

Finance and Operational Performance Committee

**Thursday, 12 September 2002
Commencing at 9.30 am**

Part III: Finance

**Item 8: 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, 12 SEPTEMBER 2002 COMMENCING AT 9.30 AM.

PART III - FINANCE

8 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, JULY 2002

The Council's gross term debt position has increased by \$1.4 million since June with a closing balance at July month end of \$126 million. Working capital borrowings of \$11.1 million as at 31 July 2002 have been funded using call borrowings.

SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING JULY 2002

- Sinking Fund investment rollover, ANZ Bank term investment of 91 days, invest \$278,559.03 accruing interest at 6.02%.
- Refinance maturing term debt using ANZ Bank committed cash facility, principle \$7.5 million, interest rate 6.26% maturing 14 October 2002.

FINANCIAL MARKET COMMENTARY

Interest Rate Overview

As a result of continued investor concerns within corporate America, New Zealand long term interest rates showed significant volatility during early August. This presented a number of favourable opportunities to fix interest rates in the 8 to 10 year periods at very attractive levels. Interest rates volatility later in August subsided, yet the result was a much flatter yield curve than that presented in the August Finance and Operational Performance Committee meeting.

The August Monetary Policy Statement meeting presented no surprises with the hold on the Official Cash Rate at 5.75%. The statement made by Dr Carr, the Acting Governor of the Reserve Bank of New Zealand, literally extinguishing comments made during the May policy statement of 90 day interest rates being 7.0% by year end.

Dr Carr commented, "we are not treating the need for a further rise in interest rates as urgent, or at all certain".

Dr Alan Bollard, who was Secretary to the Treasury since February 1998, replaced the Acting Governor of the Reserve Bank of New Zealand. This appointment came with hardly a murmur from the markets.

Interest Rate Expectations

Middle eastern tensions and United States investor confidence is likely to dampen New Zealand long term interest rates for some time yet. The inventory swing in the United States may have represented the turning point in the United States recession, however, with the uncertainties now very present in the United States economy consumers appear to be favouring saving rather than spending. This presents some significant risks to United States growth, which largely is dependent on the consumer. There are some calls for the United States Federal Reserve to cut it's cash rate further from 1.75%, to continue the stimulation of the economy. That move has yet to materialise, and at this stage appears unlikely.

Mean while, the comments made at the August Monetary Policy Statement meeting on the future of New Zealand short term interest rates, literally diminishes the probability of further hikes to the Official Cash Rate. The neutral position, commented on in the past of 6.0%, now seems under pressure, with a possible hold at 5.75% for some time.

The decrease in local farming incomes over the 2002/2003 season will have an unfavourable impact on New Zealand growth prospects. It is likely that this will finally impact the Auckland consumer by early 2003.

It is of some interest which direction will be taken with the Reserve Bank of New Zealand Policy Target Agreement. Dr Cullen, Finance Minister, intends to relax the inflation target, with the hope that this will fuel growth. The Government wants monetary policy outcomes to be similar to those of Australia. However, it is questionable how much Government tinkering with Reserve Bank policy targets, will result in the loss of independence of the Reserve Bank of New Zealand, heralding a return to 1970's style governance.

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 budget.

RECOMMENDATION

That the information be received.

Report prepared by: Bruce Wilkin, Funds Accountant.



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

| TERM DEBT PORTFOLIO | | |
|---|--|----------------|
| <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 |

| | July 02 | June 02 | |
|---|---|----------------|----------------|
| TERM DEBT PORTFOLIO | | | |
| <i>Term debt position at 31 July 2002</i> | Term debt borrowed externally | 114,359 | 112,843 |
| | Special funds (used to reduce Council's external borrowing) | 11,688 | 11,634 |
| | Gross term debt | 126,047 | 124,682 |
| | Total Sinking Fund Commissioner assets | 5,558 | 5,531 |
| | Net term debt | 120,489 | 119,151 |

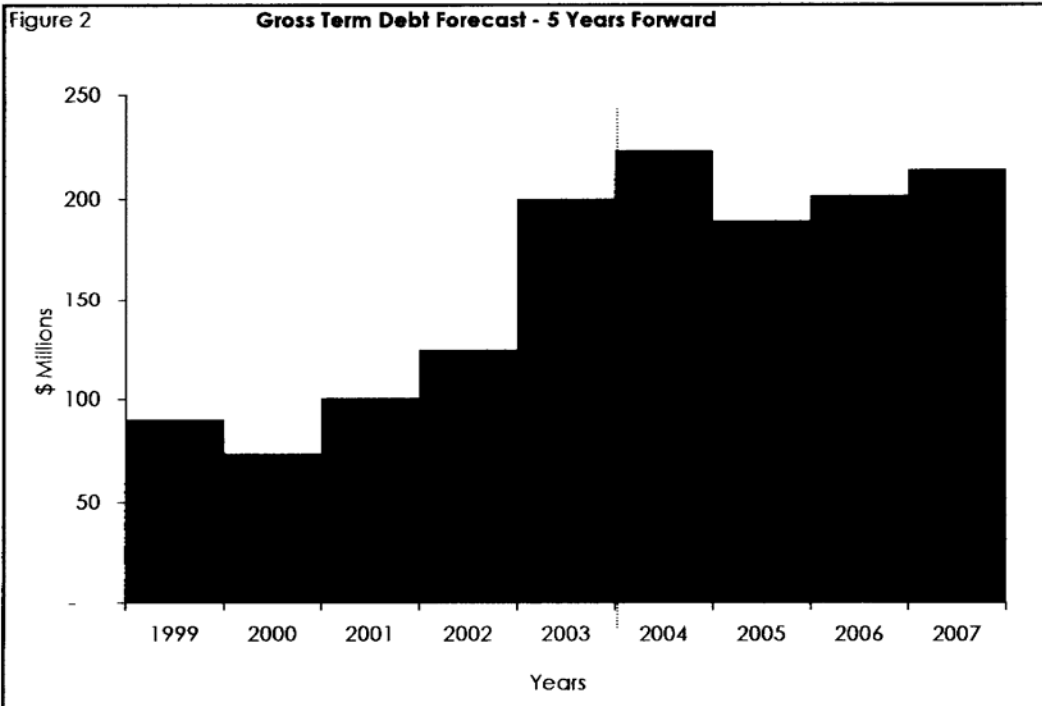
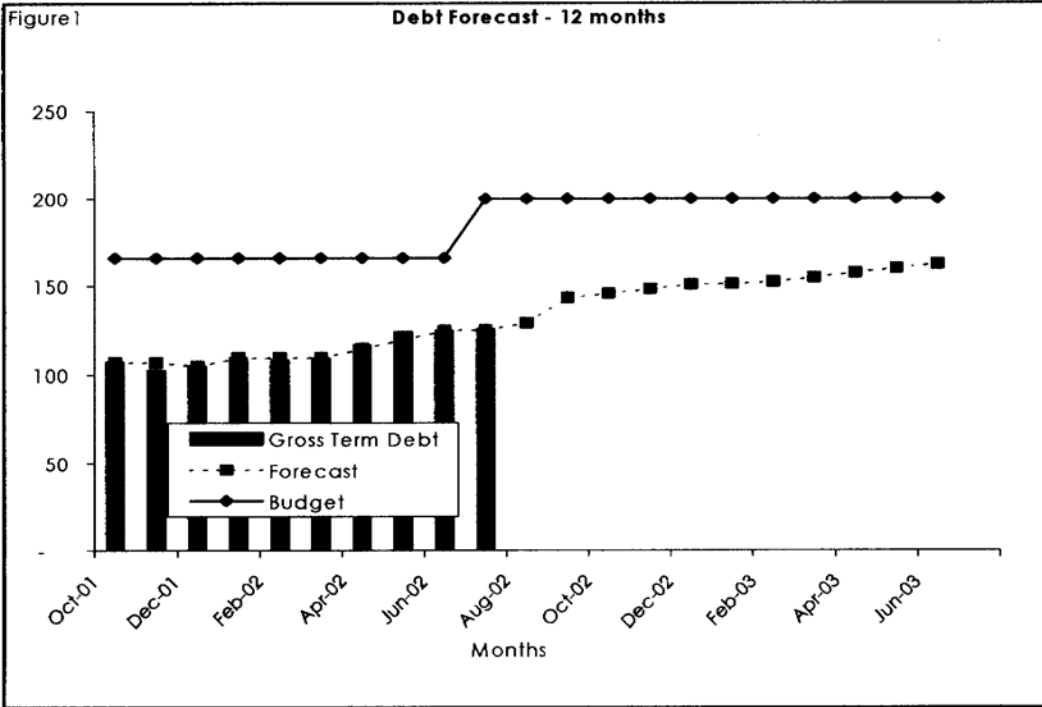
| | | | |
|--|--|---|----------------|
| <i>Term debt - source of funds at 31 July 2002</i> | Debenture stock - fixed rate (security: Debenture Trust Deed) | 62,796 | 62,796 |
| | Debenture stock - floating rate (security: Debenture Trust Deed) | 47,525 | 50,025 |
| | Secured bank loans (security: Debenture Trust Deed) | - | - |
| | Unsecured bank loans | \$3,650 | \$0 |
| | Finance Leases (security: associated asset) | 388 | 394 |
| | External borrowing | 114,359 | 112,843 |
| | | Special funds (used to reduce Council's external borrowing) | 11,688 |
| | Gross term debt requirement | 126,047 | 124,682 |

| | | | |
|--|---|---------------|----------------|
| <i>Working capital borrowing at 31 July 2002</i> | Unsecured bank loans / (investments) | 11,100 | (1,300) |
| | Special funds (used to reduce Council's external borrowing) | 0 | 0 |
| | Council working capital borrowing requirement | 11,100 | (1,300) |

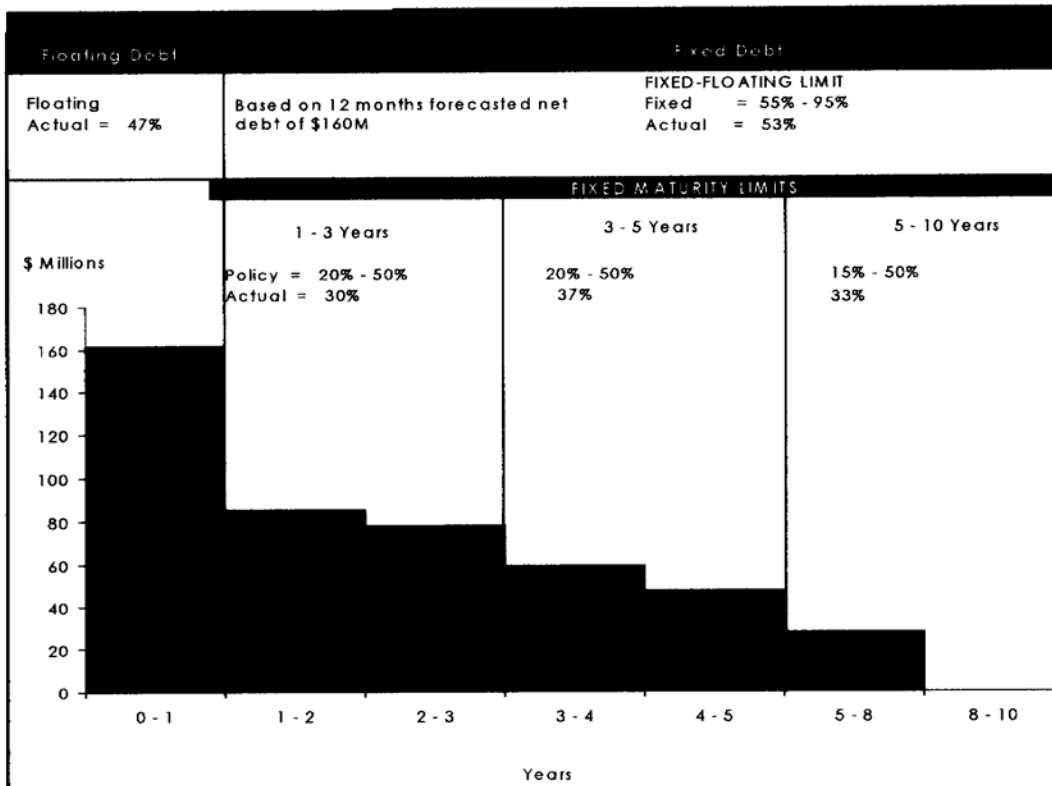
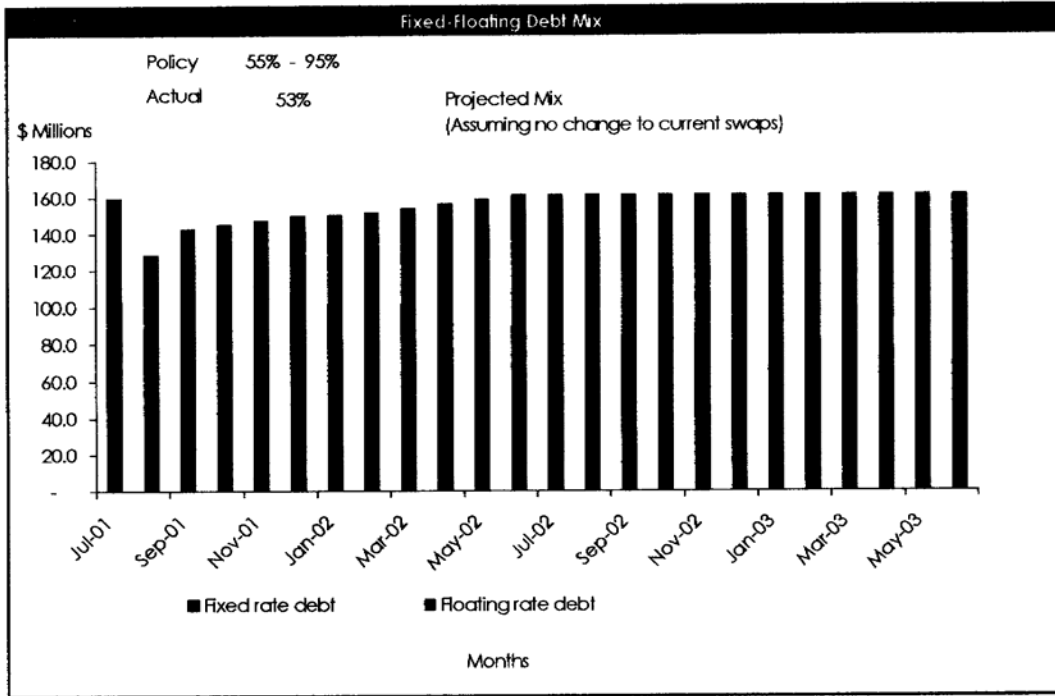
| | | | |
|--|---|--------------|--------------|
| <i>Cash investments held in trust 31 July 2002</i> | Debt repayment fund | - | - |
| | ARST fund (excluding fund allocations) | 1,092 | 1,087 |
| | Total cash investments | 1,092 | 1,087 |
| | Invested for 90 days - Current investment interest rate | 5.93% | 5.93% |

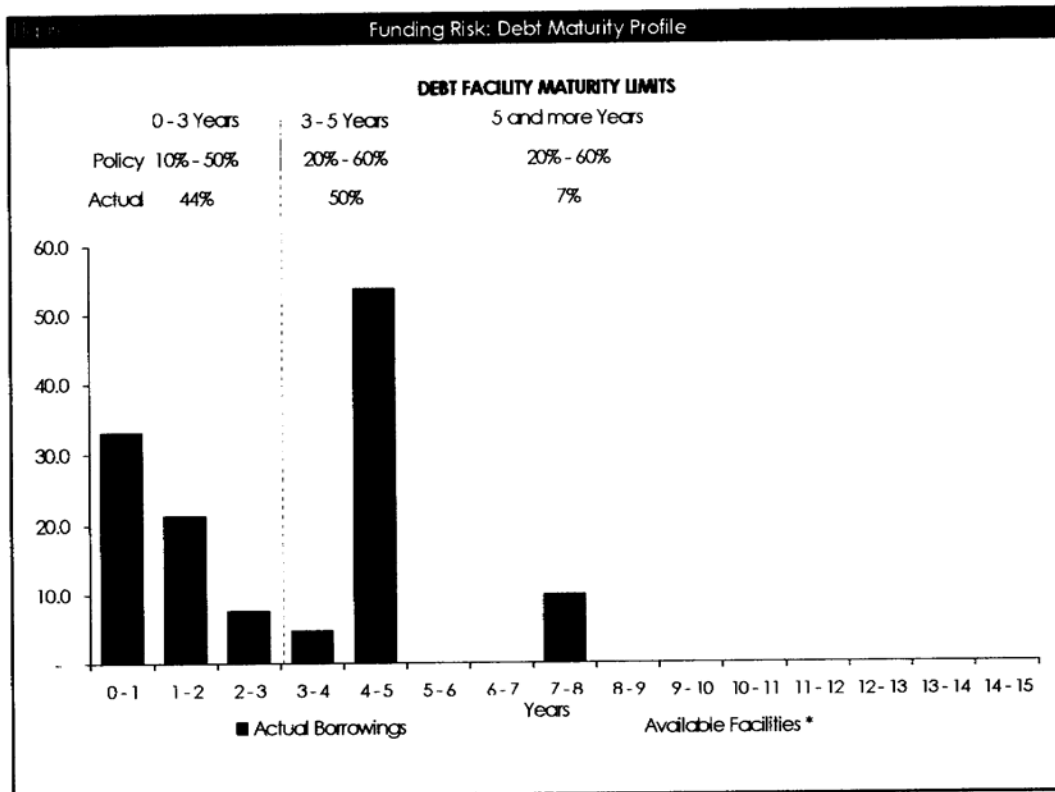
| | | |
|---|--------------|--------------|
| Gross Weighted Average Interest Rate | 7.30% | 7.29% |
|---|--------------|--------------|

Debt Forecast



Fixed-Floating Debt Mix





* Note: (1) Available facilities net of 14.8m 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 | \$14.8 | \$0.0 |
| Long Term (committed) | \$50.0 | \$7.5 | \$42.5 |
| 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 | \$125.5 | \$43.5 |

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

