greater WELLINGTON
THE REGIONAL COUNCIL

Report	**04.21**
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Committee	**Policy, Finance and Strategy**
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Borrowing Approval

1. Purpose

To seek approval to enter into a new committed funding facility.

2. Background

The Council's overall level of external debt has been steadily reducing since 1991/92, apart from a significant increase in 1998/99 when the Council borrowed $25 million in order to on-lend it to the Wellington Regional Stadium Trust. The Council's historical external debt position at 30 June each year has been as follows:

1991/92	$123.5 million
1992/93	$110.2 million
1993/94	$114.6 million
1994/95	$105.1 million
1995/96	$106.8 million
1996/97	$89.6 million
1997/98	$82.0 million
1998/99	$100.7 million
1999/00	$95.7 million
2000/01	$87.4 million
2001/02	$82.7 million
2002/03	$70.1 million

At 31 December 2003 Council's total external debt was at a historic low of $69.7 million.

At the same time as the total Council debt has been reducing, the composition of that debt has been changing, away from a high concentration of local authority stock (the traditional manner used by local authorities to borrow money) into increased bank funding (via committed funding facilities).

This decision to move towards increased bank funding was taken after the introduction of the Local Government Amendment Act (No 3) 1996 which provided councils with increased flexibility in terms of borrowing.

At 31 December 2003 the Council's external debt comprised of:

	Amount	%
Local authority stock	$9.3 million	13.4
Committed bank funding	$31.6 million	45.3
Bank funding (Stadium loan)	$21.6 million	31.0
Forestry encouragement loans	$7.2 million	10.3
Total	**$69.7 million**	**100%**

Taking into account the "ring fenced" Stadium loan, the Council's major source of funding is currently from banks (76.3%) and this trend is expected to continue as the majority of the remaining $9.3 million of local authority stock is due to mature during the 2004 calendar year.

The Council's bank funding is currently sourced from a combination of the National Bank of New Zealand (Council's transaction bank) and the ANZ Bank.

During the second half of 2003 the ANZ Bank purchased the National Bank of NZ, meaning that our previous banking relationship with two banks is soon to become one bank.

3. Why do we need to look at Council's committed funding facilities?

Essentially, there are four key drivers which have led me to review Council's committed bank facilities:

a) **Council's increasing reliance on bank funding through the change in mix of funding**

As noted in section 2 of this report, although Council's total debt has been reducing in recent years, the steady stream of local authority stock maturities which need to be refinanced, have meant Council's use of existing committed bank funding lines has been steadily increasing in recent years, even though total Council debt has been reducing.

This trend is expected to continue during 2004 with approx $9 million of stock maturing which will need to be refinanced by bank funding.

b) **Council's LTCCP includes a projection that external debt will remain around $70 million until 2009/10**

Our latest long term debt projections (soon to be considered as part of the 2004/05 Annual Plan process) indicate that our total external debt will be held between $65 and $70 million for the next five to six years. Implicit in this projection therefore is a replacement of local authority stock funding with committed bank funding (ref (a) above), rather than the stock maturing and not requiring to be refinanced.

c) **Officers have previously reported a technical breach against Council's Treasury Policy for the September 2003 quarter where our liquid bank deposits and undrawn committed funding did not quite cover our self insured funding requirement**

As noted in report 03.711, at 30 September 2003 the Council had available liquidity of $50.4 million to cover self insurance requirements and contingency reserves of $51.5 million, giving rise to a shortfall of $1.1 million.

Although this was not considered to be a serious breach of policy (as the self insured assets and contingency reserves were 98% covered) I did note in report 03.711 that the Council's Treasury Management Group would continue to monitor the situation, and if necessary, a recommendation would be made to the Committee for increased committed line funding in the new year.

d) **The ANZ's purchase of the National Bank means that we will soon be effectively sourcing the majority of our debt funding from one bank**

As the CFO I am uncomfortable continuing to source an increasing percentage of our long-term funding requirements from one bank. Although there is no credit risk to the Council (as we are the borrower) I think it is still prudent not to put all our eggs in one basket if it can be avoided. Establishing a long-term relationship with another bank would provide more assurance that should the Council need access to more funding (perhaps in the event of an emergency) we would have more scope to readily access the necessary funding. This is due to the fact that banks are always mindful of customer concentration risk and employ limits for each customer over which they are reluctant to go. Spreading our borrowing across two banks would significantly reduce this risk in my view.

Summary

Although Council's total external debt requirements are projected to hold steady at around the current level for the next few years there is a further $9.3

million of local authority stock which will need to be funded by committed bank funding.

In addition, the Council was technically in breach of its Treasury Policy as at 30 September by not having sufficient unutilised committed bank funding (a shortage of approx $1.1 million). While this compliance limit was not breached at 31 December it does suggest ongoing compliance could become touch and go.

Taking these two factors together suggests that our committed bank funding facilities need to increase by approx $10 million over the next 12 months.

Faced with this situation I would normally be asking the Committee to authorise an increase to our existing committed line facilities with our current banks (National Bank and the ANZ).

However, the purchase late last year of National Bank by the ANZ Bank means that we will shortly in effect be dealing with only one bank. Therefore officers have been investigating the establishment of a new committed line facility with a new bank.

4. What does the Council's Treasury Policy say?

The authority to approve the Council's external borrowing programme, including new debt facilities, rests with the Council.

5. How much should the new committed facility be for?

As noted in section 3 of this report it appears that the Council will have a requirement for additional bank funding of up to $10 million over the next 12 months or so (to replace existing local authority stock and to provide sufficient cover for self insured assets).

As our existing facility with the ANZ is for $20 million I am recommending that the Council establishes a new committed funding facility of $30 million with a new bank.

Depending on Council's funding requirements arising from the 2004/05 Annual Plan/LTCCP update process (including any funding associated with rail) we will then be in a position to determine whether any of the existing $20 million ANZ facility amount needs to be added to the existing $24 million National Bank committed funding line, or whether we can terminate the current ANZ facility altogether. If we no longer need the $20 million ANZ facility we will in effect increase our total committed facilities by $10 million ($30 million new facility less $20 million ANZ facility).

6. What is the current position in terms of selecting a new bank?

Late last year officers invited the three major banks, other than Council's current relationship banks (i.e. Westpac, BNZ and ASB), to submit offers to the Council outlining the terms and conditions under which they would be prepared to establish up to a $30 million committed advance facility with the Council.

Prior to Christmas the Council's Treasury Management Group considered these offers and decided to shortlist the Westpac and BNZ offers for further consideration.

I then sought advice from Council's independent Treasury advisor (Bancorp) and legal advisors (Chapman Tripp) on the merits of both offers.

Discussions have since been held with key representatives of each bank and revised term sheets have been received from the banks.

On 5 February the Treasury Management Group further considered the two competing offers taking into account the independent advice received as noted above.

We have since commenced discussions with Westpac, our preferred bank, in terms of the detailed documentation which will be required to establish a new committed funding facility for $30 million. However, until negotiations are concluded I am seeking approval to enter into a new facility with either of our shortlisted banks. If that process is concluded by 19 February I will advise you at the meeting.

7. Establishment of a new incidental arrangement facility

The Council currently has facilities to enter into incidental arrangements with two banks, namely National Bank of New Zealand and the ANZ Bank.

These facilities were entered into pursuant to the following Council resolution:

Report 98.360 4 August 1998

(2)(a) Council authorise the use of incidental arrangements (as defined in section 122ZB of the Local Government Act 1974) but limited to use of the following instruments:

Forward Rate Agreements
Interest Rate Swaps
Interest Rate Options

(b) Council's Treasury Management Policy – Appendix IV be amended to reflect Council's approval of the use of the instruments identified in resolution (2)(a) above.

(c) Council authorise the establishment of incidental arrangement facilities to be provided by one or more financial institutions, on such terms and conditions to be determined by the Chief Financial Officer, pursuant to, and in accordance with, section 122ZD (3) of the Local Government Act 1974 (as amended) (the "Act").

(d) *Council agree that pursuant to section 122ZD (2) of the Act, the incidental arrangements authorised pursuant to resolution (2)(c):*

- *shall be for the management of interest rate risks associated with actual, committed and projected borrowings or investments of the Council;*

- *shall be unsecured and entered into on the basis of the negative pledge to be given by the Council.*

- *after considering the risks and benefits to the Council of the incidental arrangements, shall be for the benefit of the Council and will not give rise to any unreasonable risks for the Council; and*

- *shall be entered into in accordance with the Council's Treasury Management Policy (dated April 1997, as amended).*

(e) *Council authorise the Chief Financial Officer to negotiate, approve and agree the precise terms and conditions of one or more incidental arrangements with such financial institutions and on such terms and conditions as considered appropriate and to execute all documentation on behalf of the Council or cause such documentation to be executed by the Council, under its common seal, as the case may be.*

In conjunction with the establishment of a new committed funding facility, I now also wish to enter into a new incidental arrangement facility with either Westpac or BNZ. This does not require specific approval at this time (as it was approved in 1998 through resolution (c) above). However, it is included here for the Committee to note.

8. Communications

We are communicating closely with all affected parties i.e. all the major banks. No other communication is considered necessary at this time.

9. Recommendations

That the Committee recommend to Council that it:

(1) *receive the report and note its contents.*

(2) *authorise the entry into a new committed funding facility of up to $30 million with either Westpac Banking Corporation or the Bank of New Zealand on terms and conditions to be determined by the Chief Financial Officer, pursuant to relevant provisions of the Local Government Act 2002.*

(3) *note that the borrowing authorised pursuant to resolution (2):*

- *shall be for general working capital and cash management purposes of the Council, for capital expenditure purposes of the Council, more particularly described in the Long-term Council Community Plan of the Council, and for refinancing existing borrowings of the Council;*

- *will be unsecured, supported by Council's Negative Pledge Deed dated 19 May 1998;*

- *will be for the benefit of the Council and will not give rise to any unreasonable risks for the Council; and*

- *is in accordance with the Treasury Management Policy.*

(4) authorise the Chief Financial Officer, in accordance with the Treasury Management Policy, to negotiate, approve and agree precise terms and conditions of the committed funding facility, with either Westpac Banking Corporation or the Bank of New Zealand on such terms and conditions as considered appropriate and to execute all documentation giving effect to the committed funding facility on behalf of the Council, or to cause such documentation to be executed by the Council under its common seal.

(5) note that the Chief Financial officer is also currently negotiating with either Westpac Banking Corporation or the Bank of New Zealand for the establishment of a new incidental arrangement facility pursuant to the resolutions of Council in relation to report 98.360.

Report prepared by:

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Chief Financial Officer