11. INTEREST RATES APPLICABLE TO COMMUNITY LOANS

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PURPOSE OF REPORT

1. The purpose of this report is to consider and recommend new procedures for the charging of interest on community loans. Attached schedules 1-3 are the documents which will be forwarded to borrowers and attached schedule 4 sets out the existing schedule of loan.

EXECUTIVE SUMMARY

2. Under New Zealand International Financial Accounting Standards (NZ IFRS), the Council is required to account for loans to community and sporting organisations at fair value (ie, using commercial rates of interest).

3. This requirement directly conflicts with the Council's intent to assist these organizations by providing loans at beneficial interest rates (typically 2%).

4. A solution is for the Council to return the additional interest cost to the borrower by way of a grant, the term of which will match that of the loan. This will provide the added benefit of identifying the true level of financial support accorded to each entity by the Council when a loan is advanced.

FINANCIAL AND LEGAL CONSIDERATIONS

5. Pursuant to the Local Government Act 2002, the Council must comply with generally accepted accounting practice.

6. The Council will be required to record additional interest revenue based on commercial rates of interest, which will be directly offset by grants expense. There is no financial impact on either the Council or the organisation.

STAFF RECOMMENDATION

It is recommended that the Council provide community loans at commercial rates of interest, and, at the same time, provide a grant to the loan recipients for the incremental interest cost.

BACKGROUND ON INTEREST RATES APPLICABLE TO COMMUNITY LOANS

7. NZ IFRS were introduced in New Zealand in December 2004. These new accounting standards are mandatory from 1 January 2007, although entities have the option to adopt them as early as 1 January 2005. The Council, at its meeting on 30 June 2006, resolved to adopt NZ IFRS from 1 July 2006, to coincide with the preparation of the LTCCP 2006-16. NZ IFRS represents a move from historic cost towards fair value.

8. The Council, under its Investment Policy, makes loans to community organizations.

9. In its meeting of 10 February 2006, the Audit and Risk Management Subcommittee resolved:

   "1. That future community loans be granted at commercial rates, with the additional interest cost being returned to the borrower by way of a grant.

   2. That existing loans be amended to reflect commercial rates, backdated to 1 July 2006, and that the appropriate grants be given.

   3. That community loans be designated as Loans and Receivables at transition to IFRS, and annual amortisation and impairment testing occur thereafter."

10. In practical terms, new loan agreements will be prepared for the existing material community loans (ie, loan balances of $50,000 or more at 30 June 2006), to reflect the use of commercial interest rates. Grant documents will also be prepared for the additional interest cost incurred above the beneficial rate. A covering letter will be provided, explaining the impact of the change in interest rates. It is expected this procedure will cause minimal disruption to the borrowers. There are currently 58 loans in place of which only 15 are for $50,000 or more.

11. The new loan agreements and grant documents will also be used where new loans are granted.

12. The commercial rate of interest is based on the Council's cost of borrowing, using the relevant benchmark rate-setting mechanism for interest rate swaps over the period of the loan, plus a 1% margin in recognition of risk and administration costs.

OPTIONS

13. The Council has the following options:

    (a) Status quo (ie, do nothing); or

    (b) Adopt the staff recommendation.