1. Investment Management

1.1 Executive summary for Investment Management

Group overview

Business as usual activities and function carried out by the Investment Management Group included:

- 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
- Managing and coordinating the Council's Insurance programme.

1.2 Key results for the quarter

1.2.1 Market rates

The Official Cash Rate (OCR) remained unchanged at 2.50%. The 90 Day rate ranged from 2.63% to 2.85%, currently it is at 2.77%

The 5 year interest rate swap ranged from 3.20% to 4.05% and is currently at 3.50%.

The 10 year swap ranged from 3.90% up to 4.80% and is currently at 4.20%.

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

31 December 10	$135
31 March 11	$173
30 June 11	$171
30 September 11	$156
30 December 11	$158

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 $8.0 million negative in Greater Wellington and about $650,000 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 5.17%. This position will change favourably going forward if interest rates rise.

In anticipation of future borrowing we entered into a $5 million pay fixed interest rate swap. It is a forward starting swap, beginning in December 2012 for a period of 7 years at a fixed interest rate of 3.98%.

At the same time we extended an existing $10 million pay fixed swap which matured in May 2014 and lengthened it to November 2016. This had the benefit of reducing the rate from 5.28% to 4.56%.

At the time swap rates were at all time lows, as evidenced by our increase in the swap valuations. The swaps provide protection against rising rates and also lower our current cost of funds in respect of the swap extension.

The Treasury Risk Management Policy (TRMP) was presented to the Audit, Risk and Assurance committed. Two changes were made with the Policy now being presented to the Council in February for approval of incorporation into the next LTP.

1.2.2 Investments

The $33 million liquidity deposits were invested on average during the quarter at 4.02%.

The contingency funds for the Water and Flood Groups were invested at around 3.70%, comparing favourably to the 90 day rate of 2.70%.

A revised SOI for the three years 2011/12 till 2013/14 has been completed for WRC Holding Group, incorporating the change from a Profit Oriented Entity to a Public Benefit Entity. This has updated the initial SOI with the new accounting methodology, but retaining the original forecasts. This SOI will be presented to the WRC Holding Board at their February meeting and used for December reporting. It will be presented to the Shareholder for approval thereafter.

A new draft SOI for the WRC Holdings Group for the 2012/13 to 2014/15 years is currently being prepared.

1.2.3 Debt

The $44 million of WRCH debt was rolled over at a margin of 11 points (0.11%). WRCH received $71 million in bids and settled with a weighted average interest cost of 2.86%, which is $216,000 per annum cheaper then direct bank borrowing.

Market conditions remain constrained due to the European debt crisis. Last time we issued we received $62 million in bids and a margin of 15 points (0.15%) our AA/A1+ credit rating remains attractive to investors along with the fact the investment can be used as collateral to raise funds from the Reserve Bank (repo-eligible).

During the quarter we continued with borrowing $20 million via the issuance of Commercial Paper and placing 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 the Council.

Greater Wellington’s debt level has increased by $48.5 million since 30 June 2011. The increase is due to the issuance of $25 million of term debt due June 2014, plus $20 million of Commercial Paper. This increase is offset by an additional $23.1 million of funds on deposit. Overall, our net borrowing position has increased, which relates mainly to the purchase of the Matangi trains, offset by funding for this project in advance.

1.2.4 Local Government Funding Agency

The Local Government Funding Agency (LGFA) was established in early December. The CEO and two Councillors signed all the legal documents setting up the LFGA.

On incorporation of the LGFA, Greater Wellington received back the $200,000 contribution it had made as part of the set up costs, and paid over the agreed $2,000,000 as part of our contribution to the $25,000,000 establishment equity.

Philip Combes was appointed as CEO. His previous role was Treasurer for the New Zealand Debt Management office – this is an outstanding appointment for the LFGA, given Philips experience.

The LGFA’s inaugural issue of debt will be in early February and we have agreed indicative bond maturities. Bruce Simpson (CFO) has spoken with Craig Stobo, the Chairman of the LGFA, to gain some comfort that Greater Wellington can rely on the LGFA to lend us funds when our existing $50 million Bond matures.

There is some concern as Greater Wellington is bound to borrow from the LGFA, yet it does not have a commitment from the LGFA to lend. We have taken steps to ensure we have adequate liquidity to cover the eventuality that the LGFA would not lend to us. Normally this would not have been a concern but with the financial issues coming out of Europe, we have taken additional protection.

1.2.5 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.

The commentary is expected from Philips Fox shortly.

- We met with Aon Risk Management in early December to review our insurance coverage and with particular emphasis on the level of risk we are prepared to take on. Other areas of discussion involved 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. We expect to receive their report very soon.

1.3 Looking ahead

The next quarters will focus more on raising debt via the LGFA, monitoring our interest risk and treasury strategy. This could see us prefunding debt, given the likelihood that funding margins are likely to widen further and financial disturbances from Europe may continue to escalate.

The refinancing of our $50 million of maturing bonds requires the Council to tender with the LGFA on 15th February and pay back the bondholders on 17th February and settle with the LGFA on 20th February. We have sufficient liquidity in terms of maturing deposits and undrawn credit lines to finance this small gap.

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 completed.

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.

2. Group financial summary

2.1 Financial summary

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 10% of the Matangi cost.

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

Investment Management has also prefunded a portion of the organisation's debt requirements. The incurred interest expense is more than offset by the interest income generated, as the excess funds are placed on deposit with a margin of about 70BP (0.70%).

At the end of December the surplus after non operating items was $7.99 million unfavourable. The operating surplus, however, is only $116,000 unfavourable to budget. The main reason for the difference is $7.87 million lower grant revenue, which has not been received from Public Transport. The $116,000 lower operating surplus is caused by $218,000 lower then budgeted income and $102,000 lower operating expenditure.

2.2 Group consolidated financial statements

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Income Statement 6 months ending 31 December 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
1,338	1,338	1,338	-	Rates & Levies	2,676	2,676	2,676	-
1,497	1,897	1,010	887	Investment Revenue	5,051	6,561	5,047	1,513
4,262	5,689	6,796	(1,107)	Internal Debt Interest Recovery	8,836	12,135	13,591	(1,456)
111	112	112	0	Internal Revenue	222	223	223	-
7,208	**9,037**	**9,255**	**(218)**	**TOTAL INCOME**	**16,784**	**21,594**	**21,537**	**57**
				less:				
24	24	39	14	Materials,Supplies & Services	75	85	85	-
0	0	0	(0)	Travel & Transport Costs	0	0	0	-
197	20	88	68	Contractor & Consultants	193	136	216	80
206	196	196	-	Internal Charges	412	392	392	-
426	**241**	**323**	**82**	**Total Direct Expenditure**	**679**	**613**	**693**	80
			-					-
2,621	3,616	3,637	21	External Finance Costs	5,348	7,531	8,532	1,001
0	0	0	-	Bad Debts	0	0	0	-
398	434	432	(2)	Internal Reserve Investment Cost	789	864	864	(0)
13	13	14	1	Depreciation	26	28	28	-
3,032	**4,063**	**4,083**	**20**	**Total Indirect Expenditure**	**6,163**	**8,423**	**9,424**	1,001
			-					-
3,459	**4,304**	**4,406**	**102**	**TOTAL OPERATING EXPENDITURE**	**6,842**	**9,036**	**10,117**	1,081
			-					-
3,749	**4,734**	**4,849**	**(116)**	**OPERATING SURPLUS/(DEFICIT)**	**9,942**	**12,558**	**11,420**	1,138
								-
0	0	0	-	Unrealised Revaluation Gains / (Loss)	(2,798)	(288)	(288)	-
5	0	7,874	(7,874)	Grants and Subsidies - Revenue	13,341	28,755	39,781	11,026
								-
3,753	**4,734**	**12,723**	**(7,990)**	**Surplus / (Deficit) after non operating items**	**20,484**	**41,025**	**50,913**	(9,888)

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Funding Statement 6 months ending 31 December 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
3,754	4,735	12,723	(7,988)	Operating Surplus(Deficit)	20,484	40,571	50,913	(10,342)
13	13	14	(1)	Add Back Depreciation	26	28	28	-
-	-	-	-	Other Non Cash	2,798	288	288	-
(15)	(206)	(1,212)	1,006	Net Asset Acquisitions	(252)	(660)	(2,424)	1,764
(5,045)	(25,100)	(10,374)	(14,726)	Net External Investment Movements	(26,725)	(31,600)	(43,081)	11,481
(1,293)	**(20,558)**	**1,151**	**(21,709)**	**NET FUNDING BEFORE DEBT & RESERVE MOVE**	**(3,669)**	**8,627**	**5,724**	**2,903**
(16,744)	44,238	(3,621)	47,859	Debt Additions / (decrease)	(7,860)	7,209	(9,705)	16,914
8,353	(23,857)	9,082	(32,939)	Debt Repaid	2,817	(6,662)	17,206	(23,868)
(43)	(976)	(2,446)	1,470	Net Reserves (Increase) / decrease	(151)	(2,162)	(2,791)	629
(9,727)	**(1,153)**	**4,166**	**(5,319)**	**NET FUNDING SURPLUS (DEFICIT)**	**(8,863)**	**7,012**	**10,434**	**(3,422)**

Last Year YTD Actual $000	YTD Actual $000	YTD Budget $000	YTD Variance $000	Investment Management Capital Expenditure Statement 6 months ending 31 December 2011	Last Year FY Actual $000	Full Year Forecast $000	Full Year Budget $000	Full Year Variance $000
-	-	-	-	Total Asset Acquisitions	-	-	-	-
48	205	1,212	1,007	Capital Project Expenditure	252	660	2,424	1,764
33	-	-	-	Asset Disposal Cash Proceeds	-	-	-	-
81	**205**	**1,212**	**1,007**	**Net Capital Expenditure**	**252**	**660**	**2,424**	**1,764**

2.3 Departmental financial summary and variance analysis

Total income is $218,000 below budget, which is due to $1.107 million lower internal debt interest recovery which is caused by slower Capex spending by the business units. This is offset by $887,000 higher investment revenue. The main reasons for the higher investment revenue is $929,000 higher interest revenue from money market investments deposits and $68,000 higher other interest revenue, offset by $112,000 costs for a swap.

The $929,000 interest revenue from money markets is due to the prefunding of $25 million term debt and $20 million Commercial Paper with proceeds invested short term with a positive margin.

Other interest revenue is $68,000 higher, due to a larger guarantee fee from CentrePort as their debt levels were higher earlier in the year than budget.

Total operating expenditure is $102,000 below budget. The unbudgeted refund from the LGFA, of which $100,000 relates to contributions in previous years, is the main reason for the variance.

Interest costs are very close to budget ($21,000 favourable) reflecting the fact that we have borrowed funds as expected, but not used them to fund the business, but instead placed them on deposit.

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 $7.9 million.

Capital expenditure relates to the construction of the new Masterton office and is currently running slower than budget with the design process taking longer than anticipated. We anticipate the construction phase to begin in July this year. This is leading to $1.76 million lower Capex expenditure in the current year.

2.4 Forecast

The forecast is for a year end surplus of $41.0 million, which is $9.9 million below budget.

We are expecting a higher investment return due to receiving funds in advance from NZTA, plus additional income from prefunding debt and a $538,000 higher dividend from WRC Holdings due to CentrePort paying an additional dividend. 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 $1.1 million.

The grant from Public Transport to fund the share capital of Greater Wellington Rail is expected to be $11.0 million below budget and is due to the timing of the Matangi train purchase.

2.5 Departmental risk analysis

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