

Finance and Operational Performance Committee

**Monday, 7 July 2003
Commencing at 9.30 am**

Part III: Finance

**Item 9: 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 MONDAY, 7 JULY 2003 COMMENCING AT 9.30 AM.

PART III - FINANCE

9 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 section 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.

STRATEGIC CONTEXT

Council's Fund Management function actively manages a large portfolio of various debt and investment instruments. The benefit of borrowing is that it enables Council to carry out the projects identified in the Annual Plan while spreading the costs for those projects over time to recognise the future benefits. Borrowing funds therefore assists Council with its entire loans funded strategic initiatives. The Borrowing and Investment Policy requires that on a regular basis a report detailing the management of the portfolio be presented to the Finance and Operational Performance Committee. The report must include information on the following subjects:

- Cash/Debt position
- Forecasted borrowing profile
- Interest rate profile
- Risk management
- Material transactions
- Market commentary

This report addresses the requirement of the Borrowing and Investment Policy and also from time to time includes other information that is relevant to the Funds Management function.

FINANCIAL IMPLICATIONS

The active management of the treasury portfolio seeks to minimise Council's borrowing costs and maximise investment returns of liquid assets. The Funds Management function is also charged in seeking investors, thus ensuring that there is sufficient liquidity available for the organisation to continue its work programme. New Zealand financial markets are significantly volatile and therefore interest rate management is also a key responsibility of the Funds Management function. Detailed financial information included within this report is intended to give assurance of the prudent management of Council's portfolio.

Council approved a new loans funded capital works programme for the 2002/2003 year, including carry forward projects from the 2001/2002 year of \$87.734 million. Interest expense was budgeted to be \$8.647 million.

Council resolved to borrow up to \$123.2 million to cover the loans funded work programme and for the refinancing of maturing loans:

“6. That pursuant to section 122ZD of the Local Government Act 1974, the Council authorises the Chief Executive to borrow up to \$123.2 million in this or future financial years, by way of bank loan or loans or credit facilities or facilities or the issue of stock for the Borrowing secured by the Debenture Trust Deed”

2651/2002

Council has also resolved to obtain a Standard and Poors Credit Rating:

“1. That approval is given to obtain a credit rating for Waitakere City Council.”

2970/2001

The Finance and Operational Performance Committee has since carried the following resolutions:

- Execute a facility agreement with the ASB Bank for a term loan of \$15 million and offer \$3 million of security for interest rate risk management instruments completed March 2003:

“3. That authority is given to execute under seal the standard International Swap Dealers Association agreement with ASB Bank Limited, and the proposed facility agreement for the \$15m term loan subject to the Corporate Solicitor’s approval as to the form of the facility agreement.”

2592/2002

- Renegotiate, as required, uncommitted bank facilities which are used to cover working capital requirements on a daily basis, currently totalling \$35 million:

“2. That the Director: Finance is delegated authority to act as Council’s authorised representative for the purposes of negotiating cash facilities agreements on the basis outlined in the agenda report.”

2591/2002

- Execute a facility agreement with the Bank of New Zealand for a 364 day committed cash advance facility of \$20 million, now completed but not drawn:

“3. That authority is given to execute under seal the proposed facility agreement for \$20 million with the BNZ, subject to the satisfactory review by Council’s external Solicitors.”

2840/2002

- Renegotiation of the ANZ committed cash advance facility to a value of \$50 million, and a further \$7.5 million in security for interest rate risk management instruments:

“3. That the terms and conditions applicable to the ANZ Banking Group (New Zealand) Limited facilities agreement be accepted to a limit of \$50 million term debt draw down and a limit of \$7.5 million risk management instruments for interest rate hedging and the common seal of Waitakere City Council be authorised to be affixed to that document.”

938/2002

- Use the \$56,353,589.60 received from the sale of the UnitedNetworks Limited shares to repay debt:

“That the \$56,353,589.60 received from the sale of the UnitedNetworks Limited shares be applied in accordance with the Borrowing and Investment Policy to repay debt.”

3612/2002

SUMMARY OF BORROWING AND INVESTMENT MOVEMENTS, MAY 2003

Council's gross term debt position has decreased by \$1.67 million since April 2003 with a closing balance at May month end of \$110.678 million. Working capital borrowings of \$16.112 million as at 31 May 2003 has been funded using internal borrowings.

SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING MAY 2003

- UnitedNetworks fund investment of \$7,068,365.26 for 33 days at 5.60%.
- UnitedNetworks fund investment of \$7,068,425.00 for 33 days at 5.59%.
- Sinking Fund Investment of \$1,732,293.62 for 31 days at 5.58%.
- UnitedNetworks fund investment of \$2,650,000 for 31 days at 5.61%.
- UnitedNetworks fund investment of \$1,500,000 for 30 days at 5.62%.
- Sinking fund investment of \$1,559,247.07 for 30 days at 5.62%.
- UnitedNetworks fund investment of \$3,058,603.90 for 30 days at 5.61%.
- Sinking fund investment of \$1,918,704.69 for 30 days at 5.61%.
- Auckland Regional Services Trust fund investment of \$1,143,357.77 for 30 days at 5.56%.
- Renegotiate existing interest rate swap. Close out at 7.495% and restart 1 March 2003 for 5 years at 7.22%.
- Renegotiate existing interest rate swap. Close out at 6.50% and restart 27 September 2004 for 7 years at 6.82%.
- Renegotiate existing interest rate swap. Close out at 6.605% and restart 13 September 2004 for 9 years at 6.93%.
- UnitedNetworks fund investment of \$2,200,000 for 30 days at 5.55%.
- UnitedNetworks fund investment of \$3,650,000 for 29 days at 5.55%.

ESTIMATED USE OF UNITEDNETWORKS LIMITED SHARE SALE PROCEEDS AS AT 30 JUNE 2003

Since the receipt of the share sale proceeds, a significant number of short term investments have been entered into, as well as offsetting of overnight uncommitted borrowings and the full repayment of the committed cash facility. The return on the investment is therefore a combination of actual interest income and interest savings.

As at 30 June 2003 the investment has resulted in the following:

Estimated Interest Income received	\$1,249,403.31
Estimated Interest Accrued on existing investments	\$ 71,672.36
Estimated Interest Saved	\$ 913,137.56
Estimated benefit for 244 Days to 30 June 2003	\$2,234,213.23
Estimated rate of return	5.93%

Interest income from the investment has been reinvested, effectively compounding the investment. The amount of funds invested in interest bearing deposits as at 30 June 2003 is \$25,664,104.39, while the amount offsetting the need to borrow is \$31,938,888.53. Short term investments have been spread amongst banks approved within the Borrowing and Investment Policy. The amount invested with each bank does not exceed the limits adopted within the same policy. Investment durations have been spread amongst different short term maturities in order to maintain a fair level of liquidity. Shorter term deposits do give the advantage of increasing the number of compounding opportunities, however, the risk is that a sudden decrease in short term interest rates will be reflected immediately on maturing deposits. This risk is not hedged.

FINANCIAL MARKET COMMENTARY

Interest Rate Overview

Interest rates continued their downward trend over the past month with new lows being reached in 10 year swap rates of 5.38%. After the Reserve Bank of New Zealand decreased its Official Cash Rate by 0.25% on 5 June 2003, the market has steadily priced in further cuts, most notably as at the date of writing this report, 1 year swap rates at 4.91% and 90 day futures at 4.86%. Expectations of the Official Cash Rate decreasing to 4.75% by year end are now widely held.

New Zealand's Trade Weighted Index continued its upward trend after a small softening shortly after the Official Cash Rate was decreased. This upward trend is largely a result of a continued strengthening cross rate against the US Dollar and Japanese Yen. Other cross rates, such as the Australian Dollar have remained relatively stable compared to the New Zealand Dollar.

Interest Rate Expectations

Data from the US suggest that core CPI inflation (excluding food and energy) has moved from a flat position to a positive 0.3% over May, the single largest increase since a matched increase in August 2002. The importance of this is that fears of deflation are somewhat reduced by this news, as is the widely held belief of the US Federal Reserve aggressively cutting their cash rate to further stimulate the economy. This small but positive news added 0.20% to the New Zealand 10 year swap rate demonstrating just how volatile the New Zealand financial market currently is.

Due to the time of writing this report and the date it will be heard, a verbal update will be presented at the Finance and Operational Performance Committee meeting.

Upcoming Dates

Official Cash Rate Announcement	24 July 2003
Monetary Policy Target	4 September 2003

CONCLUSION

All transactions covered by this report have complied with the requirements of Council's Borrowing and Investment Policy.

RECOMMENDATION

That the information be received.

Report prepared by: Bruce Wilkin, Funds Accountant.



**WAITAKERE CITY COUNCIL DEBT PORTFOLIO AT
31 May 2003**

		TERM DEBT (to fund long term assets)	(\$000's)
<i>Budget year end term debt position per 2002/2003 Annual Plan</i>	Budget term debt		199,824
	Further term debt approved by Council during 2002/2003		7,655
	Budget 2002/2003 year end gross term debt		207,479
	Less funds introduced from UnitedNetwork Share Sale		56,354
	Less duplicated project in Annual Plan		3,279
	Forecast year end Sinking Fund Commissioner assets		5,448
	Anticipated 2002/2003 Year End Net Term Debt		142,398

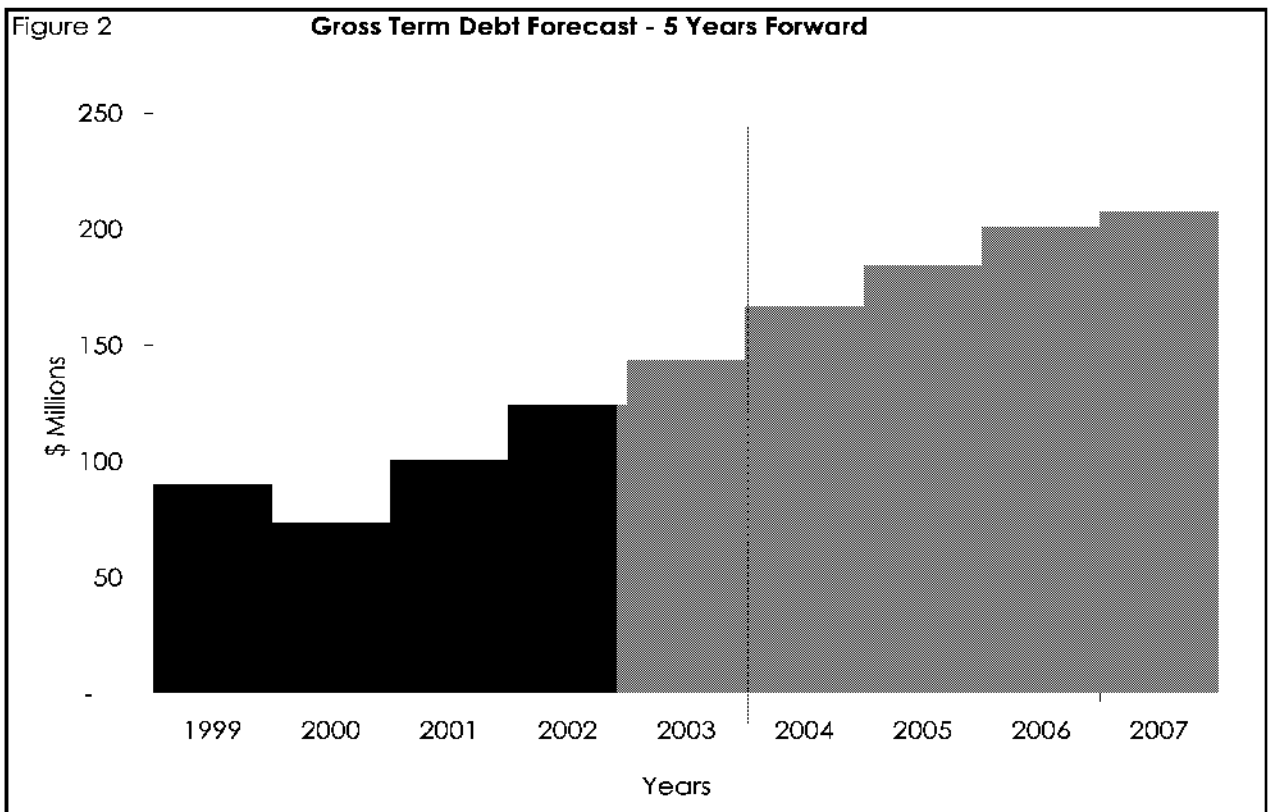
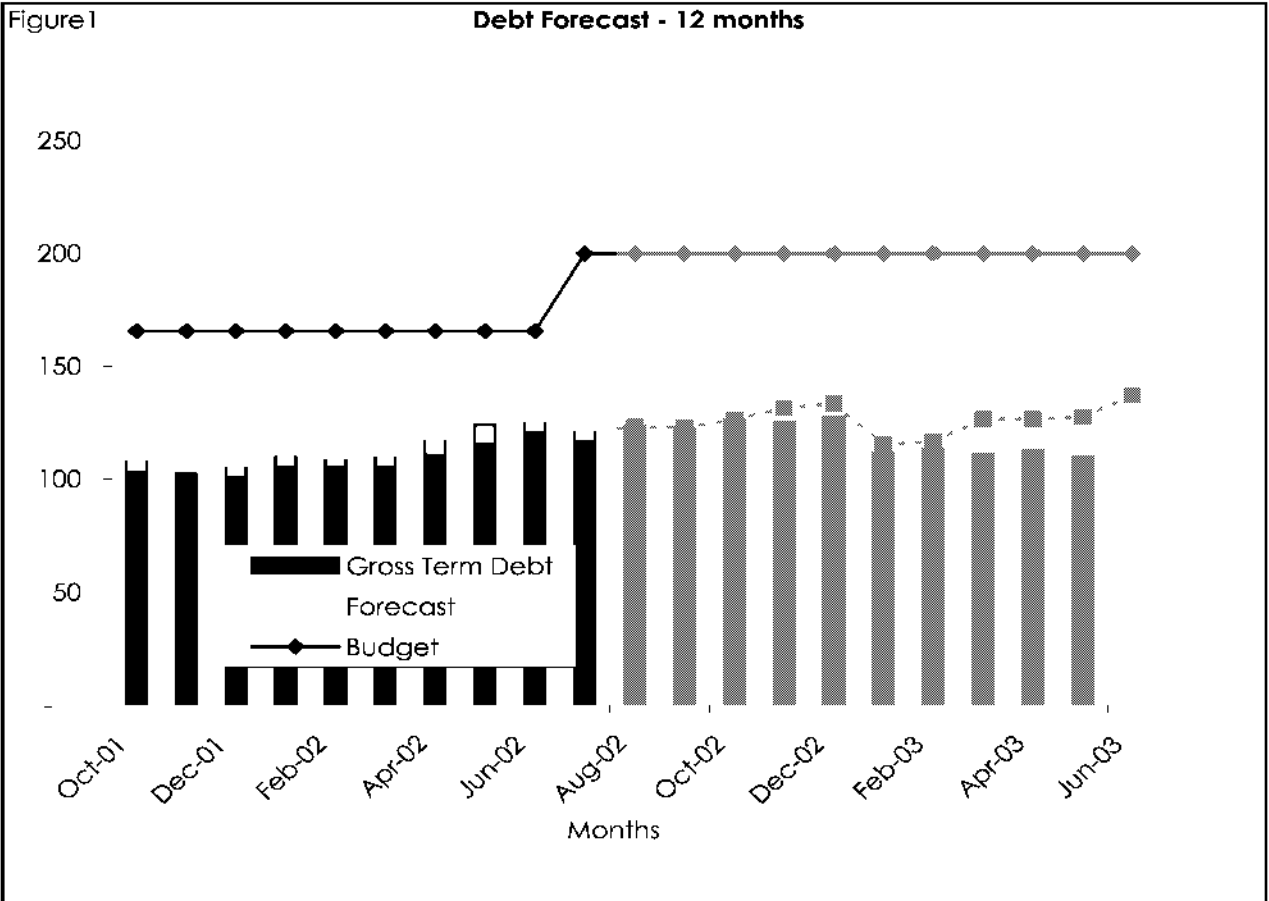
		May 03	April 03
		TERM DEBT PORTFOLIO	
		(\$000's)	(\$000's)
<i>Term debt position at 31 May 2003</i>	Term debt borrowed externally	96,821	103,821
	Special funds (used to reduce Council's external borrowing)	13,857	8,527
	Gross term debt	110,678	112,348
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	Total Sinking Fund Commissioner assets	5,226	5,201
	Net term debt	105,452	107,147

<i>Term debt - source of funds at 31 May 2003</i>	Debenture stock - fixed rate (security: Debenture Trust Deed)	46,796	53,796
	Debenture stock - floating rate (security: Debenture Trust Deed)	35,025	35,025
	Secured bank loans (security: Debenture Trust Deed)	15,000	15,000
	Unsecured bank loans	0	0
	Finance Leases (security: associated asset)	0	0
	External borrowing	96,821	103,821
	<hr/>		
	Special funds (used to reduce Council's external borrowing)	13,857	8,527
	Gross term debt requirement	110,678	112,348

		WORKING CAPITAL	(\$000's)	(\$000's)
<i>Working capital borrowing at 31 May 2003</i>	Unsecured bank loans / (investments)		0	0
	Special funds (used to reduce Council's external borrowing)		11,116	7,905
	UNL Share Fund		4,996	9,203
	Council working capital borrowing requirement		16,112	17,107

		CASH INVESTMENTS	(\$000's)	(\$000's)
<i>Cash investments held 31 May 2003</i>	UNL Share Fund		27,195	24,237
	Debt repayment fund		-	-
	ARST fund (excluding fund allocations)		1,146	1,141
	Total cash investments		28,342	25,378
	ARST Invested for 30 days - Current investment interest rate		5.56%	5.82%
Weighted Average Interest Rate		%	%	
	Gross Weighted Average Interest Rate		7.74%	7.58%

Debt Forecast



Fixed-Floating Debt Mix

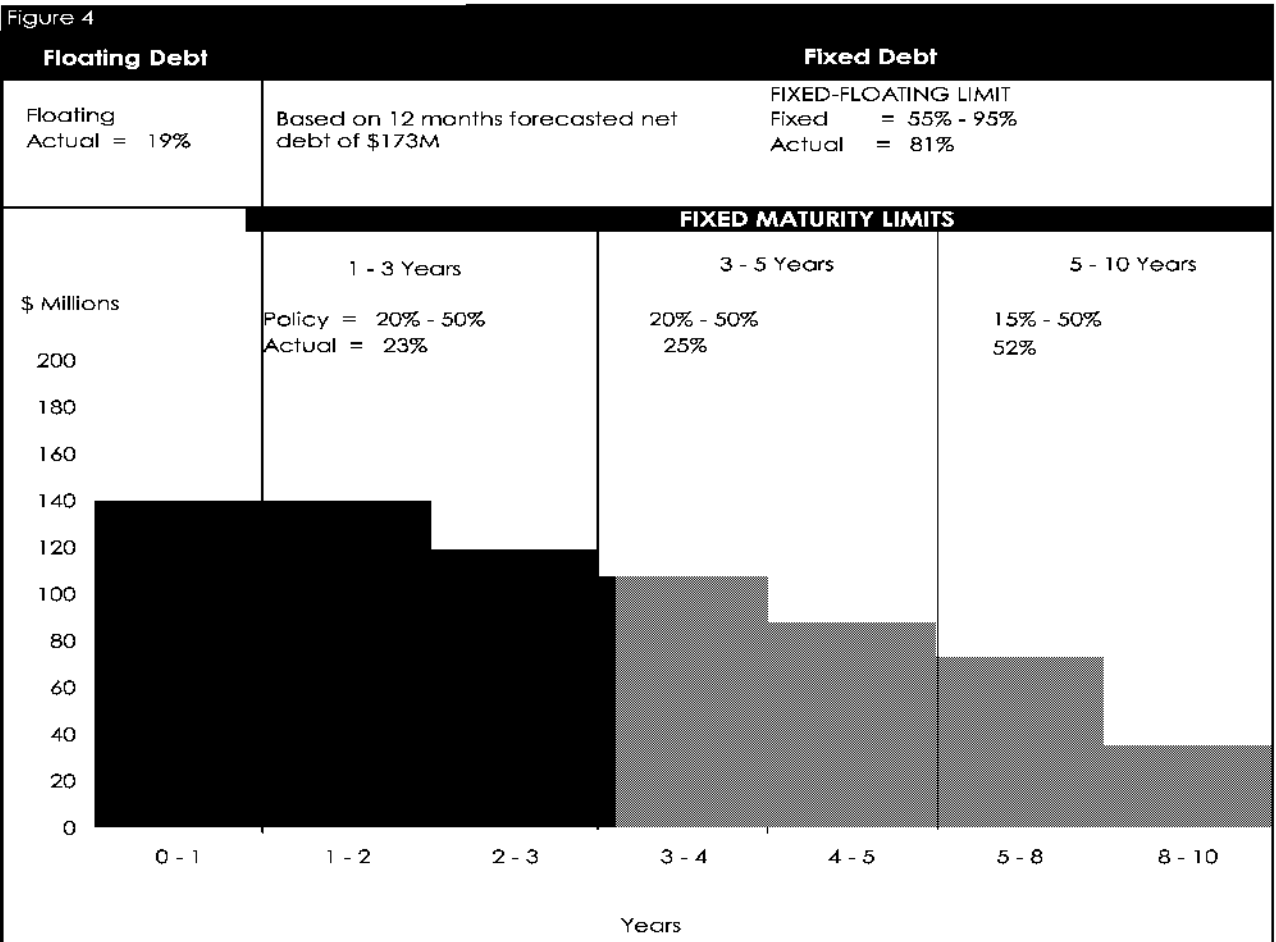
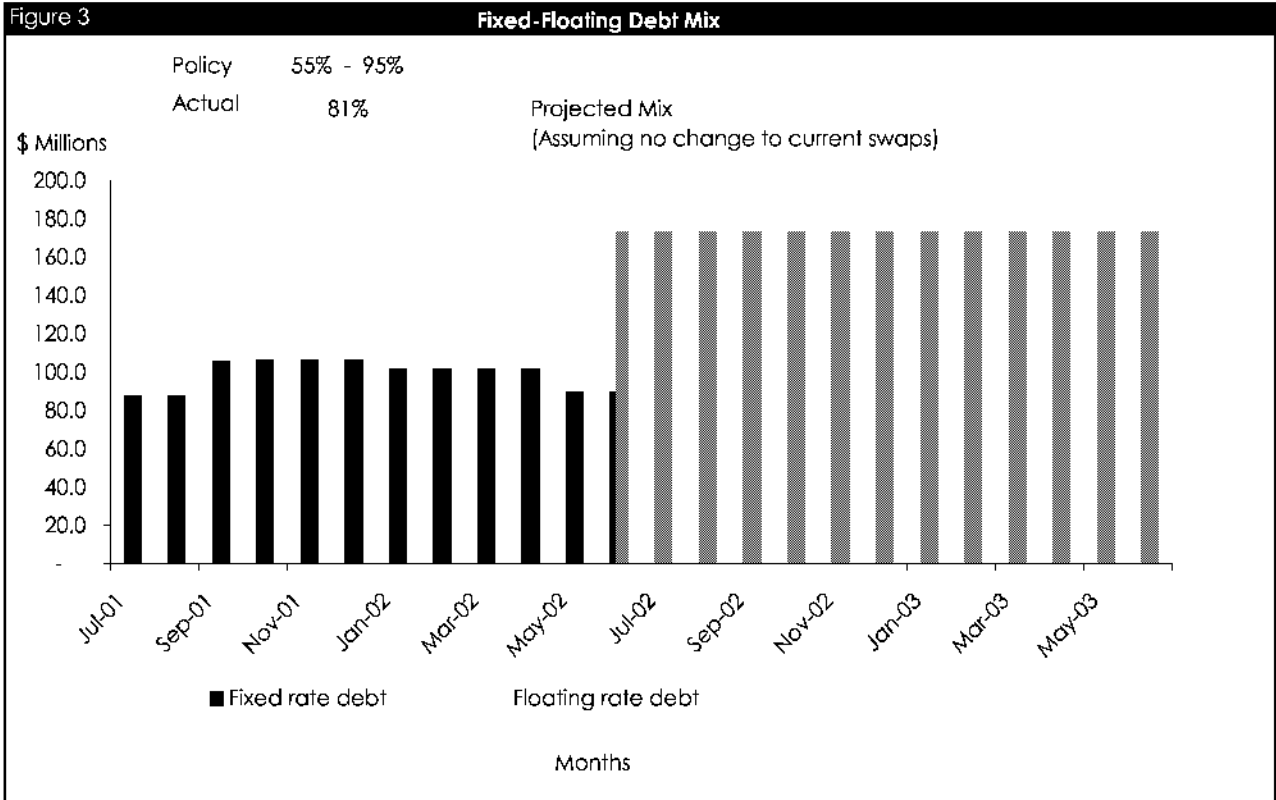
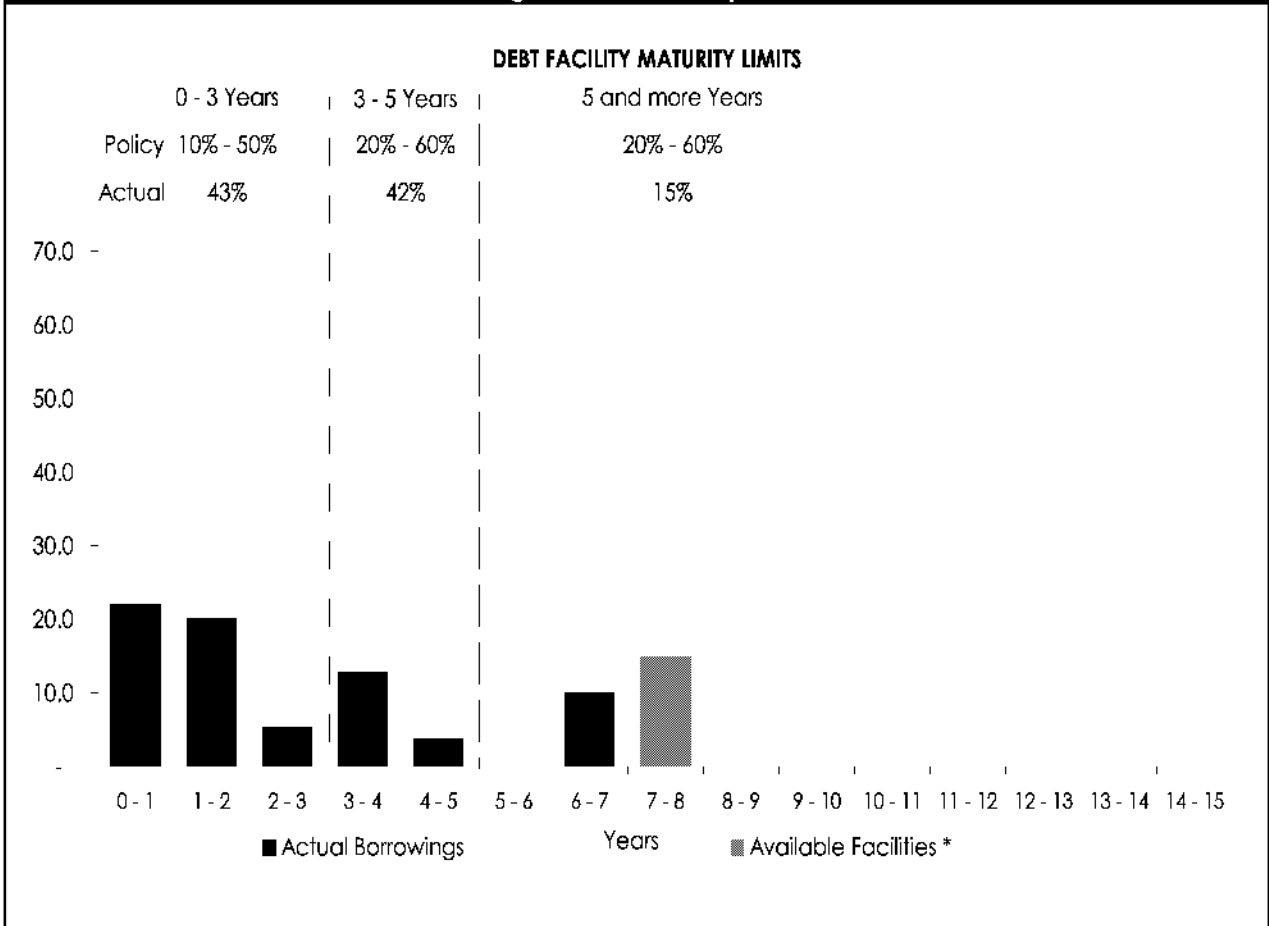


Figure 5

Funding Risk: Debt Maturity Profile



(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	\$ Millions		
	Total		
	Committed Funding Sources	Usage	Available
Bank Loans			
Short Term (uncommitted)	\$0.0	\$0.0	\$0.0
Long Term (committed)	\$85.0	\$15.0	\$70.0
Commercial Paper			
Bank Overdraft	\$1.0	\$0.0	\$1.0
Senior Bonds			
Retail	\$15.7	\$15.7	\$0.0
Wholesale	\$66.2	\$66.2	\$0.0
Other	\$0.0	\$0.0	\$0.0
TOTAL	\$167.8	\$96.8	\$71.0

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 2002/2003 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 55% 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

