greater WELLINGTON
THE REGIONAL COUNCIL

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Committee **Policy, Finance and Strategy**
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Investments - Financial Forecasts 2004-2013

1. Purpose

To provide a summary of the returns expected from the Council's investments in 2004/05 and the following eight 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) are projected to contribute $7,549,000 towards the rate line in 2004/05. This equates to approximately 14% of the total level of Regional rates.

3. Overall Financial Summary of Investment Area

The focus of this report is primarily on the 2004/05 year (the Council's next financial year).

The tables below detail the projected 2004/05 rate line impact of the investment area, compared with both the 2003/04 budget (table 1) and the 2004/05 budget which was set 12 months ago through the LTCCP (table 2).

In terms of the remaining eight years the contribution from investments is expected to remain relatively constant across the planning period.

TABLE 1

	2003/04 budget ($000)	2004/05 'New' budget ($000)	Difference ($000)
Bank Deposits	(2,464)	(2,794)	(330)
WRC Holdings Group	(729)	(696)	33
Admin Properties	107	(48)	(155)
Treasury	(3,523)	(3,736)	(213)
Forestry & Business Unit Dividends	(275)	(275)	-
Sub Total	(6,884)	(7,549)	(665)
Regional Stadium	2,676	2,676	-
Total	**(4,208)**	**(4,873)**	**(665)**

( ) 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 $665,000 more than the 2003/04 budget level.

The major changes relate to:

- Increased budgeted returns from Council's bank deposits as a result of changes in projected market interest rates.
- Reduced budgeted returns from the WRC Holdings Group as a result of increasing interest costs.
- Increased returns from the Admin Properties activity largely due to the uneven timing of building improvement works.
- 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

	2004/05 'Old' budget ($000)	2004/05 'New' budget ($000)	Difference ($000)
Bank Deposits	(2,574)	(2,794)	(220)
WRC Holdings Group	(856)	(696)	160
Admin Properties	(29)	(48)	(19)
Treasury	(3,959)	(3,736)	223
Forestry & Business Unit Dividends	(275)	(275)	-
Sub Total	(7,693)	(7,549)	144
Regional Stadium	2,676	2,676	-
Total	**(5,017)**	**(4,873)**	**144**

The major changes between the "old" budget for 2004/05 and the updated budget for the 2004/05 year (the "new" budget) relate to:

- Increased budgeted returns from Council's bank deposits as a result of increasing market interest rates.
- Reduced budgeted returns from WRC Holdings Group as a result of increasing market interest rates.
- Reduced 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 from 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 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 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.

Council's Mabey Road depot has previously been included in this category. However, this has now been transferred to Flood Protection as the sole occupier of depot.

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 7.5% for the 2004/05 year, which is down by 0.25% on the rate applied in 2003/04. All departments have budgeted financial costs for 2004/05 using 7.5%.

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 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 2003 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 nine years is shown in **Attachment 1**.

The overall Treasury funding surplus in 2004/05 is projected to be $3.7 million.

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 2003/04. At this stage it is considered premature to require a dividend from Council's recently established Bovine business unit.

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. 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 2003/04 and is not expected to change within the remaining eight years of the LTCCP horizon.

5. Communications

Any communication opportunities will be dealt with as part of the overall communication of the Annual Plan.

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) approve the draft nine year Investment financial forecasts (as amended by the Committee) for inclusion in the Council's proposed 2004/05 Annual Plan.

Report prepared by:

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Attachment 1: Investments Financial Forecast