1. Investment Management

1.1 Executive Summary for Investment Management

Group overview

The main activities and functions carried out by the Investment Management Group include:

- Investing surplus funds and contingency funds
- Managing the council's debt portfolio and interest rate risk, ensuring adequate cash is available, relationships with bankers, rating agencies
- Monitoring CentrePort and completing the WRC Holdings group Statement of Intent and reporting to its Board
- Managing the Councils interest rate risk on the Stadium Debt and reviewing their Statement of Intent
- Coordinating the Council's risk management via the Quantate risk management system
- Managing and coordinating the Council's Insurance programme.

Key results for the quarter

(a) Market rates

The OCR remained unchanged at 2.50%. The 90 Day rate ranged from 2.65% to 3.05%, currently it is at 2.70%.

The 5 year interest rate swap ranged from 3.60% to 4.60% and is currently at 4.00%.

The 10 year swap ranged from 4.30% up to 5.20% and is currently at 4.80%.

The price of Singapore Gas oil (Diesel) in NZ Dollars per barrels was:

30 September 08	$185
30 June 09	$115
31 June 10	$124
31 December 10	$135
31 March 11	$173
30 June 11	$171
30 September 11	$156

The hedging of this exposure, while approved by Council remains complex and is not without risk. The proportion of Diesel in the index, under which we pay the service providers, has been adjusted from approximately 26% to 14.6%, therefore, significantly reducing our exposure to the price movement of Diesel.

The valuation of swaps was $5.7 million negative in Greater Wellington and about $419,000 negative for WRCH. The negative valuation is due to the 90 day bank bill rate being at 2.70%, compared to our average borrowing swap rate of about 5.57%. This position is likely to change, going forward, as interest rates begin to rise.

An existing $5 million interest rate pay fixed swap was extended from 15 September 2012 to 15 December 2015, this had the benefit of reducing the interest rate from 6.19% to 5.08% and assisted with complying with our Treasury Policy.

(b) Treasury Risk Management Policy (TRMP)

As part of the 3 yearly LTP process the Treasury Risk Management Policy (TRMP), incorporating the liability management and investment policies of Council, has been reviewed and updated with the assistance of our treasury advisors, Asia Pacific Risk Management.

The Policy will be presented to Council for approval for incorporation into the LTP.

A presentation to Council on the workings of Investment Management, its investments, its debt and operations, has been prepared.

(c) Investments

The $33 million liquidity deposits were invested on average during the quarter at 4.83%.

The contingency funds for the Water and Flood Groups were invested at an average of 3.90%

The Guarantee for CentrePort has been renewed due to the Harbour Quays sell- down and has reduced from $203 million to $125 million. As a result, our guarantee fee will reduce from November, which has been budgeted for.

The final accounts for the WRC Holdings group have been completed and received a clean Audit Opinion. The accounts were not completed by 30 the September in contravention of the Local Government Act. We have recorded this in notes to the Accounts.

The delay was due to the accounting methodology for Greater Wellington Rail Limited (GWRL). This has changed in order to be compliant with the accounting standards.

GWRL is now a Public Benefit entity for accounting purposes, which means all grants received (to cover capital or operating costs) are accounted for via the statement of comprehensive income and assets are valued at depreciated replacement cost. Previously, capital grants were accrued to the balance sheet under a Profit Orientated Entity accounting methodology.

(d) Debt

The $44 million of WRCH debt was rolled over at a margin of 15 points (0.15%). WRCH received $62 million in bids and settled with a weighted average interest cost of 3.12%, which is $198,000 per annum cheaper then direct bank borrowing.

Market conditions had deteriorated significantly since our last issuance and this is due to the European debt crisis. Last time we issued we received $108 million in bids and a margin of 10 BP. Our debt is able to be used at collateral to raise funds from the Reserve Bank (being repo-eligible) and remains a favourable investment.

The bank facility with Commonwealth Bank was extended for a further year to mature in September 2014 and the pricing was also reduced by 10 points (0.10%), providing a small cost saving.

We took the opportunity of recent relatively low lending margins in July to prefunded $25 million of this year's $70 million planned debt requirement. The Council issued a 3 year Floating Rate Note (FRN) which matures in June 2014. The margin over the 90 day bank bill rate was 70 points (0.70%) and compares to current margins in the vicinity of 100 points (1%). This FRN replaced the Commercial Paper (CP) we had on issue to cover the share purchase in WRC Holdings.

During the quarter, the Council issued $20 million of Commercial Paper and placed the funds on deposit at close to a 1% profit margin, this has assisted in defraying our fixed bank facility costs at little risk to Council.

Greater Wellington's debt level has increased by $38.1 million since 30 June 2011. The increase is due to the issuance of $25 million of debt as noted above, plus $20 million of Commercial Paper. This increase is offset by $27.4 million of additional funds on deposit. Overall, our net borrowing position has increased by around $10 million, which relates mainly to the purchase of the Matangi.

(e) Local Government Funding Agency

The Local Government Funding Agency (LGFA) is progressing well with legislation now passed in Parliament allowing the Agency to be formed.

An acting chair (Craig Stobo) and five other shadow directors, including two from the Local Government sector, have been appointed.

Documentation has been prepared and is currently being reviewed. This includes all the base funding documents setting up the relationships between the LGFA and the Councils, and the LGFA's internal policies.

The nine founding Councils or "Tight Nine" have all met individually with the international rating agency Fitch.

Fitch is keen to learn about each Council and may in the future be an option for our credit rating, rather than Standard & Poors. Fitch appeared impressed with our Treasury Management and Liquidity strategy.

A draft Statement of Intent (SOI) has been prepared along with an updated business case and financial projections, which underlie the LGFA.

In the meantime a paper is being prepared for Council to give an update on the LGFA and also to ask the Council to ratify the LGFA Directors appointments.

The CFO of Hamilton City Council was elected as Chair of the Shareholder Council; the latter is essentially the tight nine plus other shareholder Councils. Its role will be to monitor the LGFA, provide a forum to discuss issues, receive the LGFA's SOI and provide a channel for communication to and from the LGFA.

On incorporation of the LGFA, Greater Wellington will receive back our $200,000 contribution, including our first $50,000, which was initially agreed would be not be recoverable.

Greater Wellington's Debenture Trust Deed documentation, which replaces our Negative Pledge Deed, which provides security to our lenders, has been completed.

Trustee Executors has been appointed as our trustee to monitor the security charge over rates the Debenture Trust grants to our lenders.

This is a requirement of borrowing from the LGFA and will be executed by the CEO in the coming month.

(f) Insurance

Work is progressing with reviewing Greater Wellington's Insurance and we have undertaken the following work:

- Phillips Fox are preparing a brief commentary on the various documents with KiwiRail with regard to the impacts and coverage of our Insurance arrangements. This is particularly relevant to our liability cover, which might be compromised as we have a number of situations where we have accepted liability and our insurer may not be fully aware of this. Consequently, our insurers could avoid a claim on the grounds that they were unaware of the risk.

- Insurers tend to charge premiums based on the worst case scenario, and if we can spell out to them what the actual exposures are, they are better placed to price our risk more finely, given the large number of documents we have with KiwiRail and the related complexity of our relationships.

- Aon Risk Management has been engaged to assist us with a review of our insurance coverage. The review covers such things as the level of risk we are prepared to take on, the potential to set up some additional contingency funds, areas of the business where money could be spent to reduce risk and consequently reduce premiums, and how we can generally optimise the premium paid.

- John Sloan (an insurance adviser) was also approached in early October to see how he could assist us with premium reduction and to review our insurance cover. He presented a plan which we have presently put on hold pending the outcome of the review by Aon Risk Management.

Looking ahead

The next quarters will focus more on raising debt via the LGFA, monitoring our interest risk and treasury strategy.

Insurance, and how we move forward with this, will be an area of focus which is likely to see a number of initiatives implemented to reduce premiums and to optimise our exposure to risk in a cost effective manner.

The Statement of Intent for the WRC Holdings Group will be modified to reflect the change in the accounting methodology from a Profit Orientated Entity to a Public Benefit Entity.

As time allows, risk management will be reviewed in more detail to determine the correct risks are recorded in Quantate and the scoring is accurate.

Financial Summary for Investment Management

Investment Management is showing an adverse position to budget. The majority of this relates to the timing of the Matangi project. Investment Management receives a revenue grant from Transport which it uses to capitalise WRC Holdings for 20% of the Matangi cost.

The balance of the adverse result relates to lower borrowing by the business (Income to Investment Management) due to a slower capital expenditure spend.

Investment Management has also prefunded a portion of the organisation's debt requirements, leading to adverse finance costs, but this is more than offset by Investment Income as the funds are placed on deposit.

In term of the figures at the end of September, the surplus after non operating items was $4.226 million unfavourable. The operating surplus, however, is only $404,000 unfavourable to budget. The main reason for the difference is $3.8 million lower grant revenue, which has not been received from GW Rail. The $404,000 lower operating surplus is caused by $186,000 lower then budgeted income and $218,000 higher operating expenditure.

Group consolidated financial statements

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Income Statement 3 months ending 30 September 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
669	669	669	-	Rates & Levies	2,676	2,676	2,676	-
668	955	511	444	Investment Revenue	5,051	6,091	5,047	1,043
2,079	2,766	3,398	(632)	Internal Debt Interest Recovery	8,836	12,602	13,591	(989)
55	56	56	0	Internal Revenue	222	223	223	-
3,472	**4,447**	**4,633**	**(186)**	**TOTAL INCOME**	**16,784**	**21,592**	**21,537**	**54**
				less:				
14	14	19	6	Materials,Supplies & Services	75	85	85	-
0	0	0	-	Travel & Transport Costs	0	0	0	-
17	110	44	(66)	Contractor & Consultants	193	216	216	-
103	98	98	-	Internal Charges	412	392	392	-
133	**222**	**161**	**(61)**	**Total Direct Expenditure**	**679**	**693**	**693**	-
			-					-
1,329	1,818	1,662	(156)	External Finance Costs	5,348	8,130	8,532	402
0	0	0	-	Bad Debts	0	0	0	-
198	217	216	(1)	Internal Reserve Investment Cost	789	864	864	0
7	7	7	0	Depreciation	26	28	28	-
1,534	**2,041**	**1,884**	**(157)**	**Total Indirect Expenditure**	**6,163**	**9,022**	**9,424**	402
			-					-
1,667	**2,264**	**2,046**	**(218)**	**TOTAL OPERATING EXPENDITURE**	**6,842**	**9,715**	**10,117**	402
			-					-
1,804	**2,183**	**2,587**	**(404)**	**OPERATING SURPLUS/(DEFICIT)**	**9,942**	**11,876**	**11,420**	456
								-
0	0	0	-	Unrealised Revaluation Gains / (Loss)	(2,798)	(288)	(288)	-
2	6	3,828	(3,822)	Grants and Subsidies - Revenue	13,341	39,781	39,781	-
								-
1,806	**2,190**	**6,415**	**(4,226)**	**Surplus / (Deficit) after non operating items**	**20,484**	**51,369**	**50,913**	456

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Funding Statement 3 months ending 30 September 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
1,806	2,190	6,415	(4,226)	Operating Surplus(Deficit)	20,484	51,369	50,913	457
7	7	7	-	Add Back Depreciation	26	28	28	-
-	-	-	-	Other Non Cash	2,798	288	288	-
(21)	(55)	(606)	551	Net Asset Acquisitions	(252)	(2,424)	(2,424)	-
(45)	(27,100)	(6,328)	(20,772)	Net External Investment Movements	(26,725)	(43,081)	(43,081)	-
1,747	**(24,958)**	**(511)**	**(24,447)**	**NET FUNDING BEFORE DEBT & RESERVE MOVEMENTS**	**(3,669)**	**6,181**	**5,724**	**457**
(6,778)	36,694	(269)	36,963	Debt Additions / (decrease)	(7,860)	(13,882)	(9,705)	(4,177)
4,262	(9,572)	3,164	(12,736)	Debt Repaid	2,817	16,520	17,206	(686)
(121)	(1,008)	(1,670)	662	Net Reserves (Increase) / decrease	(151)	(1,648)	(2,791)	1,143
(890)	**1,156**	**714**	**442**	**NET FUNDING SURPLUS (DEFICIT)**	**(8,863)**	**7,171**	**10,434**	**(3,263)**

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Capital Expenditure Statement 3 months ending 30 September 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
-	-	-	-	Total Asset Acquisitions	-	-	-	-
			-					
21	54	606	552	Capital Project Expenditure	252	1,124	2,424	1,300
			-					
-	-	-	-	Asset Disposal Cash Proceeds	-	-	-	-
21	**54**	**606**	**552**	**Net Capital Expenditure**	**252**	**1,124**	**2,424**	**1,300**

Departmental financial summary and variance analysis

Total income is $186,000 below budget. This is due to $632,000 lower internal debt interest recovery (due to slower Capex spending by the business units, which is offset by $444,000 higher investment revenue). The main reasons for the higher investment revenue is $452,000 higher interest revenue from money market investments deposits and $59,000 higher other interest revenue, offset by $56,000 costs for a swap.

The $451,000 interest revenue from money markets is mainly due to the prefunding of $25 million and the $20 million of Commercial Paper being raised and invested the funds with a margin of about 0.9% in short term investments.

Other interest revenue is $59,000 higher, due to receiving a higher guarantee fee from CentrePort.

Total operating expenditure is $218,000 above budget. An unbudgeted contribution of $100,000 to the LGFA and higher interest costs of $156,000 for the above mentioned borrowings are the main contributors.

The grant from Public Transport to fund the share capital of Greater Wellington Rail has not been received yet due to the timing of the project, providing an adverse variance of $3.8 million

Capital expenditure relates to the construction of the new Masterton office and is currently running slower than budget due to the design process taking longer than anticipated. This delay is not expected to be closed by 30 June. Currently we expect the start of the construction phase to be three month later then initially budgeted, leading to $1.3 million lower Capex expenditure in the current year.

Forecast

The forecast is for a year end surplus of $51.4 million, which is $456,000 above budget.

We are expecting a higher investment return due to receiving funds in advance from NZTA, plus additional income from prefunding debt. This is offset by lower interest received from the business on loans due to slower capital spend.

Finance costs are favourable due to lower borrowing levels overall, leading to a favourable position of $456,000.

Departmental risk analysis

All risks have been reviewed and reported under the Finance and Support Group’s report.