Treasury management update

Whakatāne District Council

27 March 2025

Brett Johanson - Executive Director

Agenda

1. Risk management environment
2. Treasury risks
3. Interest rate swaps
4. Summary

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An environment of risk management

Statutory objectives

Context is that Council is a prudent financial manager

- Paragraph 14 – Principles relating to local authorities

- "A local authority should ensure prudent stewardship and the efficient and effective use of its resources in the interests of its district or region, including by planning effectively for the future management of its assets"

- Paragraph 100 – Balanced budget requirement
- Paragraph 101 – Financial management

- "A local authority must manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community"

Risk framework

- Provides comfort to stakeholders that financial market risks are appropriately monitored and managed:
  - E.g. LGFA, bank lenders, ratepayers, auditors.
- Maintains consistency with statutory objectives of stewardship and inter-generational objectives.
- Risk framework provides safeguards from:
  - Financial market shocks that are likely to be from offshore.
  - Borrowing cost variability to plans.
  - Lack of certainty and protection in setting borrowing costs for the Long Term Plan consultation.
- Treasury is a risk management function.

Treasury risk framework

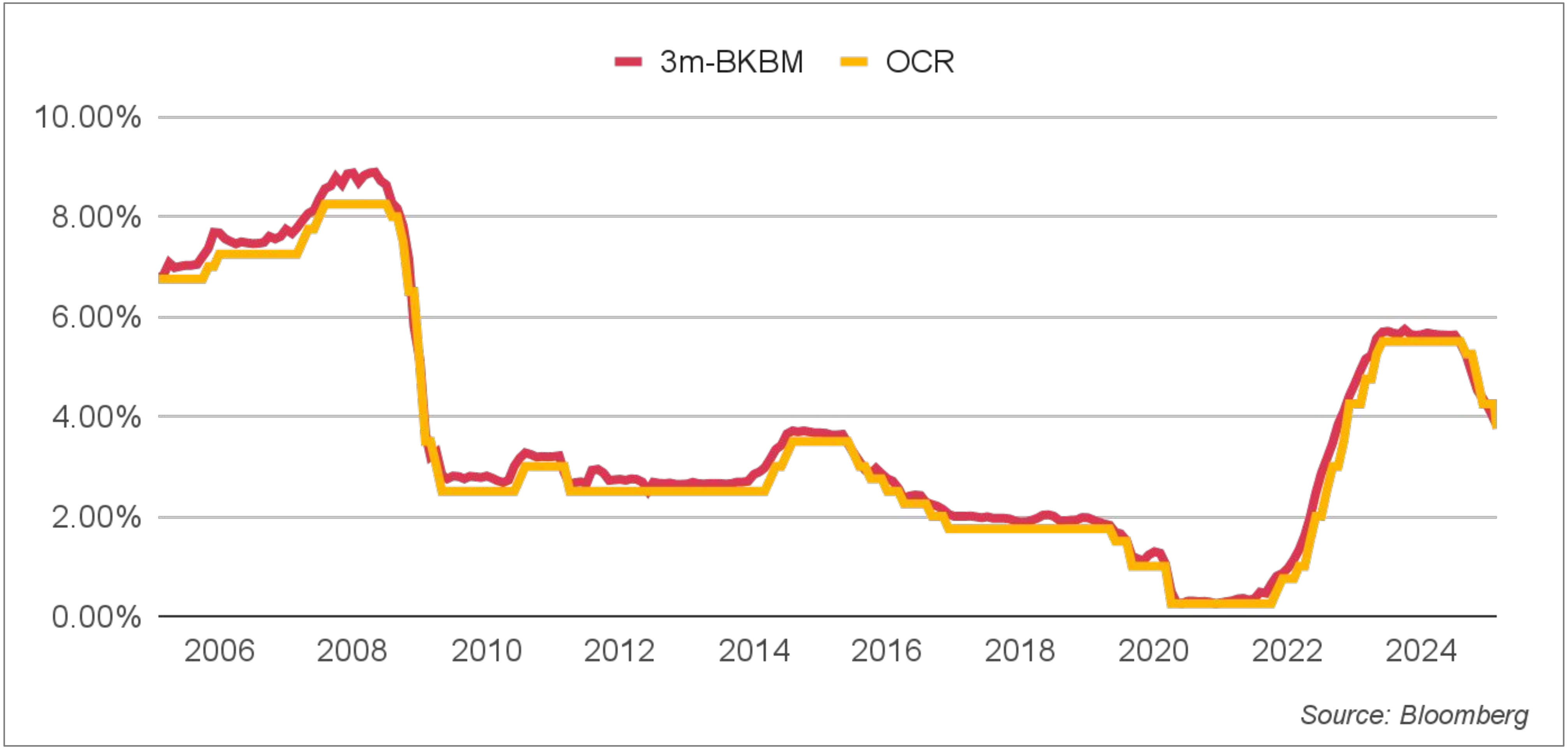
Sensitivity of wholesale interest rate movements

Since 2000, floating interest rates have varied by an average range of 1.2% in a calendar year. In 2022, floating interest rates rose 3.7%.

Council currently has $177.5 million of drawn debt. If all debt was on a floating interest rate basis, a 1% movement higher in interest rates would result in an increase in interest expense of $1.78m. Based on rates revenue of ~$59m (2024), rates revenue would need to increase by 3% to offset the increased interest expense.

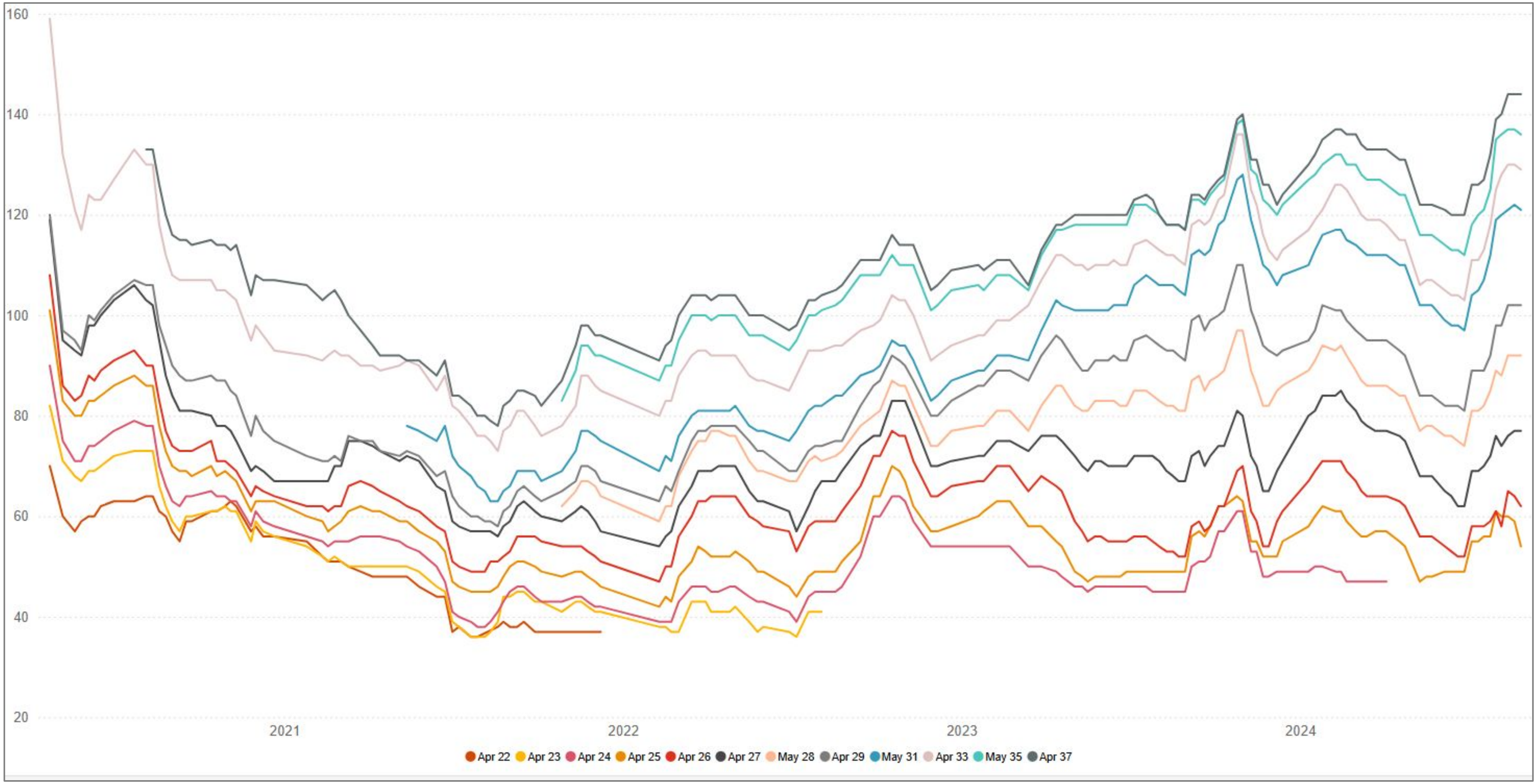
OCR and BKBM rates

Debt is typically raised from the LGFA on a floating interest rate basis. Council pay a funding margin above wholesale interest rates.



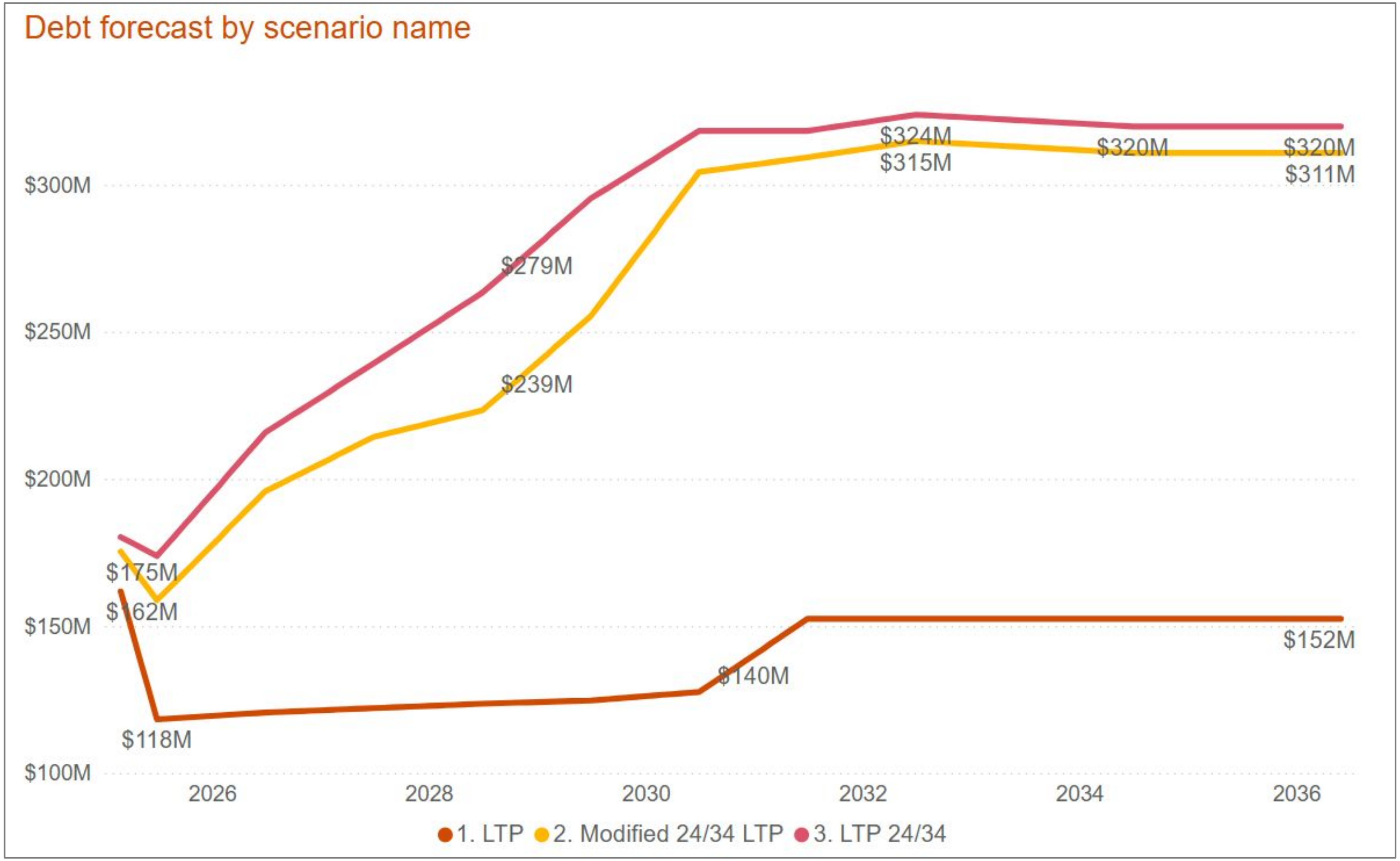
Changing LGFA funding margins

Debt is typically raised from the LGFA on a floating interest rate basis. Council pay a funding margin above wholesale interest rates. These funding margins move independently of wholesale interest rates.



Debt forecasts

Successful treasury management relies on Council's long term debt forecasts. These will change over time based on the delivery of the capital works programme



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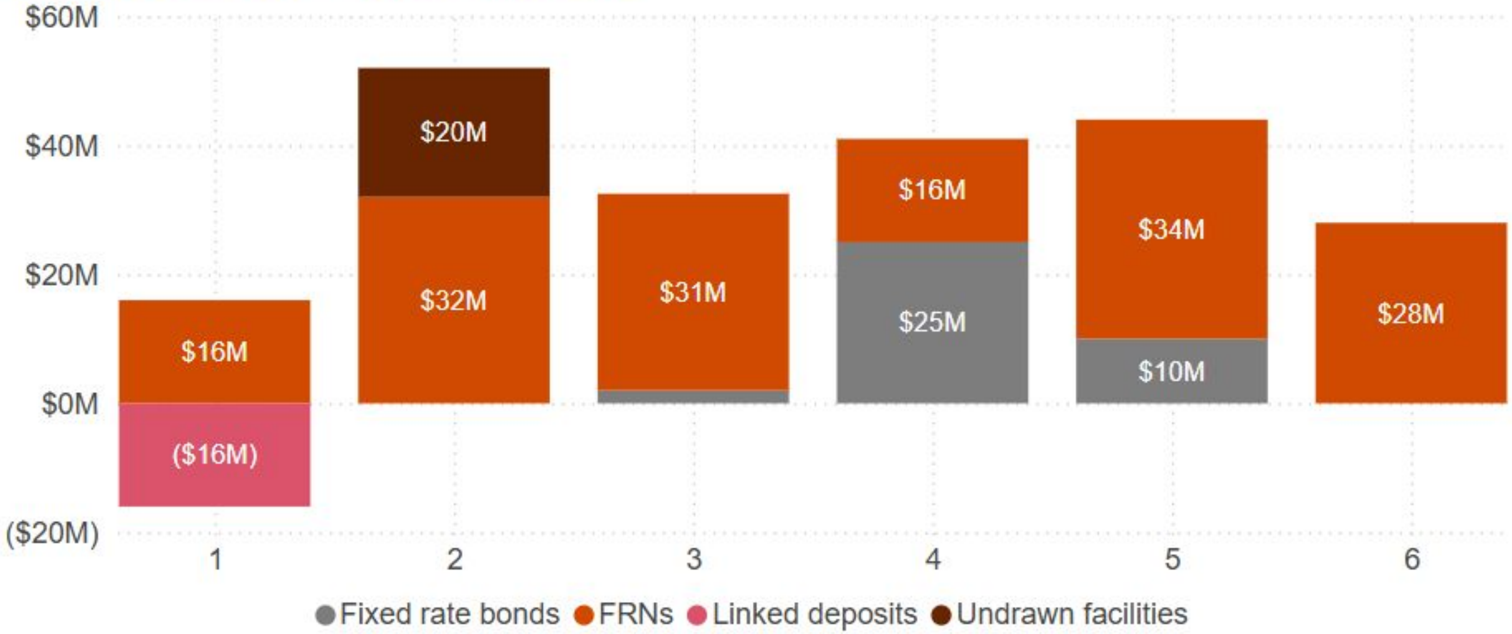
Treasury risks

Liquidity and funding risk management

- Reduce the concentration of borrowing refinancing and repricing at one time
- Spreading and smoothing of debt maturities over time to smooth the impact on borrowing costs and plans
- Managing liquidity and funding positions within LGFA financial covenants and policy limits
- Strategies
    - Proactive debt forecast discussions around LGFA tender dates
    - Pre-funding of upcoming debt maturities of up to 18 months in advance, to reduce the risk of near-term disruption to funding markets
    - Maintaining a permanent liquidity buffer

Liquidity and funding risk management

Funding and liquidity risk timeline



$177,500,000
Gross external debt, less prefunding

$20,000,000
Undrawn and unlinked bank facilities

$15,700,000
Liquid assets

$16,000,000
Linked deposits

2.93
WA term of debt (years)

Liquidity summary

120%
Liquidity ratio (liquid deposits)

110%
Liquidity ratio policy

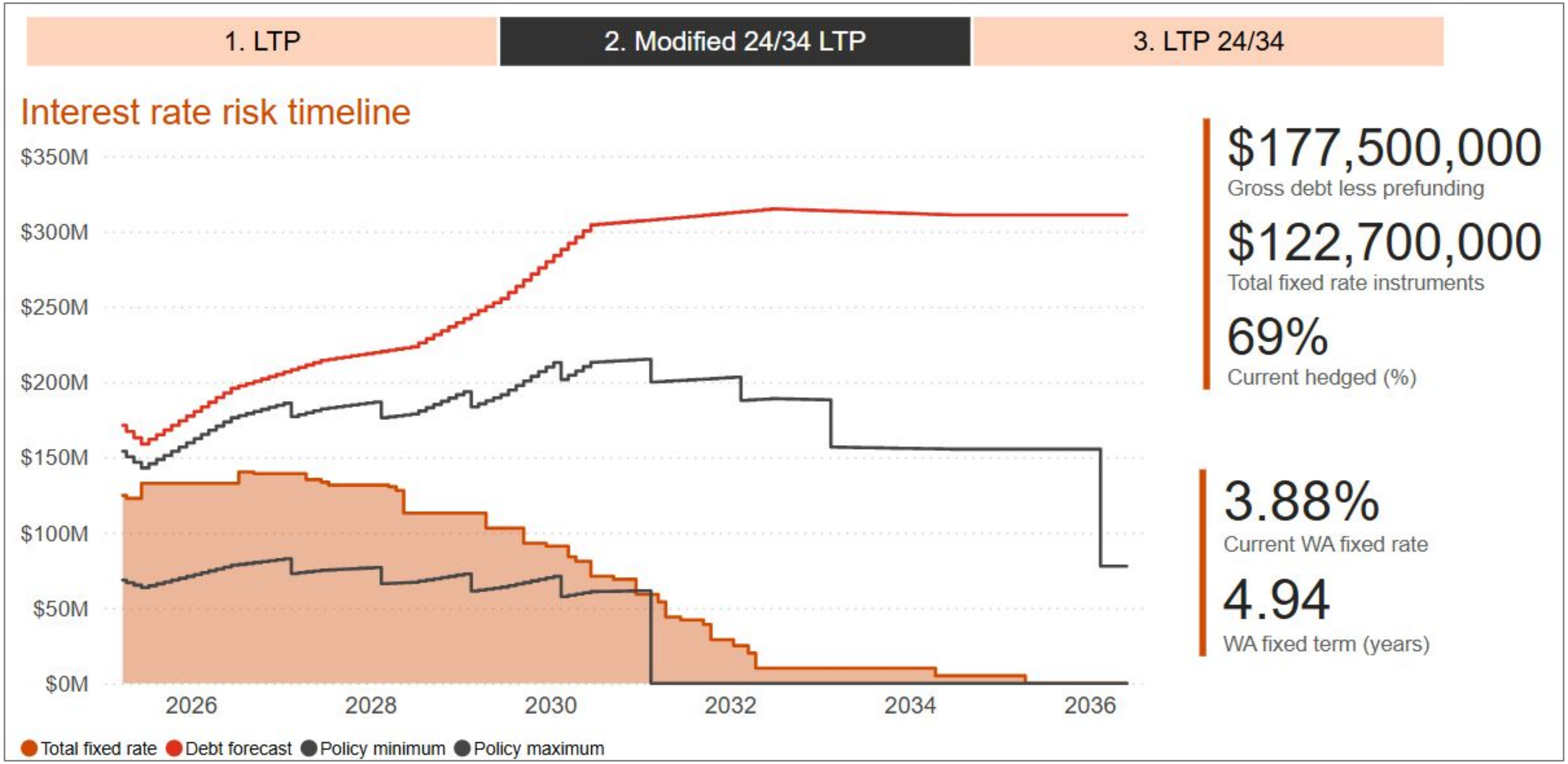
Funding summary

Bucket (years)	Maturing in period ($)	Policy	Actual
0 - 3	$84,500,000	15% - 60%	43%
3 - 7	$113,000,000	25% - 85%	57%
7 - 15	$0	0% - 60%	0%
Total	**$197,500,000**		**100%**

Interest rate risk management

- Provide protection from changing New Zealand interest rates
  - Short-term rates, RBNZ
  - Long-term rates, US interest rates
- Reduce the concentration of interest rates on borrowing repricing at one time. <u>Manage to policy limits.</u>
- Strategies
  - Proactive management of interest rate risk (i.e. medium to long-term focus)
  - Forward managing interest rate risk to policy control limit framework
  - Use of both fixed rate debt and interest rate swaps

Interest rate risk management



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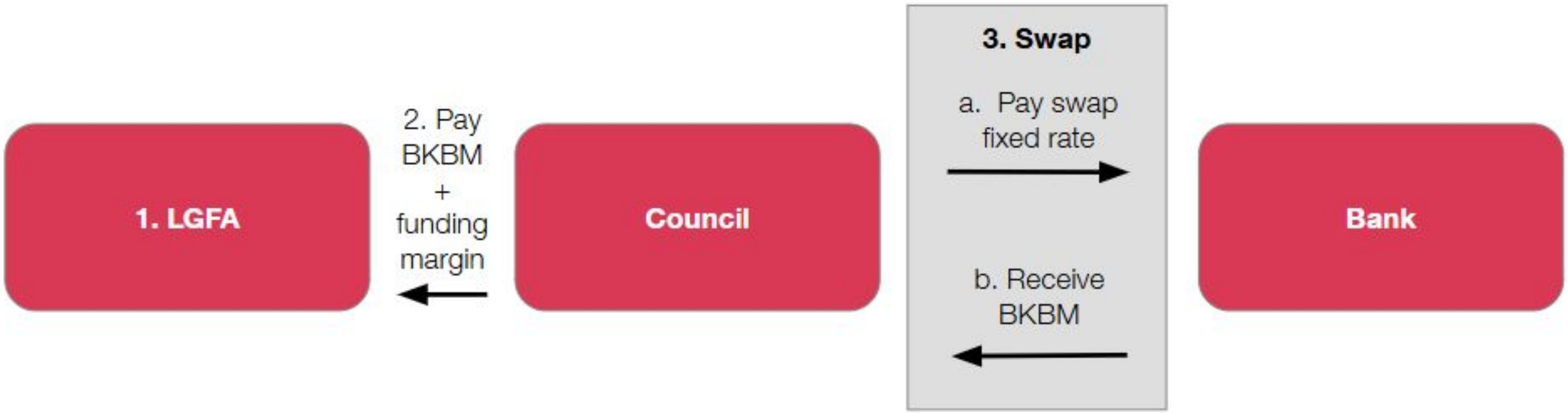
Interest rate swaps

Features of interest rate swaps

- Authorised instruments under Local Government Act 2002. Known as incidental arrangements in Act.
- Must be used within a controlled environment - Council approved Treasury Management Policy.
- Most common interest rate risk management instrument used amongst councils.
- Supports long term planning and decision making.
- Council's typically raise floating rate debt from the LGFA, only raise debt when needed, saving the funding margin. Manage interest rate risk separately.



Pros and cons of interest rate swaps

Pros	Cons
• **Reduced uncertainty** in the wholesale interest rate component of borrowing costs • **Proactively manage interest rate risk in advance** of expected new and refinanced LGFA debt issuance • **Manages variability in interest rates** spreading and smoothing the impact on financial budgets and plans. **Supports achieving LGFA interest expense financial covenants** • **Flexible** to accommodate specific exposures, amount and term • Only borrow when needed, saving costs • **Flexibility** and less costly to manage/change fixed interest rate portfolio when debt forecasts change, business changes and/or market interest rate changes • Manage with a number of banks providing choice and **diversification**	• **Specialist knowledge** and understanding required • **Accounting and administration** considerations • **Changes in swap market values flow through Income Statement** requiring explanation. IPSAS30 year-end disclosures • **Opportunity cost** of potentially lower interest rates • Require **legal documentation** and swap dealing lines set up with banks. Security stock issuance • **Counterparty exposure** to banks

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Summary

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- Council proactively manages treasury risks within an evolving business and financial environment
- Uncertainty around key inputs requires consideration in treasury strategy design and execution
- Adherence to Council approved policies
    - Capture, monitor and manage treasury risks
    - Regular treasury reporting to Council
    - Monthly meetings with PwC Treasury Advisory
- Treasury management approach consistent with sector and good practice


Questions?

Thank you