidence of executed deals on an agreed form.
- Ensuring all financial instruments are valued and accounted for correctly in accordance with current best practice standards.
- Managing the operation of all bank accounts.
- Handling all administrative aspects of bank, LGFA agreements and documentation.
- Completing, reviewing and approving treasury journals, bank, borrowing and investment spreadsheet reconciliations to the general ledger (ensuring segregation of completion, review and approval tasks amongst Accountant(s).

- Undertaking a triennial review of the Liability Management and Investment Policy, treasury procedures and all dealing and counterparty limits.
- Updating treasury spreadsheets for all new, re-negotiated and maturing transactions.
- Checking all treasury deal confirmations against internal deal documentation and reporting any irregularities immediately to the GMCS.
- Reconciling monthly summaries of outstanding financial contracts from banking counterparties to internal records.
- Review electronic batch payments to creditors and arranging for approval by authorised signatories.

Delegation of authority and authority limits

Treasury transactions entered into by Council without the proper authority are difficult to cancel given the legal doctrine of "apparent authority". Insufficient authority for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays). Therefore, the following procedures will apply:

- All delegated authorities and signatories will be reviewed at least every six months to ensure that they are still appropriate and current.
- A comprehensive letter will be sent to all bank and lender counterparties, at least every year, detailing all relevant current delegated authorities of the Council and contracted personnel empowered to bind the Council.
- Whenever a person with delegated treasury authority leaves Council, all relevant banks and other counterparties will be advised in writing on the same day to ensure that no unauthorised instructions are to be accepted from such persons.

The Council has the following responsibilities, either directly, or via the following stated delegated authorities:

Activity	Delegated Authority	Limited
Approving and changing policy	The Council	Unlimited
Borrowing new debt	The Council CE (delegated by Council) GMCS (delegated by Council)	Unlimited (subject to legislative and regulatory limitations) Subject to Council resolution and policy
Acquiring and disposing of investments other than financial investments	The Council	Unlimited
Approving charging assets as security over borrowing	The Council	Subject to terms of the Debenture Trust Deed
Overall day-to-day treasury management	GMCS (delegated by Council) CFO (delegated by Council)	Subject to policy
Re-financing existing debt	GMCS (delegated by Council) CFO (delegated by Council)	Subject to policy
Approving transactions outside policy	The Council	Unlimited
Adjusting debt or investment interest rate risk profile	GMCS (delegated by Council) CFO (delegated by Council)	Per risk control limits
Managing investments and funding maturities	GMCS (delegated by Council) CFO (delegated by Council)	Per risk control limits
Maximum daily transaction amount (borrowing and interest rate risk management) excluding roll-overs under bank debt facilities	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $5 million $2.5 million
Maximum daily transaction amount (investing and cash management)*	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $10 million $5 million
Maximum daily transaction amount (foreign exchange risk management)	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $0.5 million $0.25 million
Approving bank signatories	CE	Unlimited
Approving the opening/closing bank accounts	CE	Unlimited
Reviewing the Liability Management and Investment Policies every three years	FARC	N/A
Ensuring compliance with Policy	GMCS	N/A

*Daily transaction amounts relate to internally managed Investment Funds only with external Investment Funds managed under Council's SIPO document.

Operational Risk

Operational risk is the risk of loss as a result of human errors including fraud, system failures, or inadequate procedures and controls. Operational risk is very relevant when dealing with financial instruments given that:

- Financial instruments may not be fully understood
- Too much reliance is often placed on the specialised skills of one or two people
- Most treasury instruments are executed over the phone

Operational risk is minimised by this policy.

Dealing Authorities and Limits

Transactions will only be executed by those persons and within limits approved by Council.

Segregation of Duties

There will be adequate segregation of duties among the borrowing and investment functions of deal execution, confirmation, settling and accounting/reporting. However, there are a small number of people involved in borrowing and investment activity. Accordingly, strict segregation of duties will not always be achievable.

The risk will be minimised by the following:

- The Accountant(s) will report directly to the CE to control the transactional activities of the GMCS and the CFO
- There is a documented approval process for borrowing and investment activity.

Procedures and controls

- The CFO will have responsibility for establishing appropriate structures, procedures and controls to support borrowing and investment activity
- All borrowing, investment, cash management and risk management activity will be undertaken in accordance with approved delegations authorised by Council
- All treasury products will be recorded and diarised within a treasury system/spreadsheet, with appropriate controls and checks over treasury journal entries into the general ledger. Deal capture and reporting will be done immediately following execution and confirmation. Details of procedures, including templates of deal tickets, will be included in a treasury procedures manual separate to this policy.

Procedures and controls will include:

- Regular management reporting
- Regular risk assessment, including review of procedures and controls
- Organisational systems, procedural and reconciliation controls to ensure:
    - All borrowing and investment activity is bona fide and properly authorised
    - Checks are in place to ensure Council's accounts and records are updated promptly, accurately and completely
    - All outstanding transactions are revalued regularly and independently of the execution function to ensure accurate reporting and accounting of outstanding exposures and hedging activity
    - Cheque/electronic banking signatories will be approved by the CE. Dual signatures will be required for all cheques and electronic transfers.
- All treasury counterparties will be provided with a list of personnel approved to undertake transactions, standard settlement instructions and details of personnel able to receive deal confirmations
- The CFO will record all deals on properly formatted deal tickets. Deal summary records for borrowing, investments, risk management and cash management transactions (on spreadsheets) will be maintained and updated promptly following completion of transaction.

- All inward deal confirmations, including registry confirmations, will be received and checked by the Accountant(s) against completed deal tickets and summary spreadsheets records to ensure accuracy
- Deals, once confirmed, will be filed (deal ticket and attached confirmation) in deal date/number order
- Any discrepancies arising during deal confirmation checks which require amendment to Council records will be signed off by the GMCS
- Where possible borrowing and investment payments will be settled by direct debit authority
- For electronic payments, batches will be set up electronically. These batches will be checked by the Accountant(s) to ensure settlement details are correct. Payment details will be authorised by two approved signatories as per Council register
- The Accountant(s) will perform bank reconciliations monthly. Any unresolved unreconciled items arising during bank statement reconciliation which require amendment to the Council's records will be signed off by the GMCS
- A monthly reconciliation of the borrowing and investment spreadsheets to the general ledger will be completed,reviewed and approved by the Accountant(s), ensuring of completion, review and approval tasks.

Cash Management

The Accountant(s) have the responsibility to carry out the day-to-day cash and short-term debt management activities. The Accountant(s) will:

- Calculate and maintain cash flow projections on a daily (two weeks forward), weekly (four weeks forward), monthly (12 months forward) basis
- Electronically download all Council bank account information daily.
- Co-ordinate Council's operating units to determine daily cash inflows and outflows with the objective of managing the cash position within approved parameters
- Undertake short-term borrowing functions as required, minimising overdraft costs
- Ensure efficient cash management, through improvement to accurate forecasting using spreadsheet modelling
- Minimise fees and bank charges by optimising bank account/facility structures
- Monitor Council's usage of committed cash advance facilities
- Match future cash flows to smooth over time
- Provide reports to CFO detailing actual cash flows during the month compared with those forecast.

Financial Instrument Accounting Treatment

Council uses financial arrangements ("derivatives or financial instruments") for the primary purpose of reducing its financial risk to fluctuations in interest rates. The purpose of this section is to articulate Council's accounting treatment of financial instruments in a broad sense.

Under NZ IPSAS changes in the fair value of financial instruments go through the Income Statement unless financial instruments are designated in an effective hedge relationship.

Council's principal objective is to actively manage the Council's interest rate risks within approved limits and chooses not to hedge account. Council accepts that the marked-to-market gains and losses on the revaluation of financial instruments can create potential volatility in Council's annual accounts.

The Accountant(s) responsible for advising the CFO of any changes to relevant NZ IPSAS, which may result in a change to the accounting treatment of any financial instruments .

Reporting

Report Name	Frequency	Prepared by	Recipient
Daily Cash Position	Daily	Accountant(s)	CFO
Treasury investments	Quarterly	Accountant(s)	CFO
Summary Treasury Report*	Quarterly Six-monthly	Accountant(s)	CFO, GMCS, CE, FARC, and Council
Counterparty Credit Limits Report	Daily for exceptions / Quarterly	Accountant(s)	CFO, CE, GMCS, and FARC
Debt Maturity Profile	Quarterly Six-monthly	CFO	FARC and Council
Statement of Public Debt	Quarterly Six-monthly	CFO	FARC and Council
Revaluation of financial instrumentand review of guaranteess	Quarterly	Accountant(s)	CFO

*The 'Summary Treasury Report' includes the following:

- Treasury exceptions report
- Risk exposure positions
- Policy compliance
- Borrowing limit report
- Cost of funds report
- Cash flow forecast report

Draft Funding and Financial Policies

Contents

~~Draft Investment Policy | Page 1~~ Draft Funding and Financial Policies

~~Summary of Amendments to Previous Investment Policy~~

~~This is a summary of the substantive changes proposed in the Investment Policy 2018-28 from the current operating Investment Policy 2015-25. The summary below is set out by reference to the section headings of the Investment Policy 2018-28.~~

~~Section 4 Objectives~~

~~The new Investment Policy has removed the previous reference to "First preference to investment in the Hawke's Bay Region, provided any such investment satisfies all other conditions of this investment policy, and subject to the availability of suitable strategic economic and financial investment opportunities in the region." It was believed that this objective restricted the ability to earn better returns and also increased the overall risk profile due to concentration of investments in one location.~~

~~Section 6 Ethical Investment~~

~~HBRC has included an ethical investments section to take into consideration when making investment decisions. Where practical, investments will be made taking into account the ethical practices of the investment entity. HBRC's intention for its investment portfolio is to avoid direct involvement with industries that have a negative impact on society and the environment. This includes:~~

- ~~Alcohol~~
- ~~Tobacco~~
- ~~Fossil fuels~~
- ~~Military/weapons.~~

~~Section 7 Investment Classes~~

~~HBRC has changed the focus of equity investments. HBRC has previously held a view that capital appreciation and dividend and income growth in its equity holdings is more valuable to the regional community than dividend or income yield at any point in time. The change is that annual income is now the priority with capital appreciation important but secondary.~~

Draft Investment Policy

1. General Policy Context

HBRC's ~~investment policy is~~ Investment Policy is consistent with its objectives, Long Term Plan (LTP), Annual Plans and established in accordance with ~~Sections 102(2)(c) and 105 of~~ the following relevant legislation:

- Local Government Act 2002, ~~and is consistent with its objectives~~in particular sections 102 and 105.
- Trustee Act 1956. When acting as a trustee or investing money on behalf of others, the Trustee Act highlights that trustees have a duty to invest prudently and ~~its Long Term Plan (LTP),~~ that they shall exercise care, diligence and ~~Annual Plans~~skill that a prudent person of business would exercise in managing the affairs of others. Details of relevant sections can be found in the Trustee Act 1956 Part ll Investments.
- Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.

2. Purpose

The purpose of the Investment Policy is to present HBRCs policies in respect to investments including:

- The mix of investments
- The acquisition of new investments
- An outline of the procedures by which investments are managed and reported to Council
- An outline of how risks associated with investments are assessed and managed.

3. Scope

HBRC has a significant portfolio of investments comprising of:

- Equity investments
- Property investments
- Forestry investments
- Treasury investments
- Externally managed investment funds

Investments bound by this ~~policy~~Policy are all of HBRC's financial assets and reserves, which are held to produce a financial return within accepted risk parameters, and help achieve its strategic economic objectives, while collectively retaining their real capital value over the period of their ownership.

~~Capital~~The real capital value is the ~~greater of historical cost of each investment or the~~ current ~~statement of financial position~~ market value in New Zealand dollars (based on market or independent valuation) ~~of the investment~~adjusted for movements in the ~~purposes of this definition~~CPI.

There are two investment categories that HBRC may invest in:

- **Financial Investments** – the purpose of financial investments is to provide annual cash income at budgeted amounts.

Blended Investments – the purpose of blended investments are to invest in projects that may have a combined objective of providing some financial benefit as well as environmental or regional economic growth benefits.

- Blended investments are only to be invested in if the total investment portfolio can provide the annual cash income requirements of HBRC.

4. Objectives

The objectives of this ~~investment policy~~Investment Policy are to:

- to manage investments to optimise returns in the long term whilst balance risk and return considerations
- to balance the mix of financial investments and blended investments
- obtain an acceptable ongoing annual cash income from the investment portfolio as a whole
- ensure sufficient cash is available (liquidity) as needed to assist with the funding of HBRC's ongoing operations
- and to meet known and reasonably unforeseen funding requirements, maintain long term gains in capital value of its investments for the benefit of future as well as current generations of ratepayers

- ~~To balance~~hold certain investments for strategic benefits as well as for the ~~minimisation of risk and the maximisation of returns~~
- ~~To balance the mix of~~ financial ~~investments and blended investments~~benefits to the region
- invest funds within an environment of control and compliance so as to protect HBRC's financial assets
- to minimise exposure to credit risk by investing in credit worthy counterparties
- to ensure adequate internal controls exist to protect Council's financial assets and to prevent unauthorised transactions
- develop and maintain relationships with financial institutions, credit agencies, LGFA, investment managers, investors and investment counterparties.

5. Responsible Investment

Investments will be made with judgment and care, under circumstances prevailing at the time which people of prudence, discretion and intelligence exercise in the professional management of financial assets.

~~It is~~HBRC does not ~~HBRC's intention to~~ make speculative investments (such as contracts for difference in prices over time of any commodity or asset and other financial derivatives~~).~~) or any other investments not detailed within this Policy or Council's SIPO document. Council has adopted an ethical based investment strategy. This will involve companies and industries being reviewed for sustainability, socially responsible and ethical practices. Investments will be periodically reviewed against these principles; any contraventions discovered will lead to the prudent and timely divestment.

Its economic and financial objectives should be achieved by balancing potential risks.

Prudent investment management requires managing investment risk and return by consideration of the mix of investments by investment class, and location.

In its financial investment activity, HBRC's primary objective is to protect the value of its assets. Accordingly investment may only be made in creditworthy counterparties having acceptable standing and credit ratings. Where investments are externally managed these activities are approved under a separate policy.

6. Ethical Investment

Where practical, investments will consider the ethical practices of the investment entity. HBRC's intention for its investment portfolio is to avoid direct involvement with industries that have a negative impact on society and the environment. This includes but is not limited to:

- Alcohol
- Tobacco
- Fossil fuels
- Military/weapons.

~~7~~

7. Externally Managed Funds

Where Council funds are to be managed externally by a suitably qualified Investment Manager, investment funds (Funds) are managed in line with a separate Statement of Investment Policy and Objectives (SIPO) document. An external Investment Manager will be appointed in the knowledge of and operate the portfolio according to, the investment guidelines outlined in the SIPO.

Council will be responsible for the following:

- Setting the Fund's Investment Strategy, including the level of risk and investment performance objectives, and investment policies.
- Selecting and changing the Manager as appropriate after having taken advice from the Investment Advisor.
- Formally reviewing the SIPO annually, including the investment strategy, policies and manager configuration, and instructions to the Investment Manager.
- Formally reviewing the SIPO every three years by an external independent Investment Advisor. The review includes the investment strategy, return objectives, policies and manager configuration, and instructions to the Investment Manager.
- Ensuring that the level of redemptions from the Fund is consistent with the Fund's objective to maintain its real capital value, and amounts available for distribution, between present and future generations.
- Providing cash flow information to the Investment Manager with respect to future deposits to, and redemptions from the Fund.
- Appointing the external Investment Advisor.

The strategic asset allocation and tactical ranges provided below are included within HBRC's SIPO document:

Sector	Benchmark %	Ranges %
NZ equities	15%	13% - 18%
International equities (fully hedged)	29%	25% - 34%
NZ property	3%	1% - 4%
International property (fully hedged)	3%	1% - 4%
Total growth assets	**50%**	**40% - 60%**
Cash and short term securities	5%	2% - 8%
NZ fixed interest securities	20%	15% - 24%

8. Mix of Investments

Equity Investments

HBRIC Ltd

Since its establishment on 1 February 2012, HBRC beneficially owns 100% of the shares in HBRIC Ltd, a company established to manage HBRC's corporate investments.

HBRIC Ltd is classified as a strategic asset in terms of Section 97 of the Local Government Act 2002.

A key requirement of HBRC is that HBRIC adopt an investment policy for the management of the investments that is consistent with, and reflects the purpose, objectives and requirements of this investment policy, which will remain the overriding policy document for all HBRC's investments, including any investment company and its assets.

HBRC sets a series of performance and strategic targets for HBRIC Ltd in an annual Statement of Objectives, which in turn is reflected in the company's annual Statement of Intent (SOI). The 2017-18 performance targets as set out in HBRC's Statement of Objectives for HBRIC Ltd are outlined in the following tables.

Notes:

EBIT = Earnings Before Interest and Tax

EBITDA = Earnings Before Interest, Tax, Depreciation and Amortisation

These performance targets may change from year to year as a result of HBRC's annual review of its Statement of Objectives and the company's Statement of Intent and changing economic, market and financial circumstances.

As controlling shareholder HBRC appoints the directors of HBRIC Ltd and, as controlling shareholder, HBRC will have an expectation that the company's policies will support its strategic objectives.

Port of Napier Limited

As at 30 June 2017, HBRC beneficially owned 100% of the shares in PONL through HBRIC. HBRC's strategic objective is to continue to beneficially hold a majority of the shares of PONL as a key means of assisting economic development of the region. The investment is expected to be a significant source of non-rate revenue and has long term prospects for growth and development.

As controlling shareholder HBRC approves the appointment of the directors of PONL recommended by HBRIC Ltd.

Property Investments

Napier leasehold property

HBRC owns leasehold endowment property within and around Napier City. The portfolio was acquired in 1989 during the reformation of Local Government, and under the terms of each lease, the properties can only be sold to lessees. This means HBRC will retain ownership of each lease unless the lessor is willing to buy the freehold interest in the property at a value acceptable to both lessee and lessor.

HBRC intends to continue to sell freehold interests to lessors wherever an acceptable sale price can be achieved, and reserves the right to sell the annual cash flows arising from ongoing rents paid by lessors from time to time. With effect from 1 July 2013, HBRC sold the annual rentals due from this portfolio over the next 50 years (i.e. until July 2063) to ACC for a lump sum of $37.8 million. The underlying properties

Hawke's Bay Regional Investment Company Initial Performance Targets (subject to annual SOI review) HBRIC Ltd Parent 2017-18	
Performance Indicator	**Target**
Net debt to net debt plus Equity	<10%
Interest cover (EBIT/Interest paid)	>3x
EBITDA/Total Assets	3%
Return on Shareholder's Funds	3%

continue to be owned by HBRC and sales to lessors have continued, and may

Hawke's Bay Regional Investment Company Initial Performance Targets (subject to annual SOI review) Consolidated 2017-18	
Performance Indicator	**Target**
Net debt to net debt plus Equity	<40%
Interest cover (EBIT/Interest paid)	>3x
EBITDA/Total Assets	9%
Return on Shareholder's Funds	5%

continue in the future, in the same way as they have done in the past.

Ground rents paid by lessors have been predominantly set at 5% or "fair annual ground rental" and reviewed every 21 years.

Wellington leasehold property

HBRC owns 12 leasehold properties in the suburbs of Kelburn and Thorndon in Wellington, which are not subject to endowment restrictions. These leases provide an annual return with leases renewed every 14 years. HBRC reserves the right to sell some or all of these properties and reinvest the proceeds in appropriate investment classes specified in this policy.

Other Property Investments

HBRC may invest in other property if they meet section 1 to 6 of this investment policy and the correct delegations are engaged.

Forestry Investments

HBRC has an existing forestry portfolio consisting off:

Site Name	Area (ha)	Assumptions
CHB	168	No material investment, maintenance only, no harvesting in LTP period
Mahia	36	No material investment, maintenance only, no harvesting in LTP period
Waihapua	213	No material investment, maintenance only, no harvesting in LTP period
Tutira	114	Harvesting proposed over the period from 2018/19 to 2022/23. Replanting after harvest
Tutira Manuka Honey	130	Maintenance continues with yearly honey income of $46,000 assumed
Tangoio	150	Harvesting proposed over the period from 2020/21 to 2021/22. Replanting after harvest

Return on the forestry investments are determined by the harvest revenue received.

Tangoio forestry is treated differently from all the other forestry investments as HBRC does not own the land but does have responsibility for the management and control of the forest. Any income received from harvest is kept on reserve to fund the continuing maintenance programme and is not available for the funding of general.

~~Treasury investment~~

NZ LGFA Limited Investments

Despite anything earlier in this Investment Policy, the Council may invest in shares and financial instruments issued by the New Zealand Local Government Funding Agency Limited, and may borrow to fund that investment.

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

- obtain a return on the investment, and
- ensure that the LGFA has sufficient capital to become and remain viable as a source of debt funding for the Council.

Because of this dual objective, 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, Council may also subscribe for uncalled capital in the LGFA.

Treasury investments

Council maintains Treasury Investments for:

- investing money allocated to accumulated surpluses, Council-created special, and restricted reserves, and general reserves,
- investing funds allocated for approved future expenditure in strategic initiatives or support inter-generational allocations,
- Investing funds arising from pre-funding upcoming maturing debt amounts,
- investing surplus cash, to be used for operational and capital expenditure requirements and
- investing proceeds from asset sales.

Treasury Investments will be managed within Council by the CFO and will be prudently invested as follows:

- Investments which have the intention of supporting liquidity should be matched to meet future cash flow and capital expenditure projections.
- Interest income from financial investments is credited to general funds, except for income from investments for special funds, reserve funds and other funds where interest income may be credited to the particular fund.
- The CFO executes Council's investment strategy within approved policy limits by regularly reviewing cash flow forecasts (incorporating plans for approved expenditure and strategic initiatives).
- Council adopts a conservative risk position for these funds and only accepts investments that have a minimum risk of loss. Accepting that a low-risk portfolio may result in lower returns.
- Treasury Investments must be compliant with the Investment Parameters, Approved Financial Instruments and Counterparty Credit Limits sections of this Policy.

Term deposits

HBRC currently holds both investment and reserve funds on term deposits with approved banking institutions.

9. Investment ~~Portfolios~~ Parameters

~~HBRC may invest in investment portfolios if they meet section 1 to 6 of this investment policy and the correct delegations are engaged.~~

~~8~~The following percentages are calculated on the total current investment portfolio managed internally by Council. These Policy limits concurrently apply to both the maturity term and the interest rate re-pricing profile of the investment portfolio (and should be reported separately where they differ):

Maturity Term	Minimum limit	Maximum limit
0 to 1 year	50%	100%
1 to 3 years	0%	50%

When cash flow projections are changed, the maturity profile may have to be adjusted to comply with the policy limits.

The Council must only invest in acceptable financial instruments and counterparties, as covered in the Approved Financial Instruments and Counterparty Credit Limits sections of this Policy.

10. Acquisition of Investments

New investments will be acquired from time to time within the investment classes specified in accordance with the policies and objectives recorded in this policy.

New investments will be made by HBRC, HBRIC and its officers in accordance with the management authorities and delegations summarised below.

Acquisition of new investments will be made after assessment of their benefits, alignment with strategic objectives, costs and risks in accordance with the assessment procedures approved by HBRC from time to time.

~~9~~11. Disposal of Investments

Sale or liquidation of investments held for special purpose reserves may only occur when the funds are required for the particular purpose each reserve was established for by HBRC.

Any disposal of unrestricted assets requires the approval of Council, other than those made within delegated authority granted by HBRC.

HBRC regards Napier Port as a strategic asset and will retain beneficial control of it through its wholly owned investment company. In the event it contemplates reducing its interest in Napier Port from its present 100% shareholding to not less than 51% (i.e. still retaining control) by selling shares to a third party (or parties) or by changing how the Napier Port is managed and operated, it will comply with the provisions of Section 97(1)(b) of the Local Government Act 2002 where "a decision to transfer ownership or control of a strategic asset" is to be considered.

HBRC will use either the Annual or LTP process, or a separate Special Consultative Process, it deems appropriate at the time, to obtain the views of ratepayers and stakeholders on its proposed sale of shares before committing to it.

HBRC wishes to retain the right to use a limited amount of funds from the proceeds of the disposals of leasehold property for purposes other than reinvestment in the investment classes of this policy, where appropriate. Such purposes will be restricted to capital related projects, loans (including interest free loans), and servicing the costs of borrowings by HBRC used for these purposes and may be initiated by HBRC or other organisations in the region. When proposing such a course of action, HBRC will, subject to the exceptions stated below, adopt a special consultative process under the Act which will ensure a fully inclusive decision making process with the Hawke's Bay regional community. This process is intended to extensively canvass the community's views and seek their input into any such proposals.

There will be no requirement to carry out a special consultative process when:

- no more than $300,000 of sale proceeds will be used for any one project, or
- HBRC uses the sales proceeds to acquire land or enters into partnership for the development of further open space areas, particularly those that are in environments that are of high ecological or landscape value or extensively used by the public.

HBRC's objective will be to indicate in either the LTP or relevant Annual Plan any proposals not covered by the above exceptions. There may be some occasions when the special consultative process for such initiatives may not always coincide with these HBRC planning processes and so may occur as standalone consultations.

~~10~~12. Disposition of Income

Investment income other than that to be applied to reserve funds and in compliance with the provisions of Section 3(b) of the Endowment Act, will be included in the revenue account and used for the general purposes of HBRC.

~~11~~13. Risk Assessment and Management

The risk profile of the investment portfolio is continuously assessed to ensure adherence to the following risk management rules:

- HBRC will not invest where there is a significant known risk of decreased asset value, except where it has identified potential advantages to the Hawke's Bay economy in pursuit of its economic development objectives that may arise from making particular investments and has assessed whether potential economic gains could more than offset any potential decreases in asset value.
- For prudent management, while retaining a flexible approach to future investment opportunities, no more than 33% of HBRC's total investment portfolio will be invested in any one investment, or institution or groups of institutions in the same investment class, other than in institutions which are Government guaranteed (in which instance up to 100% of the portfolio may be invested). This rule does not apply to existing investments in Napier Port and Napier endowment property and the investment company established by HBRC.
- HBRC may use financial derivatives to "hedge" against fluctuations in interest rates and equity indexes. In some instances HBRC matches foreign currency denominated purchases with forward exchange contracts to reduce the risk of exchange rates increasing the cost of its purchases.
- HBRIC and Napier Port (and subsidiary Council Controlled Organisations (CCTO's) yet to be formed) will from time to time use interest-rate swaps and forward exchange contracts to manage interest rate and currency risk, consistent with prudent treasury and risk management practices.
- HBRC will appoint external professional investment advisers to provide an overall assessment of investment markets using its market intelligence and independent monitoring, and, specifically, to manage the funds invested in HBRC's managed funds portfolio and HBRC's Disaster Damage Reserve.

~~12~~14. Investment Classes

HBRC can invest in the following investment classes.

~~12~~14.1 Investment Instruments

Investment instruments include bonds, ~~fixed interest~~debt securities, cash, bills, commercial paper and term deposits. International investments are managed within the external Investment Fund.

~~12~~14.2 Investment Property

Investment property includes Napier endowment property and other unrestricted investment property assets. New Zealand and international property investments are managed within the external Investment Fund.

~~12~~14.3 Forestry

This includes physical assets including trees and land for forestry and forest development.

~~12~~14.4 Equities

This excludes the Port of Napier, but includes shares in publicly listed New Zealand and International Companies ~~held directly or through appointed investment managers, and other equity instruments such as New Zealand carbon units (or emission units). .~~ Equites are managed through the external Investment Fund by an appointed Investment Manager.

~~12~~New Zealand carbon units (or emission units) are purchased for the satisfaction of Council generated carbon liabilities.

14.5 Related Equity Investments

Equity investments in HBRIC, PONL, CCTOs, and other subsidiary companies established in accordance with this policy, including those established by HBRIC.

~~12~~14.6 Equity Investments: Joint Ventures

Equity investments in joint ventures with external partners.

~~12~~14.7 Loans and Mortgages

This includes mortgages to buyers of the freehold of Napier endowment property.

~~12~~14.8 Investment Portfolios

Both professionally managed (external to HBRC) and internally managed investment portfolios of assets classes itemised in this Section, either by direct investment or through unit trusts or other structures.

~~12~~14.9 Internal loans

Internal Loans for the development of infrastructure and property, plant and equipment assets.

~~13~~

15. Specific Investment Criteria

~~13~~15.1 Investment Instruments

Investments made under this investment class are only made in alignment with~~:~~

- ~~Any bank licensed by~~ the ~~Reserve Bank of New Zealand which has a minimum credit rating as issued by Standard & Poors (or other credit rating agencies of similar reputation) of~~following parameters:
  - ~~"A" for short term debt (i.e. for up to 12 months)~~
  - ~~"A" for long term debt (i.e. for longer than 12 months).~~
- ~~Any institution whose debt is issued by or guaranteed by the New Zealand Government.~~
- ~~Local authorities, but excluding Council controlled organisations and Council controlled trading organisations.~~
- ~~Any corporation, State Owned Enterprise or other legal entities which have minimum credit ratings for their short and long term debt as set by Standard & Poors (or other credit rating agencies of similar reputation) of:~~
  - ~~"A" for short term debt (i.e. for up to 12 months)~~
  - ~~"A+" for long term debt (i.e. for more than 12 months).~~
- ~~Investments with any one institution at any time are limited to the greater of:~~
  - ~~$5 million, or~~
  - ~~40% of this investment class.~~

~~13~~

Issuer / counterparty	Instruments	Minimum short term credit rating	Minimum long term credit rating	Maximum exposure per counterparty (% of rates revenue[1])	Maximum exposure per counterparty Category (% of rates revenue[1])
New Zealand Government	Treasury bills, NZ government bonds, debt issued by entities explicitly guaranteed by the NZ Government	n/a	n/a	unlimited	100%
RBNZ registered banks	Term deposits	A-1	A+	50%	100%
	Bank bills	A-1	A+	30%	
	Bonds	A-1	A	20%	

[1] Rates revenue is defined as general rates, targeted rates and uniform annual general charges and in the 2017 Annual Report was $17.66 million.

	Interest rate risk management contracts	A-1	A+	15%	
LGFA	Borrower notes, bonds, CP	A-1	AA-	40%	40%
Local authorities –rated	Local authority bonds, CP	A-1	AA-	20%	50%
Local authorities – non rated	Local authority bonds, CP	n/a	n/a	5%	20%
Supranational	Bonds	n/a	Aa+	40%	40%
Other issuers including state owned enterprises, listed companies	Commercial paper,	A-1+	AA-	15%	25%
	Corporate bonds	A-2	BBB+	10%	

- Investments (such as bank deposits) – Transaction Notional × Weighting 100% (unless a legal right of set-off over corresponding borrowings exists whereupon a 0% weighting may apply)
- Interest Rate Risk Management (such as swaps, FRAs) – Transaction Notional × Maturity (years) × 3%.
- Individual counterparty limits are kept on a register and updated on a day to day basis with specific approvals made by the GMCS. Credit ratings should be reviewed by the FA on an ongoing basis and in the event of material credit downgrades; this should be immediately reported to the GMCS and assessed against exposure limits. Counterparties exceeding limits should be reported to the Council.

Approved Treasury Investment Instruments

Category	Instrument
Treasury Investments	Bank term deposits (senior) Treasury bills(senior) Commercial paper (CP) (senior) Bank certificates of deposit (RCDs) (senior) Local Authority bonds (secured) State Owned Enterprise (SOE) bonds (senior) Government and Supranational bonds (senior) Corporate bonds (senior) LGFA borrower notes Note: bonds are either fixed rate or floating rate.

15.2 Investment Portfolios (excluding the Disaster Damage Reserve)

Investment portfolios may invest in any of the investment classes indicated in this policy.

The portfolio must earn at least 4.5% cash return on the funds for the first year of the LTP and then a 5% cash return for the rest of the LTP in line with the financial strategy.

Fund managers have the responsibility to obtain these returns while taking into account the following considerations and requirements of this policy.

- Cash Return
- Liquidity
- Capital Gains
- Risk Balance – Location, Industry risk
- Diversification of investments
- Responsible Investment
- Ethical Investment

~~13~~15.3 Disaster Damage Reserve

As a specific part of its Disaster Damage Reserve HBRC holds New Zealand Shares and quasi equity instruments (such as convertible notes) listed on the New Zealand Stock Exchange, as well international shares (held in diversified global funds which may be investment trusts, investment companies or unitised funds).

These investments are held to generate long term capital appreciation for the Reserve, while providing ready liquidity in order to meet any call on the Disaster Damage Reserve funds.

Investments in equities for the reserve are limited to an overall maximum of ~~30~~45% of the Disaster Damage Reserve, and further limited to:

- New Zealand shares - up to ~~10~~20% of the Reserve
- International ~~Shares~~shares - up to ~~22.5~~35% of the Reserve (fully hedged)

~~13~~15.4 Other Reserves

HBRC holds a number of reserves for which is holds investments for. These include asset replacement provisions, disaster damage management and land drainage and flood control schemes. These funds need to be readily realisable to meet their particular purposes. All of the returns for these reserves are retained within the individual reserves.

~~13.4~~15.5 HBRC Cash Reserves

HBRC also needs to maintain a working capital balance to ensure it can meet its obligations as and when they fall due. It is therefore important to maintain a continuing “cash reserve” in this form at a level no less than $3 million.

~~14~~15 Investment Management Responsibilities and Delegations

Investment management responsibilities and powers to delegate are summarised in the following table.

Investment Policy Investment Management Responsibilities and Delegations	
Responsible Entity	**Responsibilities**
Council / Corporate and Strategic committee	1. Approve the Investment Policy and review it, at least every three years, as part of the Long Term Plan (LTP) process. 2. Monitor compliance with the Investment Policy through the receipt of periodic reports and briefings. 3. Approve investments (in the instances where funding is required from HBRC) in HBRIC, PONL and any Council Controlled Trading Organisations (CCTOs), other subsidiary companies or trusts, including authorisations of use of investment funds and the terms and conditions of investment for these purposes. 4. As controlling shareholder, vote for the appointment of directors in HBRIC, PONL and any CCTOs or other subsidiary companies established to manage HBRC's investments in future. 5. Approve new investments to facilitate community infrastructure asset creation, whether by way of direct property ownership or by making loans to non-HBRC entities for this purpose. 6. Approve investments made outside this policy. 7. Authorise the Chief Executive to manage and invest HBRC's cash reserves, surpluses, and available working capital balances, in investment instruments specified in "Investment Classes" section of this policy, up to the limit of total cash balances available to the HBRC from time to time, and in accordance with the requirements of this Investment Policy. 8. Approve the investment strategy and distribution policy for the external Investment Fund. Review and approve the SIPO and appoint the Investment Manager and Investment Advisor. ~~8.~~9. Grant delegated authority to act on all other investment decisions and issues.
HBRIC Ltd	1. Approve new investments or divestments, including any made by its current and any future subsidiary companies, joint ventures or other investment vehicles, except where the new investment or divestment: (a) Is inconsistent with delivery of HBRC's strategic objectives (b) Significantly varies performance targets agreed through respective Statements of Intent (c) Requires HBRC to assist funding these investments by increasing its equity in its subsidiary, associate, joint venture or other investment vehicle, or provide loans or other financial assistance to them (d) Involves divestment of a strategic asset as defined under Section 97 of the Local Government Act 2002.
Chief Executive	1. Ensure compliance with this policy through the appointment and accountability of appropriate staff. 2. Exercise delegated authority to make and implement investment decisions in accordance with authority delegated by HBRC. 3. Monitor investment conditions and performance and recommend initiatives and changes to HBRC as circumstances require. 4. Grant delegated authority to implement investment decisions to senior staff as appropriate.

~~15~~16. Reporting

Investment mix and performance is reported to HBRC for all investments through the following means.

1. Reporting annually

- For all equities, (including HBRIC, PONL, CCTOs and other subsidiary companies, and New Zealand and international shares):
  - Dividends and other payments received
  - Sales and acquisitions; gains and losses on disposal (if any)
  - Changes in capital values of the assets (based on market or independent valuation)
  - Financial and operating results
  - Economic impacts (if any) generated during year.
- ~~For all investment instruments, (bonds, term deposits, fixed interest investments, loans and mortgages):~~
  - ~~Interest and other income received during the year~~
  - ~~Repayments of loan principal~~
  - ~~Gains and losses (if any) on disposal~~
  - ~~Changes in capital values of the underlying assets (based on market or independent valuation).~~
- For property investments (including the Napier endowment property):
  - Movements in rental renewals
  - Sales and acquisitions of leases and property over the year
  - Any transfers of leasehold properties between lessees
  - Gains and losses on disposal (if any)
  - Net income and change in capital values of the underlying assets (based on market or independent valuation)
  - Economic impacts (if any) generated during the year.

~~**2.** Periodic Annual Plan progress reports which will show:~~

2. ~~Ongoing income returns from~~Reporting quarterly

- For all treasury investments:
  - Dividends, interest and other income received during the quarter
- Sales and acquisitions ~~of investments to date~~
  - ~~Gains~~; gains and losses ~~(if any)~~ on disposal (if any)
  - ~~Indicative economic~~Changes in capital values of the assets (based on market or independent valuation)
  - Economic impacts (if any~~).~~) generated during quarter.
- For all externally managed investment funds :
  - Fund valuation
  - Fund duration
  - Compliance reporting (including approved exceptions)
  - Performance summary for the Fund and by asset class
  - Performance against benchmarks
  - Fund income
  - Asset transactions summary
  - Cash transactions
  - Investment management fees
  - Custodial fees
  - Individual fund management fees
  - Brokerage and other transaction costs.

3. Individual issue papers submitted to HBRC dealing with matters of relevance (including changes in investment policy) to the investment portfolio that may arise during the year.

4. Additional requirements on HBRIC, PONL, CCTOs and other subsidiary companies reporting through HBRIC, including:

- Agreeing financial and other relevant strategic and performance targets for these businesses through an annual Statement of Intent
- Confirm appointment of directors having appropriate expertise to their boards

Item 8

Attachment 3

- Where requested, for HBRC's strategic planning purposes, review businesses strategic plans, annual budgets and financial forecasts for their medium and long term future operations
- Receiving 6 and 12 month reports on financial performance and position and operating results of these businesses
- Being briefed by the Chairperson of Directors and Chief Executive Officer of the businesses as required by the HBRC, but no less than twice a year
- Being consulted, and where necessary, making decisions as shareholders, at any time on new developments or significant departures from anticipated performance.

~~16~~

17. Review of Policy

This policy will be reviewed no less than every three years.

Draft Liability Management Policy

Introduction and Scope

The following Liability Management Policy has been prepared in accordance with the ~~requirements of sections 102(4)(b) and 104 of the~~ following relevant legislation:

- Local Government Act 2002~~-~~, in particular Part 6 including sections 101, 102, 104 and 113. The policy covers Council management of all borrowing, as defined in section 112 of the Act, as well as management of other liabilities. Section 113 of the Act prohibits Councils' from borrowing or entering into incidental arrangements denominated in other than New Zealand currency.
- Local Government (Financial Reporting and Prudence) Regulations 2014, in particular Schedule 4.

Commentary

- HBRC has large infrastructure assets with long economic lives yielding long term benefits for the community. The use of debt as a funding option is seen as an appropriate and efficient mechanism for promoting inter-generational equity between current and future community members in relation to such assets. In addition, debt may allow scheme or other projects to progress at an earlier stage than might otherwise be possible as it reduces the cash flow burden on beneficiaries and therefore increases affordability.

General Policy

In accordance with the Act, and by resolution, Councils' may borrow on such terms and conditions that they consider appropriate. HBRC uses short-term and long-term funding to achieve an effective borrowing mix and to balance the requirements of liquidity and funding risk management.

~~Councils'~~

Council may borrow for any of the following primary purposes:

- Funds for the acquisition of any assets expected to have a useful economic life of more than 2 years
- Funds for specific one-off projects
- The acquisition of low risk investments
- Short term debt to manage timing differences between cash inflows and outflows and to maintain Council's liquidity position and, if necessary, to fund emergency expenditure.

In approving new borrowing, Hawke's Bay Regional Council (HBRC) will apply the following principles:

- Borrowings will be repaid over the economic life of the assets being funded, or such shorter period as determined, at its discretion
- Interest costs and principal repayments will be funded by the beneficiaries of the borrowings
- The extent of borrowings will be determined by the beneficiaries' ability and willingness to pay, as determined by consultation~~.~~

~~Commentary~~

- ~~HBRC has large infrastructure assets with long economic lives yielding long term benefits for the community. The use of debt as a funding option is seen as an appropriate and efficient mechanism for promoting inter-generational equity between current and future community members in relation to such assets. In addition, debt may allow scheme or other projects to progress at an earlier stage than might otherwise be possible as it reduces the cash flow burden on beneficiaries and therefore increases affordability.~~

~~Interest Rate Exposure~~

~~Interest rate risk refers to the impact that adverse movements in interest rates may have on Council's cash flows and interest expense. To avoid this risk, and given the low level of current and forecast future borrowings, Council's preference is to borrow long-term on fixed interest rates. From time to time it may be appropriate (depending on Council's outlook on interest rates at the time of borrowing and the term of a loan), to choose borrowing mechanisms that have a floating interest rate. In this case, the level of such borrowings must not exceed the maximum floating rate exposure allowed; being:~~

- ~~up to 50% of total external borrowings outstanding at any time may have a floating interest rate.~~

~~Where floating interest rates are used, interest rate hedging mechanisms may only be used as directed by HBRC.~~

~~Liquidity~~

- ~~Liquidity refers to the availability of~~HBRC considers the impact on borrowing limits, and its consistency with the LTP.

In evaluating strategy for new borrowing (in relation to source, term, size and pricing), HBRC considers:

- available terms from banks, domestic capital markets and LGFA,
- the overall debt maturity profile to ensure concentration of debt is avoided at re-issue/rollover time,
- prevailing interest rates and credit margins relative to domestic capital markets, LGFA and bank borrowing,
- liquidity, funding and interest rate risk-management parameters as detailed in this Policy,
- legal documents and financial covenants, together with credit rating considerations, and
- the market and HBRC's outlook on future credit margin and interest rate movements.

General objectives

- Minimise HBRC's costs and risks in the management of its borrowings.
- Borrow funds ~~to settle Council's financial~~ and transact risk management instruments within an environment of control and compliance under the Policy to protect HBRC's costs.
- Maintain liquidity levels and manage cash flows within HBRC to meet known and reasonable unforeseen funding requirements.
- Arrange and structure appropriate funding for the HBRC at the lowest achievable credit margin from debt lenders. Optimise flexibility and spread of debt maturity within the funding risk limits established by this Policy.
- Monitor and report on financing/borrowing covenants and limits under the obligations of the HBRC's lending/security arrangements.
- Monitor, evaluate and report on treasury performance.
- To minimise liquidity and credit risk by dealing with credit worthy counterparties.
- Ensure that all statutory requirements of a financial nature are adhered to.
- To ensure adequate internal controls exist to protect HBRC's financial assets and to prevent unauthorised transactions.

- Develop and maintain relationships with financial institutions, the LGFA and investors.

Local Government Funding Agency

HBRC has proposed, as part of the public consultation for this LTP, to join the LGFA Scheme, including borrowing from the LGFA and entering into the transactions relating to that borrowing.

In connection with LGFA borrowings, HBRC may enter into the following related transactions to the extent it considers necessary or desirable:

- Contribute a portion of its borrowing back to the LGFA as an equity contribution to the LGFA. For example borrower notes.
- Provide guarantees of the indebtedness of other local authorities to the LGFA and of the indebtedness of the LGFA itself.
- Commit to contributing additional equity (or subordinated debt) to the LGFA if required.
- 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.
- Subscribe for shares and uncalled capital in the LGFA.

Debt Repayment

HBRC will repay borrowings from rates, surplus operating funds, proceeds from the sale of assets or investments, re-financing with new debt or from specific sinking funds.

Guarantees/contingent liabilities and other financial arrangements

HBRC may act as guarantor to financial institutions on loans or enter into incidental arrangements for organisations, clubs, Trusts, or Business Units, when the purposes of the loan are in line with HBRC's strategic objectives.

HBRC is not allowed to guarantee loans to Council Controlled Trading Organisations under Section 62 of the Local Government Act.

Specific Borrowing Limits

~~they fall~~The following table summarises the specific borrowing limits that HBRC adheres to, in conjunction with the LGFA's lending covenants.

	HBRC	LGFA
Net external debt as a percentage of total revenue	<150%	<175%
Net interest on external debt as a percentage of total revenue	<15%	<20%
Net interest on external debt as a percentage of annual rates income	<20%	<25%
Liquidity (liquid assets, term debt and committed debt facilities as a percentage of existing total external debt)	>110%	>110%

- Revenue is defined as earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue.
- Revenue excludes non-government capital contributions (e.g. developer contributions and vested assets)
- Net debt is defined as total external debt less liquid funds.
- Liquid funds are cash and cash equivalents defined as being:
  - Overnight bank cash deposits
  - Wholesale/retail bank term deposits no greater than 30 days
  - Bank issued registered deposits no greater than 181 days
  - Allowable fixed interest bonds as per approved investment instruments
  - Bank term deposits linked to pre-funding of upcoming maturing term debt exposures

Debt will be repaid as it falls due ~~for payment~~in accordance with the applicable agreement. Subject to the debt limits, a loan may be rolled over or re-negotiated as and when appropriate.

Borrowing limits are measured on Council only, not the consolidated group.

Disaster recovery requirements will be met through the liquidity ratio and contingency reserves (e.g. Disaster Damage Reserve).

Liquidity and Funding limits

Liquidity risk management focuses on the ability to access committed funding at the that future time to fund the gaps. Council will maintain liquidity by:

- Matching average expenditure closely to revenue streams and managing cash flow timing differences to its favour
- Avoiding concentrations of debt maturity dates
- Maintaining operating cash balances (being less than 1-year investment timeframes) of not less than $3,000,000.

~~Credit Exposure~~

~~HBRC will only borrow from reputable financial institutions so there are no minimum credit rating requirements imposed on lenders. Furthermore, there is no limit on the level of borrowing to which HBRC may commit from any one lender.~~

~~Local Government Funding Agency Ltd~~

~~HBRC has proposed, as part of the public consultation for this LTP, to join the LGFA Scheme, including borrowing from the LGFA and entering into the transactions relating to that borrowing.~~

- Liquid funds (including cash and cash equivalents) and committed debt facilities must be maintained at an amount equal to at least 110% of current total external debt.

Funding risk management centres on the ability to re-finance or raise new debt at a future time at the same or more favourable pricing (fees and borrowing margins) and maturity terms of existing facilities.

HBRC has the ability to pre-fund up to 12 months of forecast debt requirements including re-financings. Debt re-financings that have been pre-funded, will remain included within the funding maturity profile until their maturity date.

The ~~primary objective of these changes is to allow borrowing~~GMCS has the discretionary authority to re-finance existing debt on more favourable terms. Such action is to be reported and ratified by the Council at ~~lower interest margins~~the earliest opportunity.

The debt maturity profile of the total committed funding in respect to all external debt and committed debt facilities, is to be controlled by the following risk control limits:

Period	Minimum	Maximum
0 to 3 years	15%	60%
3 to 5 years	15%	60%
5 years plus	0%*	60%

**Should HBRC's external debt exceed $30 million, this minimum will increase to 15%.*

A funding maturity profile that is outside the above limits, but self corrects within 90 days is not in breach of this Policy. However, a maturity profile outside these limits for greater than ~~it currently faces.~~90 days will require specific Council approval.

~~Debt Repayment~~

~~HBRC will repay borrowings from rates, surplus funds, proceeds from the sale of assets or investments or from specific sinking funds.~~

~~Specific Borrowing Limits~~

~~In managing its borrowings, HBRC will adhere to the following limits.~~

- ~~Total interest expense on external public debt (including lease annuity) will not exceed 25% of total annual operating expenditure. In addition, HBRC loan funding will not exceed a debt to debt equity ratio of 28%.~~

Notwithstanding the $25 million external core debt threshold, at all times, the LGFA require that no more than the greater of NZD 100 million or 33% of HBRC's borrowings from the LGFA mature within an immediate 12-month period.

Security

~~HBRC will offer security for its~~HBRC's external borrowings and interest rate risk management instruments are secured by way of a charge over ~~its~~ rates~~. However, in~~ and rates revenue offered through the Debenture Trust Deed. Under the Debenture Trust Deed, HBRC's borrowing is secured by a floating charge over all HBRC rates levied under the Rating Act. The security offered by HBRC ranks equally or pari passu with other lenders to Council.

Other borrowing structures are possible, but HBRC does not normally offer assets, other than rates, as security. Under special circumstances, and if considered more appropriate, ~~HBRC~~security may ~~offer security~~be offered over specific assets, but only with HBRC's prior approval.

Internal Debt Management

When considered appropriate, HBRC uses cash operating and reserve balances as internal borrowing sources, thereby reducing the level of external borrowings. The following guidelines apply to the use of internal borrowings:

- Interest will normally be charged on the average of opening and closing loan balances in each financial year
- The interest rate charged is the average rate of return achieved from short term investments during the financial year.

The reserves established to cover the funding of replacement operating property, plant and equipment and renewal of flood and drainage scheme infrastructure are treated as one reserve balance for the purposes of providing funds for the purchase of new assets. Therefore for the most part loans are only raised from external funding sources when the total reserve balance is low.

Approved financial instruments

Category	Instrument
Cash management and external borrowings	Bank overdraft Committed cash advance and bank accepted bill facilities (short term and long term loan facilities) Bonds (Fixed Rate or Floating Rate) either through the LGFA or domestic capital markets Commercial paper (CP) –
Interest rate risk management (for borrowing activity only)	Forward rate agreements ('FRAs') on bank bills Interest rate swaps including: • Forward start swaps (start date <24 months, unless linked to existing maturing swap/collar with notional amount amounts

	not exceeding maturing swap/collar) • Amortising swaps (whereby notional principal amount reduces) • Swap extensions and shortenings Interest rate options on: • Bank bills (purchased caps and one for one collars) Interest rate swaptions (purchased swaptions and one for one collars with matching notionals only)
Foreign exchange risk management	• Spot foreign exchange • Forward exchange contracts (including par forwards)

Interest Rate Risk Management

Interest rate risk refers to the impact that adverse movements in interest rates may have on Council's cash flows and interest expense.

The following interest rate risk control limits apply to external core debt:

Debt interest rate policy parameters		
(calculated on a rolling monthly basis)		
Debt period ending	**Minimum fixed**	**Maximum fixed**
Current	50%	100%
Year 1	45%	95%
Year 2	40%	90%
Year 3	35%	85%
Year 4	30%	80%
Year 5	25%	75%
Year 6	0%	70%
Year 7	0%	65%
Year 8	0%	60%
Year 9	0%	55%
Year 10	0%	50%
Year 11	0%	45%
Year 12	0%	40%
Year 13	0%	35%
Year 14	0%	30%
Year 15	0%	25%

- "Fixed Rate" is defined as all known interest rate obligations on core debt, including where hedging instruments have converted floating interest rate obligations into firm commitments.
- "Floating Rate" is defined as any interest rate obligation subject to movements in the applicable reset rate.
- The fixed rate percentages are calculated on the projected core debt level at month-end reporting dates.
- Core debt is the amount of total external debt for a given period. This allows for pre-hedging in advance of projected physical drawdown of new debt. When approved debt forecasts are changed, the amount of fixed rate protection in place may have to be adjusted to ensure compliance with the Policy minimums and maximums.

- A fixed rate maturity profile that is outside the above limits, however self corrects within 90-days is not in breach of this Policy. Maintaining a maturity profile beyond 90-days requires specific approval by Council.
- Bank draw down advances may be for a maximum term of 12 months.
- Any interest rate hedge with a maturity beyond 15 years must be approved by Council. The exception to this will be if Council raises LGFA funding as fixed rate or an interest rate hedge is linked to floating rate LGFA debt that has a maturity date beyond 15 years.
- Interest rate options must not be sold outright. 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, one side of the collar cannot be closed out by itself, both must be closed simultaneously. The sold option leg of the collar structure must not have a strike rate “in-the-money”.
- Purchased borrower swaptions must mature within 12 months.
- Interest rate options with a maturity date beyond 12 months that have a strike rate (exercise rate) higher than 2.00 per cent above the appropriate swap rate, cannot be counted as part of the fixed rate cover percentage calculation.
- The forward start period on swap/collar strategies to be no more than 24 months, unless the forward start swap/collar starts on the expiry date of an existing swap/collar/fixed rate debt instrument and has a notional amount, which is no more than that of the existing swap/collar/fixed rate debt instrument.

Foreign currency

HBRC has minor foreign exchange exposure through the occasional purchase of foreign exchange denominated services, plant and equipment.

All individual commitments over NZ$100,000 equivalent are hedged using foreign exchange contracts, once expenditure is approved and legally committed. Both spot and forward foreign exchange contracts are used.

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

All foreign currency hedging must be approved by the GMCS.

Foreign currency management of the external Investment Fund is managed within the SIPO.

Counterparty Credit Limits

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where Council is a party. The credit risk to the Council in a default event will be weighted differently depending on the type of instrument entered into.

External borrowing, cash and interest and foreign exchange risk management related transactions would only be entered into with organisations specifically approved by the Council.

Counterparties and limits can only be approved based on long-term credit ratings (Standard & Poor’s or Moody’s or Fitch) being A+ and above or short term rating of A-1 or above.

Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.

The matrix guide of counterparty credit limits can be found as part of the Specific Investment Criteria within the Investment Policy.

Review of Policy

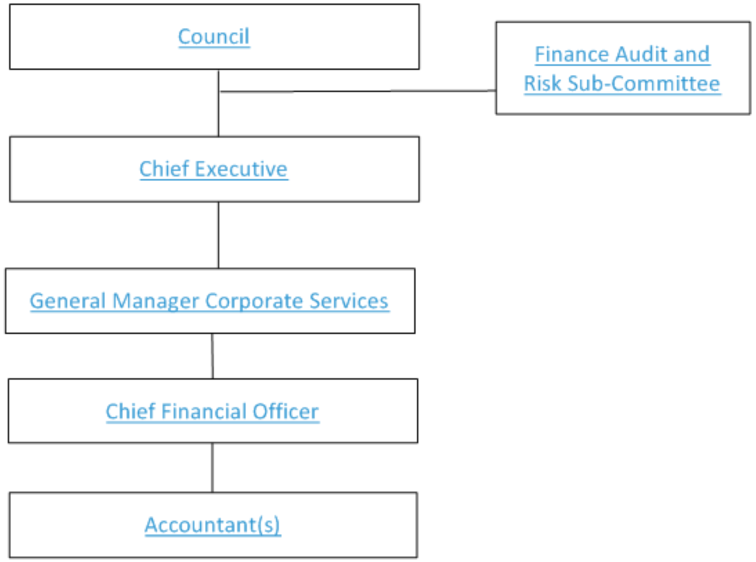
This policy will be reviewed no less than every ~~3 years~~three years and amendments can be made through Council resolution any time within the three year period.

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 23

Management responsibilities

All of the Council's treasury management activities are undertaken by the Treasury function. The following diagram illustrates those individuals and bodies who have treasury responsibilities.



Council

The Council has ultimate responsibility for ensuring that there is an effective policy for the management of its risks. In this respect Council decides the level and nature of risks that are acceptable.

Council is responsible for approving these Liability Management and Investment Policies and any changes required from time to time. While the Policy can be reviewed and changes recommended by other persons, the authority to make or change Policy cannot be delegated.

In this respect, the Council has responsibility for:

- Approving the long-term financial position of the Council through the 10-year LTP and the Annual Plan
- Approving HBRC's SIPO document, including the investment strategy, return objective, policies, manager configuration, and instructions to the Investment Manager.
- Approving new debt funding via resolution of the Annual Plan
- Approving the Liability Management and Investment Policies, incorporating the following delegated authorities:
  - borrowing, investing and dealing limits and the respective authority levels delegated to the Chief Executive (CE), General Manager Corporate Services (GMCS), Chief Financial Officer (CFO) and other managers
  - risk management control limits
  - guidelines for the use of financial instruments.
- Delegating authority to the CE and other officers
- Reviewing and approving changes to the Liability Management and Investment Policies as well as the SIPO document every three years.

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 24

Council will also ensure that:

- Issues raised by auditors (both internal and external) in respect of any significant weaknesses in the Treasury function are resolved immediately
- Approval will be gained by the GMCS for any transactions falling outside Policy guidelines.

Finance Audit and Risk Sub-Committee ("FARC")

The FARC will oversee the implementation of the Council's borrowing and investment strategies and monitor and review the effective management of the treasury function, borrowing and investment activities.

The FARC will ensure that the information presented to the Council is accurate, identifies the relevant issues and is represented in a clear and succinct manner.

The FARC will discuss treasury matters on a quarterly basis.

Responsibilities are as follows:

- Recommending the Liability Management and Investment Policy and SIPO document (or changes to existing policy) to the Council
- Receiving recommendations from the GMCS and make submissions to the Council on all treasury matters requiring Council approval
- Recommending performance measurement criteria for externally managed funds
- Review all matters concerning the SIPO as well as providing guidance and leadership on the appointment, management, monitoring and review of the appropriate Investment Manager
- Monitoring quarterly performance of externally managed funds against benchmarks

Approving allowable financial instruments.

Chief Executive Officer ("CE)

While the Council has final responsibility for policy governing the management of Council's risks, it delegates overall responsibility for the day-to-day management of such risks to the CE. The Council formally delegates to the CE the following responsibilities:

- Ensuring Council's policies comply with existing and new legislation
- Approving the bank signatories
- Approving new counterparties and counterparty limits as defined within this policy and recommended by the GMCS
- Approving the opening and closing of bank accounts.

General Manager Corporate Services ("GMCS")

The CE formally delegates the following responsibilities to the GMCS:

- Approving new borrowing undertaken in line with Council resolution and approved borrowing strategy
- Approving re-financing of existing debt
- Approving all treasury deal tickets (borrowing, investment and risk management instruments) within delegated authority
- Approving treasury transactions in accordance with policy parameters outside of the CFO's delegated authority
- Authorising the use of approved risk management instruments within discretionary authority
- Receiving advice of breaches of Policy and significant treasury events from the CFO.

Chief Financial Officer ("CFO")

The GMCS formally delegates the following responsibilities to the CFO:

- Recommending policy changes to the FARC for evaluation.

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

- Ongoing risk assessment of borrowing and investment activity, including procedures and controls
- Receive quarterly reporting from the Investment Manager(s) and Investment Advisor
- Proposing any new funding requirements falling outside the Annual Plan and LTP to the FARC for consideration and submission to the Council
- Designing, analysing, evaluating, testing and implementing risk management strategies to position Council's interest rate risk profile to be protected against adverse market movements within the approved Policy limits
- Investigating financing alternatives to minimise borrowing costs, credit margins and interest rates, making recommendations to FARC as appropriate.
- Reviewing and making recommendations on all aspects of the Liability Management and Investment Policy to the FARC including dealing limits, approved instruments, counterparties, and general guidelines for the use of financial instruments.
- Negotiating bank funding facilities.
- Managing bank, LGFA, Investment Manager, Trustee, Custodial and other financial institution relationships.
- Executing treasury transactions in accordance with approved limits. In the absence of the CFO, the GMCS will execute treasury transactions.
- Completing deal tickets for treasury transactions.
- Overseeing a triennial review of the Liability Management and Investment Policy, treasury procedures and all dealing and counterparty limits.
- Managing the long-term financial position of the Council in accordance with Council's requirements.
- Ensuring that all borrowing and financing covenants/limits to lenders are adhered to.
- Ensuring management procedures and policies are implemented in accordance with this Policy.
- Monitoring and reviewing the performance of the Treasury function in terms of achieving its objectives .

Accountant(s)

The CFO formally delegates the following responsibilities to the Accountant(s):

- On a continuing basis, monitoring and updating credit ratings of approved counterparties.
- Recommending changes to credit counterparties to the CFO.
- Monitoring treasury exposure on a regular basis, including current and forecast cash position, treasury investment portfolio, interest rate exposures and borrowings.
- Checking compliance against limits and preparing reports on an exceptions basis.
- Preparing treasury reports.
- Delivering weekly reports to the CFO covering cash/liquidity, investment portfolio, debt funding portfolio and interest rate risk position.
- Forecasting future cash requirements.
- Check the written evidence of executed deals on an agreed form.
- Ensuring all financial instruments are valued and accounted for correctly in accordance with current best practice standards.
- Managing the operation of all bank accounts.
- Handling all administrative aspects of bank, LGFA agreements and documentation.

- Completing, reviewing and approving treasury journals, bank, borrowing and investment spreadsheet reconciliations to the general ledger (ensuring segregation of completion, review and approval tasks amongst Accountant(s).
- Undertaking a triennial review of the Liability Management and Investment Policy, treasury procedures and all dealing and counterparty limits.
- Updating treasury spreadsheets for all new, re-negotiated and maturing transactions.
- Checking all treasury deal confirmations against internal deal documentation and reporting any irregularities immediately to the GMCS.
- Reconciling monthly summaries of outstanding financial contracts from banking counterparties to internal records.
- Review electronic batch payments to creditors and arranging for approval by authorised signatories.

Delegation of authority and authority limits

Treasury transactions entered into by Council without the proper authority are difficult to cancel given the legal doctrine of "apparent authority". Insufficient authority for a given bank account or facility may prevent the execution of certain transactions (or at least cause unnecessary delays). Therefore, the following procedures will apply:

- All delegated authorities and signatories will be reviewed at least every six months to ensure that they are still appropriate and current.
- A comprehensive letter will be sent to all bank and lender counterparties, at least every year, detailing all relevant current delegated authorities of the Council and contracted personnel empowered to bind the Council.
- Whenever a person with delegated treasury authority leaves Council, all relevant banks and other counterparties will be advised in writing on the same day to ensure that no unauthorised instructions are to be accepted from such persons.

The Council has the following responsibilities, either directly, or via the following stated delegated authorities:

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 27

Activity	Delegated Authority	Limited
Approving and changing policy	The Council	Unlimited
Borrowing new debt	The Council CE (delegated by Council) GMCS (delegated by Council)	Unlimited (subject to legislative and regulatory limitations) Subject to Council resolution and policy
Acquiring and disposing of investments other than financial investments	The Council	Unlimited
Approving charging assets as security over borrowing	The Council	Subject to terms of the Debenture Trust Deed
Overall day-to-day treasury management	GMCS (delegated by Council) CFO (delegated by Council)	Subject to policy
Re-financing existing debt	GMCS (delegated by Council) CFO (delegated by Council)	Subject to policy
Approving transactions outside policy	The Council	Unlimited
Adjusting debt or investment interest rate risk profile	GMCS (delegated by Council) CFO (delegated by Council)	Per risk control limits
Managing investments and funding maturities	GMCS (delegated by Council) CFO (delegated by Council)	Per risk control limits
Maximum daily transaction amount (borrowing and interest rate risk management) excluding roll-overs under bank debt facilities	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $5 million $2.5 million
Maximum daily transaction amount (investing and cash management)*	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $10 million $5 million
Maximum daily transaction amount (foreign exchange risk management)	The Council GMCS (delegated by Council) CFO (delegated by Council)	Unlimited $0.5 million $0.25 million
Approving bank signatories	CE	Unlimited
Approving the opening/closing bank accounts	CE	Unlimited
Reviewing the Liability Management and Investment Policies every three years	FARC	N/A
Ensuring compliance with Policy	GMCS	N/A

*Daily transaction amounts relate to internally managed Investment Funds only with external Investment Funds managed under Council's SIPO document.

Item 8

Attachment 3

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 28

Operational Risk

Operational risk is the risk of loss as a result of human errors including fraud, system failures, or inadequate procedures and controls. Operational risk is very relevant when dealing with financial instruments given that:

- Financial instruments may not be fully understood
- Too much reliance is often placed on the specialised skills of one or two people
- Most treasury instruments are executed over the phone

Operational risk is minimised by this policy.

Dealing Authorities and Limits

Transactions will only be executed by those persons and within limits approved by Council.

Segregation of Duties

There will be adequate segregation of duties among the borrowing and investment functions of deal execution, confirmation, settling and accounting/reporting. However, there are a small number of people involved in borrowing and investment activity. Accordingly, strict segregation of duties will not always be achievable.

The risk will be minimised by the following:

- The Accountant(s) will report directly to the CE to control the transactional activities of the GMCS and the CFO
- There is a documented approval process for borrowing and investment activity.

Procedures and controls

- The CFO will have responsibility for establishing appropriate structures, procedures and controls to support borrowing and investment activity
- All borrowing, investment, cash management and risk management activity will be undertaken in accordance with approved delegations authorised by Council
- All treasury products will be recorded and diarised within a treasury system/spreadsheet, with appropriate controls and checks over treasury journal entries into the general ledger. Deal capture and reporting will be done immediately following execution and confirmation. Details of procedures, including templates of deal tickets, will be included in a treasury procedures manual separate to this policy.

Procedures and controls will include:

- Regular management reporting
- Regular risk assessment, including review of procedures and controls
- Organisational systems, procedural and reconciliation controls to ensure:
  - All borrowing and investment activity is bona fide and properly authorised
  - Checks are in place to ensure Council's accounts and records are updated promptly, accurately and completely
  - All outstanding transactions are revalued regularly and independently of the execution function to ensure accurate reporting and accounting of outstanding exposures and hedging activity
  - Cheque/electronic banking signatories will be approved by the CE. Dual signatures will be required for all cheques and electronic transfers.
- All treasury counterparties will be provided with a list of personnel approved to undertake transactions, standard settlement instructions and details of personnel able to receive deal confirmations
- The CFO will record all deals on properly formatted deal tickets. Deal summary records for borrowing, investments, risk management and cash management transactions (on spreadsheets) will be maintained and updated promptly following completion of transaction.

Item 8

Attachment 3

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 29

- All inward deal confirmations, including registry confirmations, will be received and checked by the Accountant(s) against completed deal tickets and summary spreadsheets records to ensure accuracy
- Deals, once confirmed, will be filed (deal ticket and attached confirmation) in deal date/number order
- Any discrepancies arising during deal confirmation checks which require amendment to Council records will be signed off by the GMCS
- Where possible borrowing and investment payments will be settled by direct debit authority
- For electronic payments, batches will be set up electronically. These batches will be checked by the Accountant(s) to ensure settlement details are correct. Payment details will be authorised by two approved signatories as per Council register
- The Accountant(s) will perform bank reconciliations monthly. Any unresolved unreconciled items arising during bank statement reconciliation which require amendment to the Council's records will be signed off by the GMCS
- A monthly reconciliation of the borrowing and investment spreadsheets to the general ledger will be completed,reviewed and approved by the Accountant(s), ensuring of completion, review and approval tasks.

Cash Management

The Accountant(s) have the responsibility to carry out the day-to-day cash and short-term debt management activities. The Accountant(s) will:

- Calculate and maintain cash flow projections on a daily (two weeks forward), weekly (four weeks forward), monthly (12 months forward) basis
- Electronically download all Council bank account information daily.
- Co-ordinate Council's operating units to determine daily cash inflows and outflows with the objective of managing the cash position within approved parameters
- Undertake short-term borrowing functions as required, minimising overdraft costs
- Ensure efficient cash management, through improvement to accurate forecasting using spreadsheet modelling
- Minimise fees and bank charges by optimising bank account/facility structures
- Monitor Council's usage of committed cash advance facilities
- Match future cash flows to smooth over time
- Provide reports to CFO detailing actual cash flows during the month compared with those forecast.

Financial Instrument Accounting Treatment

Council uses financial arrangements ("derivatives or financial instruments") for the primary purpose of reducing its financial risk to fluctuations in interest rates. The purpose of this section is to articulate Council's accounting treatment of financial instruments in a broad sense.

Under NZ IPSAS changes in the fair value of financial instruments go through the Income Statement unless financial instruments are designated in an effective hedge relationship.

Council's principal objective is to actively manage the Council's interest rate risks within approved limits and chooses not to hedge account. Council accepts that the marked-to-market gains and losses on the revaluation of financial instruments can create potential volatility in Council's annual accounts.

The Accountant(s) responsible for advising the CFO of any changes to relevant NZ IPSAS, which may result in a change to the accounting treatment of any financial instruments .

Draft Policies on Rates Remission and ~~Postponement~~ PostponementDraft Liability Management Policy

Page 30

Reporting

Report Name	Frequency	Prepared by	Recipient
Daily Cash Position	Daily	Accountant(s)	CFO
Treasury investments	Quarterly	Accountant(s)	CFO
Summary Treasury Report*	Quarterly Six-monthly	Accountant(s)	CFO, GMCS, CE, FARC, and Council
Counterparty Credit Limits Report	Daily for exceptions / Quarterly	Accountant(s)	CFO, CE, GMCS, and FARC
Debt Maturity Profile	Quarterly Six-monthly	CFO	FARC and Council
Statement of Public Debt	Quarterly Six-monthly	CFO	FARC and Council
Revaluation of financial instrumentand review of guaranteess	Quarterly	Accountant(s)	CFO

*The 'Summary Treasury Report' includes the following:

- Treasury exceptions report
- Risk exposure positions
- Policy compliance
- Borrowing limit report
- Cost of funds report
- Cash flow forecast report

Item 8

Attachment 3

Draft Policies on Rates Remission and Postponement

Māori Freehold Land

Introduction

Māori freehold land is defined in the Local Government (Rating) Act 2002 as land whose beneficial ownership has been determined by a freehold order issued by the Māori Land Court. Only land that is the subject of such an order may qualify for remission or postponement under this policy. Whether rates are remitted or postponed in any individual case will depend on the individual circumstances of each application.

This policy has been formulated for the purpose of:

- Ensuring the fair and equitable collection of rates from all sectors of the community by recognising that certain Māori owned lands have particular conditions, features, ownership structures or other circumstances that make it appropriate to provide relief from rates
- Meeting the requirements of Sections 102 and 108 and the matters in Schedule 11 of the Local Government Act 2002 to have a policy on the remission and postponement of rates on Māori freehold land.

Objectives

The objectives of this policy are:

- To recognise situations where there is no occupier or person gaining an economic or financial benefit from the land
- To set aside land for conservation purposes because of its natural features
- To recognise and take account of the presence of waahi tapu (sacred areas) that may affect the use of the land for other purposes
- Where part only of a block is occupied, to grant remission for the portion of land not occupied.

Conditions and criteria

1. Application for a remission or postponement under this policy must be made by the person(s) liable for rates for the land (e.g. owners or trustees), or a person appointed by the Māori Land Court, or other authorised agent of the owners of the land.

2. The application is to be made in writing before 30 days of the due date of payment. Applications made after this cut-off date will apply from the beginning of the following rating year. Hawke's Bay Regional Council (HBRC) will review the appropriateness of remissions on occasion.

3. The applicant must include the following information in their applications:

- Details of the rating unit or units involved
- Documentation that shows that the land qualifies as land whose beneficial ownership has been determined by a freehold order issued by the Māori Land Court
- Details supporting the applicant's eligibility under clause 5 below.

4. Relief and the extent thereof, is at the sole discretion of Council and may be cancelled or reduced at any time.

5. HBRC may grant a remission on Māori freehold land of up to 100% of all rates for the year to which the application applies, based on the following criteria.

The land is in multiple ownership:

- Where the level of gross income derived from the land is not sufficient to cover the cost of rates levied on that land
- Where it is not possible to identify or locate the owners, or those liable to pay rates on the land
- The support for the use of the land by the owners for traditional purposes
- The support for the relationship of Māori and their culture and traditions with their ancestral lands
- Recognition of the presence of sacred areas (waahi tapu) that may affect the use of the land for other purposes
- Recognition of the importance of the land for community goals relating to:
    - the preservation of the natural character of the coastal environment
    - the protection of outstanding natural features
    - the protection of significant indigenous vegetation and significant habitats of indigenous fauna.

6. No application under this policy will be automatically backdated; however, having granted a remission on a property under the criteria laid down in clause 5 (above), Council may remit (write-off) outstanding arrears owing on that same property.

Delegated Authority

Decisions on the remission and postponement of rates on Māori freehold land are delegated to the Group Manager Corporate Services or the Chief Executive.

Review of Policy

This policy will be reviewed at least every 3 years to ensure that the conditions and criteria on which the policy is based continue to be relevant and appropriate.

Remission in Special Circumstances

Introduction

In order to allow rate relief where it is considered fair and reasonable to do so, Hawke's Bay Regional Council (HBRC) has resolved to adopt policies under Sections 102 (5) (a) and 109 of the Local Government Act 2002 specifying the circumstances under which rates will be considered for remission. There are various types of remission, and circumstances under which a remission will be considered. A remission will not be granted where an entity has qualified under the Local Government (Rating) Act 2002 (LGRA) for partial non rating under Part 2 of Schedule 1.

The conditions and criteria relating to remission in special circumstances are set out following.

Part 1 – Remission of Rates in Special Circumstances

Policy objective

To provide for the possibility of a rates remission in circumstances that have not been specifically addressed in other parts of HBRC's rating policy.

Conditions and criteria

1. HBRC may remit all or part of the rates assessed in relation to a particular rating unit in special or unforeseen circumstances where it considers it just and equitable to do so.
2. The approval of the remission must not set a precedent that unfairly disadvantages other ratepayers.
3. A remission under this policy will apply for one year only. Applicants must reapply annually.
4. No application under this policy will be backdated. Rates arrears on the land as at 1 July 2004 will remain outstanding until such time as HBRC is no longer legally able to pursue the collection of rates.
5. All applications must be received in writing detailing the rating unit(s) involved and any other relevant information supporting the applicant's eligibility for the remission.
6. The application for a rates remission must be made before 7 days of the due date of payment.

Delegation

Decisions relating to the remission of rates special circumstances are retained by HBRC.

Review of Policy

This policy will be reviewed at least every 3 years, to ensure that the conditions and criteria on which the policy is based, continue to be relevant and appropriate.

Part 2 – Remission of Penalties on Rates

Objective

To enable HBRC to act fairly and reasonably when a rates payment has not been received by the due date.

Conditions and criteria

Upon receipt of an application from the ratepayer either in written or email format, or if identified by Council, a penalty may be remitted where at least one of the conditions listed below are met:

1. A full payment of outstanding rates due (excluding a penalty amount) has been made prior to the application being received by the Council, and if the ratepayer has previously paid all rates by the due date within the last three years.
2. Where a ratepayer has rate arrears, that on entering and adhering to a payment plan, the additional penalties will be remitted at an agreed time.
3. Where payment has been late due to an unforeseen disruption to the normal activities or business of the ratepayer, i.e. serious illness, case of death, injury, accident of family member, or family circumstances.
4. The late payment was caused by matters outside of the ratepayer's control.
5. It is demonstrated that the penalty has been levied because of an error by Council.
6. Where it is considered just and equitable to do so. Each application will be considered on its merits.

Matters that will be taken into consideration by Council under above include:

1. The ratepayer's payment history
2. The ratepayer entering into an agreement with Council for the payment of rates.
3. Matters controlled by the ratepayer may include: electronic payment errors, late posting of payment, failure to update mailing or direct debit arrangement.
4. Matters out of the control of the ratepayer may include: payments missing in transit, change of ownership, bank errors.

Where there is a deliberate non-payment, remission will not be granted. Council reserves the right to impose conditions on the remission of penalties.

Delegation

Decisions relating to the remission of penalties on rates are delegated to the Group Manager Corporate Services or Chief Executive.

Review of Policy

This policy will be reviewed at least every 3 years to ensure that the conditions and criteria on which the policy is based, continue to be relevant and appropriate.

Part 3 – Remission of Rates on Properties Affected by Natural Calamity

Objective

To help ratepayers experiencing extreme financial hardship due to natural calamity which affects their ability to pay rates.

Conditions and Criteria

1. Applicable where erosion, subsidence, submersion, or other natural calamity has affected the use or occupation of any rating unit. Does not apply to erosion, subsidence, submersion, etc that may have occurred without a recognised major event.
2. HBRC may, at its discretion, remit all or part of any rate assessed on any rating unit so affected by natural calamity.
3. HBRC will set the criteria for remission with each event. Criteria may change depending on the severity of the event and available funding at the time.
4. HBRC may require financial or other records to be provided as part of the remission approval process.
5. Remissions approved under this policy do not set a precedent and will be applied only for each specific event and only to properties affected by the event.

Delegation

Decisions relating to the remission of rates on property affected by natural calamity are delegated to the Group Manager Corporate Services or the Chief Executive.

Review of Policy

This policy will be reviewed at the least every 3 years, to ensure that the conditions and criteria under which the policy is based, continue to be relevant and appropriate.

Remission for Uniform Annual General Charges (UAGC)

Introduction

In order to allow rate relief where it is considered fair and reasonable to do so, Hawke's Bay Regional Council (HBRC) is required to adopt policies to specify the circumstances under which rates will be considered for remission. This policy is prepared under Sections 102 (5) (a) and 109 of the Local Government Act 2002.

Policy Objectives

- To provide relief to ratepayers who occupy several near adjacent rating units, but which do not meet the criteria for continuity under section 20 of the Local Government Act (Rating) 2002.
- To provide relief for developers in the instances of sub-division development in urban areas.

Remissions under the Local Government (Rating) Act 2002

Section 20 of the Local Government (Rating) Act 2002, stipulates that there shall be one property for the purposes of levying the UAGC, where two or more separately rateable properties are:

- Occupied by the same ratepayer (owner or person with right to occupy by virtue of lease for more than 12 months); and
- Used jointly as a single property (for the same purpose); and
- Contiguous but separated only by a road, railway-line, drain, water race, river or stream, they shall be deemed to be one property for the purposes of any Uniform Annual General Charges.

Where not already reflected on Council's rating information database, HBRC will allow, without further enquiry except for clarification, applications made by ratepayers in the form of a statutory declaration to the effect that two or more separately rated properties are occupied by the same ratepayer and used jointly for the same purpose, the Uniform Annual General Charge levied on the second and subsequent assessments will be cancelled.

Conditions and Criteria to achieve Policy Objectives

1. Where farming or horticultural operations conducted on separate blocks of land are so far apart so as to indicate that there is no possible continuity between them, all charges may be levied on each; however, factors such as distance, stock rotation, stock driving, etc., property size and the number of properties affected, will be taken into account in determining whether remission should apply.

   a. Without dwellings

   Where a single operation is operated over a number of separate rating units, or blocks of separate rating units within close proximity the 'flagship' (major rating) may be levied a full charge and the associated rating units may receive a 100% reduction.

   b. With dwellings

   Where a single operation is operated over a number of separate rating units, or blocks of separate rating units within close proximity a charge may be levied against each rating unit with a habitable dwelling and the associated units may receive a 100% reduction.

   Where a single operation is operated over a number of separate blocks of contiguous rating units that contain dwellings, one full charge may apply to each block of such rating units.

2. Miscellaneous

   If a rating unit is of a size which would not enable a dwelling to be erected and where no dwelling exists, a 100% reduction in charge may apply.

   Remission of the charge may apply to a subdivision for the period if the individual lots continue to be in the ownership of the developer.

3. The application is to be made in writing 30 days before the due date of payment.
4. All applications must be received in writing, detailing the rating unit/units involved and any other relevant information supporting the applicant's eligibility for the remission.

Item 8

Attachment 3

Delegation

Decisions relating to the remission of Uniform Annual General Charges are delegated to the Group Manager Corporate Services and Financial Accountant.

Review of Policy

This policy will be reviewed at least every 3 years to ensure the conditions and criteria on which the policy is based, continue to be relevant and appropriate.

Postponement in Cases of Financial Hardship or Natural Disaster

Introduction

This policy is prepared under Sections 102(5)(b) and 110 of the Local Government Act 2002.

Objective

- To assist ratepayers experiencing short term extreme financial hardship that affects their ability to pay rates.
- To assist ratepayers whose property has been subject to a natural disaster to the extent that ratepayer is unable to pay rates.

Conditions and Criteria

The financial hardship must be caused by circumstances beyond the ratepayer's control. The postponement of rates in cases of financial hardship is a last resort to assist residents who own the property to which the postponement application applies.

Criteria for the postponement of rates for ratepayers in cases of hardship are:

1. The applicant can illustrate a postponement of rates will help them overcome their short term extreme financial hardship
2. The applicant has no access to other funds to pay the rates due.

Criteria for the postponement of rates for ratepayers in cases of natural disaster are:

1. The applicant is unable to pay their rates bill because of a natural disaster or severe weather event that has severely impacted on their ability to pay rates but a postponement will help enable them to pay in the future.

Other Conditions

Approval of rates postponement is for one year only. The applicant must reapply annually for the continuation of a rates postponement.

Delegation

Decisions relating to the postponement of rates in cases of financial hardship are delegated to the Chief Executive.

Decisions related to the postponement of rates in cases of natural disaster are retained by Council.

Review of Policy

This policy will be reviewed at least every 3 years, to ensure that the conditions and criteria on which the policy is based, continue to be relevant and appropriate.

Draft Revenue and Financing Policy

Introduction

This policy has been prepared in accordance with Sections 101 (3), 102 (2) (a) and 103 of the Local Government Act 2002. It identifies the funding sources and mechanisms that will be used to finance the Council's operating and capital expenditure for the 10 years beginning 1 July 2018.

Local Government is required by statute to identify the costs of its functions and fund them appropriately. This involves the allocation of costs to the functions followed by a determination of the most appropriate form of funding.

Purpose of the Policy

The purpose of the Revenue and Financing Policy is to provide and explain the policy of the Hawke's Bay Regional Council (HBRC) for the funding of operating and capital expenditure from the following sources.

- fees and charges
- general rates, including
  - choice of valuation system
  - differential rating
  - uniform annual general charges
- targeted rates
- investment income
- borrowing
- proceeds from asset sales
- development contributions
- financial contributions under the Resource Management Act 1991
- grants and subsidies
- any other source

In determining the sources that are appropriate to fund operating and capital expenditure, the Council has considered the following.

The Revenue and Financing Policy (Policy) contains Council's policies with respect to the funding of operating expenditure and capital expenditure from various revenue sources. Section 101 (3) of the Local Government Act 2002 (LGA) set out the requirements Council must consider as part of the development of the policy.

The first step requires consideration, at activity level of each of the following.

i. community outcomes - the community outcomes to which the activity primarily contributes (in other words your rationale for service delivery)

ii. the user/beneficiary pays principle – the distribution of benefits between the community as a whole, any identifiable part of the community, and individuals. This is also known as a public versus private allocation

iii. the intergenerational equity principle – the period in or over which those benefits are expected to accrue

iv. the exacerbator pays principle – the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the activity, and

v. the costs and benefits, including consequences for transparency and accountability, of funding the activity distinctly from other activities.

The second step in the process considers the aggregate all of the results from step one, and consider the impact that these results might have on the community.

The following pages outline funding considerations for each activity within the seven HBRC 'Groups of Activities'.

Revenue and Financing Policy by 'Group of Activity'

Step one allocations

Details of funding by each activity are provided in the tables that follow. The Council has used the following table in assessing each on the considerations listed (ii to v) above.

Key for allocation	
Low	10% to 20%
Low to medium	20% to 40%
Medium	40% to 60%
Medium to High	60% to 80%
High	80% to 100%

The following tables reflect the Council's considerations of each of the Council's activities. It is important that the notes to these tables are read along with the figures in the tables in the appendix to the policy as the notes provide the reasoning applied to each funding split between public and private

Groups of Activities/activities	Community outcomes	Public/private allocation	Intergenerational	Actions or inactions	Costs and benefits of funding the activity distinctly from other activities	Rationale	Operational funding	Capital funding
1. Governance								
1.1 Community Representation and Leadership	Vibrant Community	100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding	Nil
1.2 Tāngata Whenua Partnerships and Community Engagement		100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding	Nil

Groups of Activities/activities	Community outcomes	Public/private allocation	Intergenerational	Actions or inactions	Costs and benefits of funding the activity distinctly from other activities	Rationale	Operational funding	Capital funding
2. Strategic Planning								
2.1 Strategy	Healthy Environment / Vibrant Community / Prosperous Economy	100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding	Nil
2.2 Planning		100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding	Nil
2.3 Sustainable Regional Development		100% Public	Nil	Low	Nil	All ratepayers benefit from this activity, however business receive a greater value that other ratepayers	Uniform Targeted rates and Targeted rates set on a capital value	Nil

Groups of Activities/activities	Community outcomes	Public/private allocation	Intergenerational	Actions or inactions	Costs and benefits of funding the activity distinctly from other activities	Rationale	Operational funding	Capital funding
4. Asset Management								
4.1 Flood Control and Protection Works	Prosperous Economy / Vibrant Community	Low public good, high private good	High	Low to medium	High (based on a number of schemes)	Broadly the properties that are protected by this activity gain significant benefit compared with other properties	General funding, differential targeted rates based on location and area	Use of reserves, loans and targeted rates
4.2 Flood Risk Assessment and Warning		High public good	Low	Nil	Nil	Generally all ratepayers benefit from this activity	General funding	Nil
4.3 Coastal Hazards		Medium public good and medium private good	Medium	Low	Medium		General and grants funding and targeted rates based on location	General funding and targeted rates based on location
4.4 Opens Spaces		High public good	Low	Nil	Nil	Generally all ratepayers benefit from this activity	General funding and fees and charges	Use of reserves, loans and general funding
4.5 Works Group		High private good	Low	Low	Nil		Fees and charges	

Draft Revenue and Financing Policy

Groups of Activities/activities	Community outcomes	Public/private allocation	Intergenerational	Actions or inactions	Costs and benefits of funding the activity distinctly from other activities	Rationale	Operational funding	Capital funding
7. Transport								
7.1 Transport Planning and Road Safety	Prosperous Economy / Vibrant Community	100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding, local territorial authority and central government contribution and grants	Nil
7.2 Passenger Transport		Medium to high private benefit	Low	Low	Low	Those who use public transport are the primary beneficiaries, however there is a benefit to the region by having a public transport network	Fees and charges, central government subsidy	Low
7.3 Regional Cycling		100% Public	Nil	Low	Nil	All ratepayers benefit from this activity	General funding	Nil

Step two considerations

Council has considered the overall impact of these allocations including the use of fees and charges, the use of general funds which includes General rates and investment income. After the consideration of general funds, the primary tool that provides for the modification of the impacts on rating is the use of the uniform annual general charge UAGC). Council believes that by having an appropriate UAGC fairly reflects the services being delivered to the community.

It also believes that a move from land to capital value requires investigation and further discussions with the community that may impact on the overall allocation of liability on the community.

Others changes

Additional penalties to be added from July 2019

All outstanding rates including previous penalties as at 1 July each year will now have a penalty of 10% added to those rates. This penalty will be added on the first working day after 1 July each year.

Rate invoicing period change

It is proposed that during the 2018-28 LTP period HBRC will investigate changing the date that rate invoices are sent out and the final due date each year.

Detailed explanation of Council's considerations

i. Community Outcomes

The requirement to consider community outcomes in the funding process is seen as an obligation for Council to consider why it is engaged in an activity and to what level. To that extent, possible funding of activities should be consistent with achievement of desired outcomes.

ii. Distribution of Benefits

At this stage, Council is required to consider who benefits from the activities performed by Council. This is expressed as the Public/Private split. Economic theory suggests there are two main characteristics that need to be considered when looking at a particular good or service:

Rivalry in Consumption

A good is a rival in consumption if one person's consumption of the good or service prevents others from doing so, eg a chocolate bar is a good with a large degree of rivalry in consumption, i.e. if Bill eats it, Jane cannot.

Excludability

A good or service is excludable if a person can be prevented from consuming the good or service, eg if Bill does not buy a movie ticket, then the usher can exclude him by preventing him from entering the theatre.

At one end of the continuum there are so-called 'public goods'. These are goods which are both non-rival and non-excludable, ie everyone can consume them and no one can be prevented from consuming them if they wish. A good example of a public good is national defence, where the whole community is protected from an invasion by the armed forces whether it wishes to be or not, and this protection cannot be removed from anyone in New Zealand.

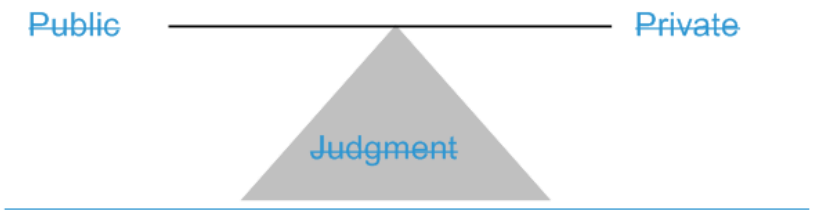
At the other end of the continuum are 'private goods' which are both rival and excludable. Most daily consumables are private goods.

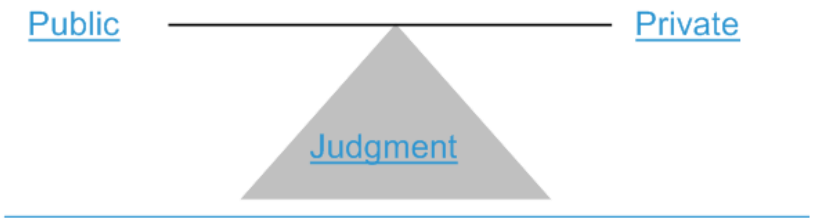
Very few goods and services are entirely public goods or private goods. Most goods and services are 'mixed goods' and fall somewhere between the two ends of the continuum.

The characteristics of a good or service determine what type of funding mechanism might be used to fund a particular service. Council has already made judgements about what it considers are public goods when deciding whether or not to undertake a particular activity.

For example, a good towards the public end of the continuum may not be a good candidate for user charges as people cannot be prevented from consuming it, or because everyone consumes it whether they wish to or not. Such goods will generally be candidates for funding from some general source such as a general rate. A good towards the private end of the spectrum may be a candidate for a targeted rate or a user charge.

In the end, it is likely to come down to 'reasonable' judgement. Both the LGA and previous case law place the responsibility on elected members to make decisions about who benefits and who should pay.





iii. Distribution of Benefits Over Time

Council needs to consider something called 'intergenerational equity' which means that funding decisions are required to consider future generations, not just today. Many of the activities provided by local government are either network or community infrastructure which has long service lives. Benefits from these services can be expected to accrue over the entire life of the asset. Current ratepayers should not be expected to subsidise the benefits that future ratepayers receive nor should future ratepayers subsidise current ratepayers.

One way that Council applies the intergeneration equity principle is by spreading costs over the future. Council will typically borrow to fund the cost of a project and future ratepayers will repay the loan (and interest cost), say over a 25 year period. Council typically only borrows to fund capital expenditure but Council may use short term borrowing to spread some operating costs smooth funding over a limited period to avoid rate spikes.

Council also needs to ensure that appropriate funding has been allocated to reasonably meet the levels of service that each activity is targeting to meet and financial sustainability into the future needs to be considered.

iv. Actions or Inactions of Individuals or Groups

This generally refers to how to make the 'exacerbators' pay. This could include funding mechanisms to allow for the fining of people that cause unwanted Council activity, eg cleaning up abandoned cars or rubbish. However, Council has very limited funding mechanisms to enable targeted charging and, in many cases, it is not possible to pass this cost on to the exacerbator and, therefore, it becomes more a case of identifying the quantum of the issue and deciding who then should bear the cost, if not the exacerbator.

V. Costs, Benefits and Separate Funding

Council is required to consider whether an activity should be separately funded and what the cost implications might be. There are administration costs associated with separate funding and these need to be weighed against any benefits of targeting specific beneficiaries/users of a service, including transparency and accountability.

Transparency and accountability are most evident when an activity is totally distinctly funded. This allows ratepayers, or payers of user charges, as the case may be, to see exactly how much money is being raised for and spent on the activity, and to assess more readily whether or not the cost to them of the activity represents good value.

However, funding every activity this way would be extremely complex. For some activities, the quantity of rates funding to be collected amounts to only a few cents per ratepayer. The administrative costs and lack of significance lead Council to fund a number of activities by way of a general rate. To aid in transparency and accountability, Council separates the total general rate into reasonable activity breakdowns when presenting the ratepayer with their rates assessment notices. This then allows the ratepayer to make some form of meaningful assessment down to activity level.

Selection of tools

Section 103(1) requires Council to identify the funding of operational expenditure and capital expenditure.

Operational expenditure is normally funded by way of revenue (income) while capital expenditure can be funded by way of both revenue and non-revenue items such as borrowings and the use of Council created reserves.

Capital expenditure is expenditure when the benefit of that expenditure is greater than one year and therefore benefits obtained by those assets spread according to the life of the asset.

Grouping of Activities

To comply with statutory responsibilities and for operational management purposes, HBRC groups its functions in the Long Term Plan into separate groups of activities. The Council has seven 'groups of activities' which form the Long Term Plan and Annual Report processes.

Groups of Activities are further analysed by individual activities within each group. This framework enables the Council to co-ordinate its various planning and reporting responsibilities and provides an appropriate base for determining the Council's revenue and financing policy.

Available Funding Sources

HBRC may lawfully fund its expenditure needs from the sources listed above. Set out below is discussion on the most significant of these to the Council.

Fees and Charges

Subject to the provisions of a number of statutes, the Council may directly charge beneficiaries for services.

These user pays charges may be made using a variety of methods from setting fees for certain activities to charges for actual time and materials based on pre-determined hourly charge out rates.

Of relevance also is Section 36 of the Resource Management Act 1991 which enables local authorities to establish charges for various administrative and monitoring activities including:

- receiving, processing and granting resource consents
- implementing requests to prepare or change plans or policy statements
- monitoring compliance with conditions on resource consents
- providing information in respect of consents or plans
- gathering information or research
- monitoring the state of the environment
- providing information on water science.

Administrative charges made under Section 36 of the Resource Management Act 1991 are required to be fair and reasonable. Before making charges, the Council is required to have regard to:

- The sole purpose of any charge is to recover the reasonable costs incurred by HBRC in respect of the activity to which the charge relates
- A particular person or persons should be required to pay a charge only to the extent that either the benefit of the Council's actions to which the charge relates is obtained by those persons as distinct from the community of Hawke's Bay as a whole, or the need for its actions to which the charge relates is occasioned by the actions of those persons
- When the charge relates to monitoring the state of the environment, a particular person or persons should only be required to pay a charge, either to the extent that the charge relates to the likely effects on the environment of those persons' activities, or to the extent that the likely benefits of the monitoring to those persons exceeds the likely benefit of the monitoring to the community of the Hawke's Bay Region as a whole.

Other direct charges include fees, and sundry charges.

Rates

Rates are a substantial and traditional source of revenue for local government. Rates are a form of taxation based on the ownership or occupation of property.

- **Rating Basis:** Under the provisions of the Local Government (Rating) Act 2002, there are four bases upon which rates can be made and levied. In brief, these are:
  - **Land value:** The market value of the land
  - **Capital value:** The market value of the land and improvements
  - **Annual value:** The rent for which a particular property could be let from year to year, less 20% in the case of buildings and 10% in the case of land, but it shall not be less than 5% of the market value
  - **Area system:** Where rates are made and levied on the basis of an amount based on the area of each rateable property.

Item 8

Attachment 3

Capital and land values are determined independently of local authorities by valuation service providers. The properties for each city and district are normally revalued every 3 years. For the Hawke's Bay Region, a certificate is obtained which equalises the values of each city and district annually to compensate for timing differences in the valuations between districts.

- **General Rates:** HBRC may make and levy a regional general rate, either:
  - across the Region, or
  - within each constituent city or district, so that the rate made or levied may vary from district to district.

  A system of differential rating for the general rate whereby rating levels may be varied for different categories of property, for example, rural versus commercial, can also be used.

  A General Rate can be set on either the basis of land value, capital value or annual value.

  HBRC has always used land value (equalised) as its base for general rates, and has not adopted any differentials, for example for commercial property.

  It is proposed that during the 2018-28 LTP period HBRC will investigate changing the general rate basis from land value to capital value. If it was proposed to change the current basis the options and implications will be publically consulted.

  Uniform Annual General Charge (UAGC): From 1 July 2004 HBRC introduced a UAGC to ensure that each rating unit in the region contributes a minimum amount of the general rate to represent the services that each ratepayer benefits from equally.

- **Targeted Rates:** In addition to the general rate, HBRC is authorised to make targeted rates for the purpose of undertaking any specific service or work for the benefit of all or part of the Region. These rates are normally applied to properties that have a direct beneficiary or cause/effect relationship with the function or service being provided (thus reflecting the locality concept).

  HBRC has used targeted rates to fund flood protection and drainage schemes, public transport, animal and plant pest control, civil defence emergency management, the heat smart assistance programme, and economic development. A combination of capital value, land value, area basis and Fixed Annual Charge have been used for these targeted rates. Detailed information of the rating for each scheme and its basis is set out in the funding impact statement included in this plan.

Investment Income

HBRC has a range of property, equity, and cash investments that provide a source of income not related to any specific function or activity. HBRC's investment assets are its 100% shareholding in the Hawke's Bay Regional Investment Company Limited (HBRIC Ltd); Napier leasehold property investments; Forestry assets and reserve funds.

General Funds

Investment income is used to offset the general rate requirements of HBRC. For the purposes of this Revenue and Financing Policy investment income, general rates and UAGCs have been combined and are referred to as general funds.

Proceeds from Asset Sales

The proceeds from any property investment sales, with the exception of Napier leasehold properties, are credited to the Sale of Land Account. These funds are initially invested in fixed deposits until suitable projects that meet the criteria of Council's 'Policy on the evaluation of investment opportunities' and comply with its general investment policies are identified.

Proceeds from the sales of Napier leasehold properties are paid to Accident Compensation Commission (ACC) under the Lease Receivables Purchase Agreement. This agreement covers HBRC's agreement with ACC for the capitalisation of Napier leasehold cash flows.

The proceeds from the sale of all other operating assets are used to fund the replacement operating asset needs of Council.

Development Contributions

The Local Government Act 2002 precludes Regional Councils from charging development contributions.

Financial Contributions under the Resource Management Act 1991

HBRC has determined that it will impose financial contributions only in relation to resource consents granted for river bed gravel extraction. These financial contributions are used to avoid, remedy or mitigate the adverse effects on the environment of this activity.

Borrowing

Local authorities may borrow New Zealand currency to finance their lawful functions. Borrowing is a useful method of funding the costs of a project where the benefits will accrue into the future, for example, funding the capital costs of a flood control scheme, or major building project. Council will periodically borrow for such purposes.

Reserves

Local authorities have traditionally, and to varying degrees, developed reserve funds. Reserve funds have been used to allocate funds for special purposes such as asset replacement, future capital works, flood and drainage schemes, and for emergencies and contingencies. HBRC have some reserves which help in the financial management of activities. Consideration of the appropriate reserves and reserve levels is addressed as part of the Long Term Plan and Investment Policy.

Government Grants

The Government may provide funds to HBRC for specific purposes and projects across a range of functions on an ongoing basis. The New Zealand Transport Agency provides funding for subsidised passenger transport.

Capital Expenditure

The funding of capital expenditure is addressed in two distinct ways depending upon the nature of the expenditure.

For fixed assets including buildings, furniture and fittings, plant, equipment etc., it is HBRC policy to fully fund depreciation from operating revenue for these assets. This depreciation is placed in an asset replacement reserve which is used to fund replacement assets. If there is any shortfall HBRC will either borrow, use other Council reserves, or other general funding revenue sources.

Financing of infrastructure assets

1. **Assets with infinite life**

   These assets include stopbanks, berm edge protection, sea or river groynes, drainage works, etc and are considered not to deteriorate over time and are maintained in accordance with Councils Asset Management plan. No depreciation is provided on these assets.

   The infrastructure asset strategy provides for continuing yearly maintenance programmes to ensure the integrity of assets in this class.

   For significant new asset construction under this category, borrowed funds are used as Council's preferred method of financing. If sufficient accumulated funds are held in the Scheme operating reserve and/or the Scheme infrastructure depreciation reserve, then where provided for in the Asset Management plans for that Flood and Drainage Scheme, such new asset purchases can be directly funded from these accumulated reserves or those reserves be used to service a loan raised to fund such a purchase.

2. **Assets with a finite life**

   These assets include culverts, detention dams, pump stations, etc and are depreciated over their useful life. Depreciation is set at a rate that is consistent with the requirements of the Local Government Act 2002 sections 100-102, and as provided for in the adopted Asset Management Plan for each scheme. Such depreciation is placed in an infrastructure depreciation reserve for each Flood and Drainage Scheme.

   Renewal of these assets will, where it is considered appropriate, be funded from this depreciation reserve, any accumulated credit balances in the scheme operating account or through the use of loan funding as set out in the adopted Asset Management plan.

   Where (new) assets that will result in improved levels of service or additional capacity are to be purchased or constructed, then it is Council's preference to fund this through external loan funding other than where adopted Asset Management plans provide for such new assets to be funded from accumulated infrastructure depreciated reserves and/or scheme operating balances for each flood drainage scheme.

Set out below in the following appendix is Council's detailed allocation of rates and rationale.

Appendix to the Revenue and Financing Policy

Please Note:

- General Funds include General Rates on Land Value, Uniform Annual General Charges and Investment Income.
- Targeted Rate denotes the amount required from targeted rates net of any internal revenue contributions or other sundry income
- Funding required excludes internal revenue contributions
- Previous Policy reflects the Policy that was adopted in the 2015-25 ten year plan as well as amendments passed through subsequent Annual Plans.
- The cost of targeted rate collection is met directly from targeted ratepayers.
- The notes to these tables provide the logic to support the distribution of benefits between Public and Private benefits.

Group of Activity: Strategic Development								
Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Strategy		100%	Nil	100%	Nil	General Funds	Nil	1
Planning		100%	Nil	100%	Nil	General Funds	Nil	2
Economic Development		Nil	100%	Nil	100%	Nil	Differential Targeted Rate	3

1. This activity ensures that organisational strategy is more effectively translated into action to achieve the desired outcomes as set by council in its Strategic Plan. It includes research, programme management, and development of statutory and non-statutory regional strategies and plans including the Long Term Plan and Annual Plan. HBRC treats these costs as a public cost and funds them through the use of general funds.
2. This activity develops, reviews and evaluates Resource Management Act 1991 (RMA) planning documents including the Regional Policy Statement, Coastal Plan and Regional Resource Management Plan. This activity also provides statutory advocacy of council's resource management policies and interests through submissions and various exchanges with other resource management agencies. HBRC treats these costs as a public cost and funds them through the use of general funds.
3. This activity promotes economic development for the region and contributes to Business Hawke's Bay and Hawke's Bay Tourism and the Regional Business Partners Programme. HBRC is the sole local government funder of Hawke's Bay Tourism by agreement with the region's TLAs. It is considered that this activity provides a greater and more immediate benefit to the broader business community. On this basis the Economic Development activity is fully fund through the use of an Economic Development Rate across the region. The basis of the rating in the 18-19 year is that 50% of the total Economic Development rate is to be funded by the commercial or industrial properties and based on capital value. The remaining 50% is to be collected from residential and rural properties as a Fixed Annual Charge. Wairoa District ratepayers' contribution is to be limited to 5% of the total Economic Development rate. For the 19/20 year onwards the rating basis will shift to 70% of the total Economic Development rate is to be funded by the commercial or industrial properties and based on capital value. The remaining 30% is to be collected from residential and rural properties as a Fixed Annual Charge. Wairoa District ratepayers' contribution is to be limited to 5% of the total Economic Development rate.

Group of Activity: Asset Management								
Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Heretaunga Plains Schemes	Drainage	10%	90%	10%	90%	General Funds	Differential Targeted Rate	4
	Flood Control	30%	70%	30%	70%	General Funds	Differential Targeted Rate	5
Upper Tukituki Scheme		18%	83%	18%	83%	General Funds	Differential Targeted Rate	6
Other Schemes	Paeroa	13%	88%	13%	88%	General Funds	Differential Targeted Rate	6
	Makara	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Porangahau	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Poukawa	5%	95%	5%	95%	General Funds	Differential Targeted Rate	6
	Ohuia-Whakaki	5%	95%	5%	95%	General Funds	Differential Targeted Rate	6
	Esk	13%	88%	13%	88%	General Funds	Differential Targeted Rate	6
	Whirinaki	13%	88%	13%	88%	General Funds	Differential Targeted Rate	6
	Wairoa	13%	88%	13%	88%	General Funds	Differential Targeted Rate	6
	Te Awanga	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Kopuawhara	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Opoho	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Kairakau	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Te Ngarue	10%	90%	10%	90%	General Funds	Differential Targeted Rate	6
	Central & Southern	13%	88%	13%	88%	General Funds	Differential Targeted Rate	6
Investigations & Enquiries	Investigations and Enquiries	100%	Nil	100%	Nil	General Funds	Nil	7
	Subsidised Work	30%	70%	30%	70%	General Funds	Fees/Charges	8
	Consultancy Services	Nil	100%	Nil	100%	Nil	Fees/Charges	9

Item 8

Attachment 3

Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Gravel Management	Gravel Management	Nil	100%	Nil	100%	Nil	Fees/Charges	11
	River Cross Sections	100%	Nil	100%	Nil	General Funds	Nil	12
Flood Assessment and Warning	Flood Risk Assessment	100%	Nil	100%	Nil	General Funds	Nil	13
	Flood Forecasting & Hydrological Flow Management	100%	Nil	100%	Nil	General Funds	Nil	13
	Flood Warning System	100%	Nil	100%	Nil	General Funds	Nil	14
Coastal Hazards	Westshore	50%	50%	50%	50%	General Funds	Contribution from Napier City Council	15
	Coastal Processes	100%	Nil	18%	82%	General Funds	Contribution from Napier City & Hastings District Council and Targeted Rate	16
Open Spaces	Regional Park Networks	98%	2%	98%	2%	General Funds / Reserve Funds	Fees/Charges	17
	Public Access to Rivers	100%	Nil	100%	Nil	General Funds	Nil	18

4. An analysis of the Heretaunga Plains Drainage Scheme has identified a 90% private benefit to those ratepayers directly benefiting from the scheme. The indirect benefits of increased productivity of the Heretaunga Plains land to the whole region, as a result of increased economic activity resulting from the productivity, are recognised in the allocation of 10% of the costs to the region as a whole which is funded through the use of general funds. The 90% private benefit is funded through a targeted rate based on capital value.
5. An analysis of the Heretaunga Plains Flood Control Scheme has identified a 70% direct benefit to the landowners within the Hastings District and Napier City Council areas. Of this, 49% results in a direct benefit to properties protected from frequent flooding and/or river coarse changes, and 21% being the indirect benefit as a result of increased opportunity arising from higher population and increased choice and competition among service industries, and improved opportunities for employment, investment and recreation. The 70% private benefit is funded through a targeted rate based on capital value, with the remaining 30% public benefit funded through the use of general funds.
6. An assessment of the public and private benefits undertaken as part of the Step 1 analysis has provided for a public contribution to be made to each of the other schemes which HBRC administers according to the following principles.
    - A scheme which provides protection to a State Highway will receive a public contribution of 12.5%.
    - A scheme which provides protection to a local roading network will receive a public contribution of 10%.

- A scheme which provides protection only to private land will receive a public contribution of 5%.
- The Upper Tukituki Scheme will receive an additional 5% public contribution because of the additional cost which arises from gravel flows from the upper catchment land.

The balance, being the private benefit, is to be funded through targeted rates which are based on a mix of land value, capital value, and Fixed Annual Charge.

7. The provisions of HBRC internal staff time to respond to public enquires and provide expert advice on Land Drainage and River Control activities is considered a public benefit and funded 100% by general funds.
8. Subsidised work including small flood control and stream improvement works undertaken on private land, but which benefit a wider community, receives a public contribution of 30% and is funded through the use of general funds. The 70% private benefit is recovered through the charging of fees to the requesting landowner(s).
9. This activity relates to the provision of consultancy services by HBRC engineering staff for drainage, flooding, and coastal erosion issues according to individual project agreements. The costs of these services are met directly by the beneficiary through the charging of fees.
10. This activity was initially identified as a 30% private benefit recognising that the main beneficiaries from the work are the owners of land and/or utilities in the areas immediately around the river mouths. However, the costs associated with the opening of river mouths are relatively small and the cost of establishing a funding mechanism to recover the private good portion of the cost could not be justified, therefore this work is treated as a public good and funded through the use of general funds.
11. The Gravel Management activity is established to administer the allocation and extraction of river bed gravel in accordance with the Regional Resources Management Plan and in the best interest of river management. The private benefit element of this activity has been assessed at 100% with resource management charges paid directly by the consent holder, under s36 of the Resource Management Act, based on the level of gravel extracted.
12. Cross section work provides data that is used for State of the Environment monitoring, and is also used for flood prediction management and assessment and is funded through the use of general funds.
13. There is a region wide benefit from flood risk assessment work for identifying and quantifying potential hazards and also for the work for flood forecasting & hydrological flow management which is funded as a public cost through the use of general funds.
14. There is a region wide benefit from being able to predict and respond to floods as they occur and also a direct benefit to the ratepayers of flood and drainage schemes. The information gathered from the flood warning system is used to predict flooding events and to input into design work associated with the flood control and drainage schemes. The public benefit has been assessed at 100% and funded through the use of general funds.
15. The Westshore coastal works are funded by 50% public / 50% private. This reflects the fact that HBRC is unable to allocate costs in accordance with its preference of Westshore renourishment because there remains uncertainty with regard to the impact of Port of Napier Limited structures on rates of erosion, and there are no legal means of identifying and collecting income from exacerbators. Consequently the use of general funds will meet the public benefit share of these costs. The private benefit costs are met by the Napier City Council.
16. The Coastal Processes activity has incorporated substantial new work in the past few years for Clifton to Tangoio Coastal Hazards Strategy, taking into account sea level rises, increased storminess, coastal erosion, coastal inundation and tsunami. This has been a joint working committee with both Napier City Council and Hastings District Council who have met 45% of the costs. There is a new Coastal Erosion targeted rate for those in the Napier and Hastings districts to 37% of the costs The remaining 18% has been treated as a public good and funded through the use of general funds.
17. HBRC maintains, develops, and provides public access to six regional parks. 2% of the funding is provided by lease and rental income with the residual 98% private benefit costs are met by general funds.

18. The public good element of this public access to rivers activity is funded through the use of general funds, and the private good element funded through charges in relation to white bait stands.

Group of Activity: Integrated Catchment Management								
Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Science and Information	State of the Environment Reporting	83%	18%	83%	18%	General Funds	Fees/Charges	19
	Research and Grants	100%	Nil	100%	Nil	General Funds	Nil	20
	Water Science	65%	35%	65%	35%	General Funds	Fees/Charges	21
	Land Monitoring	75%	25%	75%	25%	General Funds	Targeted Rate	22
	Land Research & Investigations	65%	35%	65%	35%	General Funds	Fees/Charges	23
	Air Quality	100%	Nil	100%	Nil	General Funds	Nil	24
	Sustainable Homes	Nil	100%	Nil	100%	Nil	Targeted Rate & Fees/Charges	25
	Water Information Services	Nil	100%	Nil	100%	Nil	Fees/Charges	26
Catchment Management	Environmental Enhancement Projects	New	New	100%	Nil	General Funds	Nil	27
	Future Farming Trust	New	New	100%	Nil	General Funds	Nil	28
	Integrated Catchment Activities – Afforestation/Riparian	New	New	75%	25%	General Funds	Fees/Charges	29
	Integrated Catchment Activities – FEMP	New	New	10%-13%	90%-87%	General Funds	Fees/Charges	29
	Sustainable Land Management	75%	25%	75%	25%	General Funds	Differential Targeted Rate	30
	Soil Conservation Nursery	Nil	100%	Nil	100%	Nil	Fees/Charges	31

Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Pest Animal Control	Rabbit Control	30%	70%	30%	70%	General Funds	Differential Targeted Rate	32
	Possum Control	30%	70%	30%	70%	General Funds	Differential Targeted Rate	33
	Rook Control	30%	70%	30%	70%	General Funds	Differential Targeted Rate	34
	Site Specific Pest Animal Control	30%	70%	30%	70%	General Funds	Differential Targeted Rate	35
	Predator Free Hawke's Bay	New	New	40%	60%	General Funds	Differential Targeted Rate	36
	Marine Pests	100%	Nil	100%	Nil	General Funds	Nil	37
Pest Plant Control	Research	30%	70%	30%	70%	General Funds	Differential Targeted Rate	38
	General Advice	30%	70%	30%	70%	General Funds	Differential Targeted Rate	38
	Incentive Scheme	100%	Nil	100%	Nil	General Funds	Nil	39
	Primary production pest plants	40%	60%	40%	60%	General Funds	Differential Targeted Rate	40
	Biodiversity/human health pest plants	100%	Nil	100%	Nil	General Funds	Nil	41
	Biological Control	100%	Nil	100%	Nil	General Funds	Nil	42
Pest Management Strategies		100%	Nil	100%	Nil	General Funds	Nil	43

19. The Step 1 analysis has revealed that there is a private benefit to consent holders from State of the Environment monitoring. Monitoring of state and trends in our natural resources is important to demonstrate that policy is effective in managing consented activities within limits. This demonstration allows the continued access to those resources. The assessment has revealed that half of the work in this area relates to work which attracts Zone Based Water Science Charges, therefore half of the potential 35%, being 17.5%, of this activity is deemed to be a private benefit and will be recovered through the charging of fees directly to the consent holder under s36 of the Resource Management Act.
20. This activity relates to the undertaking of specific one off research projects on environmental issues in order to meet scientific, regulatory or policy needs. Where the work undertaken is associated to recoverable projects, such as zone based water science charges, HBRC will endeavour to recover a share of these costs. As this is not considered a certain enough source of income to be used in the funding policy, all of this activity is treated as a public good and funded through the use of general funds.
21. HBRC determined through Step 1, that there is a significant private good that results from these activities which is assessed at 35%. This private benefit reflects that users benefit from our knowledge and understanding of the region's water resources as it facilitates the expeditious processing of the consent applications and enables Council to manage the resources in an efficient and sustainable fashion. The 35% private benefit is funded through the charging of fees directly to the consent holder under s36 of the Resource Management Act.

Item 8

Attachment 3

22. Council determined through Step 1, that there is a significant private good resulting from these activities which is assessed at 25%. This private benefit reflects that users benefit from Land Monitoring as it enables HBRC to identify and monitor the impacts of land use intensification on soil and water quality throughout the region. Given that this project relates directly to work undertaken as part of the Sustainable Land Management activity, and that Council has agreed to initiate a regional charge for Sustainable Land Management activities, the 25% private benefit is to be funded as part of the targeted rate on those properties in the region over 4ha
23. Land Research & Investigations are integral to the Sustainable Land Management Programme. The private benefit for this activity has been assessed at 35% recovered through s36 zone based water science charging where the work is related to water quality outcomes.
24. When allocating the benefits between public and private in Step 1 it was determined that part of the work required on this activity was a result of the action of users/exacerbators, with this being classified as a private benefit. However, the ability to charge fees for exacerbators is not legally possible because HBRC can currently only charge Resource Consent holders. It is also not practical to charge exacerbators through a targeted rate because it is impossible, for example, to practically isolate the impact of specific things such as ambient air quality on geographic areas. Consequently HBRC is to treat this as a public cost and fund it through the use of regional investment income and general rates
25. Sustainable Homes has grown in this LTP to not only include the Heat Smart programme but to also encourage the use of solar energy, domestic water storage and upgraded septic tanks. Heat Smart has the aim to reduce particles of polluting smoke in the affected airsheds by replacing open fires or wood burners with more efficient forms of heating and also installation of insulation. This activity is classified as a private benefit and is funded by way of a targeted rate based on land value for those in the Napier and Hastings airsheds, and by the charging of fees for those who take up the offer of Council assistance.

    The new areas provide assistance to homeowners to install solar systems, to provide water storage that will improve resilience in an emergency and to improve the quality of septic tanks . These activities are classified as a private benefit and are funded by the charging of fees for those who take up the offer of Council assistance.
26. The Water Information Services activity provides infrastructure and services to support the collection and management of water use data and has been established following the introduction of legislative requirements. This activity has been assessed as a 100% private benefit on the basis that water consent holders directly benefit from water metering data. Costs for this activity are recovered from these consent holders through fees and charges.
27. Environmental Enhancement Projects were introduced in the 2017/18 Annual Plan with the intention of starting the clean up of five environmental hot spots being Lake Turira, Ahuriri Estuary, Whakaki Lake and Waiora River, Lake Whatuma and Tukituki Catchment, Karamu Stream Due to the regional public benefit HBRC has treated this a public cost funded through the use of general funds.
28. The Future Farming Trust activity has been proposed to form a governance trust of regional farming leaders to provide guidance, knowledge, leadership and research into farming best practice. It is envisioned that this trust will obtain external funding from the industry and the Crown but at this stage these funding streams cannot be guaranteed and so HBRC initially treated this as 100% public cost funded through the use of general funds.
29. Integrated Catchment Activities are a new set of activities intended to reform the Land Management functions of Council to facilitate rapid delivery of solutions into catchments to attain the anticipated outcomes of in the Strategic Plan, NPSFM and RRMP. This incorporates a Farm Environment Management Plans (FEMPs) business unit to speed up the delivery of these plans. This activity encourages the completion of FEMPs by offering a facility for the cost of the FEMP to be placed against the property and the cost of the principle repaid by a targeted rate. The interest will be paid by HBRC as an incentive for compliance.

    This also incorporates the Riparian Business Unit to fund riparian fencing, planting and maintenance of planted areas and also an Afforestation scheme to get trees planted on highly erodible land. An incentive will be offered on these projects in the form of a 75% public funding for these projects with 25% directly privately funded. The public benefit is driven from improved water quality, instream ecological health and forest habitats and will be funded by general funds.

30. For Sustainable Land Management the Step 1 strict economic analysis indicates that there is a 50% public benefit and 50% private benefit element for HBRC's Sustainable Land Management activities. The private benefit reflects the level of private landowner and wider sector benefit that is derived through Council providing advisory and financial services to assist them in meeting Plan Change 6 requirements, in particular the benefit derived in meeting Farm Environmental Management Plans and other Plan Change 6 requirements where they would otherwise require resource consent to continue their rural operations. While recognising this private benefit, HBRC believes that a significant public benefit can also be applied to reflect the high regional priority on water quantity and quality, the positive regional flow-on benefits of significantly improved water management, the public good nature of a number of proposed HBRC Plan Change 6 services and the difficulty in applying the exacerbator pays factor. However, taking into account additional important considerations such as the requirement for the Council to respond to the Government's National Policy Statement on Freshwater Management, the major new resource management approach for the Council which Plan Change 6 represents, and transition costs, HBRC believes a 25% private benefit strikes a fair balance between HBRC's current benefit allocation for Sustainable Land Management and the result of the strict economic analysis. The 25% private benefit is to be funded by way of a targeted rate on those properties in the region over 4ha, with the 75% public funding being met by general funds.
31. The HBRC Soil Conservation Nursery operation has been established to provide for the regional community a consistent supply of quality poplar and willow poles for erosion control use in Hawke's Bay. This operation is set at a break even position and assessed as a private benefit because the cost of the purchase and production of poles is offset by the sale of poles to users.
32. Early identification and reduction of rabbit numbers has benefits to the whole region by reducing soil erosion and the prevention of the spread of rabbits. Many of the complaints and requests for advice arise from small rural properties and properties on the fringe of the urban area. Accordingly, 30% of the costs are publically funded through the use of general funds. The 70% private benefit is funded through a differential targeted rate on all rural properties greater than 4ha.
33. HBRC's Possum Control programme, involving Council's subsidy of animal pest control products and the protection of possum control area boundaries, has spin off benefits for the environment, biodiversity, public health and the regional economy. This is assessed at 30% of the cost of the work and is funded from general funds. The private portion of this activity is assessed as 70% because owners of productive land benefit directly from low pest densities and increased productivity and are therefore charged through a differential targeted rate on all rural properties greater than 4ha.
34. Rook control is largely a private good; however, rooks cover a significant range and the exacerbator is unlikely to be the beneficiary of any control work undertaken. With significantly reduced rook numbers the reduced public benefit of ongoing work is recognised by aligning the funding with Council's possum control programme which is assessed as 70% private through the charging of a differential targeted rate, and 30% public which is funded through the use of general funds.
35. This programme focusses on supporting land occupiers and community groups manage specific pest animals as part of a pest control programme or to protect QEII covenants and ecosystem prioritisation sites. Although there are significant biodiversity gains that the wider regional community is a beneficiary, almost all programmes are on private land in rural areas resulting in a 70% private, 30% public funding policy.
36. There will be both biodiversity benefits and primary production benefits from a Predator Free Hawke's Bay. Although the general community will benefit from the biodiversity gains, the primary beneficiary of predator control will be the agricultural sector. This is due to the programme being delivered in rural areas and the benefit from reducing the spread of parasites such as Toxoplasma gondii and bovine tuberculosis. The private portion of this activity is assessed as 60% and 40% public, to recognise the increased regional biodiversity benefits.
37. Marine pests are a major threat to production and conservation values in the Hawke's Bay marine system. Currently there is no active aquaculture being undertaken in Hawke's Bay but there are areas consented for this purpose. The primary beneficiary is the regional community therefore this activity is 100% publically funded through the use of general funds.

38. HBRC animal pest control research and general advice plays an integral part in seeking ways for the animal pest control programme to be more efficient and cost effective. The 70% private and 30% public benefits reflect a funding policy consistent with the rest of the animal pest control programme.
39. The private contribution of 50% (up to a maximum of $3,000 each application) of the costs of total control of Plant Pests (occupier responsibility) specified in the Regional Pest Management Plan does not appear in HBRC financial statements.
40. Although there are minor biodiversity benefits from managing some primary production pest plants, the primary beneficiary is the agricultural sector. To maximise the effectiveness of individual control across the region and to minimise the externality impacts of the plant the Council has proposed an advisory, inspectorial, and compliance regime. The primary beneficiaries of this programme are land occupiers, resulting in a 60% private, 40% public funding policy.
41. Biodiversity/human health pest plants are a major threat to biodiversity values and human health in the Hawke's Bay region. To maximise the effectiveness of individual control across the region and to minimise the externality impacts of the plant the Council has proposed an advisory, inspectorial, and compliance regime for these pests. The benefits of this programme are a public good rather than a private good, therefore this activity is 100% publically funded through the use of general funds.
42. Plant pest biological control has benefits to the overall region of animal and human health; the environment; and the region's economy. Although there may be an initial private benefit, biological control agents spread across the region, benefiting the regional community.
43. Pest management strategies and plans cover the whole of the Hawke's Bay region and cover a wide range of pests. It is not possible to target a particular beneficiary from any one particular strategy and plan and therefore HBRC policy is for this activity to be 100% publically funded through the use of general funds.

Revenue and Financing Policy
Group of Activity: Consents and Compliance

Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Consents	Resource Consents	40%	60%	20%	80%	General Funds	Fees/Charges	44
	Appeals & Objectives	NA	NA	100%	Nil	General Funds	Nil	45
Compliance Monitoring	Compliance Programmes	30%	70%	20%	80%	General Funds	Fees/Charges	46
	Environmental Incident Response	100%	Nil	100%	Nil	General Funds	Nil	47
	Building Act Implementation	100%	Nil	100%	Nil	General Funds	Nil	48
	Hazardous Waste/ Substance Management	100%	Nil	100%	Nil	General Funds	Nil	49
Maritime Safety	Marine Oil Spill	Nil	100%	Nil	100%	Nil	Govt. Grants	50
	Coastal Use Management	100%	Nil	100%	Nil	General Funds	Nil	51

44. HBRC determined that 80% of the work relating to the processing and administering of resource consents conferred a private benefit and would be recovered through fees and charges directly to the consent holder. It is considered that charging for general advice would be contrary to its policy of encouraging the public to enquire as to what consents are required before resource use is initiated so the provision of general advice is treated as a public good and is funded through the use of general funds.
45. Managing appeals and objections on resource consents are a statutory obligation of Council. While all costs are attempted to be recovered in the process these cannot be guaranteed and so HBRC treated this activity as 100% public cost funded through the use of general funds.
46. HBRC determined that 80% of the work relating to the processing and administering of resource consents conferred a private benefit and would be recovered through fees and charges directly to the consent holder. It is considered that charging for general advice would be contrary to its policy of encouraging the public to enquire as to what consents are required before resource use is initiated so the provision of general advice is treated as a public good and is funded through the use of general funds.
47. For Environmental Incident Response the Step 1 analysis indicated that most of the work should be treated as a private good because it was a consequence of the actions of individuals or organisations. However, it is not possible, other than through legal action, to recover any part of these costs. HBRC will initiate appropriate legal action, but because it is not considered a certain enough source of income to be used in the funding policy, all of the activity is treated as a public good and funded through general funds.
48. It is estimated that 95% of the costs arising from this activity cover the responsibilities to hold and provide information and develop audit systems, these costs not being recoverable from consent applicants and holders. Other than the occasional issuance of Project Information Memorandums and the imposition of a fine for non compliance there is limited income to be earned. Because this is not considered a certain enough source of income to be used in the funding policy, it is Council's preference to treat 100% of the activity as a public good and funded through the use of general funds.
49. Hazard Waste / Substance Management is a full public benefit project funded by through general funds as this is an incentive for the public to dispose of hazardous substances appropriately
50. Marine oil spills are caused by the actions or inactions of vessels or port operations. The costs are met by the exacerbators either through Maritime New Zealand or directly by the spiller and are therefore assessed as a 100% private benefit
51. The private benefit of this activity is estimated to be 75% which relates to costs incurred in managing navigation safety (70%) and identifiable exacerbators (5%). Current funding tools available will not allow HBRC to allocate costs in accordance with its preference. Recoveries could be made through legal action; however, this is not a certain enough source of income to use in the funding policy. Consequently the 75% private good element is funded as public cost through general funds.

Group of Activity: Emergency Management								
Sub -Activity	**Further Analysis**	**Previous Policy**		**Proposed Policy**		**Funding Tools**		**Notes**
		Public	Private	Public	Private	Public	Private	
Hazard Assessment and Response	Response Management	100%	Nil	100%	Nil	General Funds	Nil	52
HB Civil Defence Emergency Management Group	Reduction – Hazard Identification and Mitigation	Nil	100%	Nil	100%	Nil	Targeted Rate as a fixed annual charge	53
	Readiness and Response	Nil	100%	Nil	100%	Nil	Targeted Rate as a fixed annual charge	53
	Recovery and Co-ordination	Nil	100%	Nil	100%	Nil	Targeted Rate as a fixed annual charge	53
	Local Emergency Management	Nil	100%	Nil	100%	Nil	Targeted Rate as a fixed annual charge	53

52. There is a region wide benefit from being able to plan for emergencies by identifying and quantifying potential hazards which is funded as a public cost through the use of general funds.
53. The Hawke's Bay Civil Defence Emergency Management Group (CDEM) is responsible for providing effective Civil Defence Emergency Management within its area consistent with the Civil Defence Emergency Management Act 2002. The CDEM consists of the Wairoa District Council, Hastings District Council, Napier City Council, Central Hawke's Bay District Council and the Hawke's Bay Regional Council. The Hawke's Bay CDEM area is reflective of the boundaries of the member TLA Councils. The Hawke's Bay Regional Council is the administrating authority for the CDEM. The CDEM has established a Group Office to manage the day to day functions of Civil Defence Emergency Management. The benefits of the work of the Group Office are spread across the member Councils and their communities. This programme is funded through a separate targeted rate which has been set as a Fixed Annual Charge for properties within the CDEM area. As of the 2018/19 financial year all of the local TLAs have confirmed that they will no longer rate for Local Emergency Management and that this will be included in the HBRC rate.

Revenue and Financing Policy Group of Activity: Transport								
Sub -Activity	**Further Analysis**	**Previous Policy** Public	Private	**Proposed Policy** Public	Private	**Funding Tools** Public	Private	**Notes**
Regional Road Safety		15%	95%	9-12%	91-88%	General Funds	Govt. Grants and Territorial Authority Grants	54
Regional Land Transport Strategy		47%-49%	51%-53%	48%-51%	52%-49%	General Funds	Govt. Grants	55
Subsidised Passenger Transport		Nil	100%	Nil	100%	Nil	Govt. Grants/Differential Rate & Fees/Charges	56
Regional Cycling Activity		35-50%	65-50%	35-50%	65-50%	General Funds	Territorial Authority Grants	57

54. This activity is directed at promoting Road Safety education in partnership with Regional Stakeholders by the promotion of campaigns. These campaigns increase awareness and lessen the risks associated with road transport. HBRC provides 9%-12% of the total Regional Road Safety funding. The remaining funding stems from contractual agreements with the New Zealand Transport Agency (91% - 88%) with the balance provided by the Hawke's Bay Local Territorial Authorities and other Government Agencies. The funding provided by HBRC is considered to be a public benefit as all members of the regional community benefit from this activity, and is funded through the use of general funds.

55. The benefits of this activity is the development of an integrated approach to transport to meet economic, social and safety needs of the public. The New Zealand Land Transport Agency makes an annual financial contribution (52% -49%) towards the costs of undertaking this activity, with this contribution treated as a form of private user subsidy. The remaining 48% 51% is treated as a public benefit and funded through the use of general funds.

56. The current private benefit allocation at 100% includes the amount to be raised through the subsidised public transport targeted rates, the amount paid directly by private beneficiaries in the way of fares, and the New Zealand Transport Agency grant. The private contribution for the overall cost of subsidised public transport, which is raised through user charges, does not appear in the Council's financial statements as this amount is collected and retained by the bus operator and is offset against Council's payment for running the bus service. Over the last few years fare patronage has increased substantially with this rate of strengthening forecast to slow and level off throughout the 10 years of this plan. Any additional funding received by way of fare patronage may be reinvested to enhance the provision of the bus services.

57. The Regional Cycling Activity has been setup to provide support the regional cycling sector and promote our cycle pathways. This project is partially funded up to 65% by external funders with the residual funded as a public benefit through the use of general funds.

Revenue and Financing Policy Group of Activity: Governance and Community Engagement								
Sub -Activity	Further Analysis	Previous Policy		Proposed Policy		Funding Tools		Notes
		Public	Private	Public	Private	Public	Private	
Community Partnerships	Tangata Whenua Engagement	100%	Nil	100%	Nil	General Funds	Nil	58
	Community Engagement & Comms	100%	Nil	100%	Nil	General Funds	Nil	58
	Enviroschools	82% -78%	18% - 22%	82% -78%	18% - 22%	General Funds	Grants	59
Community Representation and Regional Leadership		100%	Nil	100%	Nil	General Funds	Nil	60
Investment Company Support		Nil	100%	Nil	100%	Nil	Fees/Charges	61

58. HBRC considers that the main objective of Tangata Whenua and Community engagement and communications activities is to widely inform and assist decision making across the scope of HBRC's work. It is considered a disincentive to charge beneficiaries for information promoting behaviour change which in many cases also requires significant ratepayer investment. Public benefits are recovered through the use of general funds.
59. Enviroschools is the HBRC in school environmental education programme. This is partially funded through grants with the residual funded by use of regional funds.
60. This function relates to the costs of elected political representation (including the Maori Committee) as well as the costs of reporting to the community, and is assessed 100% as a public benefit and met by general funds.
61. This function relates to the activities of the Hawke's Bay Regional Investment Company Limited (HBRIC Ltd) which is administered through the Council. This activity is assessed as a 100% private benefit and will be funded by HBRIC Ltd through the recovery of time and costs incurred by Council on behalf of HBRIC Ltd.

Hawke's Bay Regional Council
159 Dalton Street
Napier, 4110

Attention: Jessica Ellerm, Group Manager Corporate Services

5 June 2018

Dear Jessica,

PricewaterhouseCoopers (PwC) has pleasure in providing this letter outlining its recommendations in the Statement of Investment Policy and Objectives (SIPO) document it has produced for Hawke's Bay Regional Council (HBRC). This document has been produced as part of the deliverables outlined under our letter of engagement dated 21 May 2018.

Statement of Investment Policy and Objectives (SIPO)

Below is an outline of our key recommendations in relation to the SIPO.

Objectives, Risk Tolerance and Strategic Asset Allocation

Consistent with PwC's understanding of Council's return requirements, the SIPO includes a real return target (after inflation and fees) of 5.0% per annum from Year 2. We believe this return target is necessary in order to protect the Fund's capital value and meet Council's cash flow requirements. Our peer analysis (refer Appendix 1) suggests that such a return requirement is broadly in line with other local authorities and peers, but we note that achieving such a target on an annual basis may be challenging. In particular, PwC notes that Council's desire to have a 'balanced' portfolio (i.e. 50% income assets and 50% growth assets) may inhibit Council from realising this return target in each year of the 2018-28 LTP[1].

Following discussions with Council management, PwC has assessed Council's risk tolerance as being low to moderate, which is also broadly in line with peers. PwC considered Council's three primary risk factors (capacity to accept risk, willingness to accept risk and required rate of return) when coming to this determination. Of these risk factors, PwC assessed Council's capacity to accept risk as being the lowest of these factors. The reason for this determination was primarily due to Council's distribution requirements from the Fund (i.e. $2.5 million p.a.), meaning that it has a low capacity to tolerate short to medium term volatility in the value of the Fund. As the overall assessment of an organisation's risk

[1] PwC notes that a 5% p.a. real return target implies a c. 8% p.a. nominal return target. Further to this, PwC understands that over the past ten years, the following average returns (before fees) have been generated across the fixed interest and equity asset classes which collectively comprise 89% of the benchmark Fund:

- NZ fixed interest – 6.8% p.a.
- International fixed interest – 4.1% p.a.
- NZ equity – 9.1% p.a.
- International equity – 6.8% p.a.

PricewaterhouseCoopers, 113-119 The Terrace, PO Box 243, Wellington 6140 New Zealand
T: +64 4 462 7000, F: +64 4 462 7001, www.pwc.com/nz

tolerance is driven by its lowest assessed risk factor, this assessment of Council's capacity to accept risk leads to the overall risk tolerance assessment of low to moderate.

Structure/Duties and Responsibilities

The Finance, Audit and Risk Committee is identified as the governing body responsible for the implementation and monitoring of Council's investment strategy and policies. As part of this structure, the Group Manager Corporate Services and Chief Financial Officer will have ongoing management responsibility for the Investment Fund. The independent Investment Advisor will monitor and review the Investment Manager's performance to the SIPO requirements.

For clarity, the roles and responsibilities of the Investment Advisor and Investment Manager are as follows:

- Investment Advisor – An independent third party that provides assistance in relation to monitoring the performance of the fund, monitoring the appropriateness of the SIPO and the associated allocations and assisting in Investment Manager selection.
- Investment Manager – Responsible for managing the Fund's investments in accordance with the SIPO and Investment Policy Statement (IPS). The Investment Manager is also responsible for performance reporting and, if necessary, selecting Fund Managers to assist in executing the asset allocation.

Investment Parameters and Guidelines

This section sets out the specific asset classes that the Fund may invest in and the associated minimum and maximum investment ranges. Based on the preferred balanced 50/50 diversified investment portfolio, PwC has suggested the following strategic asset allocation and tactical ranges for the fund:

Sector	Benchmark %	Ranges %
Domestic equities	15%	13% - 18%
International equities (fully hedged)	29%	25% - 34%
Domestic property	3%	1% - 4%
International property (fully hedged)	3%	1% - 4%
Total growth assets	**50%**	**40% - 60%**
Cash and short term securities	5%	2% - 8%
Domestic fixed interest	20%	15% - 24%
International fixed interest (fully hedged)	25%	23% - 28%
Total income assets	**50%**	**40% - 60%**

In allocating the asset investment ranges, Council's existing investments have been considered. For example, Council has c. $15 million invested in New Zealand property outside of the Fund. As such, the Fund's investable ranges within the property asset class have been reduced in order to reflect the Fund's existing exposure.

pwc

Equities (domestic and international) collectively comprise 44% of the benchmark asset mix. Of this amount, a higher proportion has been allocated towards international equities which is consistent with other local authority SIPO's (refer Appendix 1). This investment mix has been proposed on the basis that international markets are significantly larger than the domestic market and so provide a wider variety of investment opportunities, diversification of risk and liquidity.

Of income asset investments, only 5% has been allocated towards cash and short-term debt securities. Other than being similar to peer SIPOs, the rationale for this allocation is associated with Council's liquidity and return requirements. A higher allocation (i.e. above 5%) may compromise Council's target return objectives, but liquidity requirements need to be supported. As such, it is proposed that the remaining income assets be allocated to domestic and international fixed interest securities.

To protect the Fund's New Zealand Dollar return objectives from being impacted by foreign currency volatility, PwC has proposed that all international investments made are fully hedged.

PwC has also included guidelines with respect to the ethical investments, consistent with Council's Investment Policy.

Risk Management

Appropriate internal controls, policies and risk management strategies are included within the SIPO.

Investment Performance Monitoring

In order to assess the performance of the Fund, PwC has proposed benchmarks at an asset class level that are consistent with the Fund's asset allocation. The asset class benchmarks proposed are consistent with other peer SIPOs (refer Appendix 1).

Distributions and Reserves

PwC is aware of Council's ongoing distribution requirements and, to best manage these, two Reserves are recommended within the Fund as follows:

- Inflation Fluctuation Reserve – To ensure the Fund retains its purchasing power over time. Each quarter the Inflation Fluctuation Reserve will be credited with the increase in the Fund's Real Capital Value based on the quarterly change in the New Zealand Consumer Price Index.
- Distribution Reserve – To help offset income fluctuations in future periods. Excess income after the Inflation Fluctuation Reserve adjustment will be credited to this Reserve.

PwC notes that peer councils with similar distribution requirements have utilised Reserve structure mechanisms.

Investment Manager Selection

This section outlines the criteria for Investment Manager selection and would be included within the Request for Proposal document:

- Track record and experience within the local government sector
- People
- Performance across asset classes
- Service

- Compliance
- Governance
- Fees
- Conflicts of interest
- Investment philosophy and process
- Stability of the organisation
- Ethical investments.

Tax Policy

We understand that if the funds remain within Council (not in a CCO), then there will be no tax on capital gains or income at the Council level. Investment returns may have imputation credits or withholding taxes that may diminish the net return. If the funds were to go into a CCO, further analysis would be needed. We suggest that Council confers with its tax advisor, Phil Fisher, on the Investment Fund strategy.

We are available to discuss the draft SIPO and Liability Management and Investment Policies with Council as required.

Yours sincerely,

BA Johanson

Brett Johanson
Partner
Treasury Advisory
T: +64 4 462 7234

pwc

Appendix 1 – SIPO Comparables

	Beef and Lamb NZ	*Regional Council #1*	*New Plymouth District Council*	*Otago Regional Council*	*District Council #1*	*Waikato Regional Council*
Objectives	To protect and maintain the real value of the current investment assets and all future additions to investment assets. To maximise investment returns within reasonable and prudent levels of risk. To ensure all investments are liquid. To maintain an appropriate asset allocation in order to make distributions as required while preserving the real value of the Meat Board's capital from the effects of inflation.	Maintain a long-term perspective to ensure assets are protected for future generations and over the long run will consider the impact of inflation Ensure that the overall portfolio is sufficiently liquid to meet ongoing funding requirements and ensure Council is never a forced seller of its long-term investment assets Ensure that investment returns are optimised within the risk management parameters specified in its Treasury Policy and SIPO An investment return that is in excess of its borrowing costs which can reduce overall income requirements	To at least maintain the real capital of the fund as a sustainable perpetual investment fund.	To protect and maintain the purchasing power of the current investment assets and all future additions to the investment assets. To maximise investment returns within reasonable and prudent levels of risk. To maintain an appropriate asset allocation in order to make distributions as required while preserving the real value of the Council's capital from the effects of inflation.	To deliver income to the Council to act as a rates subsidy. Until the next review date the Council requires income of $3.87m p.a. To deliver income to the Council to service loans for specified community projects, until the review date Council requires income of $1.73m p.a. To maintain the real value of the capital of the Fund over time with respect to inflation. An investment fluctuation reserve will be established at a level appropriate for the level of risk.	To ensure the assets of the Fund are invested prudently and consistent with the Council's mission, vision and rules; and To provide a Rates Subsidy and set aside funds for regional and economic development.
Risk Tolerance	Medium	Medium	Not specified	Conservative	Conservative to Medium (PwC estimated)	Conservative to Medium (PwC estimated)

Return Requirements	Real return of 3.30%	Not specified	Not specified	Targeted net return of 5.6% p.a.	Real return of 5% over longer term (rolling 10 year periods)	Real return of at least 4% p.a. over a 10 year period
Time Horizon	Greater than 15 years	Greater than 7 years	Long term	Greater than 7 years	Long term	5 – 10 years
Liquidity	High importance	Depends on Reserve	Not specified	Not specified	Around two years worth of rates subsidy should be held in Cash.	Around two years worth of rates subsidy should be held in Cash.

pwc

	Beef and Lamb NZ	*Regional Council #1*	*New Plymouth District Council*	*Otago Regional Council*	*District Council #1*	*Waikato Regional Council*
Cash and Fixed Interest	**Total: 50%** (Min: 41.5% - 58.5%) **Cash: 2%** (Min: 1.5% - Max: 2.5%) **NZ fixed interest: 36%** (Min: 31% - Max: 41%) **Intl fixed interest (100% unhedged): 12%** (Min: 9% - Max: 15%)	**Total: 80%** (Min: 15% - Max: 70%) **Cash and TD's: 40%** (Min: 15% - Max: 70%) **NZ and intl fixed interest: 40%** (Min: 0% - Max: 70%)	**Total: 5%** (Min: 0% - Max: 10%)	**Total: 65%** (Min: 51% - 80%) **Cash: 5%** (Min: 1% - Max: 10%) **NZ fixed interest: 50%** (Min: 45% - Max: 55%) **Intl fixed interest (100% hedged): 10%** (Min: 5% - Max: 15%)	**Total: 40%** (Min: 25% - 60%) **Cash and short term securities: 8%** (Min: 5% - Max: 20%) **NZ fixed interest: 6.5%** (Min: 0% - Max: 12%) **Intl fixed interest (hedged): 25.5%** (Min: 20% - Max: 32%)	**Total: 60%** (Min: 55% - 70%) **Cash: 20%** (Min: 17% - Max: 25%) **NZ fixed interest: 16%** (Min: 13% - Max: 19%) **Intl fixed interest (100% Hedged): 24%** (Min: 21% - Max: 27%)
Equity	**Total: 48%** (Min: 37.8% - 58.3%) **NZ equities: 8%** (Min: 6% - Max: 10%) **Australian equities: 8%** (Min: 6% - Max: 10%) **Intl equities (100% unhedged): 27%** (Min: 22% - Max: 32%) **Emerging market equities: 5%** (Min: 3.8% - Max: 6.3%)	**Total: 20%** (Min: 0% - Max: 55%)	**Total: 25%** (Min: 20% - Max: 30%) **Other intl listed equities: 25%** (Min: 20% - Max: 30%)	**Total: 22.5%** (Min: 12.5% - Max: 32.5%) **Australasian equities: 12.5%** (Min: 7.5% - Max: 17.5%) **International equities (at least 50% hedged): 10%** (Min: 5% - Max: 15%)	**Total: 45%** (Min: 35% - Max: 60%) **Trans-Tasman equities: 14%** (Min: 10% - Max: 20%) **International equities (least 50% hedged): 31%** (Min: 25% - Max: 40%)	**Total: 29%** (Min: 24% - Max: 34%) **NZ equities: 9%** (Min: 7% - Max: 11%) **Global equities (50% hedged after tax): 20%** (Min: 17% - Max: 23%)

Alternative Assets / Real Assets	**Total: 2%** (Min: 1% - Max: 3%) **NZ property: 1.5%** (Min: 1% - Max: 2%) **Intl property: 0.5%** (Min: 0% - Max: 1%)	N/A	**Total: 70%** (Min: 60% - Max: 80%) **Direct property assets: 15%** (Min: 10% - Max: 20%) **Other alternative assets: 55%** (Min: 40% - Max: 70%)	**Total: 12.5%** (Min: 7% - Max: 20%) **NZ property: 7.5%** (Min: 5% - Max: 10%) **Hedge funds: 2.5%** (Min: 1% - Max: 5%) **Commodities: 2.5%** (Min: 1% - Max: 5%)	**Total: 15%** (Min: 0% - Max: 30%) **Alternatives (hedged): 5%** (Min: 0% - Max: 10%) **Intl listed property (hedged): 5%** (Min: 0% - Max: 10%) **Intl listed infrastructure (hedged): 5%** (Min: 0% - Max: 10%)	**Total: 11%** (Min: 8% - Max: 14%)
Currency Exposure					**Total: 50%** (Min: 45% - Max: 55%)	**Total: 50%** (Min: 45% - Max: 55%)

pwc

	Beef and Lamb NZ	Regional Council #1	New Plymouth District Council	Otago Regional Council	District Council #1	Waikato Regional Council
Cash	One Month Bank Bill Index	ANZ 90 Day Bank Bill Index		ANZ 90 Day Bank Bill Index	ANZ 90-Day Bank Bill Index	ANZ NZ 90-day Bank Bill Index
NZ government bonds	S&P/NZX Corporate A Bond Index	NZ Government Stock Index	Sovereign NZX NZ Government Bond Index	ANZ NZ Government Stock Index	ANZ NZ Government Stock Gross Index	ANZ NZ Government stock index
NZ corporate bonds	S&P/NZX Corporate A Bond Index	Investment Grade Corporate Bond Index		ANZ Investment Grade Corporate Bond Index	ANZ NZ Government Stock Gross Index	ANZ NZ Government stock index
Intl fixed interest	Bloomberg Barclays Global Aggregate Bond Index (Unhedged)	Barclays Global Aggregate Index (hedged NZD)		Barclays Capital Global Aggregate Bond Index (NZD hedged)	Barclays Global Aggregate Index (100% hedged into NZD)	Barclays Capital Global Aggregate Index (100% Hedged to NZD)
NZ equities	S&P/NZX 50 Index (Gross)	NZX 50 Gross Index		NZX50 Gross Index	NZX50 Index (without imputation credits)	NZX 50 Gross Index (without Imputation Credits)
Australian equities	S&P/ASX 200 Total Return Index	S&P/ASX 200 Accumulation Index (NZD)		S&P/ASX 200 Accumulation Index	NZX50 Index (without imputation credits)	
Intl equities	MSCI World ex Australia Index (Unhedged)	MSCI All Country World Total Return Index (50% hedged NZD)	MSCI World Index in NZ dollars	MSCI All Countries World Net TR Index	MSCI All Country World Index ex Australia – Total Return Net Dividends (50% hedged to NZD)	MSCI All Countries World Index with net dividends reinvested (50% Hedged, after tax, to NZD)
Emerging market equities	MSCI Emerging Markets Index		MSCI Emerging Market Free Index			

Alternative Assets	NZ property – S&P/NZX All Real Estate Index (Gross) Intl property - S&P Developed REIT Index	NZ property – S&P/NZX Property Gross Index Alternatives - MSCI All Country World Total Return Index (50% hedged NZD)	Real assets - Required IRR on investment	NZ property - NZX Property Gross Index Hedge funds - HFRI Fund of Funds Index Commodities - DJ-UBS Commodity TR Index	Global property- FTSE ESPRA/NAREIT Developed Real Estate Index (100% hedged into NZD) Alternatives - HFRI FOF: Market Defensive Index (100% hedged to NZD) Global infrastructure - UBS Global Infrastructure & Utilities 50/50 Index (100% hedged to NZD)	Real assets - 50% CPI plus 5% and 50% UBS Global Listed Infrastructure and Utilities 50/50 Index (100% hedged to NZD)

Disclaimer

This Letter has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

This Letter is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, we do not accept a duty of care to any third party in connection with the provision of this Letter and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, we do not accept liability of any kind to any third party and disclaim all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of Hawke's Bay Regional Council ("HBRC or Council"). Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this Letter are based on information available as at the date of the Letter.

We reserve the right, but will be under no obligation, to review or amend our Letter, if any additional information, which was in existence on the date of this Letter was not brought to our attention, or subsequently comes to light.

We have relied on forecasts and assumptions prepared by Council about future events which, by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

This Letter is issued pursuant to the terms and conditions set out in our engagement letter dated 21 May 2018 and the Terms of Business attached thereto.

Hawke's Bay Regional Council

Long Term Investment Fund

Statement of Investment Policy and Objectives

DRAFT FOR DISCUSSION

Contents

Introduction

Purpose

The purpose of this Statement of Investment Policy and Objectives ("SIPO") is to assist Hawke's Bay Regional Council ("Council"), the Corporate and Strategic Committee, the Finance, Audit and Risk Sub-Committee, Council executives, the Investment Advisor and the Investment Manager in effectively supervising, monitoring and evaluating the management of the Investment Fund ("the Fund").

The SIPO defines the key responsibilities, and the operating parameters within which the investments and their ongoing management are to operate. The SIPO should at all times encourage the use of methodologies and processes that reflect industry best practice, encompass the principles of good governance, and reflect Council's vision and risk tolerances.

The investment activities are defined in various sections of the SIPO by:

- Stating in a written document Council's attitudes, expectations, objectives and guidelines for investment.
- Clearly defining an investment structure for managing the Fund. This structure includes various asset classes, investment management style(s), asset allocations and acceptable investment ranges that, in total, are expected to produce an appropriate level of diversification and total return over the investment time horizon.
- Establishing formal criteria to monitor, evaluate and review the performance of investments on a regular basis.
- Encouraging effective communication between the Council, the Corporate and Strategic Committee, the Finance, Audit and Risk Sub-Committee, Council executives, the Investment Advisor and the Investment Manager.
- Complying with all applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilise, and with applicable laws, rules and regulations.
- Providing guidelines and criteria for the appointment of an Investment Manager.

Philosophy

As a responsible public authority, Council is a risk averse entity. Council's philosophy is that all investments must be prudent and the associated risks and returns balanced against the key aim of capital preservation. Council's investment framework is supportive of its inter-generational responsibilities to current and future ratepayers. The primary focus is capital protection, followed by an appropriate return and acceptable liquidity.

Strategic, long-term asset allocation is the key to maximising investment returns while minimising risk. Fund investments should be continually monitored and adjusted relative to benchmark asset allocations.

All investments must apply a responsible and ethical investment framework filter when considering investments as outlined in the SIPO.

Tax Policy

The Fund is exempt from taxation on both capital gains and income. Ongoing investment management of the Fund is to be carried out in a manner consistent with the Fund's tax-exempt status.

Capital Base

In terms of the assets of the Fund, the Capital Base is $50,000,000 as at 5 June 2018.

Effective Date

This SIPO takes effect from XX XXXX 2018.

Review Date

The date of the next SIPO review is to be XXX XXXX 2019 or sooner if market conditions warrant, Council requests a review or the investment structure is altered.

Objectives, Risk Tolerance and Strategic Asset Allocation

Investment Objectives

Council's overarching strategic goals for its investment activities are as follows:

- Council will maintain a long-term perspective to ensure assets are protected for future ratepayer generations and over the long run will consider the impact of inflation.
- Council will ensure that the overall portfolio of investments is sufficiently liquid to meet ongoing cash flow requirements and ensure Council is never a forced seller of its long-term investment assets.
- Council will ensure that investment returns are optimised within the risk management parameters specified in the SIPO.

Investment Performance Objectives

Council's Fund is targeted to earn a return at least equal to a real return (after inflation and fees) of 4.5% in Year 1 and 5.0%[1] per annum in Year 2 and beyond. This is further expanded upon within the 'Risk Tolerance' section below.

All returns are assessed in NZD.

Investment Time Horizon

The investment guidelines are based upon an investment time horizon of greater than fifteen years. Therefore, interim fluctuations should be viewed with appropriate perspective (i.e. aiming to build intergenerational equity).

Investment Risk

Council bears the investment risk, as fluctuations in investment performance over time directly affect the value of the Council's investments.

Policy Setting and Management

Council approve/amend the policy parameters set in relation to investment activities. These changes will be minuted and incorporated into the SIPO and the dates of the changes noted.

Risk Tolerance

Council recognises that some risk must be assumed in order to achieve the long-term investment objectives. Risk tolerance is affected by three factors:

- Capacity to accept risk,
- Willingness to accept risk, and
- Required rate of return

1 These returns have been set as per the Financial Strategy within Council's 2018 Long Term Plan.

Capacity to Accept Risk

Council's capacity to accept risk is a function of its investment time horizon, prospective future contributions, current financial conditions and cash flow requirements.

Time horizon: This SIPO has been prepared on the basis that Council is expected to exist in perpetuity. The investment time horizon of Council is therefore long term. This increases the capacity to accept risk.

Financial capacity and cash flow requirements: Council's cash flow requirements imply low capacity to tolerate short to medium term volatility in the value of its Investment Fund. This reduces the capacity to accept risk.

Based on the combination of time horizon and financial circumstances, Council's implied capacity to accept risk is assessed as low to moderate.

Willingness to Accept Risk

Council is a risk averse entity. Where possible Council seeks to minimise volatility or risk. Notwithstanding this risk aversion, Council acknowledge that investing solely in capital stable investments exposes the Fund to the risk of inflation. This impacts the real value of investments. Council is willing to accept risk in order to increase expected returns in line with maintaining the real value of inter-generational equity. As such, Council's willingness to accept risk would characterised as moderate.

Required Rate of Return

Careful consideration of cash flow requirements is essential to determine the required rate of return. To achieve the desired level of contributions to cash flow and liquidity needs, an assumed starting fund size of $50,000,000, and an average real return (after inflation and fees) of 5.0% from Year 2, may be sufficient to meet Council's financial strategy.

Council recognises that the target rate of return is a long-term goal and will not be achieved in every measurement period.

Risk Summary and Selection of Asset Allocation

The table below summarises Council's level of risk tolerance as measured by the three risk factors:

Risk measure	Level of risk
Capacity to accept risk	Low to moderate
Willingness to accept risk	Moderate
Required rate of return	Moderate

Based on Council's return requirements and capacity and willingness to accept risk, a balanced fund is adopted which is suitable for a low to medium level of risk.

The balanced Benchmark Fund that the Fund's returns will be monitored against over the long term is as follows:

Asset Class	Benchmark
Growth assets	50%
Income assets	50%

In the table above, growth assets relate to equities (domestic and international) and property whilst income assets relate to cash, term deposits and fixed interest debt securities (domestic and international).

The appropriateness of this Benchmark Fund will be formally assessed at least once a year and kept under constant review to reflect any fundamental changes in the investment environment and changes to the Fund's investment policy.

A more detailed breakdown of the asset class allocation is contained in the 'Investment Parameters and Guidelines' section of this SIPO.

Structure

Investment Organisational Structure

Council's investment management organisational chart is displayed below. Under this structure, the Finance, Audit and Risk Sub-Committee are responsible for the oversight and monitoring of Council's investment policies and Fund.

Duties and Responsibilities

Council/Corporate and Strategic Committee

Council/Corporate and Strategic Committee will be responsible for the following:

- Setting the Fund's investment strategy, including the level of risk and investment objectives, and investment policies.
- Selecting and changing the Investment Manager as appropriate after having taken advice from an appropriate external investment advisor.
- Reviewing the SIPO annually, including the investment strategy, policies and manager configuration, and instructions to the Investment Manager.
- Formally reviewing the SIPO every three years. This involves mandating an independent third party to review the SIPO including the investment strategy, return objective, policies and manager configuration, and instructions to the Investment Manager.
- Ensuring that the level of redemptions from the Fund is consistent with the Fund's objective to maintain equity, in terms of amounts available for distribution, between present and future rate payer generations.
- Providing cash flow information to the Investment Advisor with respect to future deposits and redemptions.
- Set out the duties and responsibilities of all parties involved with respect to decision-making, planning, investment management, reporting and review.
- Appointing the external Investment Advisor.

Finance, Audit and Risk Sub-Committee

The responsibility for the implementation of Council's investment policies is that of the Finance, Audit and Risk Sub-Committee, assisted by the Group Manager Corporate Services, Chief Financial Officer and the Investment Advisor.

The Sub-Committee will:

- Provide guidance and leadership on the appointment, management, monitoring and review of the appropriate Investment Manager.
- Recommend the SIPO to Council.
- Liaise with Council's, Investment Advisor.
- Ensure that the Fund has its own Investment Policy Statement ("IPS"), which is a document, between an investor (Council) and an investment manager, recording how the investor's money is to be managed. Specific information on matters such as asset allocation, risk tolerance, investment securities and liquidity requirements are included in an IPS.
- Review all matters concerning the SIPO and IPS, considering any changes or amendments to the SIPO and IPS and making appropriate recommendations.
- Ensure that the practices and policies set out in the SIPO and IPS are adhered to.
- Regularly review Investment Manager reports, and reporting exceptions.
- Ensure that all parties overseeing, advising and managing Council's investments disclose any potential conflicts of interest. In the event that conflicts of interest arise, the policies and procedures for managing these are to be clearly defined, although, in principle, such conflicts should be avoided.

- Advise Council of changes or issues regarding the Fund.
- Report to Council on the performance of the Fund on a basis agreed with the Council.
- Confirm the management of investments complies with all applicable laws, Council's policies, risk tolerance and other supporting documents.
- Ensure that contracts for the investment manager, custodial and investment advisory services are reviewed annually.
- Ensure appropriate risk management standards and procedures are developed and maintained.
- Ensure the overall Fund is prudently diversified to meet the agreed risk/return profile.
- Approve rebalancing of the Fund.
- Follow formal criteria to monitor, evaluate and compare the investment performance results achieved against relevant benchmarks and objectives on a regular basis.
- Ensure that all service agreements and contracts are in writing and are consistent with fiduciary standards of care.

Investment Advisor

Council appoints an independent Investment Advisor to assist in developing and implementing the investment strategy and policies, advising on investments and investment managers, evaluating the performance of the Fund and by providing strategic and market information.

The Investment Advisor will:

- Use the same care, skill, prudence and due diligence under the prevailing circumstances that an experienced investment professional, acting in a like capacity and fully familiar with such matters, would use in like activities for like Funds with similar aims. This must be completed in accordance with all applicable laws, rules and regulations.
- Annually monitor the SIPO and its appropriateness, (in conjunction with Council).
- Advise the Finance, Audit and Risk Sub-Committee about events and changes that may affect the manner in which the Fund's assets should be invested.
- Annually meet with Council and/or the Finance, Audit and Risk Sub-Committee (as appropriate) to present investment monitoring reports and to discuss topical investment issues.
- Evaluate the appropriateness over time of the asset allocation policy (Benchmark Fund) based on an annual review of market assumptions. Advise on the need for a formal review of the Benchmark Fund, if warranted.
- Review the IPS drafted by the Investment Manager to ensure it complies with the SIPO.
- Make recommendations on any matters of performance and compliance not adequately covered by the Investment Manager.
- Assist Council and the Finance, Audit and Risk Sub-Committee to monitor and review the performance of the Investment Manager and Custodian.
- Provide advice on appropriate strategic asset allocation, security selection and Investment Manager selection.
- Periodically review the custodial arrangements and make recommendations.
- Monitor the Funds total performance relative to the SIPO.

Investment Manager

An external Investment Manager may be appointed to manage part of or all of the Fund.

The Investment Manager will be appointed by Council on the advice of management and the Investment Advisor. The Council may change the Investment Manager from time to time as it sees fit at its sole discretion.

The Investment Manager will:

- Use the care, skill, prudence and due diligence that an experienced investment professional, acting in a like capacity, would use and comply with all applicable laws, rules and regulations.
- Manage the Fund's investments in accordance with the guidelines and objectives as outlined in the SIPO and IPS.
- Ensure investment assets are appropriately diversified and conform within the time horizon and agreed risk/return profile. Outline expected returns and risk, or volatility, within the selected strategies.
- Manage the Fund on a day-to-day basis. Administer and attend to the day-to-day financial matters associated with the management of the Fund. The primary point of contact for the Investment Manager is the CFO.
- Ensure that "expected" and "modelled" returns for asset classes are based on sound return and risk premium assumptions.
- Provide advice on, and implementation of, the asset allocation.
- Specify, and advise on, asset and sub-asset class allocation strategies.
- Recommend a Custodian to hold and report on investment assets. Periodically review custodial arrangements and make recommendations.
- Confirm on an annual basis that best practice with respect to execution, brokerage, money sweep facilities, foreign currency spreads, transaction costs and management fees is being applied.
- Provide instructions to other Fund Managers to lodge or withdraw funds.
- Rebalance individual investments and asset class groups to within agreed benchmarks as described in the rebalancing policy contained in the SIPO and IPS documents.
- To effect all transactions for the Fund at the best price.
- Compile and account for all investment, record keeping and administrative expenses associated with the management of the Fund.
- Deliver quarterly reports including:
    - Fund valuation,
    - Fund duration,
    - Compliance reporting (including approved exceptions),
    - Performance summary for the Fund and by asset class,
    - Performance against benchmarks,
    - Fund income,
    - Asset transactions summary,
    - Cash transactions,
    - Investment management fees,

  - Custodial fees,
  - Individual fund management fees, and
  - Brokerage and other transaction costs.
- Make available appropriate personnel to attend meetings, as agreed.
- Disclose any potential conflicts of interest and steps taken to mitigate such conflicts.
- To report at least annually the 'Total cost of Delivery' being the sum of:
  - Investment Manager fees,
  - Custodial fees,
  - Administration fees, and
  - Total Fund fees – made up of; annual management fees (including annual management fees of underlying investments) and any other fees and costs.
- Provide financial information, including income and/or returns projections, as required for forecast budgeting purposes.
- Communicate all significant changes in ownership, organisational structure, financial condition, professional staff and reputation are examples of changes to the firm that are material.

Fund Manager

To manage an allocated part of the Fund on terms and conditions consistent with their mandate.

Custodian

The Custodian holds investments as bare trustee on behalf of Council and is responsible for the safekeeping of those investments. The specific duties and responsibilities of the Custodian are:

- Maintaining separate accounts.
- Valuation of all investment assets.
- Collection of income.
- Settlement of transactions (buy/sell orders) initiated by the Investment Manager.
- Provision of regular reports detailing transactions, cash flows, securities held and their current values, changes in value and returns.

Investment Parameters and Guidelines

General

Specific investment policies are outlined in Council's Investment Policy. In general terms, when making decisions on investments the Investment Advisor/Manager will consider the overall circumstances of the Fund and will comply with all applicable legislative requirements.

The Fund will be managed with a view to ensuring sufficient liquidity to meet expected cash flow and distribution requirements.

Investment risk will be limited by appropriate diversification both within and between asset classes as determined by the following asset allocations.

Asset Class Guidelines

The Fund will consist of a mixture of growth and income assets.

Council are empowered to make investments in the following asset classes and assets:

- Cash – term deposits, cash on call, commercial paper, bank bills.
- NZ fixed interest – NZ Government, Local Authority, NZ registered bank, State Owned Enterprise, Supra-national and Corporate bonds/securities, collective investment vehicles and fixed interest funds.
- International fixed interest –via managed funds, collective investment vehicles, that are fully hedged back into NZ Dollars.
- NZ and international Equities - via managed funds indirectly[2] or directly. International equities are fully hedged back into NZ Dollars.
- NZ property via managed funds indirectly or directly.
- International property via managed funds indirectly or directly, that are fully hedged back into NZ Dollars.

Asset Allocation

The strategic asset allocation and tactical ranges are provided below and form the basis on which adherence to the SIPO is measured.

Sector	Benchmark %	Ranges %
NZ equities	15%	13% - 18%
International equities (fully hedged)	29%	25% - 34%
NZ property	3%	1% - 4%
International property (fully hedged)	3%	1% - 4%
Total growth assets	**50%**	**40% - 60%**
Cash and short term securities	5%	2% - 8%
NZ fixed interest securities	20%	15% - 24%

2 Indirect investments are those in which an investment is made in a managed fund, collective investment vehicle or index. Direct investments relate to specifically purchasing a particular organisation's securities.

International fixed interest (fully hedged)	25%	23% - 28%
Total income assets	**50%**	**40% - 60%**

Ethical Investment

Where practical, investments will be made taking into account the ethical practices of the investment entity. Council's intention for the Fund is to avoid direct involvement with industries that have a negative impact on society and the environment. This includes:

- Alcohol,
- Tobacco,
- Fossil fuels, and
- Military/weapons.

Investment Structure

The selection of assets within an asset class is typically delegated to the Investment Manager. This is subject to investment guidelines that control risk, and otherwise determine the nature of potential investments for each mandate.

The Investment Manager is appointed by Council on the advice of the Investment Advisor, after assessing the universe of appropriately skilled managers available for the asset class in question. Council, at its sole discretion, may change Investment Managers from time to time as it sees fit.

Rebalancing

The exposures to the various asset classes will be monitored quarterly, taking into account the underlying exposures in any collective investment vehicles and the impact of derivatives (e.g futures and options) on an effective exposure basis, by the Investment Advisor.

If any asset class allocation exceeds the ranges set out above, then sufficient assets will be transferred, on Council's authority, to bring the weights to benchmark.

In considering rebalancing, Council can take into account recent volatility and the likelihood that market movements may result in asset classes moving back to within the specified ranges, along with transactions costs likely to be incurred in any transition.

The regular cash flow requirements of the Council provide an opportunity to assist in rebalancing the Fund towards benchmark weights, by directing the outflows to the overweight asset class(es) and any inflows to underweight asset class(es). Rebalancing can also be undertaken by selling overweight asset classes to fund underweight asset classes.

From time to time, the Council may deviate from the long-term asset allocation strategy in order to preserve capital in extreme market conditions. Such positions are to be taken after consideration of advice from the Investment Advisor with input from the Investment Manager in the appropriate investment sector.

Liquidity Policy

Council requires liquidity to meet payment obligations in relation to its rates subsidy. As such, Council requires a high degree of confidence that during any periods of extreme market volatility, liquidity demands can be met. The Fund's primary source of liquidity is its cash investments. Cash investments also play a role in the Fund's investment strategy, providing a stable return with low volatility. The Fund's investment strategy supports its liquidity requirements by predominantly investing in listed securities and allowable fixed interest securities.

Risk Management

The Finance, Audit and Risk Sub-Committee and Council executives have the responsibility to develop appropriate internal controls, policies and risk management strategies. These internal controls, policies and risk management strategies are described in this SIPO.

Risks

Market Risk

Market risk is the risk of adverse movements in investment markets (including asset prices, liquidity, volatility, changes in yield curves or other market related variables) that affect the value or income of the Fund. The volatility of investment markets means that returns are uncertain.

Investment Manager Risk

The Investment Manager's returns may vary from expected levels.

Credit Risk

Credit (or counterparty) risk is the risk of default by a counterparty to a particular transaction or an issuer of a security held in the Fund.

Liquidity Risk

Liquidity risk is the risk that a security cannot be sold when required or that the price achieved is significantly different from the quoted price. Liquidity also relates to the "accessibility" of Council's cash and fixed interest investments.

Operational Risk

Operational risk is the risk of financial loss due to mismanagement, error, fraud or unauthorised transactions.

Currency Risk

Currency risk is the risk that foreign currency denominated assets will lose value due to the effect of an adverse exchange rate movement.

Procedures

Market Risk

Managed by:

- Diversifying Fund investments,
- Seeking professional advice, through the Investment Advisor and
- Requiring the Investment Manager to manage the Fund within prescribed mandates.

Investment Manager Risk

Managed by:

- Robust selection process for the Investment Manager,

- Appointing the Investment Manager with mandates that prescribe acceptable risk limits, and
- Regular assessment and review of performance against benchmark and peers.

Credit Risk

Managed by:

- Measuring and maintaining the credit quality of the Fund within prescribed guidelines,
- Limiting exposure to individual issuers,
- Diversification across investment type and instrument,
- Maintaining appropriate policies and procedures relating to counterparties, and
- Appointing the Investment Manager with mandates consistent with prescribed risk limits.

Liquidity Risk

Managed by:

- Requiring the Investment Manager to invest only in liquid securities,
- Requiring the Investment Manager to hold diversified a Fund,
- Requiring the Investment Manager to consider the jurisdiction in which they are investing, and
- Limiting the credit rating of the fixed interest and cash investments to approved minimum credit ratings.

Operational Risk

Managed by:

- Having in place a robust system of internal controls and regularly monitoring the Fund,
- Requiring an independent custodian to hold assets as bare trustee, record transactions and report on performance,
- Having a specific mandate for each Investment Manager, and
- Having clear separation of investment management, custodial and overall supervisory and monitoring functions.

Currency Risk

Managed by:

- Maintaining a foreign exchange hedging policy for the Fund and individual asset classes.

Investment Performance Monitoring

The goals of performance monitoring are to:

- Assess the extent to which the Fund's investment objectives are being achieved;
- Compare the performance of the Fund's appointed Investment Manager against the agreed performance benchmarks, performance of other relevant professional managers and market indices;
- Understand the existence of any particular weakness in the Investment Manager or the investment product(s) utilised.
- Allow the Finance, Audit and Risk Sub-Committee to continually assess the ability of both the Council and the Investment Manager to meet the treasury objectives.

Benchmarks

Benchmarks are a tool against which to measure the effectiveness of the investment strategy either at a whole of Fund level, an asset class level or at the manager level. The general principle of benchmarks at an asset class or manager level is they should be replicable – that is, it should be possible to create a fund of securities which mirrors (or at least very closely resembles) that used within the benchmark.

At the asset class level, benchmarks provide an effective way of measuring the skill with which the manager selects securities within the Fund being managed.

The risk and return characteristics of the benchmarks used for the Fund as a whole and for individual asset classes must be broadly consistent with those considered in the analysis used to construct the Fund's asset allocation.

Performance (before tax and fees) for individual asset classes will be measured against suitable indices such as those indicated in the following table:

Asset class	Index
NZ equities	NZX50 Gross Index (without imputation credits)
International equities (fully hedged)	MSCI world index (fully hedged)
NZ property	S&P/NZX all real estate index
International property (fully hedged)	S&P developed REIT index (fully hedged)
Cash and short term securities	ANZ 90 day bank bill index
NZ fixed interest securities	S&P/NZX Investment Grade Corporate A Bond Index
International fixed interest (fully hedged)	Barclays global aggregate index (fully hedged into NZD)

Fund Performance

Returns on the Fund will be monitored by the Finance, Audit and Risk Sub-Committee in relation to the Benchmark fund nominated in this SIPO. The Benchmark Fund is a performance-monitoring tool intended to reflect the Council's adopted investment policy objective.

Manager Performance

- Returns achieved by the appointed Investment Manager will be assessed by the Council in relation to their stated objectives and the objectives of the Fund. Returns will also be compared with returns earned by a suitable peer group, such as a group of other professional Investment Managers.
- The Investment Manager will report at least quarterly in accordance with a format agreed.
- Investment Manager performance will be monitored quarterly with a view to an annual evaluation of rolling three-year results.
- The Investment Manager's role will be reviewed by Council on an annual basis. Factors taken into account in these reviews will include investment style, resources, organisational strength, investment performance relative to objectives, and any other factors considered relevant to the Investment Managers' continuing ability to meet the applicable investment objectives.

Distributions and Reserves

Volatility of Returns

Council notes that the investment objective is a long-term goal, but that its investment strategy contemplates an asset allocation which is likely to generate returns that demonstrate some volatility over the short term. Council recognises that asset values over shorter time-periods may fall due to negative returns and that the total Fund value may fall below the Real Capital Value in the shorter term. The Council acknowledges that exposing the Fund to this volatility is necessary to pursue higher long-term returns and thereby maximise the level of annual distributions from the Fund.

In order to account for investment risk or volatility, the assets of the Fund are to be invested in such a manner as to achieve a level of return in order to meet the following requirements:

1. The amount required to meet the Council's rates subsidy needs (currently c. $2.5 million p.a.).
2. An amount equal to the New Zealand Consumer Price Index ("CPI") for the year will be credited to the Inflation Fluctuation Reserve.
3. Any remaining amount will be credited to the Distribution Reserve.

Capital Base

In terms of the assets of the Fund, the Capital Base is $50,000,000 as at 5 June 2018.

Real Capital Value

For the purposes of this SIPO, the Real Capital Value is the Capital Value expressed in the current market value in New Zealand dollars – i.e. the Capital Value as calculated above as at June 2018 adjusted for movements in the CPI since that time.

The value of the Fund may fall below the Capital Base.

Distribution Policy

The Fund's annual returns in any year will be distributed as follows:

1. The amount required to meet the Council's rates subsidy needs (currently c. $2.5 million p.a.).
2. An amount equal to the New Zealand CPI for the year will be credited to the Inflation Fluctuation Reserve.
3. Any remaining amount will be credited to the Distribution Reserve

In the event of an insufficient annual return to meet inflation proofing and/or distribution requirements, the amounts required for inflation proofing and/or distribution will be funded from the Distribution Reserve.

Reserving Policy

Council will establish the following Reserves to facilitate the achievement of its Distribution Policy:

Inflation Fluctuation Reserve

Each quarter the Inflation Fluctuation Reserve shall be adjusted by the increase in the Real Capital Value based on the quarterly change in the New Zealand CPI. This ensures that the Fund will retain its purchasing power over time. If there are insufficient returns available to make this adjustment, the Distribution Reserve should be adjusted accordingly.

Distribution Reserve

Each year any excess income after the adjustment to the Inflation Fluctuation Reserve and annual distributions to Council shall be credited to the Distribution Reserve. This Reserve will help offset income fluctuations in future periods. In particular, this Reserve can be used to meet distribution requirements during years with low or negative investment returns without recourse to the Capital Base.

A consistently significant positive balance (equal to 4 year's distribution sustained for one year or more) in this Reserve is a signal to Council that it may be appropriate (but it is not necessary) to review the investment objectives or the priorities (or both).

Investment Manager Selection

The Finance, Audit and Risk Sub-Committee will be responsible for recommending the appointment of the Investment Manager to assist with the management of Council's investment Fund. The Finance, Audit and Risk Sub-Committee is responsible for applying the following due diligence criteria in selecting the Investment Manager.

Request for Proposal Process

Investment Manager roles should be tendered through a Request for Proposal (RFP) process. The Finance, Audit and Risk Sub-Committee should seek tenders. Relevant considerations for tenderers include:

- Track record: Each Investment Management firm should have a minimum track record of at least five years. Firms should have at least New Zealand Dollar 500 million under management. Experience and credentials in the local government sector.
- People: Each Investment Management firm should provide an overview of the experience level and depth of their Firm.
- Performance across asset classes: Each Investment Management firm should provide their past results and performance against benchmarks.
- Service: Each Investment Management firm must confirm that it will report quarterly and make relevant staff available to attend meetings. Firms should also state the level of regular reporting (oral, written and face-to-face) Council would receive.
- Compliance: Investment Management firms who are, or have been within the last five years, the subject of adverse regulatory or professional association findings will be excluded from consideration.
- Governance: Investment Management firms must submit and manage to an IPS that conforms with the SIPO.
- Fee only: Investment Management firms should offer a fee only service.
- Conflicts of Interest: Must be adequately disclosed and avoided where possible.
- Investment Philosophy and Process: Each Investment Management firm should have an investment philosophy which it can articulate to Council and the Finance, Audit and Risk Sub-Committee (if required). Each Investment Management firm should follow modern portfolio theory.
- Stability of the organisation: There should be no perceived organisational problems, the majority of the management team should have been in place for more than three years.
- Ethical investments: The Investment Management firm must be able to articulate its approach with respect to ethical investment requirements.

Fund Expenses

Total Fund expenses should be fair and reasonable. The Investment Manager must offer a fee only service with all commissions returned to the Fund and reported to the Finance, Audit and Risk Sub-Committee.

The Investment Advisor is to report to the Finance, Audit and Risk Sub-Committee quarterly the breakdown of the total cost of delivery including:

- Investment Management fees,
- Custodial fees,
- Individual and weighted average Funds Management fees, and

- Brokerage and other transaction costs.

The Finance, Audit and Risk Sub-Committee acknowledge that cost reductions can be achieved through scale. Council's objective is to minimise total cost of delivery.

Appendix 1 – Investment Guidelines and Constraints

The guidelines and constraints required by the Council to be observed by each Investment Manager, as applicable are set out below. For the purposes of these constraints, "Fund" shall relate to the portion of the Fund's assets under the management of the Investment Manager.

Where the Council has an Investment Management agreement with the Investment Manager, these guidelines and constraints should, so far as relevant, be incorporated into that agreement. Where the Fund is invested into a pooled or collective investment vehicle or product Council recognises that the strict application of these guidelines and constraints may not be possible. Council expect the Investment Manager to inform them of any investment or management practice that materially falls outside the guidelines and constraints so that the Council can continually reassess the overall suitability of such an investment approach.

Investment of the Fund shall be made in compliance with all laws and regulations governing investments and Local Authority bodies.

Each Investment Manager is entitled to make use of derivative contracts within the Fund for the following purposes:

- Strategies relating to yield curve and modified duration for cash and fixed interest funds within the given exposure ranges.
- To alter the Fund's asset allocation (including country and/or currency allocations) within the given exposure ranges.
- As a hedge to manage exposure to foreign currency or other investment risks.
- To reduce transaction costs and improve liquidity by using derivative contracts to take a position, which would otherwise have been taken by buying or selling physical stock.

The Investment Manager must not use derivatives, physical securities or any combination of the two to produce financial exposures that would result in the leverage[3] of the Fund. That is, the Fund's net exposure to investment markets exceeding the value of the Fund's physical assets. Derivatives should only be used to produce financial exposures that would be otherwise obtained through the use of physical securities in the absence of leverage. The Investment Manager must also not use leveraged derivative strategies or sell derivatives outright.

Not more than 10% of the Fund's assets may be invested in any one investment without specific consideration and approval by the Council.

The Fund's interest in any externally managed pooled fund/collective investment vehicle domiciled offshore shall not exceed 10% of the assets of that pool, unless a larger investment is specifically authorised by the Council.

All mandates should be actively managed (except for passive currency hedging where required).

Investment in assets other than those contemplated by this policy statement (including antiques, art, stamps, gold, silver, hedge funds, commodities, private equity or venture capital investments) are not permitted without the prior approval of the Council.

New Zealand Fixed Interest

Investment in a fixed interest instrument (debt/bond) should have a minimum rating of BBB+ as measured by Standard & Poors, or equivalent agency.

3 Leverage relates to an investment strategy of using borrowed money, specifically, the use of financial instruments or borrowed capital to increase the potential return on an investment.

No investments in direct mortgages[4], subordinated debt, structured debt, high yield/junk bonds and leveraged loans should be made.

All investments made must be made in accordance with the counterparty credit limits articulated within Council's Investment Policy.

International Fixed Interest

No more than 5% of the market value of the assets held by the fixed interest Investment Manager should be invested in non-benchmark markets (i.e. markets not in the Barclays Global Aggregate Index).

No more than 5% of the assets held by the fixed interest Investment Manager is to be held in any one security or with one single issuer, other than a fund or a security representing a collective investment of other securities, unless the security represents an OECD sovereign borrower, issuer, or agency of an OECD government and supranational borrowers.

Investment in a fixed interest instrument (debt/bond) should have a minimum rating of BBB+ as measured by Standard & Poors, or equivalent.

No investments in direct mortgages, subordinated debt, structured debt, high yield/junk bonds, and leveraged loans should be made.

All investments made must be made in accordance with the counterparty credit limits articulated within Council's Investment Policy.

Cash

Council may invest cash on call or deposit. Where it does so it may invest in the following:

- New Zealand Government Treasury Bills and short term (no more than 12 months to maturity) New Zealand Government Bonds.
- Call, term deposits and registered bank bills with New Zealand Registered Banks with a Standard and Poor's or equivalent agency, short term credit rating of 'A-1' or stronger. To be classified as a cash investment, term deposits must have a maturity date of 30 days or less. Registered bank bills must have a maturity date of no more than 12 months.
- Commercial Paper issued by a corporate borrower, with a Standard and Poor's or equivalent agency, short term credit rating of 'A-1' or stronger. The maturity date can be no more than 12 months.

All investments made must be made in accordance with the counterparty credit limits articulated within Council's Investment Policy.

Equity

Investments must be confined to publicly listed widely held securities trading in recognised markets. Unlisted shares and shares in companies about to be listed may be held provided Council has given its prior approval.

The Fund should not hold more than 5% of the equity of any one company.

[4] Direct mortgage investment relates to mortgage funds and individual mortgage loans. Subordinated debt relates to debt investments that rank below senior ranking, loans or securities. Structured debt relates to complex debt securities and collateralised arrangements. A junk bond relates to bonds with a sub-investment grade credit rating (i.e below BBB- credit rating) . Leveraged loans relate to sub-investment grade debt securities.

Investment Managers are delegated full discretion to exercise all voting rights, including but not limited to voting proxies. Investment Managers must exercise these voting rights in the best interests of, and consistent with, the investment objectives of the Fund.

No investments are to be made in preference shares.

New Zealand Property Investments

Council may invest in direct New Zealand property investments. Where it does so, the following rules shall apply:

- Investment in property entities that are listed on the New Zealand Stock Exchange.
- Investments in partly paid shares in respect of shares of the type referred to above.
- Exposure limits for New Zealand property investments (based on the market value of the assets held by the Property Investment Manager) and benchmarks are set out in the following table:

Security Type	Minimum percentage of NZ property	Maximum percentage of NZ property
Companies not represented in the appropriate Benchmark	0%	25%
Individual entity in the appropriate Benchmark	0%	25%

International Property Investments

Council may invest in International property investments. Where it does so, the following rules shall apply:

- Investment in international property will be through one or more Collective Investment Vehicle.
- International property investments must be fully hedged from foreign exchange risk.
- CIVs in international property must hold a broadly diversified portfolio of property securities, be benchmark aware, have appropriate policies and procedures and impose reasonable exposure limits.
- Ensure that any investment is sufficiently liquid to enable exit from the investment at any time.