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Corporate Plan Output: Borrowing Management Policy and Investment Policy Volume I Pages 22-26	

This is the first of regular reports on the performance of the Council's treasury management as required by the adopted policies for borrowing and investments. The reports are intended to provide accountability for management of the debt and investment portfolios. The activities covered are for Christchurch City Council from 1 July 1998 and exclude Christchurch City Holdings Ltd which reports separately to the Council.

### BACKGROUND

In 1998 the Council adopted Borrowing and Investment Policies which came into effect on 1 July 1998. This is in compliance with the requirements of the Local Government Act introduced by the No. 3 Amendment in 1996. The adopted policies incorporate the Financial Management Policy of the Council and set out management procedures and policies to be applied in respect of loan borrowing to fund capital expenditure and investing Council funds.

As this is the first report it includes background information which will not necessarily be included in future reports.

### TREASURY REVIEW TEAM

A Treasury Review Team has been established to overview investments, funding and strategy issues as required by the policies. This team meets on a regular basis (currently monthly) and reviews treasury position and requirements, policies and procedures and strategies adopted. The review team is chaired by the Director of Finance, Bob Lineham. Other members are Geoff Barnes, Financial Policy and Funds Manager, Paul Melton, Financial Services Manager and Paul Baldwin, Funds Account. Also a member is Peter Cavanaugh of Bancorp New Zealand Ltd, merchant bankers, who have been appointed as independent treasury advisors in terms of the policies.

### INVESTMENTS – GENERAL OVERVIEW

The Council's investment policy provides for reporting on the position of the Council's investments on a quarterly basis.

The Council's portfolio of investments fall within several distinct classes.

- Short term liquid investments to provide liquidity for the Council's operations (overnight to one year term).
- Long term investments to provide a higher level of return and generally matched to the expected need to draw-down funds to meet project commitments. Generally these are special purpose and trust funds.
- Loans to individuals and community organisations. Loan terms are set to meet the particular requirements of each case with no security or varying levels of security taken.

- Shares in listed public companies. The only shares currently held are those bequeathed to the Council for a new Art Gallery.
- Real estate for investment purposes invariably where there are other reasons for Council ownership. The Property Manager has primary responsibility for this portfolio and reports separately to the Council on its performance.
- Investment in Subsidiaries. The Council has significant investment in subsidiary trading companies (LATES) through its holding Company, Christchurch City Holdings Ltd. These are reported on separately.

No external investments are held which fall outside the Council's investment policy.

## **INVESTMENTS REPORT – PARTICULAR ISSUES**

### **Interest Rate View**

The Investment Policy (section 5.3) provides that the Funds Manager shall form an interest rate view based on professional advice. A similar provision is made in the Borrowing Policy. Following consultation with Bancorp and discussion by the Treasury Review Team the most recent view formed for investment purposes is that by December 1999, 90 day bank bills rate is expected to be 5.5% and 10 years bonds expected to be 6% with positively varying rates between for other terms. Since that view was formed in mid March the Reserve Bank has moved from using the Monetary Conditions Index (MCI) for "desired conditions" to an Official Cash Rate (OCR) the first of which was announced on 17 March 1999 and set at 4.5%. The Review Team will reconsider its interest rate view in light of the announcement at its next meeting in April.

### **Use of Special Funds**

During the period the Review Team has approved the use of special funds to provide temporary funding for operations. The factors taken into account were:

- Timing of special dividends and capital repayment receipts that have not passed to the Council in the timeframe originally budgeted.
- The timing of draw-down of loan funds for carried forward capital works.
- Provision being made to credit the special funds so utilised with full interest earnings by the standard formula calculated from the weighted average of all Council investments.

### **Short Term Liquid Investments**

The Council requires a reasonable level of short-term funds for liquidity reasons. The levels held meet these needs without recourse to external borrowing except in exceptional circumstances. Short-term borrowing would normally be by bank overdraft facility.

The delay in receipt of special dividends and capital receipts has meant that funding for scheduled debt repayment and capital projects have been from working capital or other reserve funds. Investments have therefore been lower than expected and kept relatively short. Once special dividends and capital receipts are fully to hand this situation will be rectified.

It is planned that these be expended over the next two to three years for programmed capital expenditure in place of new borrowing and repayment of existing debt as it falls due. In the meantime, the Council is in the position of being a net investor while funds balances are available.

In recent years in response to the change in shape and slope of the interest yield curve the Council's investments had moved towards the shorter maturities (less than one year) to take advantage of higher short term interest rates that have prevailed. The interest yield curve had been inverse and premiums were gained by investing short.

However from July 1998 interest returns have diminished. This is a result of both a change to a positive shaped interest yield curve (i.e. lower short term compared to higher long term) and the general easing of interest rates as the impact of the Asian economic crisis hit economies world wide and brought recession to New Zealand.

Short term and at call investments currently comprise 78.5% of the Council's investment portfolio. However this will be reviewed as the liquidity position improves.

No exposure to any bank exceeds 20%.

#### **LONG TERM INVESTMENTS IN AUTHORISED STOCKS AND BONDS**

As interest rates on long term investments have increased over short term interest rates the Council has increased its holdings in stocks and bonds which meet the investment criteria. The strategy adopted has been to increase yield and maintain flexibility to take advantage of expected future yield increase and match long term funding requirements.

Long term investments currently comprise 16.6% of the Council's investment portfolio.

#### **Loans to Individuals and Community Organisations**

Included in this category are loans to sports clubs, community organisations (e.g. Theatre Royal, Christchurch East School) special projects (e.g. lighting Jade Stadium) and private individuals and groups (e.g. drainage loans).

These loans are subject to authorisation by the Council (or Committee if delegated) either on a one off basis or by class (e.g. drainage improvement loans).

Terms and rate of interest are set on a case by case and take account of the level of benefit to the community if discretionary rates are charged. In the absence of specific instructions then rates at least one percent above the Council's borrowing rate are charged for administration and risk.

One loan for \$3,150 has been written off this financial year. The final instalment of \$4,830 on another loan is outstanding more than six months. Discussions are taking place with the club concerned to achieve repayment. A drainage loan secured by a statutory land charge is in default. The principal sum outstanding is \$148. Full recovery of principal and interest is expected.

No other loans are subject to recovery action for default.

Loans to individuals and community organisations total \$3,483,224 and comprise 4.3% of the Council's investment portfolio.

## **Shares in Listed Public Companies**

The Council holds a medium-sized portfolio of shares in listed public companies as a result of a bequest to assist with building a new Art Gallery. The shares held are in Australian and New Zealand companies.

The capital value of the portfolio has grown over the time held and has additionally provided a dividend stream to augment the funds available from the special fund for a new Art Gallery.

The portfolio is not actively traded and any action is taken only after advice is received from an independent broker. Activity is normally limited to bonus share issues, rights to participate in share purchase plans within existing share holdings and consequent actions that result from company restructurings.

Brokers, Hamilton Hindin Greene, revalue the portfolio each year and make recommendations applicable to the stock held.

Shares in listed public companies comprise 0.7% of the Council's investment portfolio.

## **BORROWING – GENERAL OVERVIEW**

As reported above the Council is a net investor for the next two to three years and is not expected to borrow in the meantime for rate funded activities. However some external borrowing may be required over this period to new maturing loans which specifically fund investments in Council LATES.

### **Interest Rate View**

Based on the present market conditions and the Council's very strong Standard and Poors long term credit rating of AA the Council could expect to pay the following margins over Government bond rates if it were borrowing.

Term	Margin
1 - 3 years	70 – 75 points
3 – 5 years	95 points
Over 5 years	95 points

For floating rates if the Council were a borrower it could be expected to obtain funds at rates equal to or very close to bank bills. This interest rate view will be reconsidered at the next meeting of the Treasury Review Team following announcement of the Official Cash Rate (OCR) by the Reserve Bank. Margins are expected to reduce. The Reserve Bank has signalled that it expects 90 days bank bill rates in the open market to be closely related to the market cash rate which itself will trade within a range of .25% either side of the OCR (initially set at 4.5%). The OCR will be reviewed approximately every six weeks and any changes the Reserve Bank considers necessary will be in .25% intervals.

## **BORROWING REPORT – PARTICULAR ISSUES**

### **Interest Rate Risk**

The Council has no hedging or derivative contracts in place to cover interest rate risk on existing borrowings.

## Temporary Funding for Christchurch City Facilities Ltd

The Council has borrowed by way of bank accommodation for the purposes of lending to Christchurch City Facilities Ltd a fully owned subsidiary of the Council for cash flow purposes.

Two arrangements were made in early February and early March this year for periods of up to 48 days.

- The advances are unsecured
- The Council is charging the company interest rate of one per cent above the lending rate from the bank
- The bank interest rates are related to bank bill rates.
- Repayment will occur on 31 March when subvention payments are made to the company.

## Loan Redemptions 1998-99 and Maturity Profile

The following table sets out loan repayments due to be made during the current year.

### Funded from Rates

<b>Maturity</b>	<b>Loan</b>	<b>Amount</b>
15-Aug-98	EECA (Energy Conservation)	\$19,499.67
1-Nov-98	Works Development Loan No 1 1993	4,000,000.00
15-Nov-98	EECA (Energy Conservation)	37,583.00
15-Feb-99	EECA (Energy Conservation)	19,499.67
15-Mar-99	Works Development Loan No 1 1993	5,000,000.00
15-Mar-99	Works Development Loan No 1 1993	1,000,000.00
15-May-99	EECA (Energy Conservation)	37,583.00
	<b>Total</b>	<u>\$10,114,165.34</u>

### Housing Loans

<b>Maturity</b>	<b>Loan</b>	<b>Amount</b>
15-Nov-98	Renewal Loan 1993 – Elderly Persons Housing	\$600,00.00
15-Nov-98	Renewal Loan 1993 – Public Rental Housing	1,400,00.00
15-Dec-98	Renewal Loan 1993 – Elderly Persons Housing	2,900,00.00
15-Dec-98	Renewal Loan 1993 – Public Rental Housing	1,100,00.00
15-Mar-99	Renewal Loan 1993 – Elderly Persons Housing	500,00.00
15-Mar-99	Renewal Loan 1993 – Public Rental Housing	<u>1,000,000.00</u>
		7,500,000.00
1998/99	Housing Table Loans	<u>137,036.71</u>
	<b>Total</b>	<u>\$7,637,036.71</u>

### Fully Defeased Loans

<b>Maturity</b>	<b>Loan</b>	<b>Amount</b>
1-Jul-98	Various Loans	\$40,400.00
1-Aug-98	Various Loans	387,300.00
1-Nov-98	Various Loans	1,583,800.00
1-Feb-99	Various Loans	200,200.00

1-Mar-99	Various Loans	70,000.00
1-May-99	Various Loans	<u>1,800.00</u>
	<b>Total</b>	<u><u>\$2,283,500.00</u></u>

**Summary all loans** \$20,034,702.05

The maturity profile on the Council's debt portfolio is set out in the following table:

<b>Year</b>	<b>Rate Funded WDL</b>	<b>Separately Funded</b>	<b>Defeased Loans</b>	<b>Total</b>
1998-99	10,114,165	7,637,037	2,283,500	20,034,702
1999-00	32,829,083	3,100,000		36,028,083
2000-01	7,500,000	0		7,500,000
2002-02	2,250,000	0		2,250,000
2003-04	0	0		0
2004-05	0	0		0
2005-06	0	0		0
2006-07	0	0		0
2007-08	0	0		0
Later	<u>\$52,792,248</u>	<u>\$10,737,037</u>	<u>\$2,283,500</u>	<u>\$65,812,785</u>

As outlined above, funds are earmarked from special dividends and capital receipts to be held in debt repayment reserve to repay most of this debt as it falls due for maturity.

Graphs showing the present situation relating to Council investments are attached.

**Chairman's  
Recommendation:** That the information be received.