

Finance and Operational Performance Committee

**Thursday, 16 May 2002
Commencing at 9.30 am**

Part III: Finance

**Item 14: 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, 16 MAY 2002
COMMENCING AT 9.30 AM.**

PART III - FINANCE

14 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, MARCH 2002

The Council's gross term debt position has increased by \$2.6 million since February with a closing balance at March month end of \$111 million. Working capital borrowing of \$9.7 million at 31 March 2002 has been entirely funded using the Council's special fund reserves.

SIGNIFICANT FUNDING TRANSACTIONS ENTERED INTO DURING MARCH 2002

No significant funding transactions were entered into during the course of March 2002.

FINANCIAL MARKET COMMENTARY

Interest Rate Overview

Again the Official Cash Rate was increased after the Reserve Bank of New Zealand's Official Cash Rate review on 17 April 2002, taking the cash rate to 5.25%. All other major trading partners have continued to leave their cash rates on hold. However New Zealand, which has been on a different economic cycle, has begun to feel inflationary pressures. The New Zealand Official Cash Rate is now 1.00% greater than the Australian (4.25%) and 3.50% greater than the United States (1.75%) cash rates. The 90 day bank bill continues to price in further increases in the Official Cash Rate as shown in the graph below (courtesy of National Bank of New Zealand), which indicates the markets belief of the Official Cash Rate being as much as 5.75% by July 2002.

90 Day Bank Bill – Last 12 Months



Allen Greenspan, Chairman of the United States Federal Reserve on the other hand has little pressure on him to increase the Federal cash rate, even though a number of United States indicators have suggested that the United States economy is on the mend. Fear still remains that the United States economy is not likely to grow as quickly out of its 2001 recession as expected. Favourable economic information may merely be a function of warehouse replenishing and may prove to be a false dawn.

Local inflation has been the result of New Zealand's economic cycle being favourably out of alignment with our overseas trading partners. As the local economy has been much stronger, there has been continued pressure on spare capacity (labour, and other resources). As demand increases, prices increase, which is a simple function of supply and demand. Housing prices, the increased taxes on fuel, and the yet unknown indirect effects of Venezuelan and Iraqi crude supply also fuels this.

The increase in interest rates has an effect on the strengthening of the New Zealand dollar compared to other currencies. As interest rates are increased, while other trading partners interest rates remain steady, the New Zealand dollar will appreciate. This is evidenced in the graph below (courtesy of the National Bank of New Zealand).



Trade Weighted Index (TWI) – Last 12 Months

As the dollar appreciates, importers and New Zealand travellers to overseas destinations are favoured, while exporters seek to protect their margins through exchange hedgers. Conversely, while the New Zealand dollar was weak, tourism and exports had flourished. Now as imports become cheaper, importers have the opportunity to either decrease prices, which is unlikely due to prices being sticky to decreases, or increase profits that were lost over the last two years of currency weakness.

Interest Rate Expectations

The Reserve Bank of New Zealand is likely to continue increasing the Official Cash Rate to a neutral position of 6.0% or higher over the course of 2002. Other major trading partners on the other hand, appear to be waiting for a move from the United States Federal Reserve, before committing themselves to increases in cash rates.

Expectations of a United States Federal cash rate increase in May have been somewhat muted by Allen Greenspan's recent dialogues. When the rest of our major partners will start to increase interest rates becomes difficult to pick. However, unless there are deeply entrenched issues contaminating the United States economy, interest rates are still likely to increase through the second half of 2002. Until this begins to occur, New Zealand long term interest rates will continue to be comfortable at the levels they have been for much of this year.

As New Zealand interest rates increase, out of sync with the rest of our major trading partners, we should expect to see the New Zealand dollar to continue its appreciation. This lends itself to a growing cynicism from some economist regarding the relationship between growth and inflation, and the Reserve Bank of New Zealand's 0 – 3% inflation target.

Up coming dates

Monetary Policy Statement	15 May 2002
New Zealand Government Budget	23 May 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
31 March 2002**

	TERM DEBT (to fund long term assets) (\$'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	-
	Budget 2001/2002 year end gross term debt	165,598
	Forecast year end Sinking Fund Commissioner assets	5,520
	Anticipated 2001/2002 Year End Net Term Debt	160,078

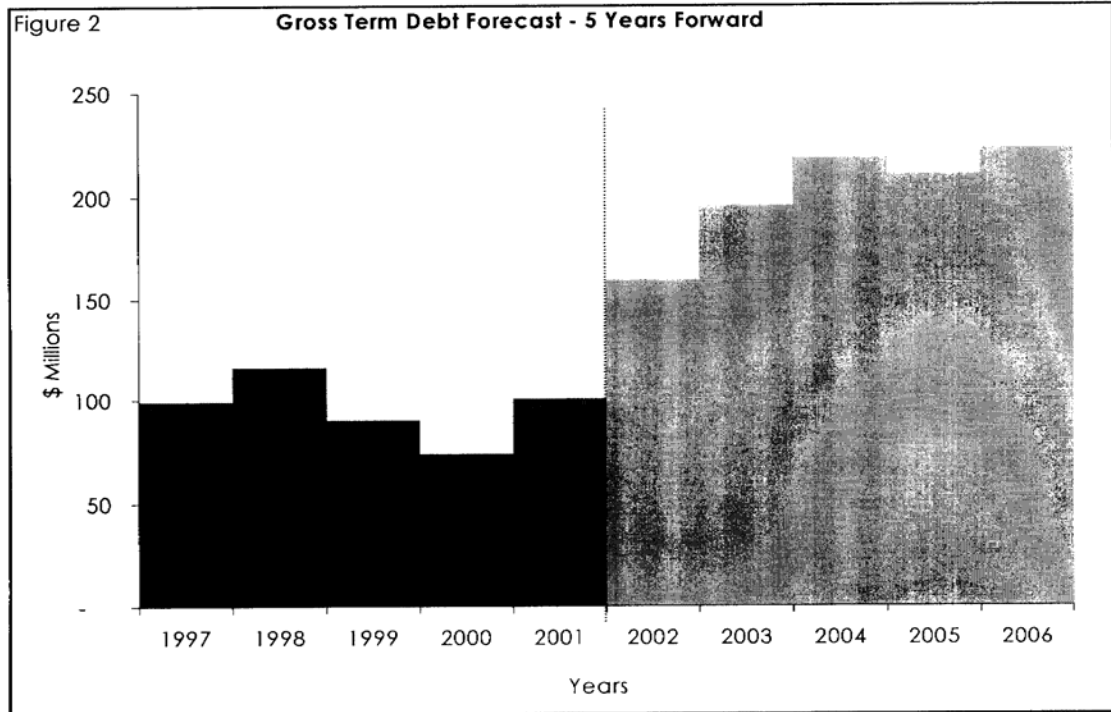
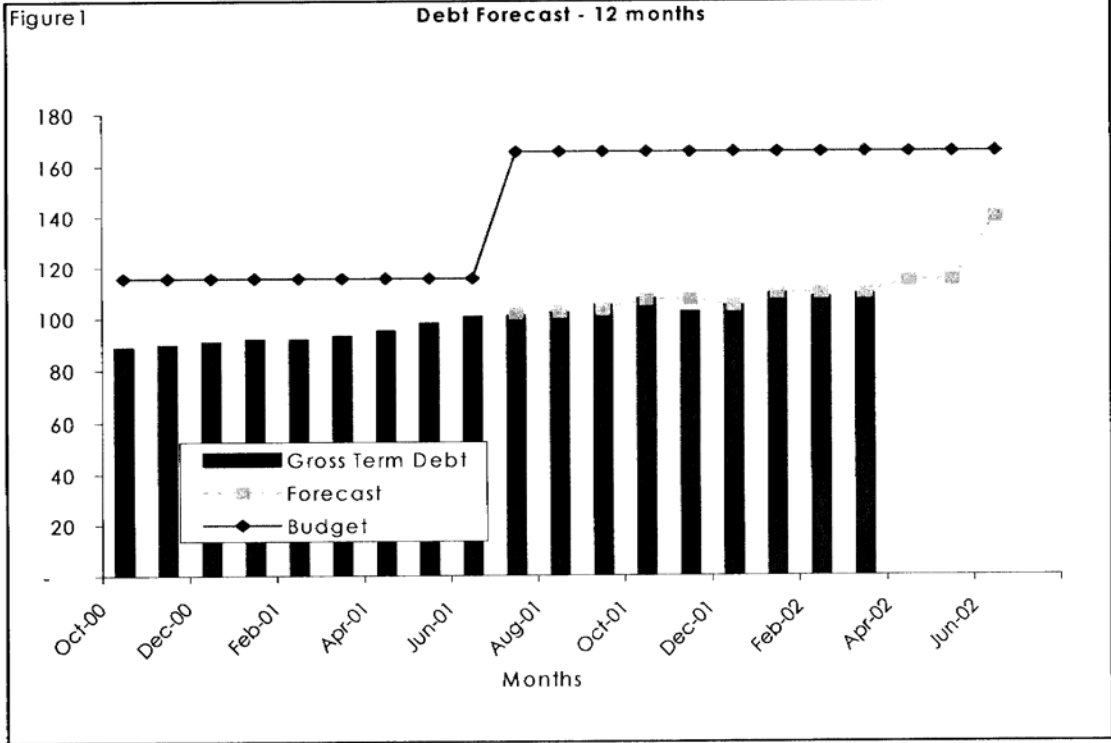
	TERM DEBT PORTFOLIO (\$'000's)		
	February 02	February 02	
<i>Term debt position at 31 March 2002</i>	Term debt borrowed externally	109,521	102,430
	Special funds (used to reduce Council's external borrowing)	1,485	5,953
	Gross term debt	111,005	108,383
	Total Sinking Fund Commissioner assets	5,250	5,420
	Net term debt	105,755	102,963

<i>Term debt - source of funds at 31 March 2002</i>	Debenture stock - fixed rate (security: Debenture Trust Deed)	57,796	58,496
	Debenture stock - floating rate (security: Debenture Trust Deed)	45,025	45,025
	Secured bank loans (security: Debenture Trust Deed)	-	-
	Unsecured bank loans	\$6,650	(\$1,150)
	Finance Leases (security: associated asset)	50	59
	External borrowing	109,521	102,430
	Special funds (used to reduce Council's external borrowing)	1,485	5,953
	Gross term debt requirement	111,005	108,383

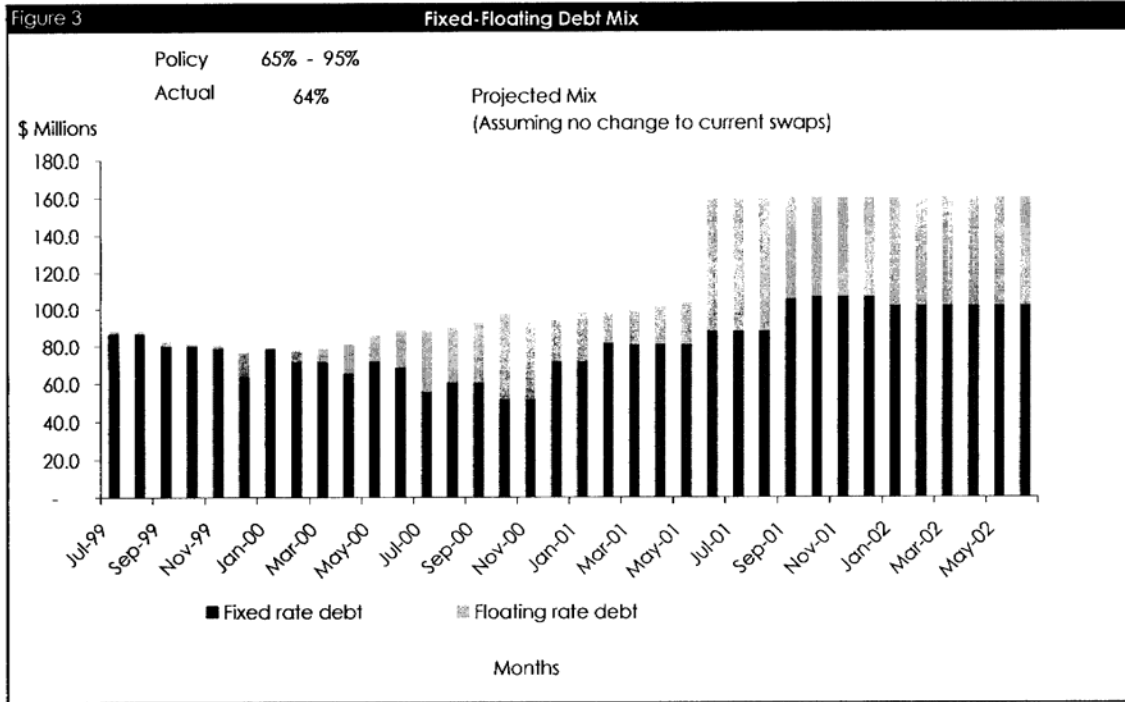
	WORKING CAPITAL (\$'000's)		
<i>Working capital borrowing at 31 March 2002</i>	Unsecured bank loans	-	-
	Special funds (used to reduce Council's external borrowing)	9,725	5,952
	Council working capital borrowing requirement	9,725	5,952

	CASH INVESTMENTS (\$'000's)		
<i>Cash investments held in trust 31 March 2002</i>	Debt repayment fund	-	-
	ARST fund (excluding fund allocations)	1,072	1,067
	Total cash investments	1,072	1,067
	Invested for 90 days - Current investment interest rate	4.85%	4.85%
	Weighted Average Interest Rate	%	%
	Gross Weighted Average Interest Rate	7.28%	7.30%

Debt Forecast



Fixed-Floating Debt Mix



Net Interest Rate Repricing Risk Profile

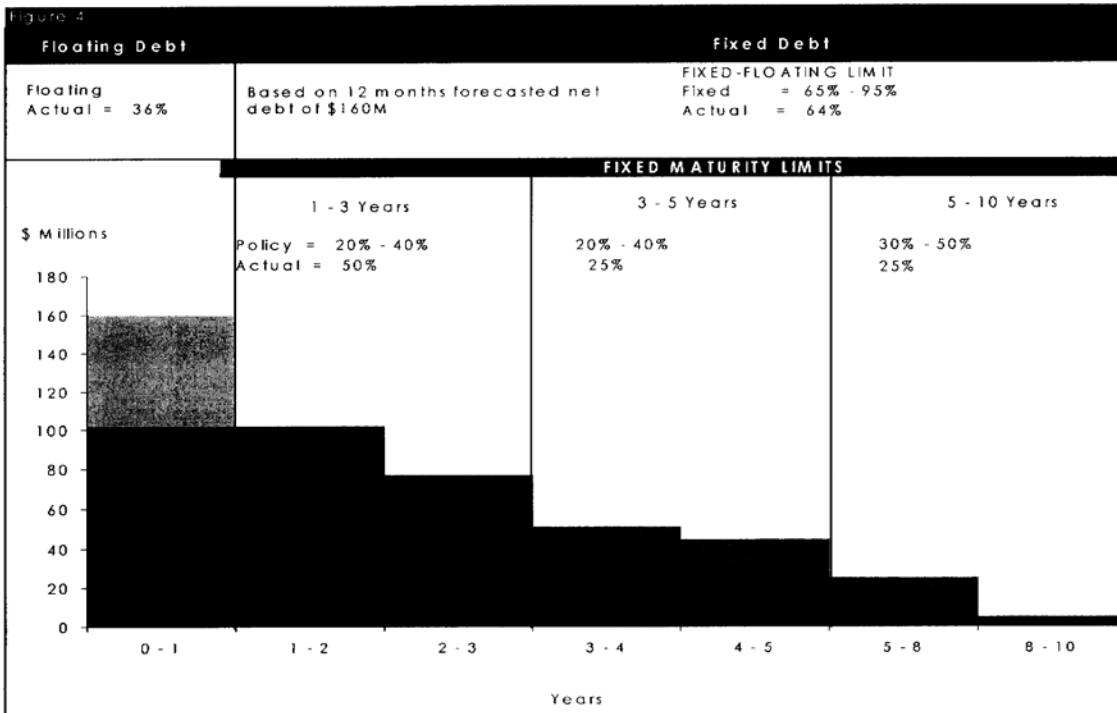
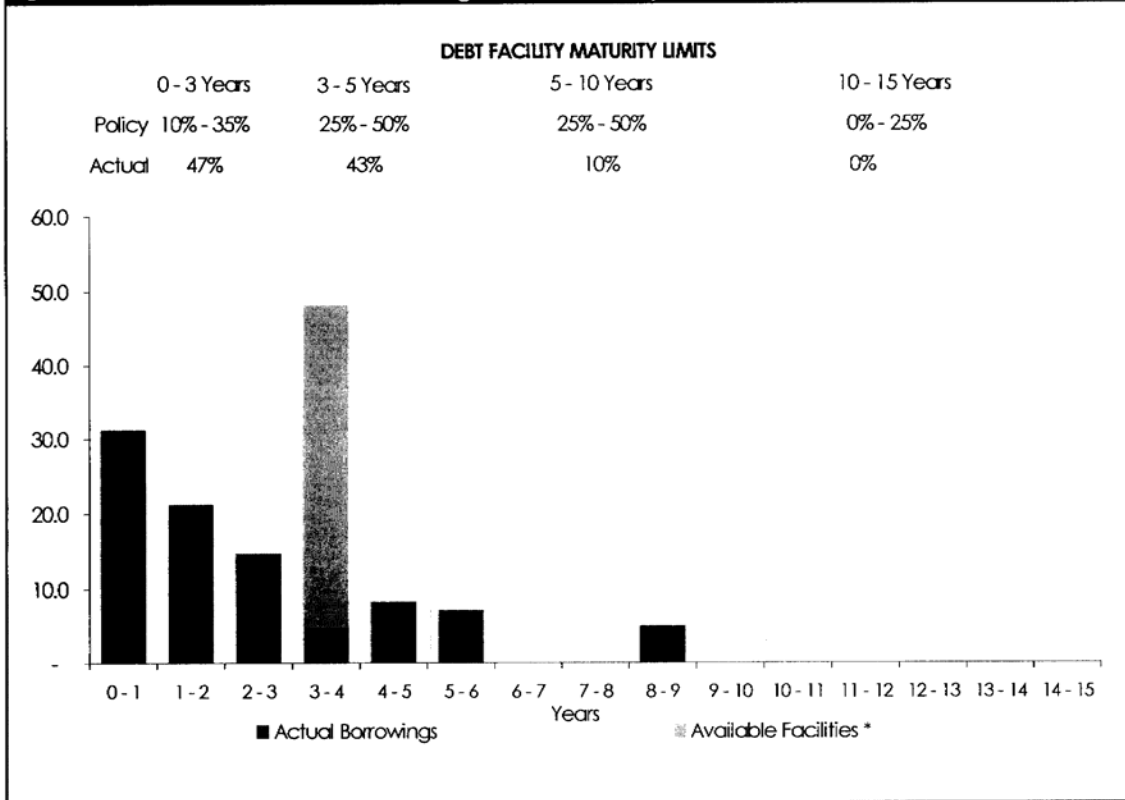


Figure 5

Funding Risk: Debt Maturity Profile



* Note: (1) Available facilities net of 6.7m 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.

Council Approved Debt Sources	\$ Millions		
	Total		
	Committed Funding Sources	Usage	Available
Bank Loans			
Short Term (uncommitted)	\$0.0	\$6.7	\$0.0
Long Term (committed)	\$50.0	\$0.0	\$43.4
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	\$0.1	\$0.0
TOTAL	\$153.8	\$109.5	\$44.4

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

