

Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

19 FEBRUARY 2013

Meeting Status: **Public**

Purpose of Report: For Information

STRATEGY FOR USING FORWARD START INTEREST RATE SWAPS

PURPOSE OF REPORT

- 1 This report seeks endorsement for the use of Forward Start Interest Rate Swaps for the 2014/15 year.

SIGNIFICANCE OF DECISION

- 2 The Council's significance policy is not triggered by the report.

BACKGROUND

- 3 A Forward Start Interest Rate Swap is a financial instrument that fixes the interest rate for a set amount of debt at some date in the future (generally up to 2 years). These transactions are negotiated with Banks.
- 4 It is been our Council's standard practice to use Forward Start Interest Rate Swaps to manage Council exposure to interest rate movements. The Council has been entering into these arrangements since 2002.

CONSIDERATIONS

Issues

- 5 Savings can be achieved to fix the interest rates for debt in that year by using Forward Start Interest Rate Swaps for the 2014/15 year.
- 6 For example Council would need to reduce its average interest rate on \$100 million of debt by 0.5%. to achieve \$500,000 of savings
- 7 Long term interest rates are projected to increase over the next few years and the long term interest rates have increased by over 0.4% already in the last few months.
- 8 The use of forward start interest rate swaps to fix interest rates for future debt is available as an approved financial instrument. This is set out in the Treasury Management Policy as per page 50 of the 2012 LTP and is shown below.

9 “Interest Rate Risk Control Limits

- The Council debt/borrowings must be within the following fixed/floating interest rate risk control limit:

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| <p>Master Fixed/Floating Risk Control Limit Minimum Fixed Rate = 55% Maximum Fixed Rate = 95%</p> |
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- “Fixed Rate” is defined as an interest rate re-pricing date beyond 12 months forward on a continuous rolling basis.
 - “Floating Rate” is defined as an interest rate re-pricing within 12 months.
 - The percentages are calculated on the projected net debt levels per the Council’s Annual Plan financial forecasts that are approved by the Council, calculated on the 12 month projected net debt figure. The calculation of interest rate control limits on projected net debt levels can also be applied to 24 month forecast net levels for the purposes of the fixed rate limits, as the result of Capital Expenditure programme impacts approved in a LTP. The 24 month forecast debt level would be subject to approval by the Chief Executive as being a fair and reasonable forecast. Net debt is the amount of total debt, less absolute matching loan repayment assets and any liquid investments. This allows for pre-hedging in advance of projected physical drawdowns of new debt. When approved forecasts are changed, the amount of fixed rate cover in place may have to be adjusted to comply with the Treasury Management Policy minimums and maximums.”
- 10 Council is currently able to secure forward start interest rate swaps that will achieve savings of \$500,000 in the 2014/15 year compared to the interest costs budgeted in the 2012 LTP for the 2014/15 year. This report seeks endorsement to proceed with that strategy.

Financial Considerations

- 11 The financial considerations are covered in this report.

Legal Considerations

- 12 There are no legal issues to be considered.

Delegation

- 13 The Audit and Risk Subcommittee may make a decision under the following delegation in the Governance Structure, Section C.4.6:

Without limiting the generality of this delegation the Subcommittee has the following functions, duties and powers:

Internal Reporting

- 6.4 *To review the processes for ensuring the completeness and quality of financial and operational information, including performance measures, being provided to council.*

Consultations

- 14 There is no need to consult on the issues raised.

Policy Implications

15 There are no policy implications to be considered.

Tāngata Whenua Considerations

16 There are no issues for consideration relating to iwi.

Publicity Considerations

17 There are no publicity issues to be considered at this stage.

RECOMMENDATIONS

18 That the Audit and Risk Subcommittee endorses the strategy of using forward start interest rate swaps to reduce the debt interest costs for the 2014/15 year compared to the interest costs budgeted in the Long Term Plan for the 2014/15 year.

Report prepared by:

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