

# **Finance and Operational Performance Committee**

**Thursday, 13 June 2002  
Commencing at 9.30 am**

**Part V: Finance**

**Item 12: Borrowing and Investment  
Report**

**SUPPLEMENT TO AGENDA FOR AN ORDINARY MEETING OF THE FINANCE AND  
OPERATIONAL PERFORMANCE COMMITTEE TO BE HELD IN THE CIVIC  
CENTRE, 6 WAIPAREIRA AVENUE, LINCOLN, WAITAKERE CITY,  
ON THURSDAY, 13 JUNE 2002  
COMMENCING AT 9.30 AM.**

---

**PART V - FINANCE**

**12 BORROWING AND INVESTMENT REPORT**

**PURPOSE OF THE REPORT**

Waitakere City Council enters into treasury related financial contracts in the ordinary course of its business. It is the role of Council's funds management function to manage such contracts and the impact that they have on the organisation. All funds management transactions are governed by the Borrowing and Investment Policy prepared in compliance with the Local Government Act 1974. As a requirement of the Borrowing and Investment Policy, this report informs Council on the current and future movements of Council's debt and cash investments and provides a general commentary of financial market conditions.

**SUMMARY OF BORROWING AND INVESTMENT MOVEMENTS, APRIL 2002**

The Council's gross term debt position has increased by \$5.7 million since March with a closing balance at April month end of \$116.7 million. Working capital borrowing of \$14.9 million at 30 April 2002 has been funded using the Council's special fund reserves and call borrowings.

**SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING APRIL 2002**

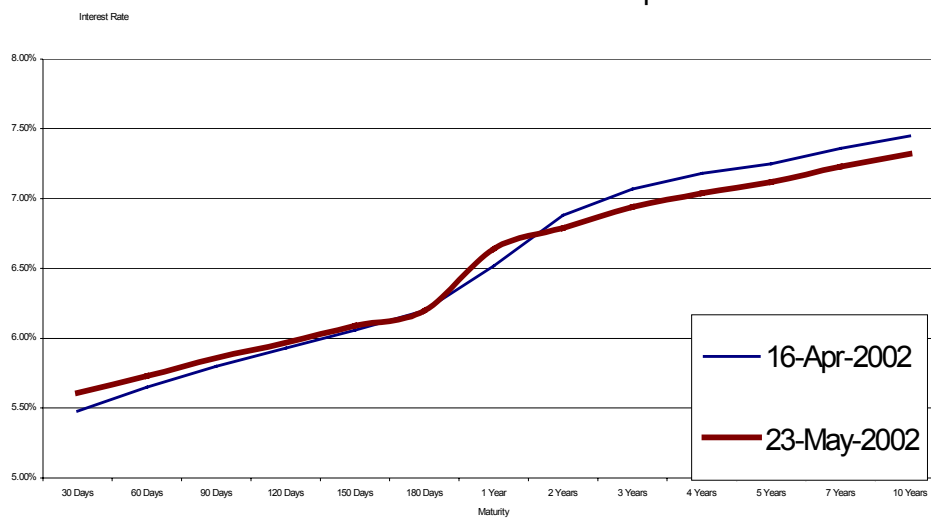
A medium term zero coupon bond of \$5 million, maturing 15 October 2002, at a discounted rate of 6.09% was entered into.

**FINANCIAL MARKET COMMENTARY**

**Interest Rate Overview**

There was little surprise in the market when the Acting Governor of the Reserve Bank of New Zealand, Dr Carr, increased the Official Cash Rate, for the third time this year, by 0.25%. Some commentators had expected the increase to be 0.50%. 90 day bank bills have maintained a interest rate range between 5.78% and 5.88% over the past 3 weeks, effectively pricing a further increase in the Official Cash Rate of at least 0.25% on July 3, 2002. The following graph represents the actual movement in interest rates, by comparing interest rate spreads on the 16 April, 2002 and the 23 May, 2002 after two Official Cash Rate increases of 0.25%.

### 10 Year Interest Rate Curve Comparison



Hence, the increases in the Official Cash Rate have been priced into New Zealand interest rate spreads for some time, and the real effect of the increases has served to slightly flatten the curve.

While Dr Carr alludes to further Official Cash Rate increases, and that the 90 Day Bank Bill could likely trade at 7.00% in 2003, we should consider the issues of such a move.

The New Zealand dollar has continued to appreciate, with NZD/ USD cross closing in on the mid 0.47's range, or approximately a level last seen 2 years ago. It is likely that this trend will continue.

Stimulating or tightening monetary policy does not have an immediate effect. The effect of changes to monetary policy will likely be noticed in economic indicators in approximately 18 months' time. Over stimulating the economy, can lead to rapid growth, though also increased inflation pressures. Capacity issues in the New Zealand economy remain, particularly the labour market. The appreciated dollar may have an adverse effect by dampening demand for New Zealand products offshore. Decreased costs associated with imports are not likely to feed into the local economy quickly, as many importers have suffered from reduced margins due to the weak currency for some 2 years. The typical New Zealand household is debt ridden. Therefore increasing the Official Cash Rate to far is likely to have an extremely unfavourable effect by late 2003 to mid 2004.

The Central Government's third and final budget for this term, resulted in only one material surprise, the scale of the budget surplus.

#### Interest Rate Expectations

Further increases in the Official Cash Rate are virtually guaranteed. The market has already priced 0.25% increase on July 3, with a potential upside risk of 0.50%. While Dr Brash was Governor of the Reserve Bank of New Zealand, and since the Official Cash Rate has existed, history shows that it is difficult to gauge when monetary policy has been overly weakened or tightened, leading to short term boom and bust cycles. In hindsight, continued interest rate decreases in late 2001 were not necessary in New Zealand, as the fall out from the US downturn had little effect on the New Zealand economy that was and perhaps still remains in a different economic cycle.

Until there are real signs of growth in the US, we can expect the long end of interest rate spreads to remain relatively stable, while increased short term rates will generally lead to a flattening in interest rate spreads. Continued US concerns of terror attacks may serve to dampen US short term growth prospects.

Claims of 90 day bills trading at 7.0% in 2003, potentially leads to reduced local consumer confidence. Debt ridden households will become increasingly weary of their spending habits as more cash is absorbed into debt financing. While the New Zealand dollar soars, potential inflation associated with imported consumer goods decreases. However, if demand decreases for such goods, both sides of the balance of payments lose. Clearly, a neutral cash rate position of 6.0 – 6.25% is favourable, until such time as the global economy improves.

### **Up coming dates**

Official Cash Rate review 3 July, 2002.

### **CONCLUSION**

All transactions covered by this report have complied with the requirements of Council Policy. Council's current net term debt is within the limits approved in the 2001/2002 Annual budget.

### **RECOMMENDATION**

That the information be received.

Report prepared by Bruce Wilkin, Funds Accountant.



**WAITAKERE CITY COUNCIL DEBT PORTFOLIO AT  
30 April 2002**

	<b>TERM DEBT (to fund long term assets)</b> (\$000's)	
<i>Budget year end term debt position per 2001/2002 Annual Plan</i>	Budget term debt	165,598
	Further term debt approved by Council during 2001/2002	-
	<b>Budget 2001/2002 year end gross term debt</b>	<b>165,598</b>
	Forecast year end Sinking Fund Commissioner assets	5,520
	<b>Anticipated 2001/2002 Year End Net Term Debt</b>	<b>160,078</b>

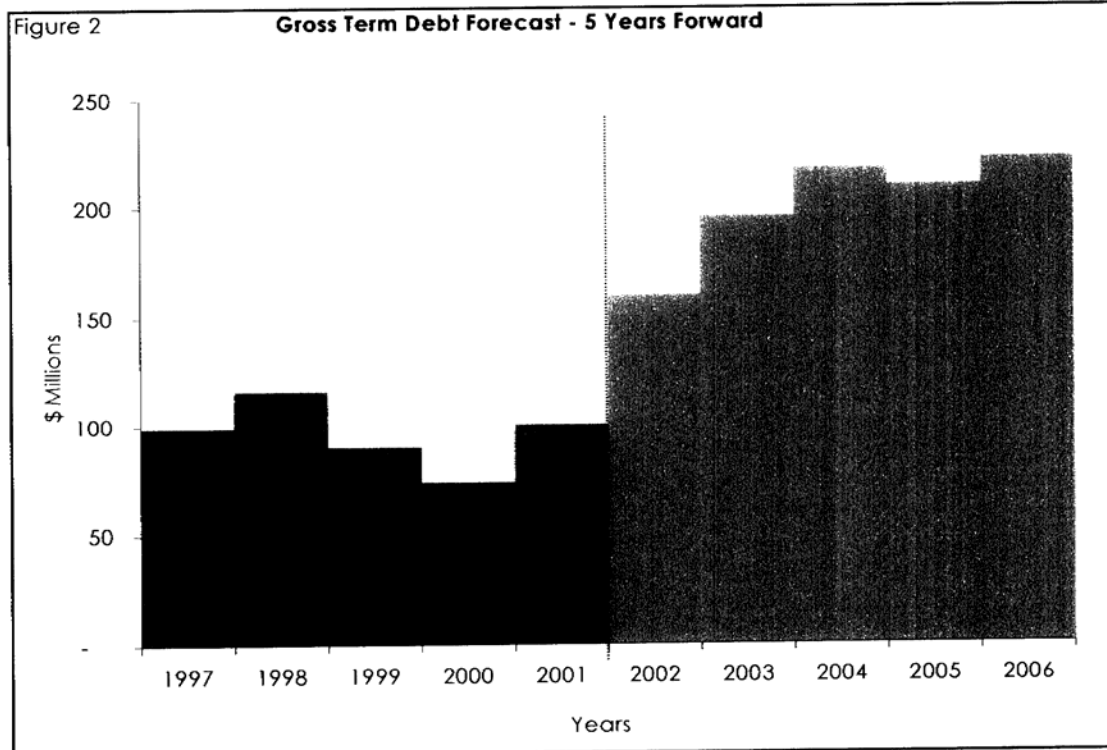
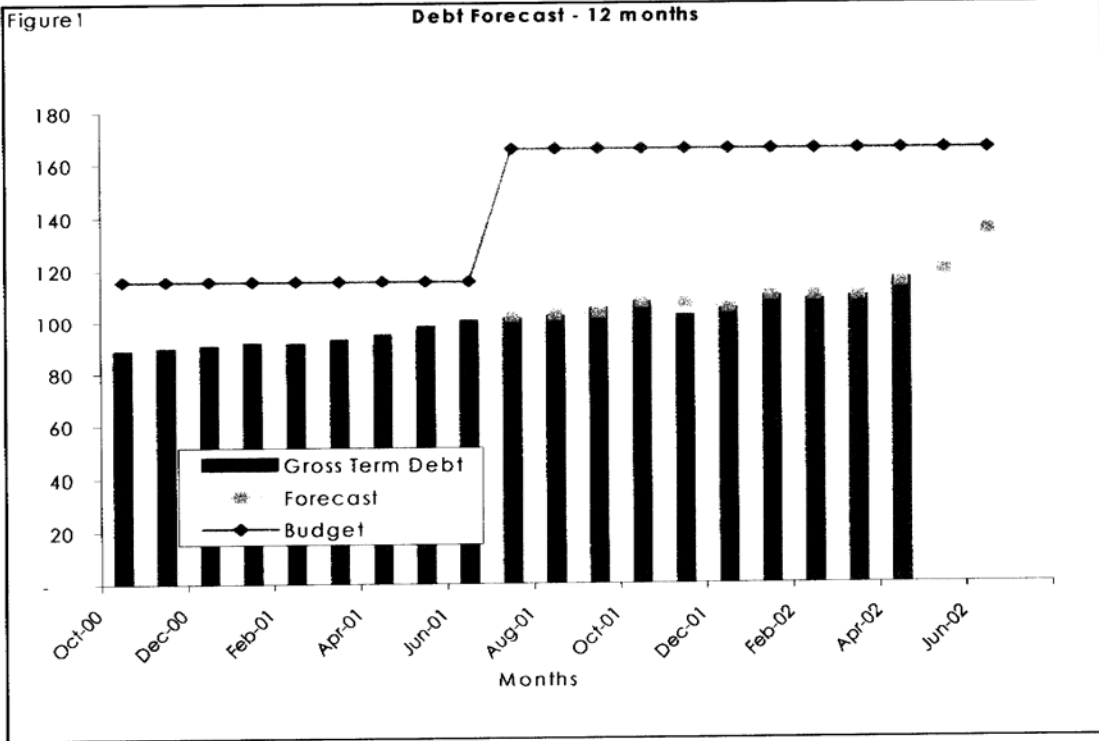
	<b>TERM DEBT PORTFOLIO</b> (\$000's)		
	April 02	March 02	
<i>Term debt position at 30 April 2002</i>	Term debt borrowed externally	116,662	109,521
	Special funds (used to reduce Council's external borrowing)	-	1,485
	<b>Gross term debt</b>	<b>116,662</b>	<b>111,005</b>
	Total Sinking Fund Commissioner assets	5,251	5,250
	<b>Net term debt</b>	<b>111,410</b>	<b>105,755</b>

<i>Term debt - source of funds at 30 April 2002</i>	Debenture stock - fixed rate (security: Debenture Trust Deed)	57,796	57,796
	Debenture stock - floating rate (security: Debenture Trust Deed)	50,025	45,025
	Secured bank loans (security: Debenture Trust Deed)	-	-
	Unsecured bank loans	\$8,800	\$6,650
	Finance Leases (security: associated asset)	41	50
	<b>External borrowing</b>	<b>116,662</b>	<b>109,521</b>
	Special funds (used to reduce Council's external borrowing)	-	1,485
	<b>Gross term debt requirement</b>	<b>116,662</b>	<b>111,005</b>

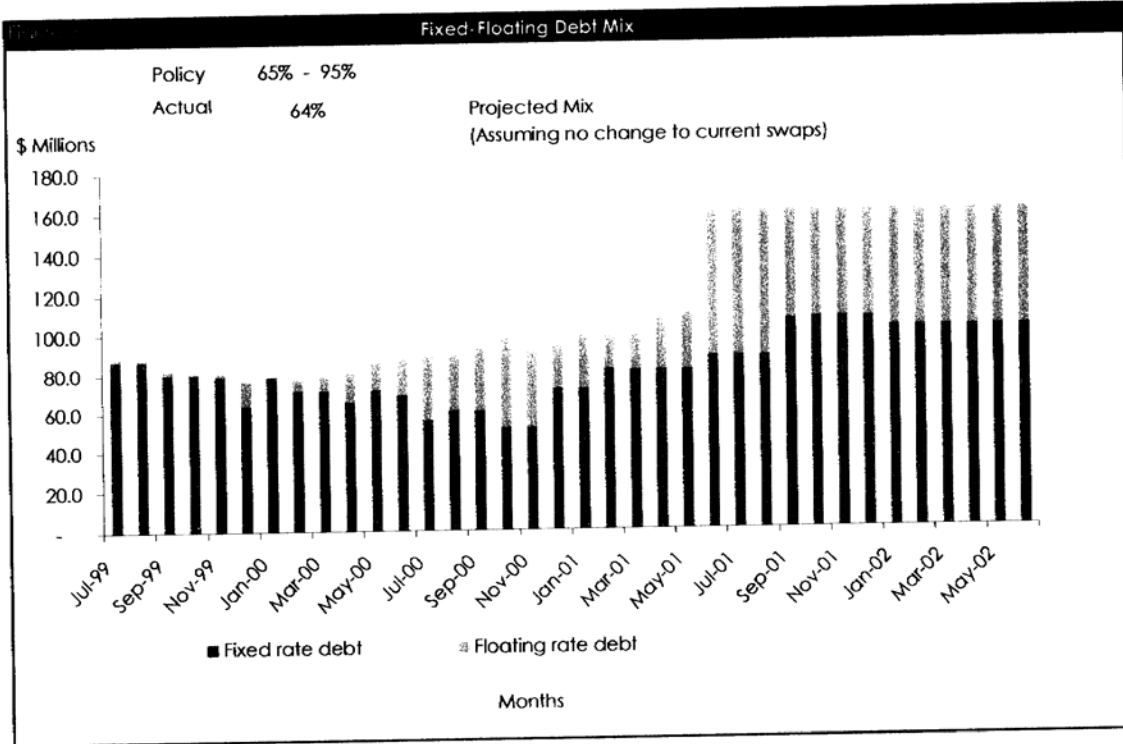
	<b>WORKING CAPITAL</b> (\$000's)		
<i>Working capital borrowing at 30 April 2002</i>	Unsecured bank loans	3,790	-
	Special funds (used to reduce Council's external borrowing)	11,159	9,725
	<b>Council working capital borrowing requirement</b>	<b>14,949</b>	<b>9,725</b>

	<b>CASH INVESTMENTS</b> (\$000's)		
<i>Cash investments held in trust 30 April 2002</i>	Debt repayment fund	-	-
	ARST fund (excluding fund allocations)	1,076	1,072
	<b>Total cash investments</b>	<b>1,076</b>	<b>1,072</b>
	Invested for 60 days - Current investment interest rate	5.63%	4.85%
	<b>Weighted Average Interest Rate</b>	<b>%</b>	<b>%</b>
	<b>Gross Weighted Average Interest Rate</b>	<b>7.30%</b>	<b>7.28%</b>

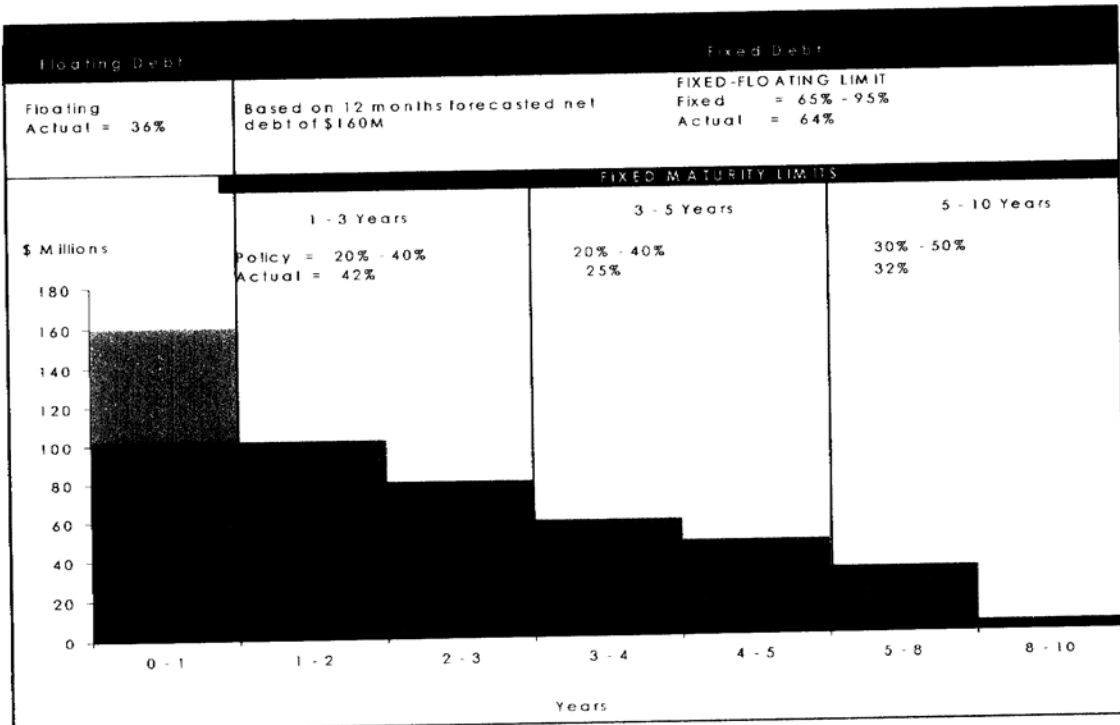
**Debt Forecast**

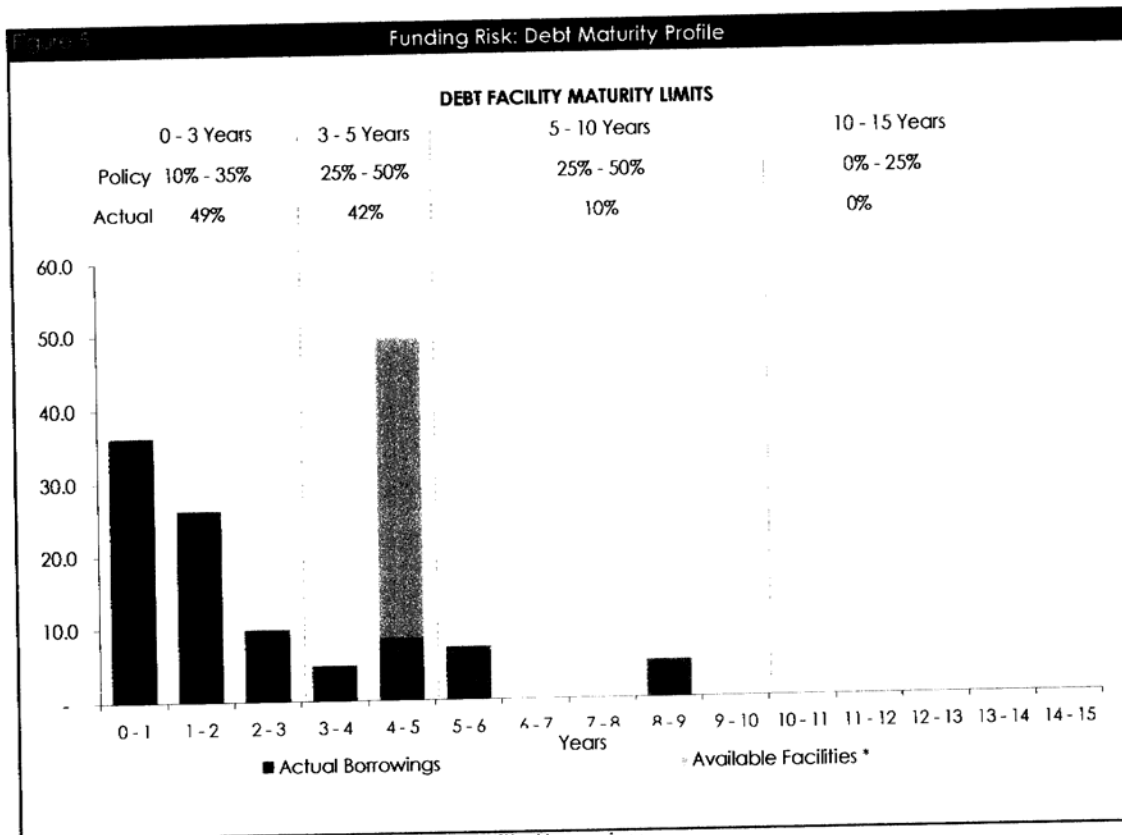


### Fixed-Floating Debt Mix



### Net Interest Rate Repricing Risk Profile





\* Note: (1) Available facilities net of 8.8m uncommitted borrowings  
 (1) Council is in the unique position of having a \$50 million committed funding facility at zero cost for the non utilised portion of the facility. The nature of this facility may, depending on the utilisation, result in a breach of the funding maturity limits. As this facility is very much in Council's favour this is an acceptable breach of policy.

**Summary of Debt Sources**

Council Approved Debt Sources	Total		
	Committed Funding Sources	Usage	Available
Bank Loans			
Short Term (uncommitted)	\$0.0	\$8.8	\$0.0
Long Term (committed)	\$50.0	\$0.0	\$41.2
Commercial Paper			
Bank Overdraft	\$1.0	\$0.0	\$1.0
Senior Bonds			
Retail	\$19.7	\$19.7	\$0.0
Wholesale	\$88.2	\$88.2	\$0.0
Other	\$0.0	\$0.0	\$0.0
<b>TOTAL</b>	<b>\$158.8</b>	<b>\$116.7</b>	<b>\$42.2</b>

## **Notes:**

**Working capital borrowing** is necessary due to fluctuations in the timing of operating revenue and expenditure. The working capital borrowing requirement also includes internal deficits relating to prior years. External working capital borrowing is reduced by the use of internal special funds with any surplus requirement funded by way of unsecured bank loans.

**Gross Term debt** is the borrowing relating to long term loan funded capital works projects. External borrowing to fund term debt is reduced by the use of internal special funds with the surplus requirement funded by way of secured or unsecured short term bank loans, fixed or floating medium or long term bonds and finance leases.

**The managed debt portfolio** refers to the portion of Council's total debt portfolio that is managed to reduce interest rate risk, liquidity/funding risk, counterparty risk and operational and legal risk as defined in the Borrowing and Investment Policy. The portfolio is managed on the external net term debt requirement excluding finance leases. i.e. it is net of the special funds that have been used to reduce the external term debt requirement and the sinking fund balance. Working capital is not included in the managed debt portfolio.

**Special Funds** are cash funds either collected through rates or vested to Council that have been 'set aside' for specific future spending. The funds are used in the interim to reduce Council's requirement to borrow externally. The fund is managed via accounting entries and a monthly interest allocation is made to the funds based on the Council's weighted average cost of borrowing for that period.

## **Description of Graphs:**

### **Figure 1**

*Gross term debt* (blue) is the actual gross term debt position of Council as defined in the notes above. The *Forecast* (orange) is the projected gross term debt level per month in the current financial year, the figures are obtained from capital works timing forecasts (provided by budget managers on a monthly basis) and the current debt maturity profile. The *Budget* (green) line represents the gross public debt as approved in the 2001/2002 Annual Plan.

### **Figure 2**

The prior year gross term debt figures (blue section) are obtained directly from the 'Term Liabilities' disclosure in published Annual Reports. The orange section is the projected gross term debt as forecast in the Annual and Strategic Plan 2000/2001 - 2009/2010.

### **Figure 3**

The fixed (blue) and floating (orange) interest rate mix, both historic and projected, based on the 12 month rolling forecast net debt requirement. The Borrowing and Investment Policy minimum is 65% fixed and maximum 95% fixed. The positioning of the portfolio between policy minimum and policy maximum is dependent on the current and forecast financial market outlook.

### **Figure 4**

Interest rate risk profile. Figure 4 shows, given the current fixed/floating rate mix and the debt forecast (assuming no changes to current swaps), the percentage of current fixed rate debt that will mature in future years. This enables Council to recognise and reduce significant concentrations of interest rate risk that may arise in future years. As debt forecasts change the amount of fixed cover in place may have to be adjusted to comply with the policy limits.

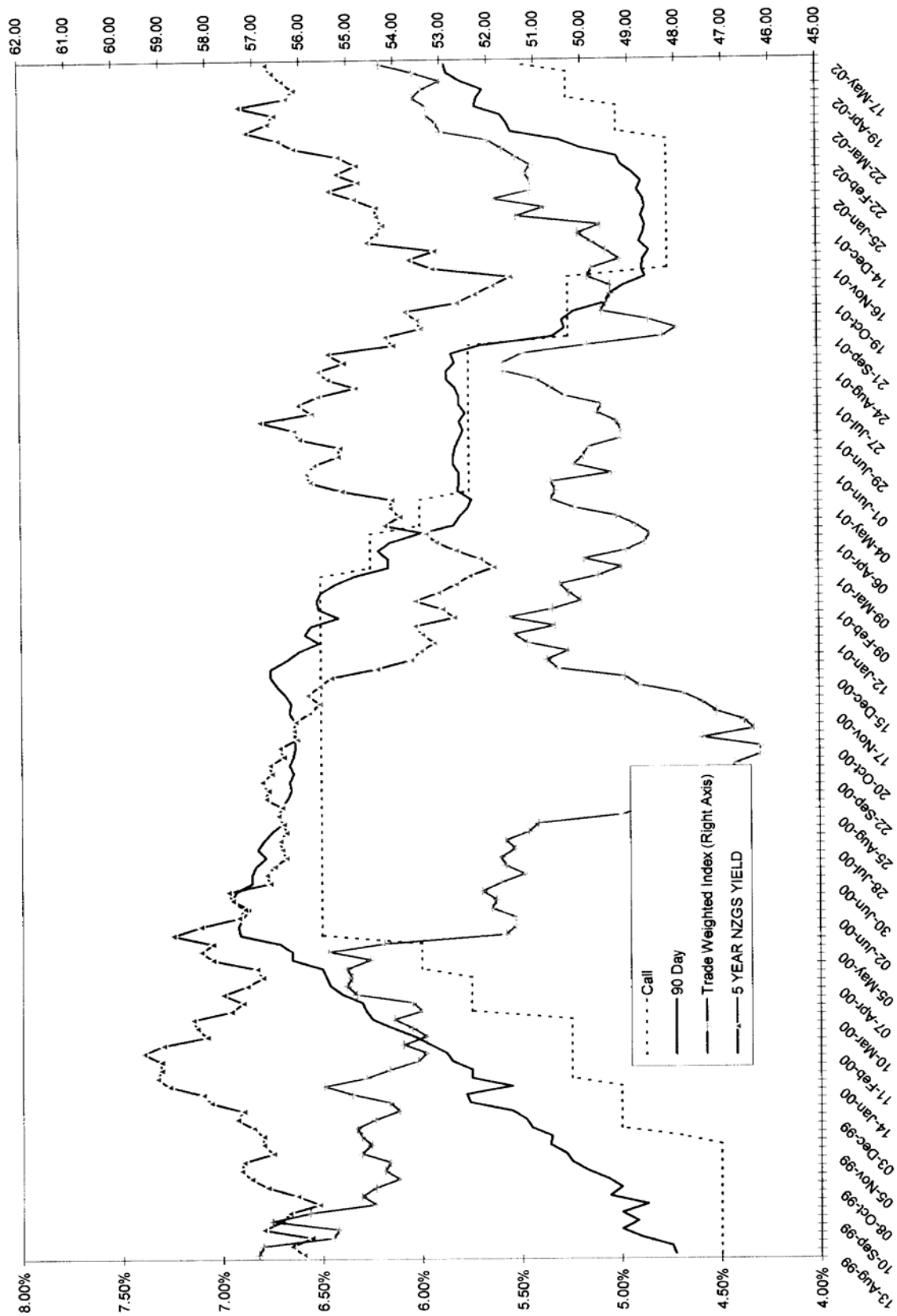
### **Figure 5**

Funding and liquidity risk. Figure 5 varies from figure 4 in that it shows the actual maturity profile of current debt on issue as opposed to the profile of Council's exposure to interest rate risk arising when debt either reprices (in the case of floating rate debt or hedges) or matures. The debt maturity profile enables Council to identify significant concentrations of maturing debt and debt facilities. Where there are significant concentrations of debt maturing Council is at risk of not being able to re-borrow from the market at favourable rates.

### **Figure 6**

In order to ensure Council has the ability to borrow from the market when funding is required committed funding facilities are arranged with approved debt sources. Figure 6 shows Council's committed funding sources and the current usage of these funds. In addition to the committed sources Council also uses uncommitted lines of funding as seen in short term bank loans and bonds, uncommitted funding is at times less expensive than committed funding however its availability is not guaranteed.

### Wholesale Market Interest Rates and the Trade Weighted Index



Source: ASB Bank Economic Reports