

Finance and Operational Performance Committee

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

- Item 15: Borrowing and Investment
 Report**

- Item 16: Options for the use of
 UnitedNetworks Limited
 Share Sale Proceeds**

**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 DECEMBER 2002
COMMENCING AT 9.30 AM.**

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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 DECEMBER 2002 COMMENCING AT 9.30 AM.

PART IV - FINANCE

15 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, OCTOBER 2002

The Council's gross term debt position has increased by \$3.729 million since September with a closing balance at October month end of \$126.328 million. Working capital borrowings of \$20.817 million as at 31 October 2002 have been funded using the proceeds from the UnitedNetworks share sale.

SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING OCTOBER 2002

- Raised \$18 million loan against the ANZ committed cash facility for 94 days at an interest rate of 6.04%;
- Raised \$2.5 million loan against the ANZ committed cash facility for 40 days at an interest rate of 6.04%;
- Repaid \$7.5 million loan raised against the ANZ committed cash facility in July;
- Reinvested Sinking fund of \$1,666,473.51 for 30 days accruing interest at 5.88%;
- Receipted \$56,353,589.60 from the proceeds of the sale of UnitedNetworks Limited (UNL) shares;
- Invested \$8 million of UNL fund accruing interest at 5.87% for 30 days;
- Invested \$8 million of UNL fund accruing interest at 5.89% for 30 days;
- Invested \$3.9 million of UNL fund accruing interest at 5.83% for 16 days;
- Invested \$3.9 million of UNL fund accruing interest at 5.86% for 23 days;
- Invested \$5 million of UNL fund accruing interest at 5.84% for 23 days;
- Invested \$3 million of UNL fund accruing interest at 5.82% for 16 days;
- Invested \$5 million of UNL fund accruing interest at 5.88% for 30 days.

USE OF UNITEDNETWORKS LIMITED SHARE SALE PROCEEDS AS AT 29 NOVEMBER 2002

Since the receipt of the UnitedNetworks Limited funds a number of short term bank deposits have been entered into, as well as the complete settlement of all overnight uncommitted borrowings of \$19.5 million as at 30 October 2002. The return on the investment is therefore a combination of actual interest income and interest savings.

As at 29 November 2002 the investment has resulted in the following:

Real Interest Income	\$160,937.69
Interest Accrued on existing investments	\$ 35,061.89
Interest Saved	\$ 79,116.36

Total benefit for 31 Days to 29 November 2002	\$275,115.94
Effective rate of return	5.85%

Interest income from the investment has been reinvested, effectively compounding the investment. The amount of funds invested in interest bearing deposits as at 29 November 2002 is \$50,714,527.29, while the amount offsetting the need to borrow on the overnight market is \$5.8 million. 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. It is currently our opinion that local short term interest rates will remain relatively stable for the next few months.

AMENDMENTS TO THE BORROWING AND INVESTMENT POLICY

There are no suggested changes to the Borrowing and Investment Policy.

FINANCIAL MARKET COMMENTARY

Interest Rate Overview

There were no great surprises with the Reserve Bank of New Zealand's decision to maintain the Official Cash Rate at 5.75%. New Zealand Short term interest rates have been relatively stable for several months, with the 90 day bank bill ranging between 5.85% to 5.92% since early August 2002. With the change in the Reserve Bank of New Zealand's target inflation rate between 1% and 3% medium term outlook, Governor Bollard's most recent speeches have introduced how the Reserve Bank is interpreting this position. The Governor has referred to a future medium term position within the target range, rather than reactive stances on current economics. With the current balance of local economic data, it follows that the cash rate of 5.75% is likely to remain steady for some months yet.

The New Zealand dollar over the last four months has continued to appreciate against monitored leading trading partners, with the dollar now comfortably testing US 0.50 cents.

The US Federal Reserve decreased it's target cash rate by 0.50% to 1.25% and signalled it's monetary policy strategy was moving from stimulatory to neutral. There are no expected further decreases in the target cash rate, unless significant adverse economic information comes to light. The United States economy has been subdued for over two years, and while in more recent times economic information has appeared more positive than negative, investor confidence and employment concerns have continued to present barriers to sustained economic growth. The decrease to the target cash rate was aggressive, but anticipated, by ourselves at least. However, financial markets have considered the move as negative.

Interest Rate Expectations

With the holiday season almost upon us, and Governor Bollard's recent indications on price stability and future inflation expectations, little change is expected with local short term interest rates over the next few months. Where the most likely changes will occur is in longer term rates, which have been significantly volatile over the last four months. With the move by the United States Federal Reserve to change it's stance from stimulatory monetary policy to neutral, the likely outcome will be increases in local long term interest rates, or at least a slightly steeper yield curve, though some volatility is still likely to remain for the near future.

There are some calls that the Reserve Bank of New Zealand could reduce its Official Cash Rate by 0.25% sometime in the second or third quarter of 2003. However, this position is difficult to predict given that so far the local economy has been somewhat more positive than the rest of the world over the last few years. Certainly, current forecasts of local economic growth are less favourable than they have been, though increased international economic activity may well serve to pull the New Zealand economy along.

Concerns have been that price pressures and the strong New Zealand dollar will impact on farming incomes, which will filter into consumer and capital spending. However, local confidence appears more upbeat than it has been, indicating that local business, excluding agriculture, is a little more optimistic about the future direction of the economy.

Up coming dates – Official Cash Rate Announcements and Statements for 2003

Official Cash Rate announcement	23 January 2003
Monetary Policy Statement	6 March 2003
Official Cash Rate announcement	24 April 2003
Monetary Policy Statement	5 June 2003
Official Cash Rate announcement	24 July 2003
Monetary Policy Statement	4 September 2003
Official Cash Rate announcement	23 October 2003
Monetary Policy Statement	4 December 2003

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.

RECOMMENDATION

That the information be received.

Report prepared by: Bruce Wilkin, Funds Accountant.



16 **OPTIONS FOR THE USE OF UNITEDNETWORKS LIMITED SHARE SALE PROCEEDS**

PURPOSE OF THE REPORT

The purpose of this report is to present various options associated with the use of proceeds received from the early release of UnitedNetworks Limited shares, and to recommend to the Finance and Operational Performance Committee the best immediate use of the funds.

BACKGROUND

Borrowing and Investment Policy

The Council has adopted a Borrowing and Investment Policy, which contains provisions for the use of surplus funds.

Under section 4.3 Debt Repayment the policy states:

The Council will manage debt on a netting basis at all times with the exception of sinking funds relating to debt raised pre 1 July 1998 as provided under legislation. From 1 July 1998, the Council will only make the statutory minimum contributions to these sinking funds. Additional exemptions apply to funds vested to the Council for specific purposes as dictated by legislation.

The funds from all asset sales and operating surpluses will be applied to the reduction of debt and/or a reduction in borrowing requirements, unless the Council specifically directs that the funds will be put to another use.

Further to this, within section 5.0 Risk Recognition/Identification/Management, under the term Shares, the policy states:

Council will consider selling its non-strategic share holdings where the rate of return from owning the asset is lower than the financial benefit to ratepayers of selling and of using the proceeds of sale to repay debt. In its considerations the Council will take into account the risks associated with continuing to own the asset and the risks associated with the Council's total debt.

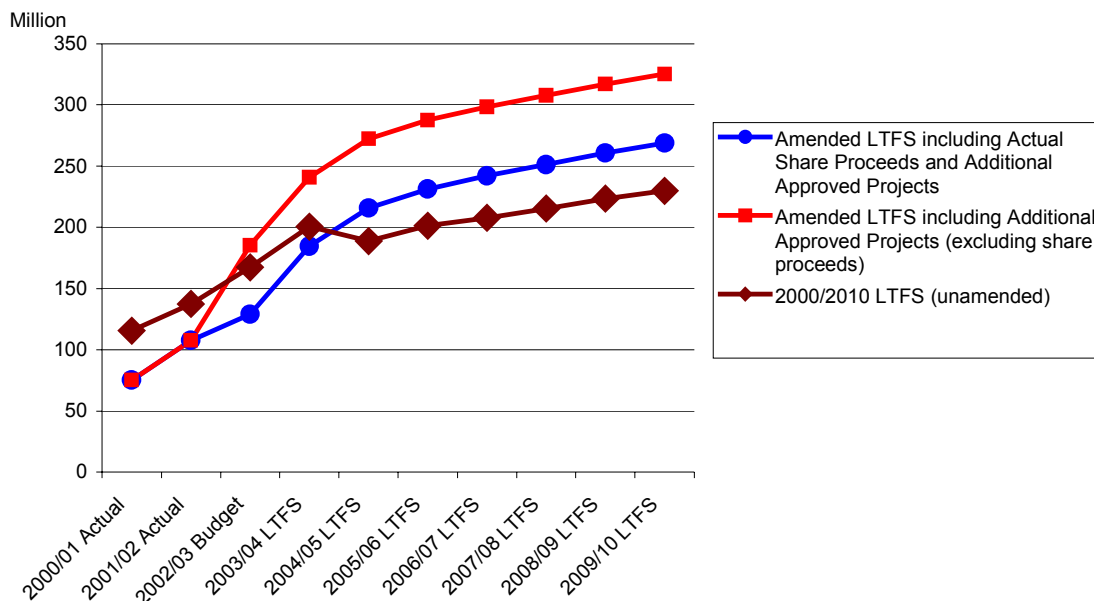
Proceeds from share sales will go to repay existing debt, unless the Council specifically directs that the funds be put to another use.

Long Term Financial Strategy

The Councils 2000/2010 Long Term Financial Strategy contains provision for the ultimate sale of the UnitedNetworks shares during the 2004/2005 year at a value of \$36.1 million. Subsequent Annual Plans have continued to factor the proceeds from the shares, into the 2004/2005 year, with the only change being the expected valuation increasing to \$51.775 million in the 2002/2003 Annual Plan, based on a discounted average valuation completed during the planning exercise.

Based on the debt position published in the 2002/2003 Annual Plan, up dated to reflect both the actual 2001/2002 year end net debt position and the inclusion of other approved projects, the following trend is predicted in net debt levels over the term covered by the current Long Term Financial Strategy.

Projected Net Term Debt to 2010



A59 - A60

During the course of the 1998 year a similar position occurred with the sale of Auckland International Airport Shares. The agenda item for the then Finance, Policy and Property Committee, dated 15 June 2000, is attached at pages A59 to A60. This shows how those funds were used to repay debt as it matured. At that time, the process took almost two years to complete.

The Annual Plan for 2002/2003 has applied an interest rate of 7.5% for loans to be refinanced and new loans. For every \$1 million of loan funds approved, there is \$75,000 added to the interest expense requirement in future years.

WINDFALL

The early distribution of UnitedNetworks share sale proceeds has been reported as a "windfall". By definition, a windfall is an unexpected financial gain, or other piece of good fortune. When considering the application of this definition against the distribution, the value of the windfall could only be the variance between the last recorded valuation of \$51.775 million and the actual proceeds received of \$56.354 million, a favourable variance, of \$4.579 million. A further favourable variance would be the difference between the present value (PV) and the discounted future value (FV) of the expected proceeds of \$51,775 million.

However, the use of the term windfall in its present context suggests that the distribution came as a complete surprise to Council. This is clearly not the case, and such rhetoric has only served to generate concerns amongst ratepayers as to the possible use of the funds.

OPTIONS CONSIDERED

Opportunity Cost

When any decision is made on the use of a particular resource, it is generally at the expense of other possible projects competing for the same resource. This is referred to as the opportunity cost. Therefore, the best use of a resource should be the project that guarantees the most valuable outcome. A minimum return on an investment should be greater than or equal to the organisations weighted average cost of capital, otherwise (in financial terms) the organisation simply should not pursue the investment.

Early Settlement of Existing Debt

This is a case of buying back debt that has been issued prior to its maturity. Additional costs can be incurred by such a strategy, as original investors would seek compensation for the difference in the issuing interest rate and the current interest rate achievable for a similar instrument. This is much the same as an individual, with a fixed interest mortgage, would expect to pay a penalty to break the contract short of its maturity. It is not recommended that this approach be taken, as current interest rates are not favourable for a repurchase strategy.

The Retirement of Existing Debt on Maturity and Funding Future Expenditure

Past Annual Plans have “netted” the proceeds of the share sale against the debt portfolio. In the 2002/2003 Annual Plan gross term debt was reported as being \$223.270 million by July 1, 2004, but decreasing to \$189,177 by June 30, 2005. Effectively, debt and the new loan funded capital works programme are offset by the share proceeds.

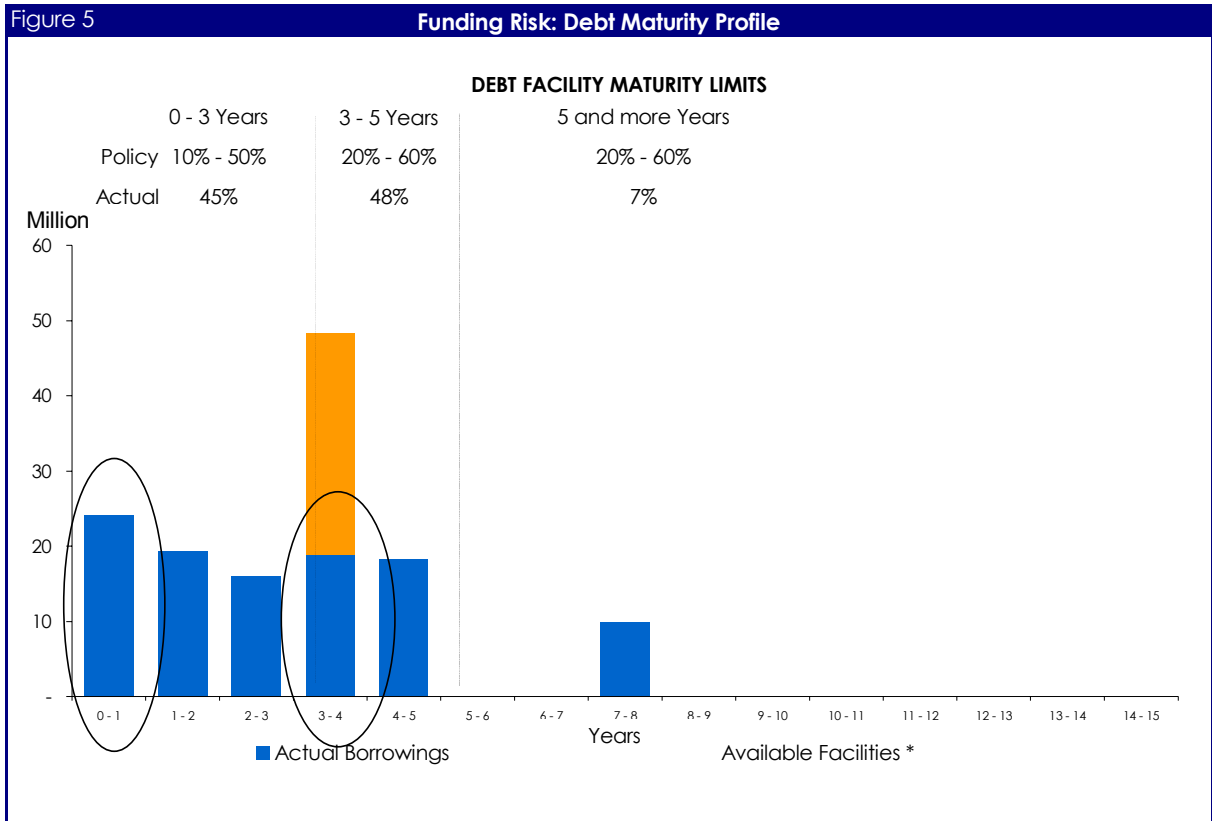
A61 - A62

During the course of the 2002/2003 Annual Plan process, an agenda item was presented discussing the future borrowing capacity of the city. This is attached at pages A61 to A62. The thrust of the report was to inform the Annual Plan Special Committee of the future restraints that Council will face. The Borrowing and Investment Policy includes some ratios as a guide to its borrowing capacity. These are as follows:

Ratio	
Net debt as a percentage of equity	<20%
Net debt as a percentage of income	<150%
Net Interest as a percentage of income	<15%
Net Interest as a percentage of annual rates income	<20%

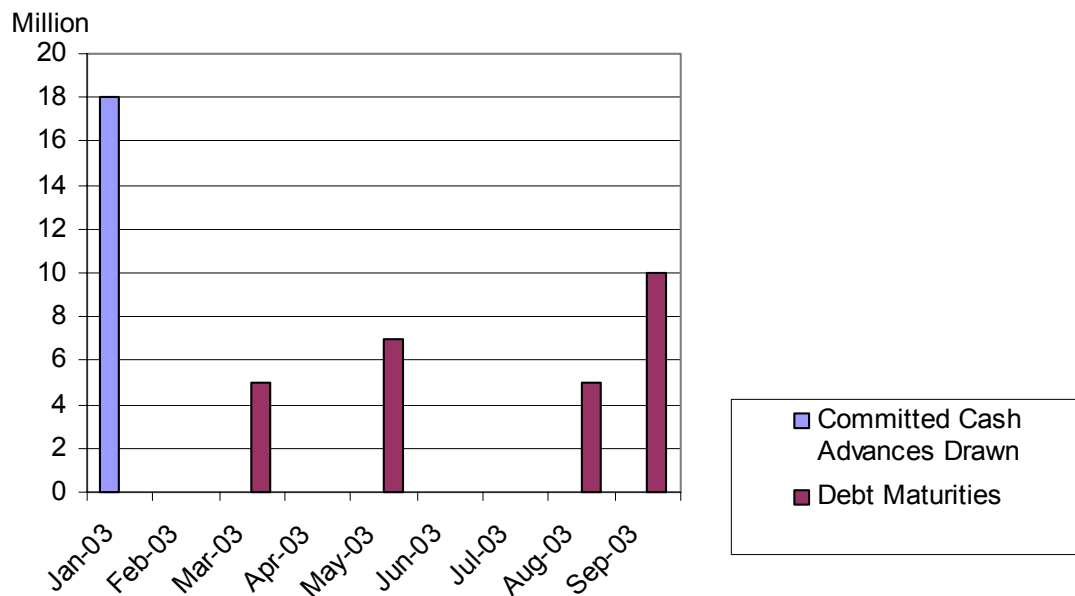
The nature of these ratios is that they indicate to Council the currently accepted prudent financial management philosophy. Further to this, they give a guide as to when the financial markets may perceive that debt levels are too high, which increases the possibility of default, resulting in an increase in borrowing costs as compensation for the increased risk.

The monthly Borrowing and Investment Report presents to Council the future debt raising and refinancing expectations. The following graphs represent the 31 October 2002 position.

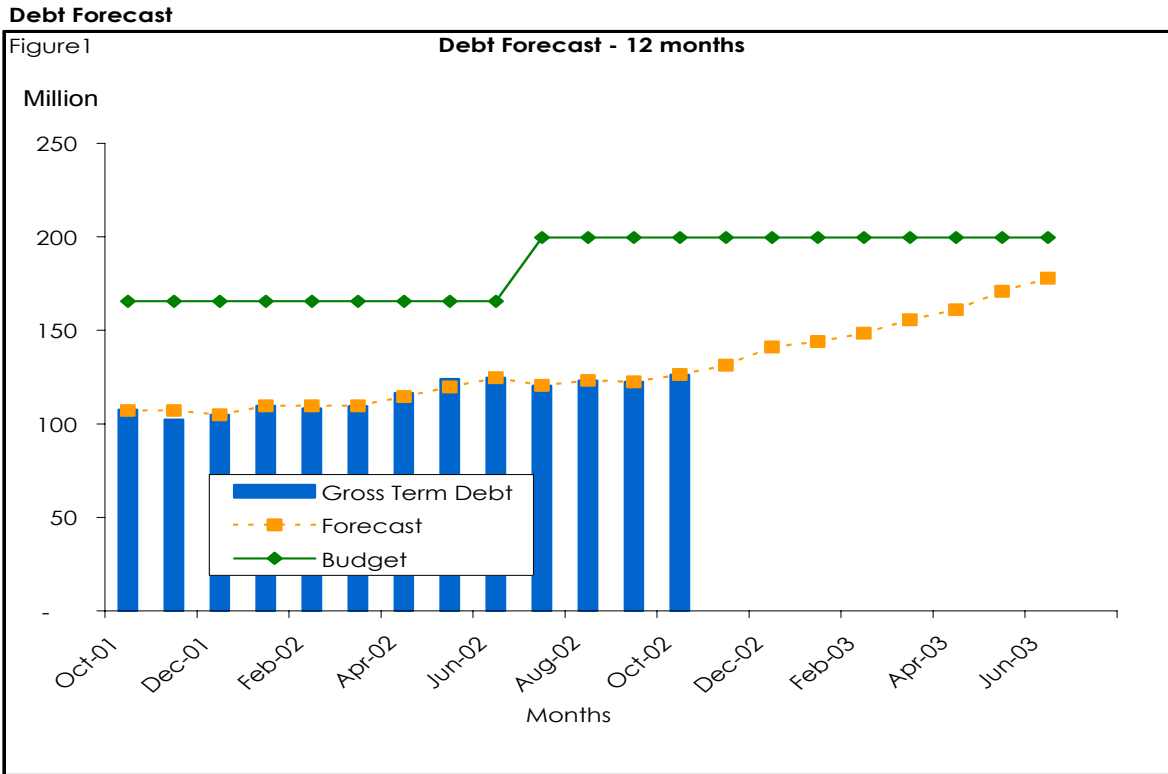


A more detailed analysis of this position is reflected as follows.

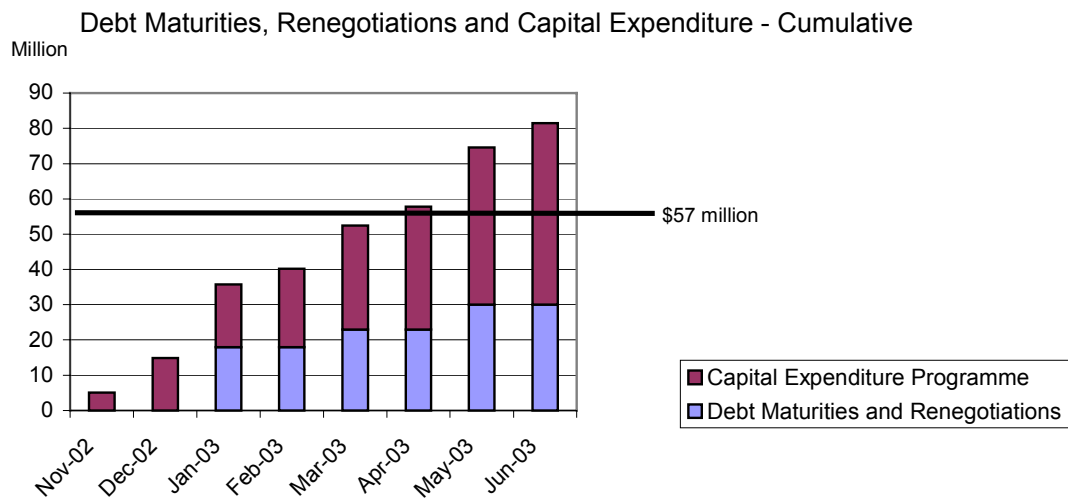
Debt Maturities and Renegotiations by Month



Forecasted debt requirements for approved loan funded capital works is considered in the following graph, which is also copied from the Borrowing and Investment Report, contained within this agenda.



By adding debt maturities and forecasted capital expenditure on an accumulative basis, the following borrowing programme is implied.



If no new loans were raised, under the October 2002 forecasted capital expenditure programme, the entire proceeds from the sale of the UnitedNetwork shares would be absorbed against the existing and future borrowing programme by May 2003.

Investments and Diversified Portfolios

There are several different liquid investment strategies that could be initiated. Generally these can be classed as debt, equity, cash deposits or a combination of the three. Debt relates to investing in securities that principally return interest income during the course of the investment, and the principle on maturity. This is also the case of cash deposits. Excluding cash deposits, debt instruments generally offer security. Equity investments relate to the purchase of shares, with little or no guarantee of any return. The investor seeks a return through dividends and the capital growth of the share value. The more diversified position would be a combination of equities, debt instruments and cash deposits.

When considering investment strategies, the investor should always look for a diversified portfolio. Investing in one class of asset is considered risky. Investing in a number of different equity or debt instruments in different sectors within the economy, a portfolio is referred to as diversified. A portfolio is further diversified if assets are purchased from offshore markets, something that Council has not approved in the past.

Counterparty credit risk is measured by an investors analysis of the organisation in which they intend to invest. Alternatively, a Standard and Poor's credit rating is an indication by a third party of the underlying strength and ability to repay debt by an organisation when debt falls due. A credit rating is not an indication of the future strength of the companies share price, however a change in credit worthiness maybe viewed by the market as an indication of how risky that organisation is, which maybe reflected in its share price.

From an equity perspective, to mitigate unsystematic risks in shares, risks associated with sudden changes in a single organisations operation, an investor should purchase 20 - 40 different shares such as those companies listed within the NZSE40 index. More technically, the investor would consider a company's equity beta coefficient, the measure of that company's market or systematic risk when compared against the market portfolio, before adding those shares to their own portfolio. Furthermore, this measure would be used to optimise an equity based investment, meaning that by investing in more of one equity over another, a better return is expected, without increasing the portfolios risk.

It is simply not sensible to invest in one or two securities, that are considered "safe" and expect to achieve a return. With all things, the greater the risk that is taken, the greater the return is expected. However, the nature of risk is that by taking a greater risk does not mean that a greater return is guaranteed.

Investing in such instruments cannot be regarded as a core Council activity. Further to this, the return on investment must be greater than the Councils weighted average cost of capital, which is reported at 7.44% at 31 October 2002. In saying this however, interest streams or dividends could be used to progress new Council initiatives or increasing the original investment. However, over the past year, favourable interest rates have been targeted to hedge future borrowing requirements. Investments in interest bearing instruments over long terms would require this position to be unwound to some degree. This position would then add additional risks to future borrowing requirements.

New Fixed Asset Creation or Operational Spending

Based on the forecasted Long Term Financial Strategy debt position, it appears to be inappropriate to channel the majority of the proceeds to new initiatives, without first either reprioritising or reviewing approved expenditure. The argument is that under the approved Long Term Financial Strategy and the inclusion of new projects, some pressure begins to appear on possible breaches of the Borrowing and Investment Policy ratios. Remembering that these ratios are adopted in order to demonstrate prudent financial management to the market in general, which in turn, reduces our cost of borrowing.

Large scale increases to the approved financial strategy only serve to limit Councils future options. The full funding of depreciation has initially generated a cash surplus that was intended to be used to mature debt. This was also included within the 2002/2003 Annual Plan. Such a position is necessary in order to minimise the possibility of breaching policy ratios, while also affording Council the freedom to move forward with its desired initiatives.

Any consideration of new capital projects and operational activities should be considered on an individual basis with the relevant research undertaken.

Distributions

When considering a distribution to a shareholder or a ratepayer in this case, Council should consider the best use of the funds. A corporate that intends to present a large distribution to shareholders, either by dividends or share buy backs, actually is saying to the market "we have no future investment initiatives". Council will always have future investment initiatives, and will require funds accordingly. A distribution to Ratepayers now, only results in greater future costs associated with future expenditure programmes.

Loans to Organisations

When considering giving loans to individuals or groups, a lender would question the feasibility of the action that is intended to be undertaken, and the likelihood of the loan and interest being repaid at some future time. Furthermore, a lender would not likely lend at an interest rate lower than their own weighted average cost of capital. In doing such a thing, the underlying value of the loan is diminished over the term of the loan. The intention of interest is to compensate the investor for the risk undertaken in granting the loan, and the loss in value of the principle over the duration of the loan.

It can therefore be said that a prudent financial strategy with any loan granted by Council should have an interest rate equal to weighted average cost of capital plus a margin associated with the risk of default. Further to this any loan should have some security and be related to a Council core community strategy. The Councils Community Assistance Policy provides for loans to various organisations.

CONCLUSION

The Borrowing and Investment Policy has clearly stated that if Council does not specifically direct that the funds be used for other purposes, then the funds will be used to repay debt. Under the current Long Term Financial Strategy with the inclusion of other new projects not included in the Long Term Financial Strategy, the Councils borrowing ratios become challenging in future years. Adding new expenditure to this position accelerates possible ratio breaches. The Long Term Financial Strategy has netted the proceeds of the UnitedNetworks share sale against debt. Investing the proceeds would require a guaranteed return greater or equal to the cost of borrowing, in order for a netting position to break even or be favourable. Investments carry greater levels of risk, while greater risk does not guarantee greater returns.

A strategy of offsetting new borrowing requirements and repaying maturing debt with the share sale proceeds provides a saving of over \$4 million, reduces pressure on future borrowing ratios and does not introduce additional risks to the treasury portfolio. It therefore follows that the strategy that is adopted should not introduce additional risk over and above those that already exists. A long term investment strategy may require that interest rate risk management instruments that have been transacted over the past year, which will eventually lower the overall cost of borrowing, would need to be unwound. This would incur future interest rate risks to the portfolio. The least disruptive and most prudent strategy is to repay debt as it matures and offset the requirement to borrow funds in the short term, dependent on what future borrowing opportunities are presented.

RECOMMENDATIONS

1. That the information be received.
2. 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.

Report prepared by: Bruce Wilkin, Funds Accountant.



**WAITAKERE CITY COUNCIL DEBT PORTFOLIO AT
31 October 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

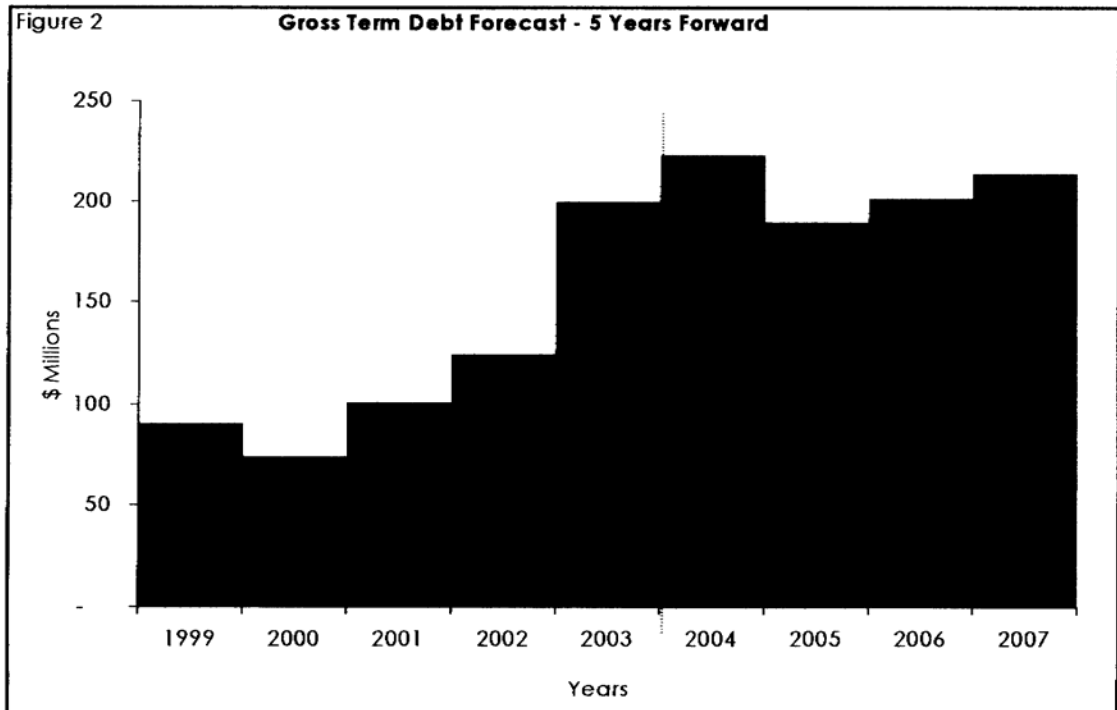
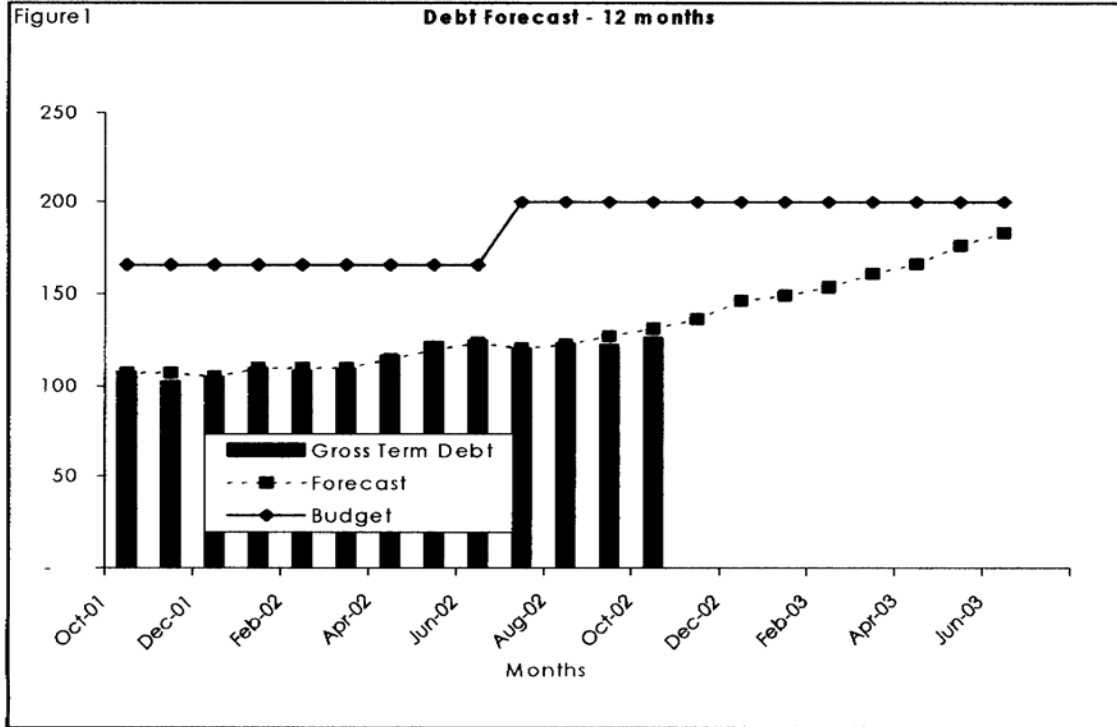
	October 02	September 02
	TERM DEBT PORTFOLIO	(\$000's)
<i>Term debt position at 31 October 2002</i>	Term debt borrowed externally	114,321
	Special funds (used to reduce Council's external borrowing)	12,007
	Gross term debt	126,328
	Total Sinking Fund Commissioner assets	4,824
	Net term debt	121,504

<i>Term debt - source of funds at 31 October 2002</i>	Debenture stock - fixed rate (security: Debenture Trust Deed)	53,796	62,796
	Debenture stock - floating rate (security: Debenture Trust Deed)	40,025	40,025
	Secured bank loans (security: Debenture Trust Deed)	20,500	7,500
	Unsecured bank loans	0	11,903
	Finance Leases (security: associated asset)	0	376
	External borrowing	114,321	122,599
	Special funds (used to reduce Council's external borrowing)	12,007	-
	Gross term debt requirement	126,328	122,599

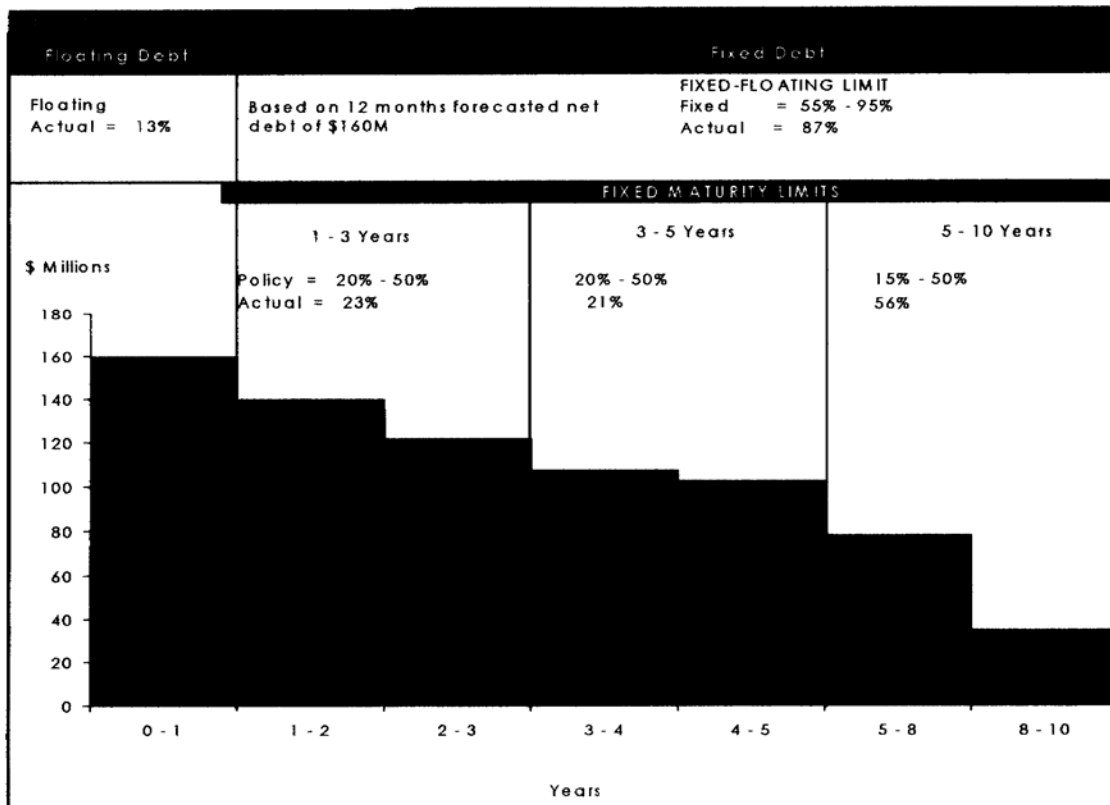
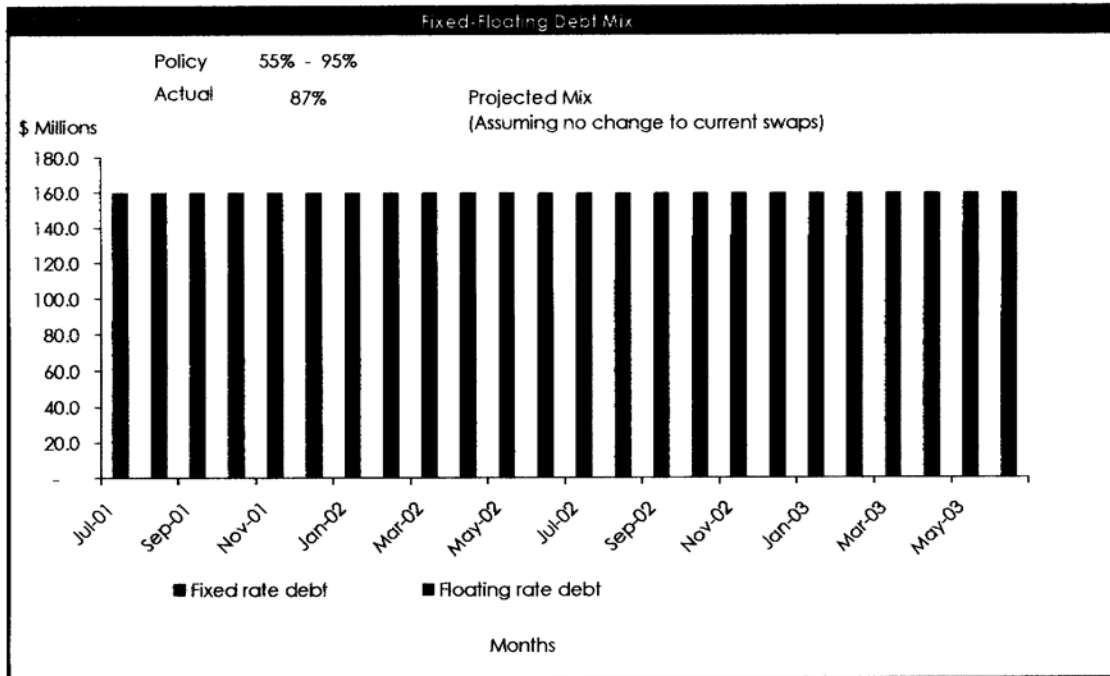
	WORKING CAPITAL	(\$000's)	(\$000's)
<i>Working capital borrowing at 31 October 2002</i>	Unsecured bank loans / (investments)	0	1,297
	Special funds (used to reduce Council's external borrowing)	1,317	11,634
	UNL Share Fund	19,500	0
	Council working capital borrowing requirement	20,817	12,931

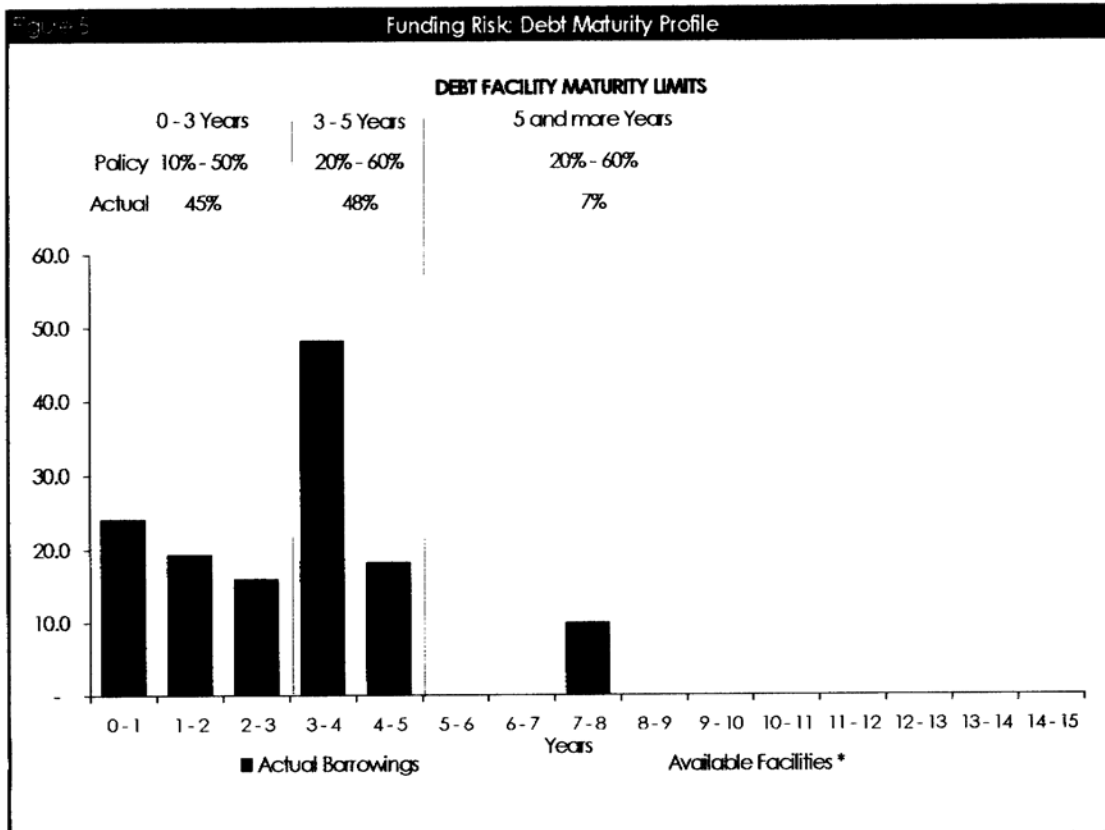
	CASH INVESTMENTS	(\$000's)	(\$000's)
<i>Cash investments held 31 October 2002</i>	UNL Share Fund	36,862	-
	Debt repayment fund	-	-
	ARST fund (excluding fund allocations)	1,108	1,103
	Total cash investments	37,970	1,103
	ARST Invested for 90 days - Current investment interest rate	5.86%	5.86%
	Weighted Average Interest Rate	%	%
	Gross Weighted Average Interest Rate	7.44%	7.58%

Debt Forecast



Fixed-Floating Debt Mix





* Note: (1) Available facilities net of 29.5m 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

Figure 6 **(\$ Millions)**

Council Approved Debt Sources	Total		
	Committed Funding Sources	Usage	Available
Bank Loans			
Short Term (uncommitted)	\$0.0	\$0.0	\$0.0
Long Term (committed)	\$50.0	\$20.5	\$29.5
Commercial Paper			
Bank Overdraft	\$1.0	\$0.0	\$1.0
Senior Bonds			
Retail	\$15.7	\$15.7	\$0.0
Wholesale	\$78.2	\$78.2	\$0.0
Other	\$0.0	\$0.0	\$0.0
TOTAL	\$144.8	\$114.3	\$30.5

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.

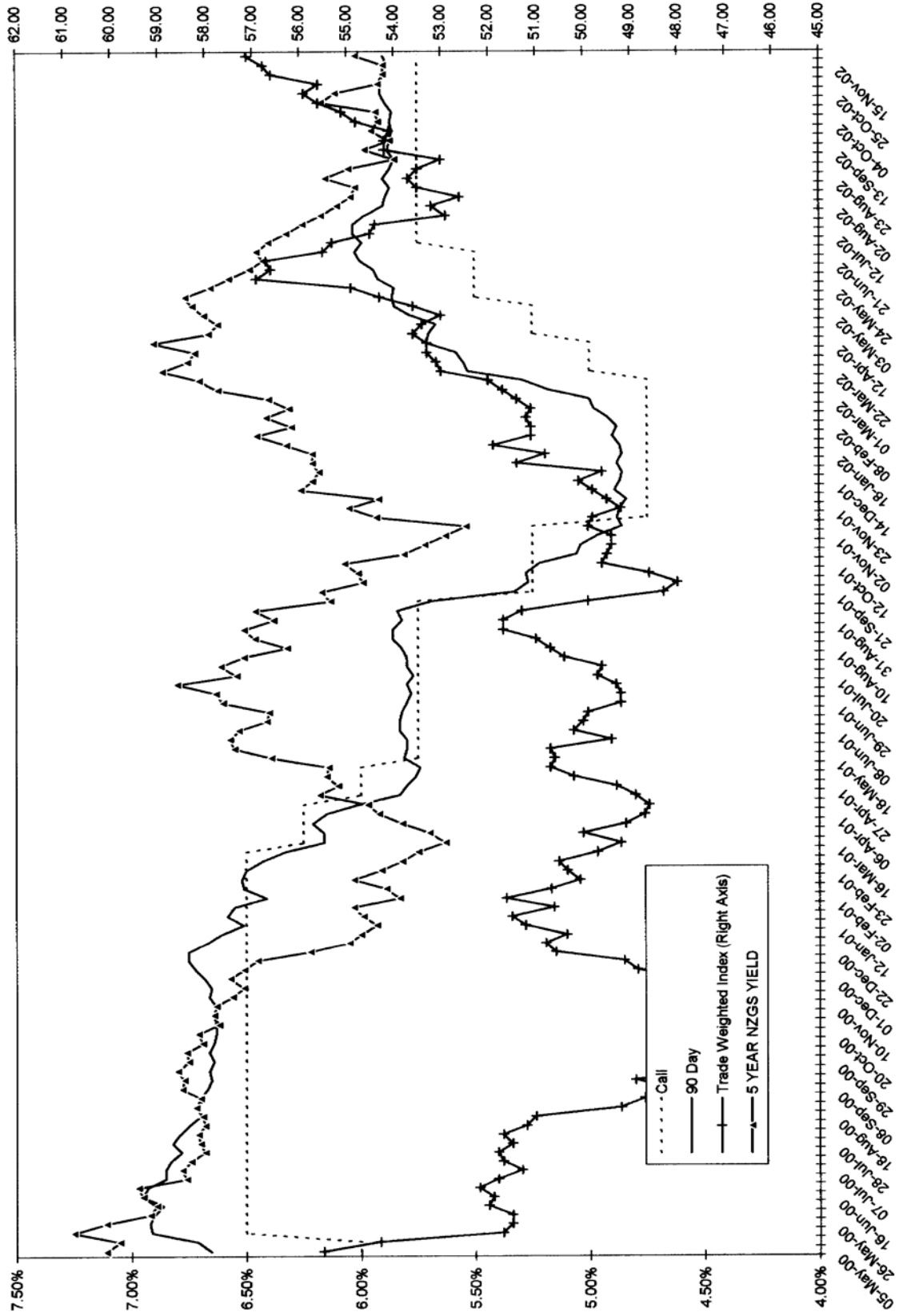
Figure 5

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



Source: ASB Bank Economic Reports

18 **AIRPORT SHARE SALE PROCEEDS FUND – FINAL SUMMARY**

PURPOSE OF THE REPORT

This report is to advise Council that the proceeds received from the sale of Waitakere City Council's shareholding in the Auckland International Airport and subsequent interest earnings on the invested funds have now been fully utilised and provide a final summary of the use of the fund proceeds through 1998/1999 and 1999/2000.

BACKGROUND

The 1998/1999 Annual Plan allowed for the sale of Council's holding in the Auckland International Airport Limited and the shares were sold after advice from Bankers Trust during July and August 1998. Net proceeds from the sale realised \$31.74 million and a special dividend of \$5 million was also received.

FUND USE AND ALLOCATION

The 1998/1999 Annual Plan budgeted for the airport share sale proceeds to fund both the sinking fund contribution and the repayment of rates funded maturing debt, approximately \$5 million and \$14 million respectively. The interest earned on the fund in this year and the normal dividend as budgeted in the 1998/1999 Annual Plan was used to reduce the general rates requirement in 1998/1999.

Throughout the 1998/1999 financial year the surplus of the fund was used in the first instance to offset Council's overnight borrowing requirement, where this requirement was satisfied the remaining fund was invested to match Council's debt maturity profile. In 1998/1999 where Council used the fund to offset its overnight borrowing requirement an internal rate of interest (based on the current market overnight borrowing rate available to Council) was allocated to the fund.

The following table summarises the proceeds received and the use and allocation of the fund in 1998/1999.

	Fund Receipts (\$000's)
Proceeds received from sale of shares	36,748
Interest received on invested funds and overnight borrowing offset	1,058
Total receipts in 1998/1999	37,806

	Fund Allocation (\$000's)
Repayment of rates funded (fixed term) maturing debt	14,848
1998/1999 sinking fund contribution	4,994
1998/1999 Annual Plan budget requirement and payment of final dividend	1,740
Total fund use in 1998/1999	21,582

For the current financial year, any surplus fund was used in the first instance to offset Council's overnight borrowing requirement and the remainder was invested to mature and match Council's debt liabilities falling due. During 1999/2000 all interest earnings from the invested funds were capitalised back to the debt repayment fund. Because all interest earnings were directly applied to future debt repayment, where the fund was used to reduce the overnight borrowing requirement in 1999/2000 it was not necessary to allocate an internal rate of interest to the fund.

On 26 April 2000 the final \$771,701 of the fund was used to repay maturing debt and the fund expired. The following table summarises the proceeds received and the use and allocation of the fund in 1999/2000, the balance of the fund carried forward from 1998/1999 was \$16.224 million.

	Fund
Interest received on invested funds	532
Total receipts in 1999/2000	532

	Fund
Repayment of rates funded (fixed term) maturing debt	16,185
Repayment of rates funded (repricing) debentures	571
Total fund use in 1999/2000	16,756

SUMMARY

Council received \$36.748 million from the sale of its shareholding in the Auckland International Airport over a two week period in late July and early August 1998. From its investment of the surplus funds throughout 1998/1999 and 1999/2000 Council earned a total of \$1.59 million in interest.

A total of \$31.605 million of rates funded maturing debt was repaid over 22 months using the airport share sale fund. A further \$4.994 of the fund has been allocated to the future repayment of debt through a contribution to the sinking fund. The general rates requirement of the City was reduced by \$1.74 million in 1998/1999, through the use of interest earnings on the fund and an anticipated normal dividend as budgeted in the Annual Plan.

RECOMMENDATION

That the information be received.

Report prepared by: Kirsty Maxwell, Funds Accountant.



DEBT AND BORROWING CAPACITY

PURPOSE OF THE REPORT

The purpose of this report is to present to Council the currently adopted Borrowing and Investment Policy guidelines for debt ratios, and to represent these guideline against the current budget and adopted LTFS.

BACKGROUND

There are two basic methods of financing that any individual or organisation can use to purchase goods. These methods are referred to as either equity financing or debt financing. Equity financing assumes that the buyer has the ready cash, derived from income, or retained surpluses. Debt financing on the other hand is common when the cash is not available when a purchase is required. The choice of financing options is dependent on the organisations financial structure.

Waitakere City Council currently finances all new capital expenditure through debt financing. The philosophy being that future users of the purchased assets should ultimately be those that pay for them. If on the other hand such assets were purchased from current rate funds, then only today's ratepayers are effectively paying for the assets.

BORROWING AND INVESTMENT POLICY

Debt is not something that anyone should be afraid of, though debt does introduce a number of risks that need to be managed. The primary risks are the exposures to adverse interest rate movements and the ability to obtain funds at a reasonable price some time in the future. The Council manages such risks by adopting a Borrowing and Investment policy that introduces limits for debt management. The policy is subject to review each year.

The limit guidelines have been set as follows.

Ratio	
Net debt as a percentage of equity	<20%
Net debt as a percentage of income	<150%
Net Interest as a percentage of income	<15%
Net Interest as a percentage of annual rates income	<20%

Also, an addition to the above financial guidelines, Waitakere City Councils Borrowing and Investment Policy undertakes to limit net debt to \$1,200 per capita.

The rational behind these was to maintain limits as set by Local Government Finance Corporation (LGFC). In some cases LGFC levels are more flexible, \$1800, net debt per capita and net interest as a percentage of rates less than 30%, for instance. As a result the ratios that have been adopted by the Council have been somewhat tighter than LGFC requirements.

Further to LGFC ratio requirements is the financial markets perceived risk of the Council. As with other Councils, Waitakere City has a Debenture Trust Deed that is used as security when raising debt. The deed gives the investor security through a charge over future rates. This effectively reduces the risk of default by Waitakere City Council when the loan matures, as the investor will have a charge over rates. Further more, if New Zealand financial markets became more illiquid than normal, Waitakere City Council can simply pursue financing options through committed cash facilities with commercial banks, as is the case with the \$50 million ANZ facility.

ANALYSIS OF CURRENT POLICY LIMITS

As debt increases, interest expense is likely to rise, and more ratepayer money is used to service the interest expense, meaning that if Council rate income stays fixed, then the Council may have to consider a decrease in service levels and activities. When we compare our current Annual Plan and Long Term Financial Strategy (LTFS) we do begin to see the current policy limits challenged. Attached at Page A is a table showing when and what current policy limits are likely to be affected.

Under the current adopted Annual Plan and LTFS some pressure is found in the 2003/04 year when net debt is forecast to reach \$218 million. This is only a short-term spike that should not cause concern as the following year the United Network shares become available for sale and the proceeds from this sale would ultimately reduce debt levels. However, pressure again is observed during the 2006/07 year and after in the net debt per capita ratio. Again this should not cause concern as the Council's ratios have some room to be increased, while still not breaching LGFC's recommended levels.

The existing ratio guidelines as adopted in the Borrowing and Investment Report are not intended to restrict Council from pursuing opportunities as they arise, though they are intended as a guide of the Councils current prudent financial management philosophy.

There is room to increase the ratios up to LGFC levels, or greater if desired. The cost of maintaining excessively loose ratio limits however, maybe the markets increased perceived risk, which will be reflected in the cost of future borrowing.

There are a number of other options the Council could consider when adopting future borrowing programmes which would not need substantial loosening of current borrowing ratio levels.

The rating for full cost of depreciation now rather than in 2005/06 would improve the Councils net debt position over the entire period reported as per the planned LTFS. By funding Depreciation sooner than later, some flexibility is obtained in increasing the future borrowing programme.

Another option is pursuing expenditure programmes that generate a return on investment to Council. This could mean clustering Council services with private sector services that are complimentary to each other. Council would raise the funds and complete the development. Return on investment for Council maybe in the form of rental from tenants. Such a return increases income for Council and increase the value of debt repayment, if directed that way.

CONCLUSION

Council borrows money in order to fund it's capital expenditure programme. Such a borrowing programme has guideline ratios contained within the Borrowing and Investment Policy. As debt increases, these ratios come under pressure. The ratios are not intended to restrict Councils ability to pursue future opportunities, however, excessively loose control may result in increased borrowing costs. As much as there is some flexibility to change the existing debt ratios, Council could consider other options of maintaining a debt programme that allows for a greater repayment programme.

RECOMMENDATIONS:

1. That the information be received.

Report prepared by Andrew Pollock, Director: Finance.