greater WELLINGTON
THE REGIONAL COUNCIL

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Committee	Policy, Finance and Strategy
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Investments - Financial Forecasts 2003-2013

1. Purpose

To provide a summary of the returns expected from the Council's investments over the next ten years.

2. Background

The investment area of the Council includes:

- Bank Deposits
- WRC Holdings Group (including dividends from CentrePort)
- Administration Properties (e.g. Depots)
- Treasury Management
- Forestry and Business Unit dividends
- Regional Stadium

It is important to appreciate that Council's investments (excluding the Stadium) contribute $5,762,000 towards the rate line in 2003/04. This equates to approximately 12% of the total level of Regional rates.

3. Overall Financial Summary of Investment Area

The focus of this report is primarily on the 2003/04 year (the Council's next financial year).

The tables below detail the projected 2003/04 rate line impact of the investment area, compared with both the 2002/03 budget (table 1) and the 2003/04 budget which was set 12 months ago through the LTFS update (table 2).

In terms of the next ten years the contribution from investments is expected to significantly increase as the Council debt associated with the WRC Holdings Group is currently programmed to be repaid by 2005/06. This means that Council's investments are expected to become an even more significant contributor to the rate line in future years.

TABLE 1

	2002/03 budget ($000)	2003/04 'New' budget ($000)	Difference ($000)
Bank Deposits	(3,014)	(2,684)	330
WRC Holdings Group	980	688	(292)
Admin Properties	(30)	107	137
Treasury	(3,488)	(3,598)	(110)
Forestry & Business Unit Dividends	(275)	(275)	-
Sub Total	(5,827)	(5,762)	65
Regional Stadium	2,676	2,676	-
Total	**(3,151)**	**(3,086)**	**65**

( ) denotes contribution to the rates line

As can be seen from table 1 the net contribution to the Regional rate line from the investment area is $65,000 less than the 2002/03 budgeted level.

The major changes relate to:

- Reduced budgeted returns from Council's bank deposits as a result of changes in projected market interest rates.
- Increased budgeted returns from the WRC Holdings Group as a result of reducing interest costs, and an increase in the budgeted dividend from Pringle House Ltd.
- Reduced returns in 2003/04 from the Admin Properties activity due to installation of air conditioning in the Masterton building.
- Increased budgeted returns from the Council's Treasury function as a result of updating the key assumptions in the Treasury budget.

Comparing the contribution from investments with what was planned this time last year (i.e. what returns are already built into Council's existing numbers) shows:

TABLE 2

	2003/04 'Old' budget ($000)	2003/04 'New' budget ($000)	Difference ($000)
Bank Deposits	(3,014)	(2,684)	330
WRC Holdings Group	897	688	(209)
Admin Properties	39	107	68
Treasury	(3,318)	(3,598)	(280)
Forestry & Business Unit Dividends	(275)	(275)	-
Sub Total	(5,671)	(5,762)	(91)
Regional Stadium	2,676	2,676	-
Total	**(2,995)**	**(3,086)**	**(91)**

The major changes between the "old" budget for 2003/04 and the updated budget for the 2003/04 year (the "new" budget) relate to:

- Reduced budgeted returns from Council's bank deposits as a result of reducing market interest rates.
- Increased budgeted returns from WRC Holdings Group as a result of reducing market interest rates and an increase in the budgeted dividend from Pringle House Ltd.
- Increased budgeted returns from the Council's Treasury function due to changes in assumptions relating to debt levels and projected interest rates.

4. Explanation of each Investment area

4.1 Bank deposits

This activity contains the budgeted income on Council's bank deposits (currently $44 million) which was established as part of Council's restructuring of its ownership of CentrePort. As the Committee is aware, direct ownership of Council's interest in CentrePort is held by Port Investments Ltd, a 100% owned subsidiary of WRC Holdings Ltd.

Because of the size of the deposit, returns to the rate line are sensitive to even small changes in interest rates. A movement of 1% in projected interest rates changes the rate requirement by $440,000.

4.2 WRC Holdings Group

As noted in section 4.1 above, Council's interest in CentrePort continues to be held by Port Investments Ltd, a 100% owned subsidiary of WRC Holdings Ltd. The budgeted contribution to/from rates from the WRC Holdings Group incorporates all projected revenue (by way of dividends and subvention payments) from CentrePort. Dividend are projected to be paid by CentrePort based on 55% of the Port Company's Net Profit After Tax.

The other investment within the WRC Holdings Group is Pringle House Ltd which owns Council's head office building - The Regional Council Centre.

4.3 Admin Properties

Although grouped under the broad category of "investments" Council's interests in the Upper Hutt and Mabey Road depots and the Masterton office building could hardly be considered to be prime investments. (i.e. Council would not own these properties if it didn't occupy them.) Nevertheless, rentals are charged to internal tenants based on market rates and the properties are run on a commercial basis.

4.4 Treasury

The Treasury area within the Council manages the total debt portfolio of the Council along with Council's day-to-day cash flow requirements. In addition, Treasury manages the financial investments and reserves of the Council.

The Treasury area acts as the 'internal bank' for the Council and all departments that have debt or require debt funding, incur that debt with the internal bank. The external debt requirements are then negotiated by Treasury with external financial institutions. Maintaining Council's external credit rating through Standard and Poor's assists the Council to obtain competitive financing.

Interest is charged on internal debt by Treasury based upon the budgeted average cost of funds of the Council. The rate is set annually during the planning process. This year I propose to apply a rate of 7.75% for the 2003/04 year, which is down by 0.50% on the rate applied in 2002/03. All departments have budgeted financial costs for 2003/04 using 7.75%.

The broad approach of Treasury is to hold and where possible "average down" the weighted average cost of debt as existing debt matures, depending on the market rates at that time. The Council has historically taken a position of being well hedged against interest rate changes. As a result it is not always possible to take advantage of reductions in short term interest rates.

On the flip side, Treasury pays interest on reserves at 5.5% (the marginal cost of borrowing) on the basis that debt would be higher if such reserves were fully funded.

As a result of past Council surpluses and other inflows of funds being applied to debt, the Treasury area has significantly more internal loans than external loans. At 31 December 2002 the difference was approximately $55 million. This creates a Treasury surplus which is available to apply against projected rate requirements. The projected Treasury surplus across the ten years is shown in **Attachment 1**.

The overall Treasury funding surplus in 2003/04 is projected to be $3.6 million which is slightly higher than what has previously been budgeted for this area.

4.5 Forestry and Business Unit Dividends

The 'quasi commercial' operations of Council are all required to return an internal dividend to the rate line as follows:

Plantation Forestry	150,000
Reserve Forests (Wairarapa)	75,000
Akura Conservation Centre	35,000
Wairarapa workshop	15,000
	$275,000

These dividends are unchanged from those budgeted in 2002/03.

The rationale behind the internal dividend is as follows:

⇒ It ensures intergenerational equity in those investments such as Forestry where the large % of positive cashflows occur at the end of the asset life

⇒ It provides good commercial discipline into commercial operations and while the dividends are not set purely on net assets employed, it does resemble a cost of capital charge (this is considered important in such discretionary activities)

The level of dividends will continue to be reviewed annually. This is done not only at planning time but also as part of the Council's annual report at the end of each year when officers recommend whether such dividends should be paid.

4.6 Regional Stadium

While the Council's advance is interest free the advance is still considered to be an investment which will ultimately be repaid (otherwise it will need to be written off). Clearly this needs to be monitored in future, but at this stage it is too early to tell when repayment might be completed.

The level of Stadium Rate is unchanged from 2002/03 and is not expected to change within the ten years of the Long-Term Council Community Plan.

5. Changes to the forecasts recommended by officers

As the Treasury function provides the operating divisions with debt funding it is possible that any changes made to divisional business plans will impact on the Treasury budget. This impact will not be known until all other business plans have been finalised.

In addition officers are recommending that the pace of debt repayment on the Regional Council Centre (RCC) is amended in line with report 03.85.

6. Recommendations

That the Committee recommend to Council that it:

(1) receive the report and note its contents.

(2) note that the investment forecasts include the following areas:

- *Bank Deposits*
- *WRC Holdings Group*
- *Administration Properties*
- *Treasury*
- *Forestry and Business Unit Dividends*
- *Regional Stadium*

(3) note that officers are recommending the draft ten year Investment financial forecasts are amended to reflect the revised debt repayment profile on the RCC, in addition to any other than consequential changes as a result of changes to divisional business plans.

(4) approve the draft ten year Investment financial forecasts (as amended by the Committee) for inclusion in the Council's proposed Long Term Council Community Plan 2003-2013 (incorporating Council's 2003/04 Annual Plan).

Report prepared by:

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Chief Financial Officer

Attachment 1: Investments Financial Forecast