

Finance and Operational Performance Committee

**Thursday, 10 October 2002
Commencing at 9.30 am**

**Item 11: 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, 10 OCTOBER 2002 COMMENCING AT 9.30 AM.

PART II - FINANCE

11 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, AUGUST 2002

The Council's gross term debt position has increased by \$2.7 million since July with a closing balance at August month end of \$123 million. Working capital borrowings of \$2 million as at 31 August 2002 have been funded using internal borrowings.

SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING AUGUST 2002

- New interest rate swap. Notional principle value \$5 million, starting 2 August 2002, terminating 2 August 2007, Waitakere City Council pays fixed interest rate of 6.655% and receives floating interest rate of New Zealand Dollar – Bank Bill Rate – FRA (NZD-BBR-FRA).
- New interest rate swap. Notional principle value \$5 million, starting 2 August 2002, terminating 2 August 2008, Waitakere City Council pays fixed interest rate of 6.745% and receives floating interest rate of NZD-BBR-FRA.
- Sinking Fund investment rollover, invested 1,970,811.62 at an interest rate of 5.88% for 30 days.
- Sinking fund investment rollover, invested 1,658,785.64 at an interest rate of 5.87% for 30 days.
- New interest rate swap. Notional principle value \$10 million, starting 15 August 2002, terminating 15 August 2012, Waitakere City Council pays fixed interest rate of 6.79% and receives floating interest rate of NZD-BBR-FRA.
- New interest rate swap. Notional principle value \$5 million, starting 15 August 2002, terminating 15 August 2011, Waitakere City Council pays fixed interest rate of 6.68% and receives floating interest rate of NZD-BBR-FRA.

AMENDMENTS TO THE BORROWING AND INVESTMENT POLICY

The following amendments are required to be made to the Borrowing and Investment Policy to be consistent with recent circumstances surrounding the Council's investment in Auckland Regional Transport Network Limited and to reflect the liquidation of New Zealand Counties Investment Company Limited.

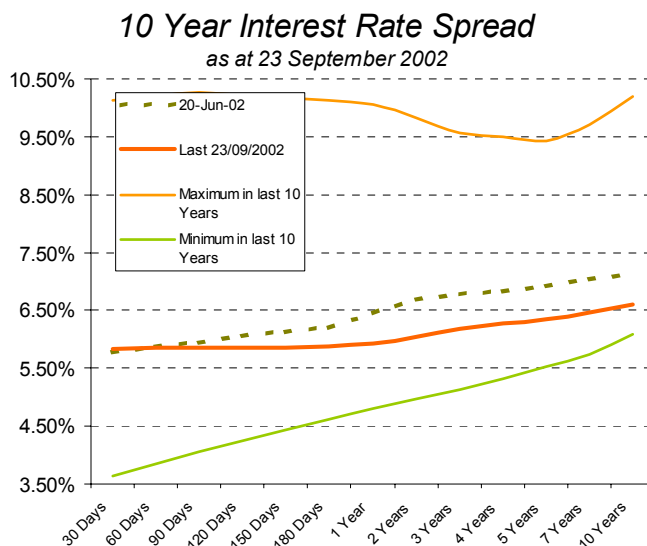
The amendment is required to Section 5.1.3 Shares.

- New Zealand Counties Investments Company Limited be deleted.
- Auckland Regional Transport Network Limited be added.

FINANCIAL MARKET COMMENTARY

Interest Rate Overview

As forecasted the local interest rate spread curve has flattened as New Zealand interest rates have decreased over in most maturity profiles. This is demonstrated by the graph below, which compares interest rates between mid June 2002 and mid September 2002.



Decreases in interest rates has benefited borrowers, now maximising portfolio interest rate cover at exceptionally good levels in the 5 plus years maturity profile. This position has continued throughout August and September with as little as a 0.75% spread between the Official Cash Rate and the 10 year swap rate.

Concerns in the US rather than local economic data have been the cause of local interest rate volatility. While economic news offshore appears more upbeat than a year ago, and the likelihood of a double dipped recession unlikely, investors, particularly in the US, are still concerned with low corporate profit forecasts, and the possibility of war.

After five months of deteriorating business confidence, the latest National Bank survey shows a 10% net decrease in respondents expecting conditions to worsen. The survey remains negative, with farmers remaining the gloomiest.

The Reserve Bank of New Zealand Policy Target Agreement has been set with a medium term inflation target, now set between 1% and 3% or a medium of 2% rather than 1.5% under the old agreement. Though considering inflation history, a 2% medium still appears low, with year on year June 2002 CPI recorded at 2.8%.

Interest Rate Expectations

With the introduction of the new Policy Target Agreement for the Reserve Bank of New Zealand, expectations in a hike in the Official Cash Rate have largely diminished. The probable situation now appears that the current cash rate of 5.75% will last at least until year end, with a possible loosening in 2003 of 0.25% to 0.50%.

Rising fuel prices, however, may lead to a flow on effect on consumer prices fuelling inflationary pressure.

While local growth so far this year has been good, the decline in export prices for key New Zealand commodities, and the appreciated New Zealand dollar are likely to ease future growth momentum.

The volatility experienced in the long-term interest rates is expected to continue for a few further months yet. However, a string of good global news will increase long term interest rates as dramatically as the current decreases. This may result in substantial profit taking, as portfolios are unwound from their long-term maximum cover levels.

Up coming dates

Official Cash Rate review 2 October 2002
Monetary Policy Statement 20 November 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 2002/2003 Annual Plan.

RECOMMENDATIONS

1. That the information be received.
2. That New Zealand Counties Investment Company Limited be deleted from the Borrowing and Investment Policy.
3. That Auckland Regional Transport Network Limited be added to the Borrowing and Investment Policy.

Report prepared by: Bruce Wilkin, Funds Accountant.



**WAITAKERE CITY COUNCIL DEBT PORTFOLIO AT
31 August 2002**

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 2001/2002	-
	Budget 2002/2003 year end gross term debt	199,824
	Forecast year end Sinking Fund Commissioner assets	5,448
	Anticipated 2002/2003 Year End Net Term Debt	194,376

1.

TERM DEBT PORTFOLIO (\$000's) (\$000's)

<i>Term debt position at 31 August 2002</i>	Term debt borrowed externally	113,503	120,523
	Special funds (used to reduce Council's external borrowing)	9,672	-
	Gross term debt	123,175	120,523
	Total Sinking Fund Commissioner assets	5,586	5,558
	Net term debt	117,589	114,965

<i>Term debt - source of funds at 31 August 2002</i>	Debenture stock - fixed rate (security: Debenture Trust Deed)	67,796	67,796
	Debenture stock - floating rate (security: Debenture Trust Deed)	35,025	35,025
	Secured bank loans (security: Debenture Trust Deed)	7,500	7,500
	Unsecured bank loans	2,800	9,814
	Finance Leases (security: associated asset)	382	388
	External borrowing	113,503	120,523

	Special funds (used to reduce Council's external borrowing)	9,672	-
	Gross term debt requirement	123,175	120,523

WORKING CAPITAL (\$000's) (\$000's)

<i>Working capital borrowing at 31 August 2002</i>	Unsecured bank loans / (investments)	0	4,936
	Special funds (used to reduce Council's external borrowing)	2,059	11,683
	Council working capital borrowing requirement	2,059	16,619

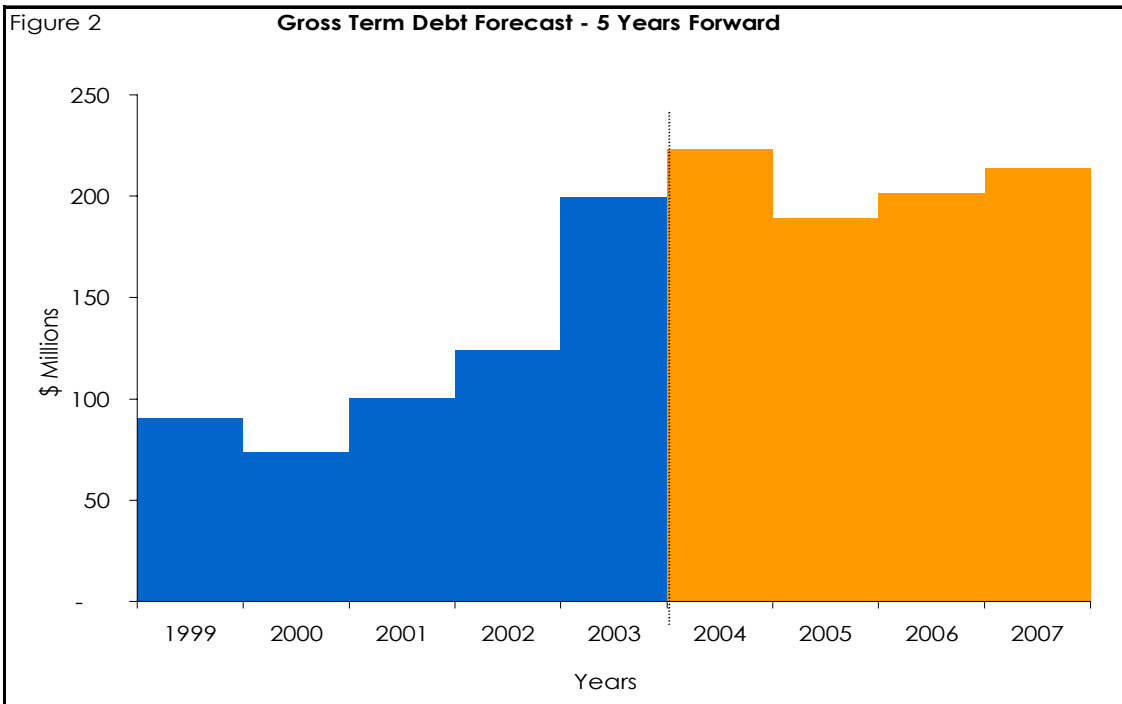
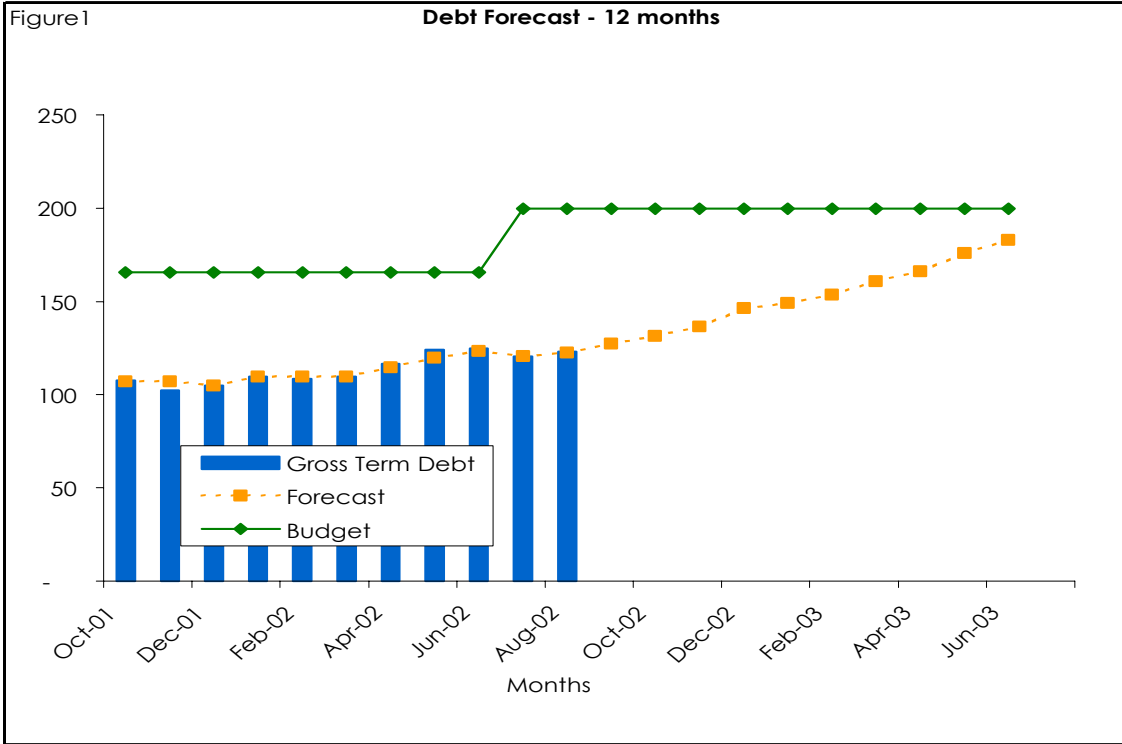
CASH INVESTMENTS (\$000's) (\$000's)

<i>Cash investments held in trust 31 August 2002</i>	Debt repayment fund	-	-
	ARST fund (excluding fund allocations)	1,098	1,092
	Total cash investments	1,098	1,092
	Invested for 90 days - Current investment interest rate	5.93%	5.93%

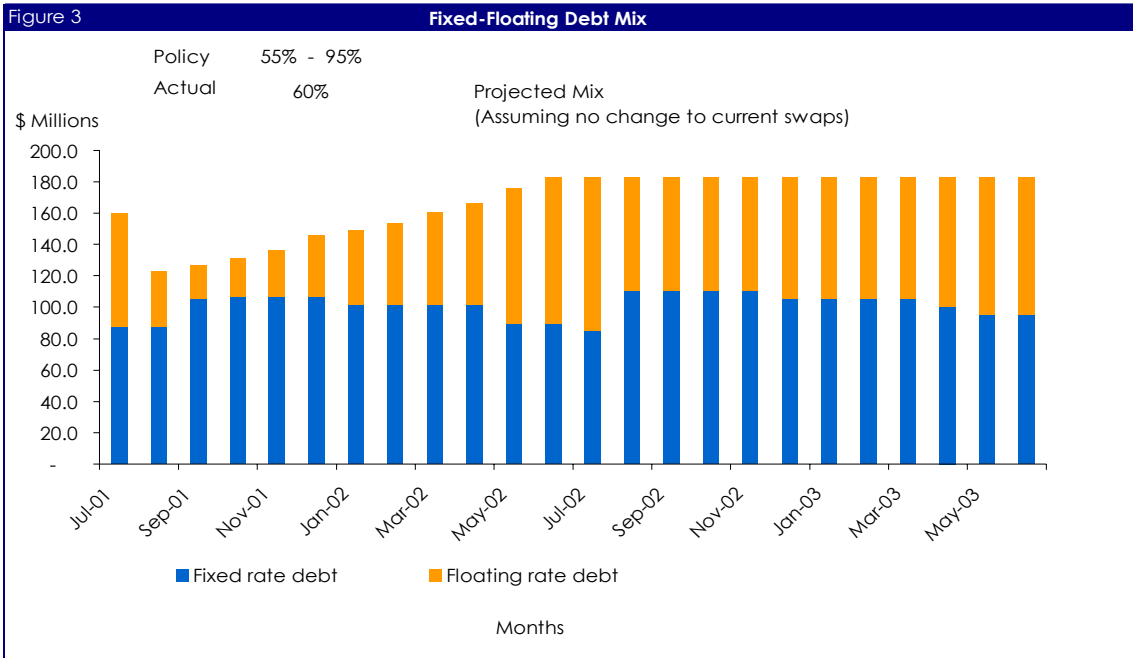
Weighted Average Interest Rate % %

Gross Weighted Average Interest Rate	7.50%	7.30%
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Debt Forecast



Fixed-Floating Debt Mix



Net Interest Rate Repricing Risk Profile

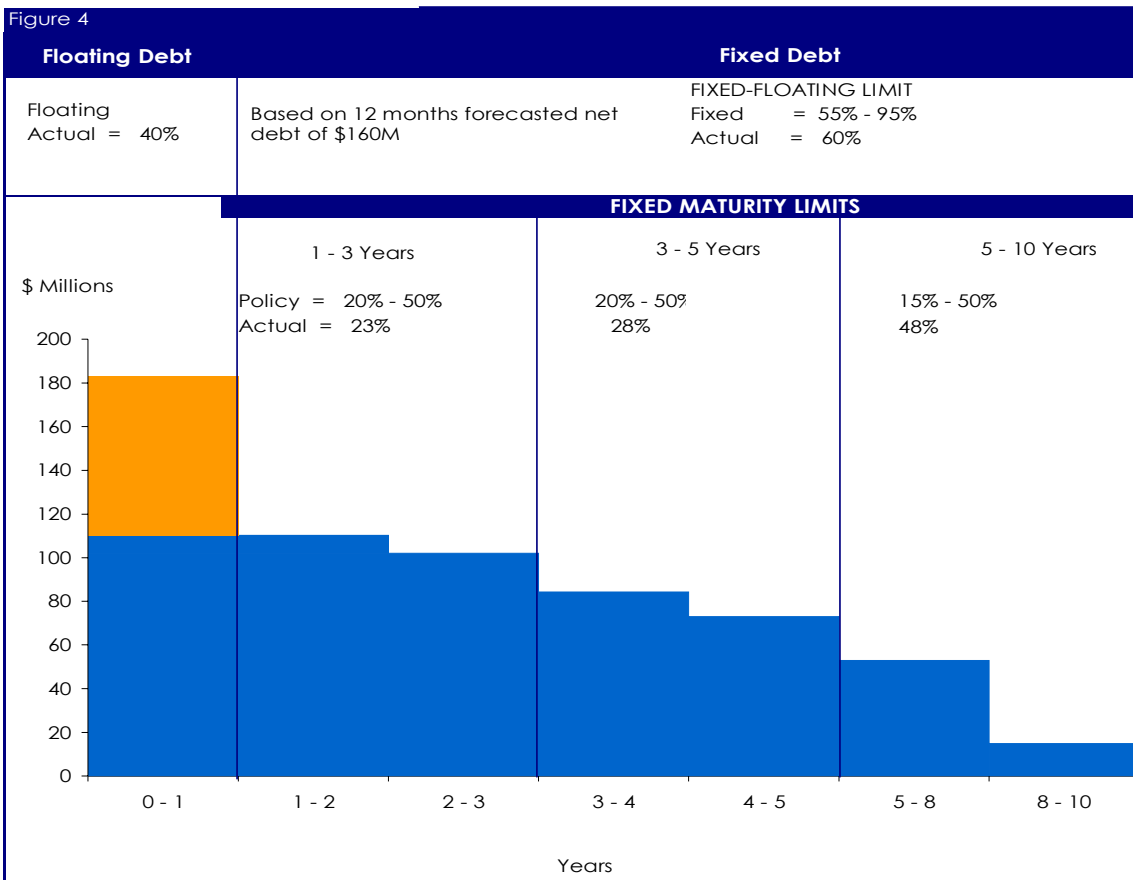
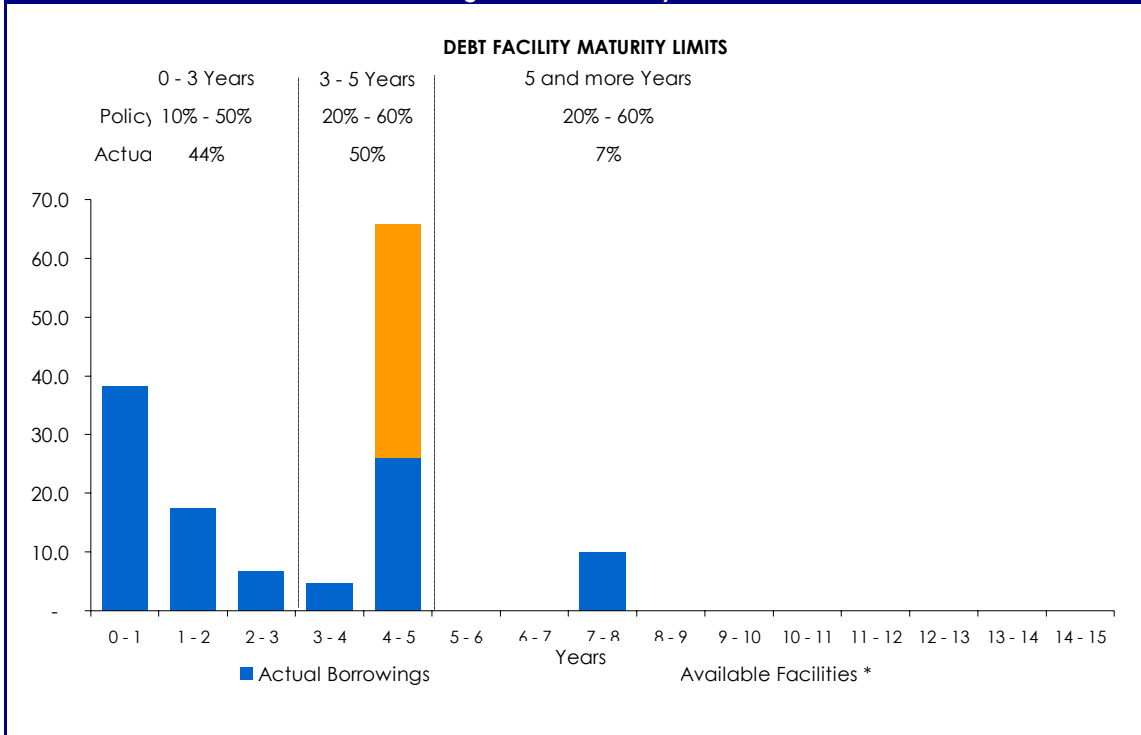


Figure 5

Funding Risk: Debt Maturity Profile



* Note: (1) Available facilities net of 10.3m 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	\$ Millions		
	Committed Funding Sources	Usage	Available
Bank Loans			
Short Term (uncommitted)	\$0.0	\$2.8	\$0.0
Long Term (committed)	\$50.0	\$7.5	\$39.7
Commercial Paper			
Bank Overdraft	\$1.0	\$0.0	\$1.0
Senior Bonds			
Retail	\$19.7	\$19.7	\$0.0
Wholesale	\$83.2	\$83.2	\$0.0
Other	\$0.0	\$0.4	\$0.0
TOTAL	\$153.8	\$113.5	\$40.7

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

