Treasury Workshop Presentation

23 January 2025

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Contents

US 10-year bond and NZ 10-year bond back 5 years

91282CLW Govt (US TREASURY N/B) DJ 10 year bond yields Daily 18JAN2020-16JAN2025 Copyright© 2025 Bloomberg Finance L.P. 16-Jan-2025 16:37:07

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US 5-year bond and NZ 5-year swap back 2 years

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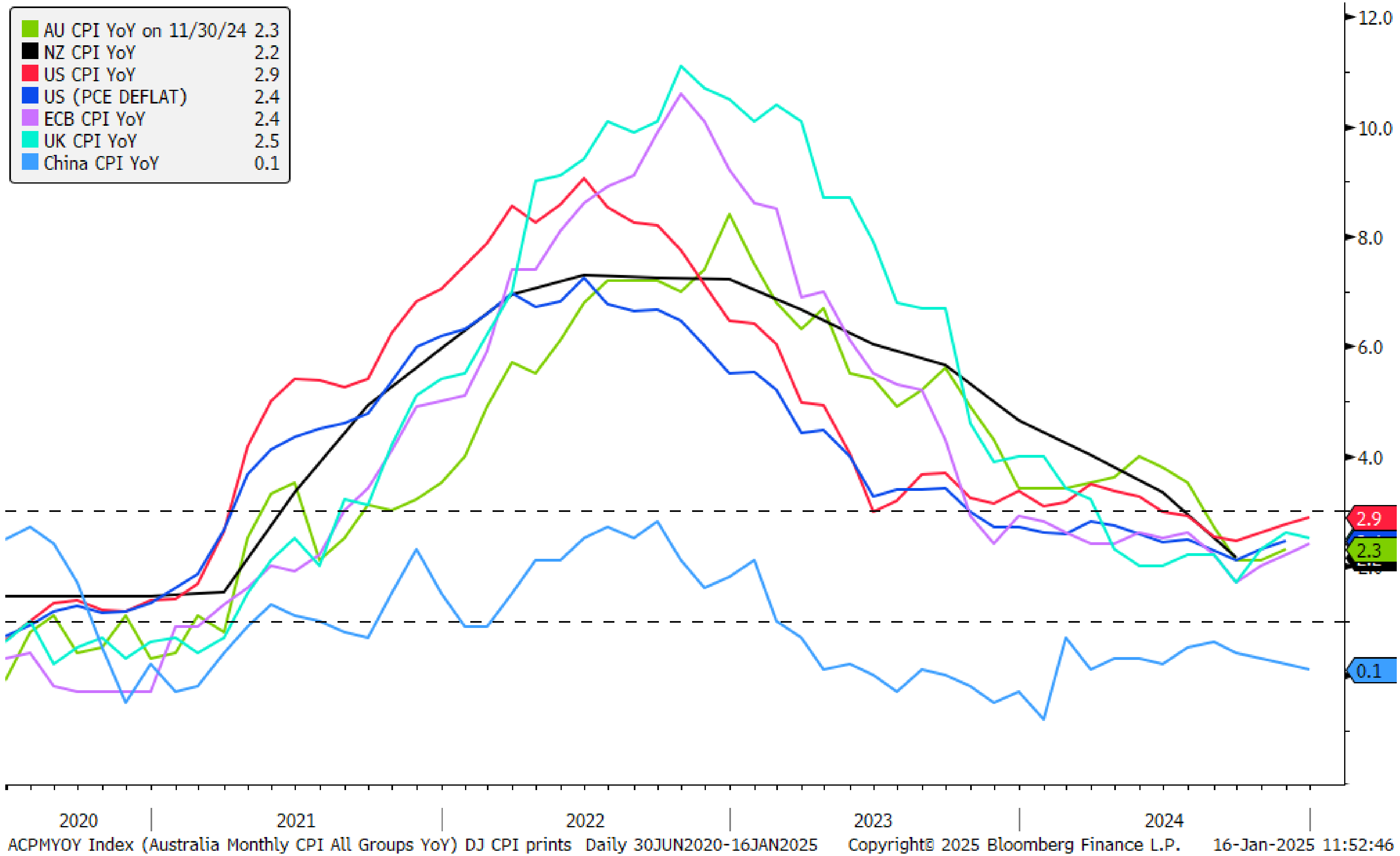
Inflation – has been ticking up recently

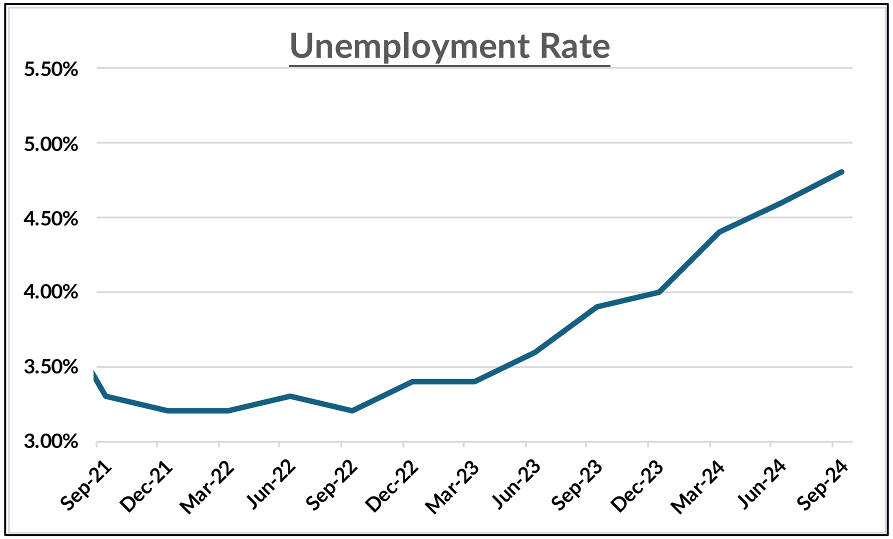


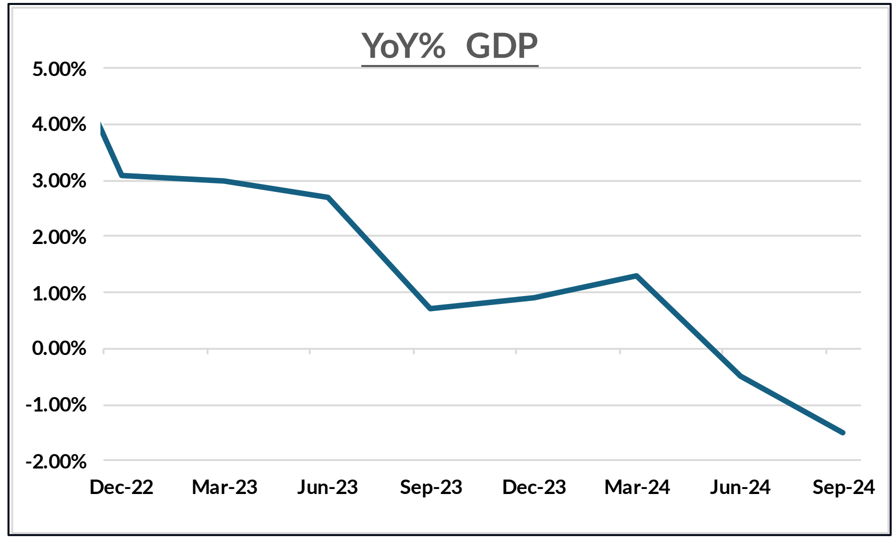
- NZ CPI eased to 2.2% for the year to September (0.6% for the quarter) – the smallest annual rise in over three years. Non-tradable (mainly domestic) inflation remains sticky at an annual rate of 4.9%, while tradable inflation fell to -1.6% over the year.

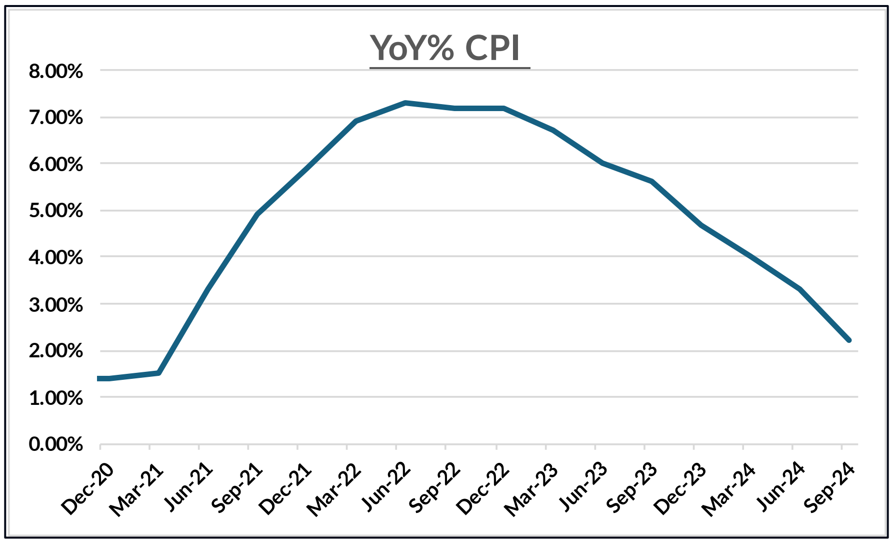
Key NZ economic indicators

- Inflation up 0.6% in the September quarter 24 and up 2.2% for the year.
- GDP declined 1.0% over the September 24 quarter and declined 1.5% over the year
- Unemployment 4.8% in the September 24 quarter
- Retail sales down 0.1% in the September 24 quarter
- REINZ house price index up 0.6% in November 24, down 1.4% for the year
- Government debt to GDP ratio is 42.5%, up from 19.0% at the start of 2020

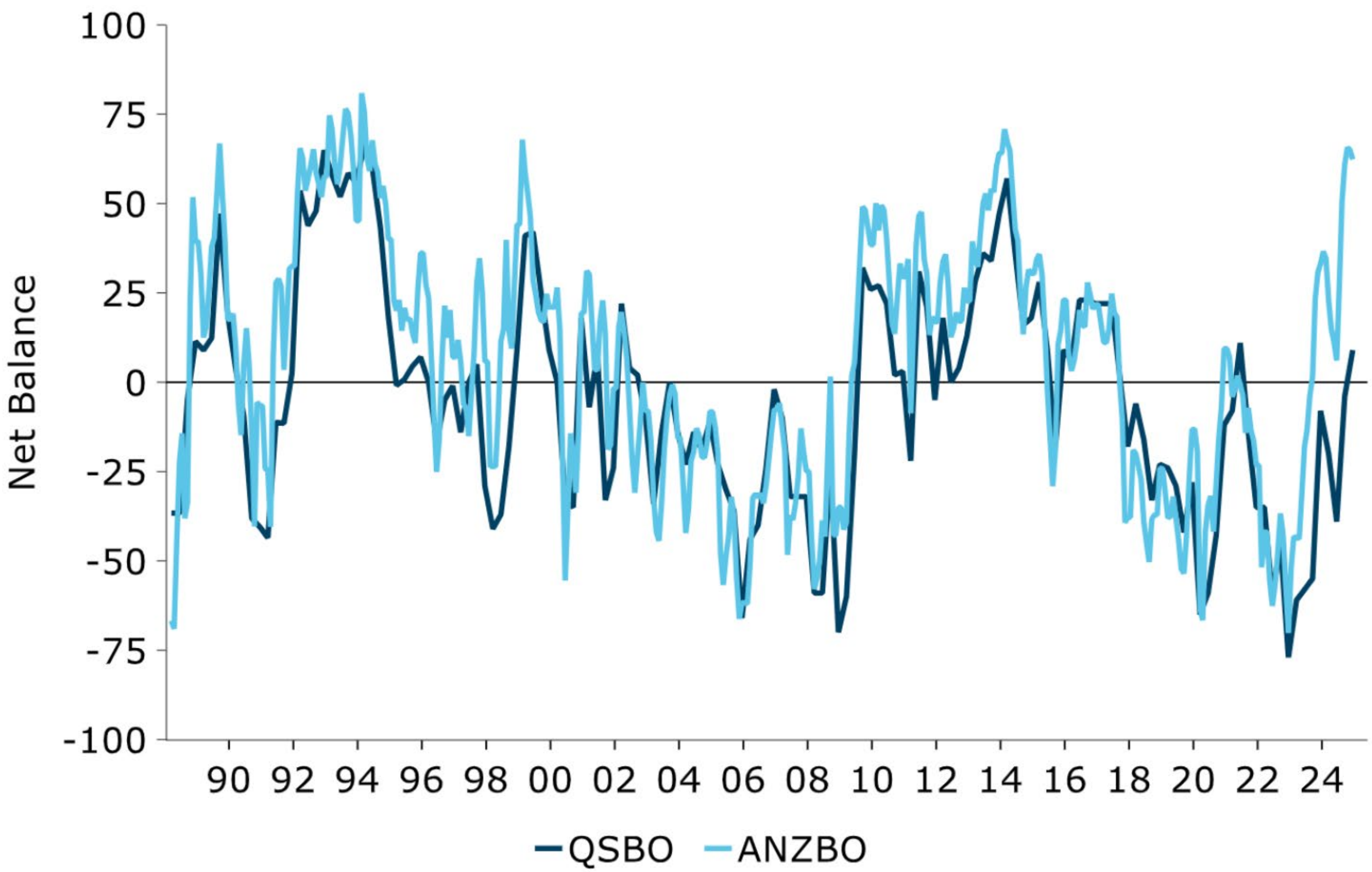
When is it going to get better (tourism excepted) ?







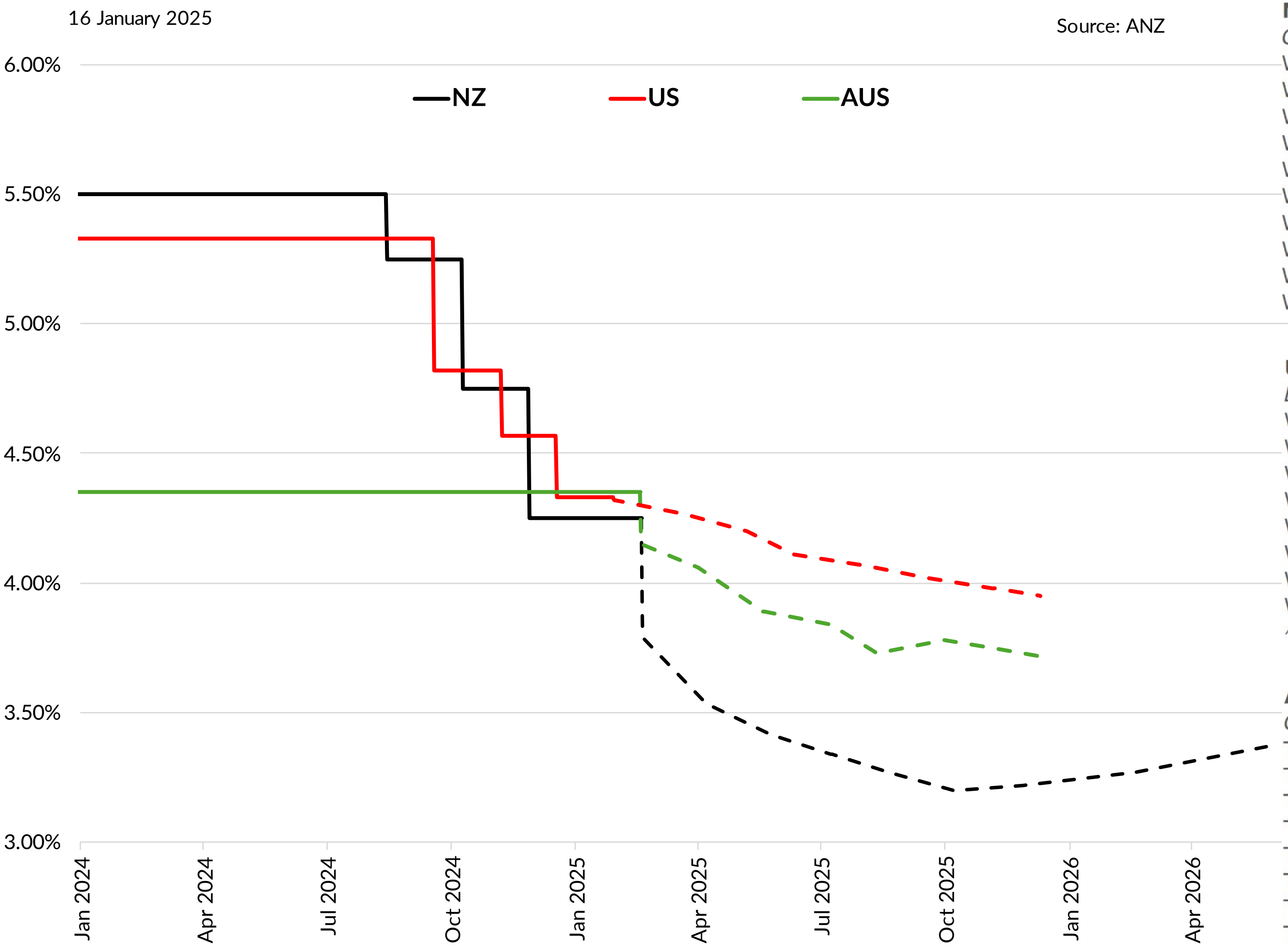
ANZBO and QSBO Business Confidence:



Source: NZIER, Macrobond, ANZ Research

- QSBO: Firms' general business confidence improved, with a net 9% of firms optimistic over the NZ economic outlook (from -4 s.a. in Q3).
- QSBO: A net 9% of firms expect an improvement in the general business environment, compared to a net -4% in September (and much stronger than the net -39% in June).
- ANZBO: Business confidence eased 3 points to +62 in December, but expected own activity rose 2 points to +50, and past own activity (a GDP indicator) jumped 10 points to 0. Past employment fell 1 point to -13.

Market expectations for the OCR



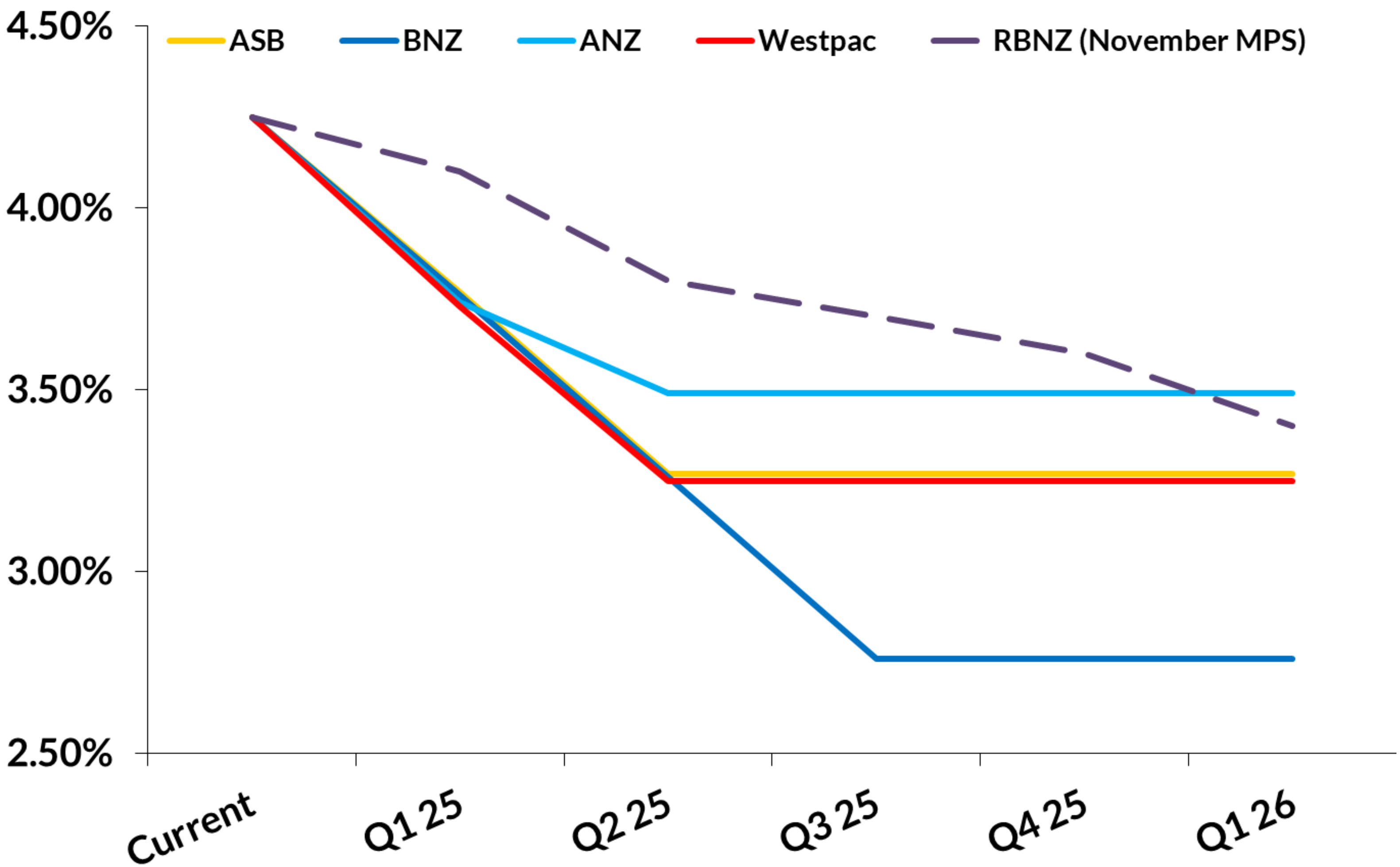
New Zealand	Rate	Change from current
Current Rate¶	*4.25*	
Wed 19 Feb 25	3.79	*-0.46*
Wed 9 Apr 25	3.53	*-0.72*
Wed 28 May 25	3.41	*-0.84*
Wed 9 Jul 25	3.34	*-0.91*
Wed 20 Aug 25	3.27	*-0.98*
Wed 8 Oct 25	3.20	*-1.05*
Wed 26 Nov 25	3.22	*-1.03*
Wed 18 Feb 26	3.27	*-0.98*
Wed 8 Apr 26	3.32	*-0.93*
Wed 27 May 26	3.37	*-0.88*

USA	Rate	Change from current
*Effective FFR^*	*4.33*	
Wed 29 Jan 25	4.32	*-0.01*
Wed 19 Mar 25	4.27	*-0.06*
Wed 7 May 25	4.20	*-0.13*
Wed 18 Jun 25	4.11	*-0.22*
Wed 30 Jul 25	4.07	*-0.26*
Wed 17 Sep 25	4.02	*-0.31*
Wed 29 Oct 25	3.98	*-0.35*
Wed 10 Dec 25	3.95	*-0.38*

^Effective Rate today 4.33%

Australia	Rate	Change from current
Current Rate Δ*	*4.34*	
Tue 18 Feb 25	4.15	*-0.19*
Tue 1 Apr 25	4.06	*-0.29*
Tue 20 May 25	3.89	*-0.46*
Tue 8 Jul 25	3.84	*-0.50*
Tue 12 Aug 25	3.73	*-0.61*
Tue 30 Sep 25	3.78	*-0.57*
Tue 4 Nov 25	3.75	*-0.59*
Tue 9 Dec 25	3.72	*-0.62*

Banks updated OCR forecasts



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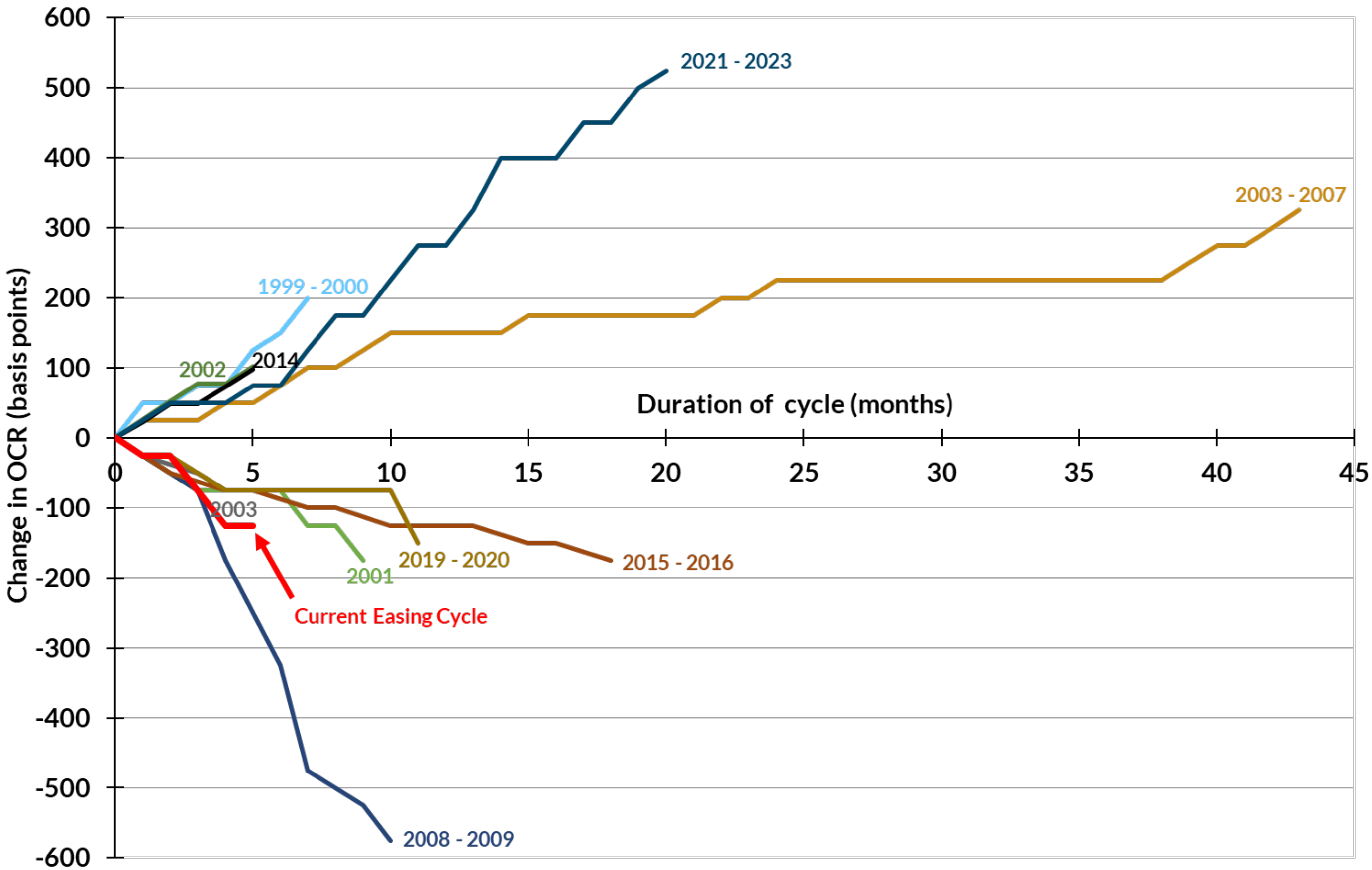
OCR hiking and easing cycles since 1999

Easing Cycles

- 2001, 1.75% for 10 months – from 6.50% to 4.75%
- 2003, 0.75% for 3 months – from 5.75% to 5.00%
- 2008, 5.75% for 11 months – from 8.25% to 2.50%
- 2015, 1.75% for 17 months – from 3.50% to 1.75%
- 2019, 1.50% for 12 months – from 1.75% to 0.25%

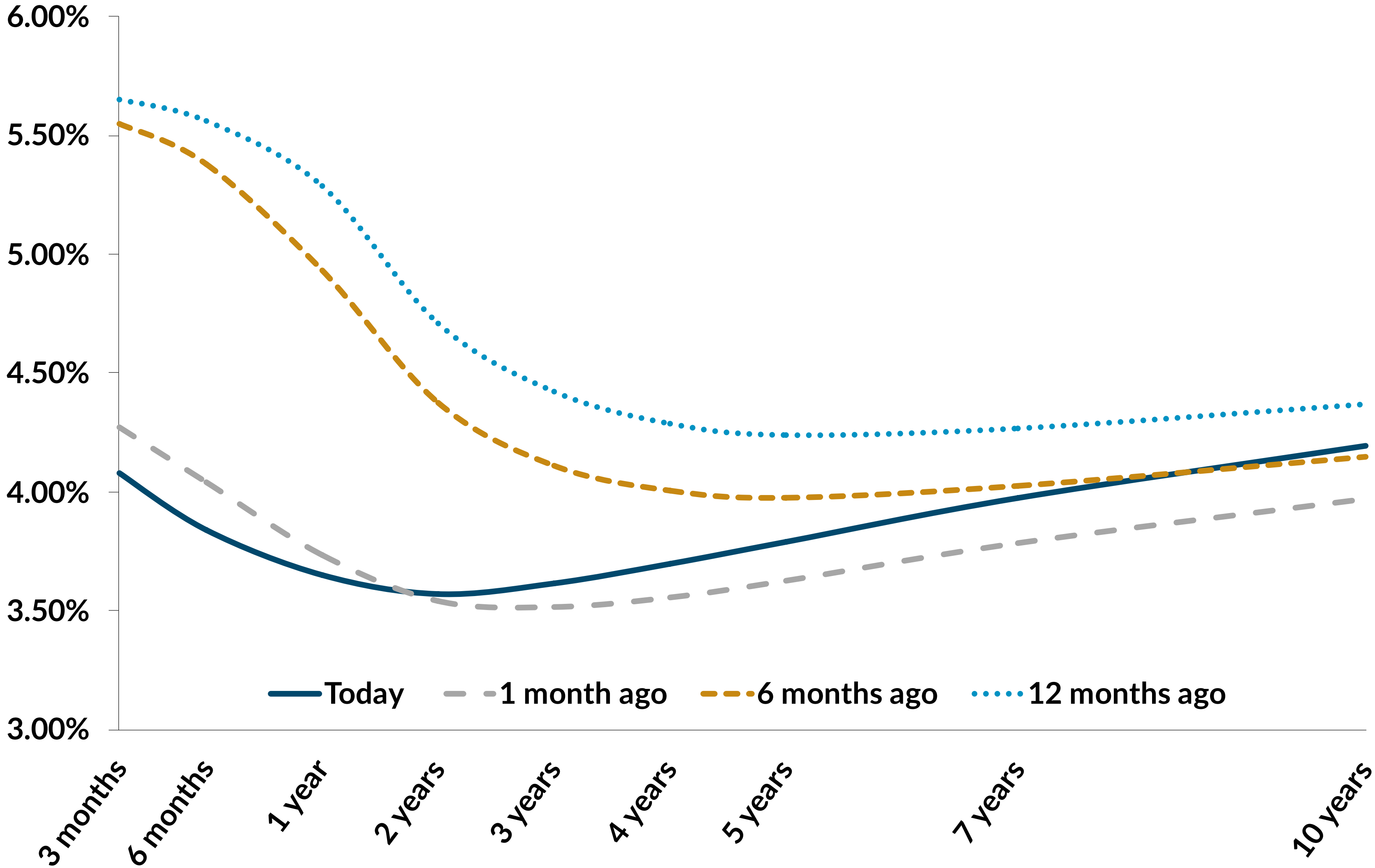
Hiking Cycles

- 1999, 2.00% for 7 months – from 4.50% to 6.50%
- 2002, 1.25% for 5 months – from 4.75% to 5.75%
- 2003, 3.25% for 43 months – from 5.00% to 8.25%
- 2014, 1.00% for 5 months – from 2.50% to 3.50%
- 2021, 5.25% for 20 months – from 0.25% to 5.50%

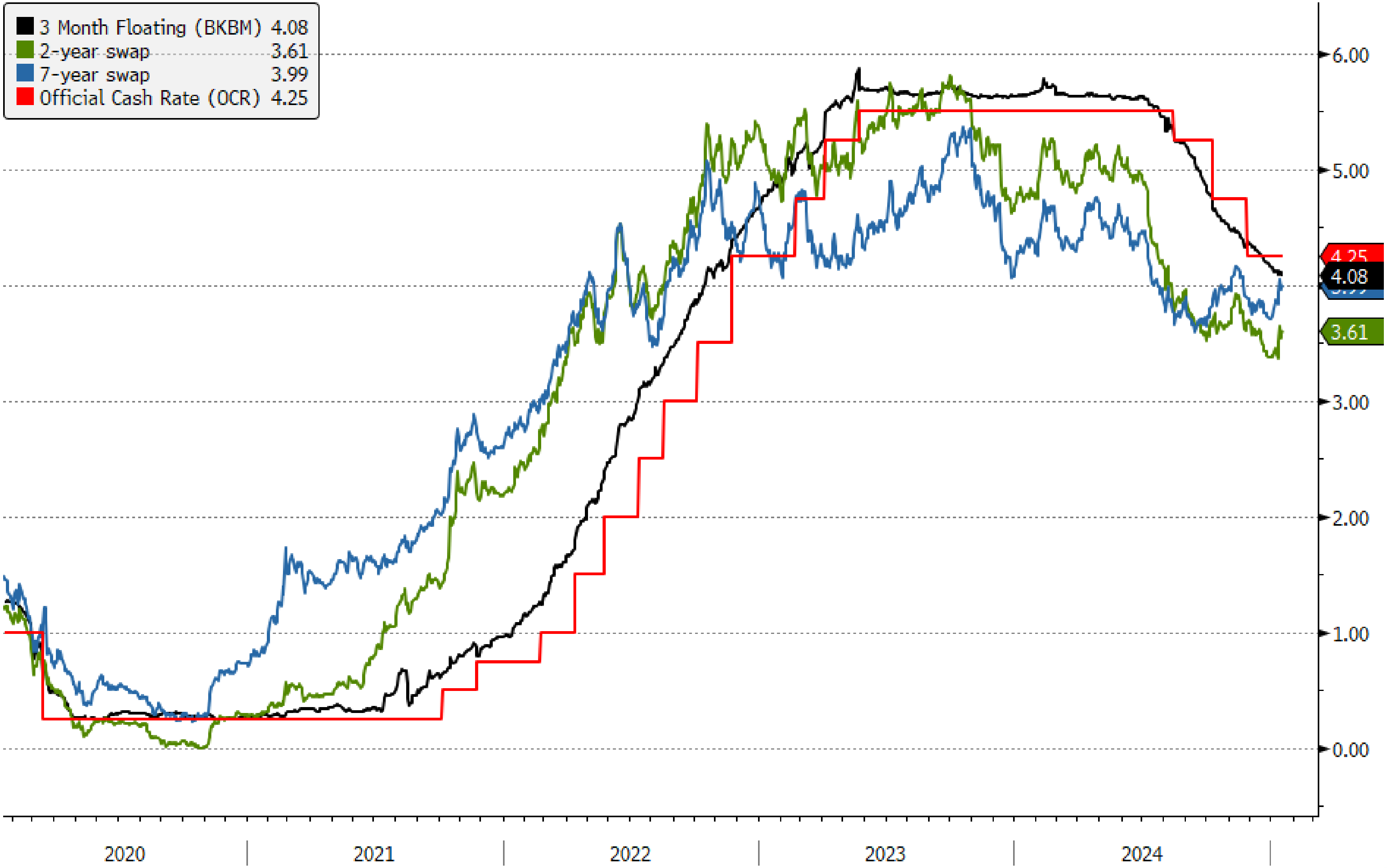


NZ yield curve

US 10-year dragging the tail



NZ OCR, 90 day 2 and 7 year swap rates



NFIX3FRA Index (NZFM New Zealand Bank Bill 3 Month FRA) DJ NZ BKBM 2 & 7 yr IRS Daily 19JAN2020-17JAN2025 Copyright© 2025 Bloomberg Finance L.P. 17-Jan-2025 13:22:39

The Reserve Bank of New Zealand

- The RBNZ’s primary objective of monetary policy is to maintain price stability.
- The price stability goal is attained when the general price level in the domestic economy remains as low and stable as possible in order to foster sustainable economic growth.
- The RBNZ uses monetary policy to achieve the Government's target of keeping inflation between 1.0% and 3.0% on average over the medium term, with a focus on keeping future average inflation near the 2.0% target midpoint.
- This is defined in the *Remit* to the Monetary Policy Committee.
- The RBNZ implements monetary policy by setting the Official Cash Rate (“OCR”) which is reviewed 7 times per year.

Local Government Funding Agency (LGFA)

- The LGFA is a Council Controlled Trading Organisation established in 2011.
- Has had a major (positive) impact on Council funding
- Has a S&P Global Ratings and Fitch Ratings long term credit rating of 'AAA', the same as the New Zealand government.
- Now has 77 council members and 7 CCO's. It raised around $24.5 billion of debt and on-lent $22.4 billion to councils and CCO's.
- Has approximately 90% market share of local authority debt
- Borrowers must meet certain covenants to be able to borrow from the LGFA.
  - Net debt as a percentage of revenue shall not exceed 250%
  - Interest as a percentage of rates shall be less than 30%
  - Interest as a percentage of revenue shall be less than 20%
  - Liquidity shall be greater than 110%
- Differential pricing applies depending on the borrowers' credit standing and whether it is a guarantor or not.
- CCO's can now borrow from the LGFA

Local Government Funding Agency

- All borrowers are required to contribute 5.0% of the total amount borrowed as capital, these are known as Borrower Notes which can be converted to equity at the discretion of the LGFA.
- A joint and several guarantee applies whereby all participating guaranteeing borrowers will be liable in the event of a default by any of the borrowers.
- However, there are a number of safeguards to avert this e.g. liquidity of $2.7 billion (invested in financial market instruments) and a standby facility from the Debt Management Office of up to $1.5 billion (currently at $0.6 billion).
- The guarantee is in proportion to the ratepayer base, **for Queenstown Lakes DC it is 1.3%** (Auckland CC 28.1%, Christchurch CC 7.8%. Wellington CC 5.2%, Dunedin CC 2.4%, Tauranga 3.3%, Hamilton CC 2.9%, Waipa DC 0.9%, West Coast RC 0.1%)

Local Government Funding Agency

- Offers maturities from one-month out to April 2037.
- There are three forms of debt that a borrower can access
- Commercial Paper – is a floating rate instrument available for terms from 1month to 1 year.
- Floating Rate Note (“FRN”) – is a floating rate instrument with interest paid quarterly and is available for terms out to April 2037. With an FRN, the margin is set for the term of the instrument, but the base rate (the 3-month bank bill mid-rate) can change at the 3 monthly (quarterly) reset dates.
- Fixed Rate Bond (“FRB”) - is a fixed rate instrument with interest paid semi-annually. With an FRB the interest rate (the coupon) is set for the life of the instrument.

Current pricing of LGFA debt

Maturity	Margin	FRN (or CP Rate)	FRB
3 month CP	0.15%	4.22%	N/A
6 month CP	0.15%	4.02%	N/A
April 2025	0.46%	4.53%	4.39%
April 2026	0.46%	4.53%	4.39%
April 2027	0.63%	4.70%	3.87%
May 2028	0.77%	4.84%	3.92%
April 2029	0.90%	4.97%	4.09%
May 2030	1.00%	5.07%	4.21%
May 2031	1.07%	5.14%	4.38%
May-2032	1.10%	5.17%	4.53%
April 2033	1.14%	5.21%	4.64%
May 2035	1.17%	5.24%	4.81%
April 2037	1.23%	5.30%	4.98%

Interest rate swaps

- Interest rate swaps are used to limit or manage exposures to fluctuations in interest rates.
- A swap is an agreement between two parties (counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.
- For a borrower, an interest rate swap is most commonly used to exchange a floating rate payment for a fixed rate payment.
- Swaps can start immediately (a spot swap) or they can be forward starting, the latter being especially useful for managing future interest rate exposures.

Interest rate swaps

QLDC

Fixed 3 years @ 3.65%

BNZ

Receives 90-day BKBM @ 4.08%

Borrows at 90-day (BKBM)4.08% +0.71% margin

LGFA

Overall cost of funds

Pay 3.65%
~~Receive BKBM~~
} Swap

~~Pay BKBM~~
Pay 0.71%
} Loan

Net pay 4.36% **FIXED**

Advantages of interest rate swaps

- Interest rate swaps are very flexible as they can be:
  - Closed out early (before the specified maturity date);
  - Extended beyond the original maturity date;
  - Can have varying principal amounts (amortising).
- Have transparent pricing and do not necessarily need to be transacted with just one bank which enables competitive pricing.
- But they are subject to ‘market to market’ valuations and when interest rates fall, the value of the swap declines and vice versa when interest rates rise. (assuming a standard pay fixed receive floating structure)
- Swaps can mature after the maturity of the underlying debt.

Disadvantages of interest rate swaps

- Swaps are subject to market to market valuations and when interest rates fall, the value of the swap declines but when interest rates rise, the value of the swap increases.
- How the valuation of the swap portfolio on the balance sheet is treated, is determined by the borrowers position on hedge accounting.
- For LGFA sourced debt, it is slightly cheaper (5- 7 basis points) to enter into a Fixed Rate Bond ("FRB") than to enter into a Floating Rate Note ("FRN") and then overlay a swap on it.

Interest rate swap grid

New Zealand Forward Starting Swap Rates - *Borrower*

Term	Maturity (years) 1	2	3	4	5	6	7	8	9	10
Spot	**3.65%**	**3.61%**	**3.66%**	**3.74%**	**3.83%**	**3.92%**	**4.01%**	**4.09%**	**4.16%**	**4.22%**
3 months	3.48%	3.54%	3.63%	3.73%	3.83%	3.93%	4.02%	4.10%	4.17%	4.24%
6 months	3.46%	3.56%	3.67%	3.77%	3.87%	3.97%	4.06%	4.14%	4.21%	4.28%
1 year	3.55%	3.66%	3.77%	3.87%	3.97%	4.07%	4.15%	4.23%	4.29%	4.36%
2 years	3.77%	3.89%	3.99%	4.09%	4.19%	4.27%	4.34%	4.41%	4.47%	4.53%
3 years	4.00%	4.11%	4.21%	4.30%	4.38%	4.45%	4.51%	4.58%	4.64%	4.69%
4 years	4.22%	4.31%	4.41%	4.49%	4.55%	4.61%	4.68%	4.73%	4.78%	4.82%
5 years	4.41%	4.51%	4.58%	4.64%	4.70%	4.77%	4.82%	4.87%	4.90%	4.92%
6 years	4.61%	4.67%	4.73%	4.78%	4.85%	4.90%	4.94%	4.97%	5.00%	5.01%
7 years	4.73%	4.78%	4.85%	4.91%	4.97%	5.01%	5.04%	5.05%	5.07%	5.08%
8 years	4.84%	4.91%	4.98%	5.04%	5.07%	5.10%	5.11%	5.12%	5.13%	5.15%
9 years	4.98%	5.05%	5.11%	5.14%	5.15%	5.16%	5.17%	5.18%	5.20%	5.22%
10 years	5.13%	5.13%	5.20%	5.20%	5.21%	5.21%	5.21%	5.23%	5.26%	5.29%

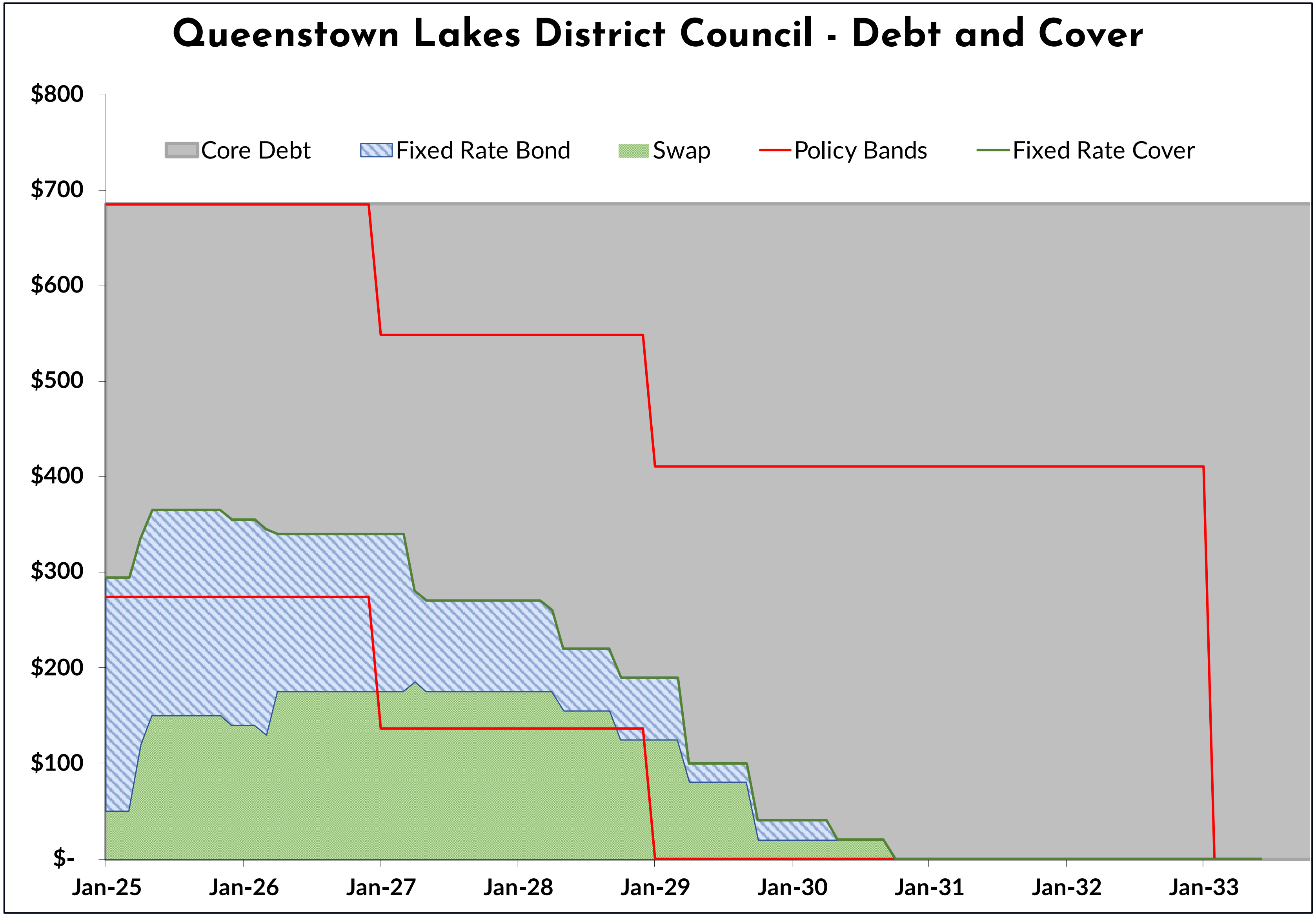
Last updated **20-Jan-25**

Managing Queenstown Lakes DC's interest rate risk

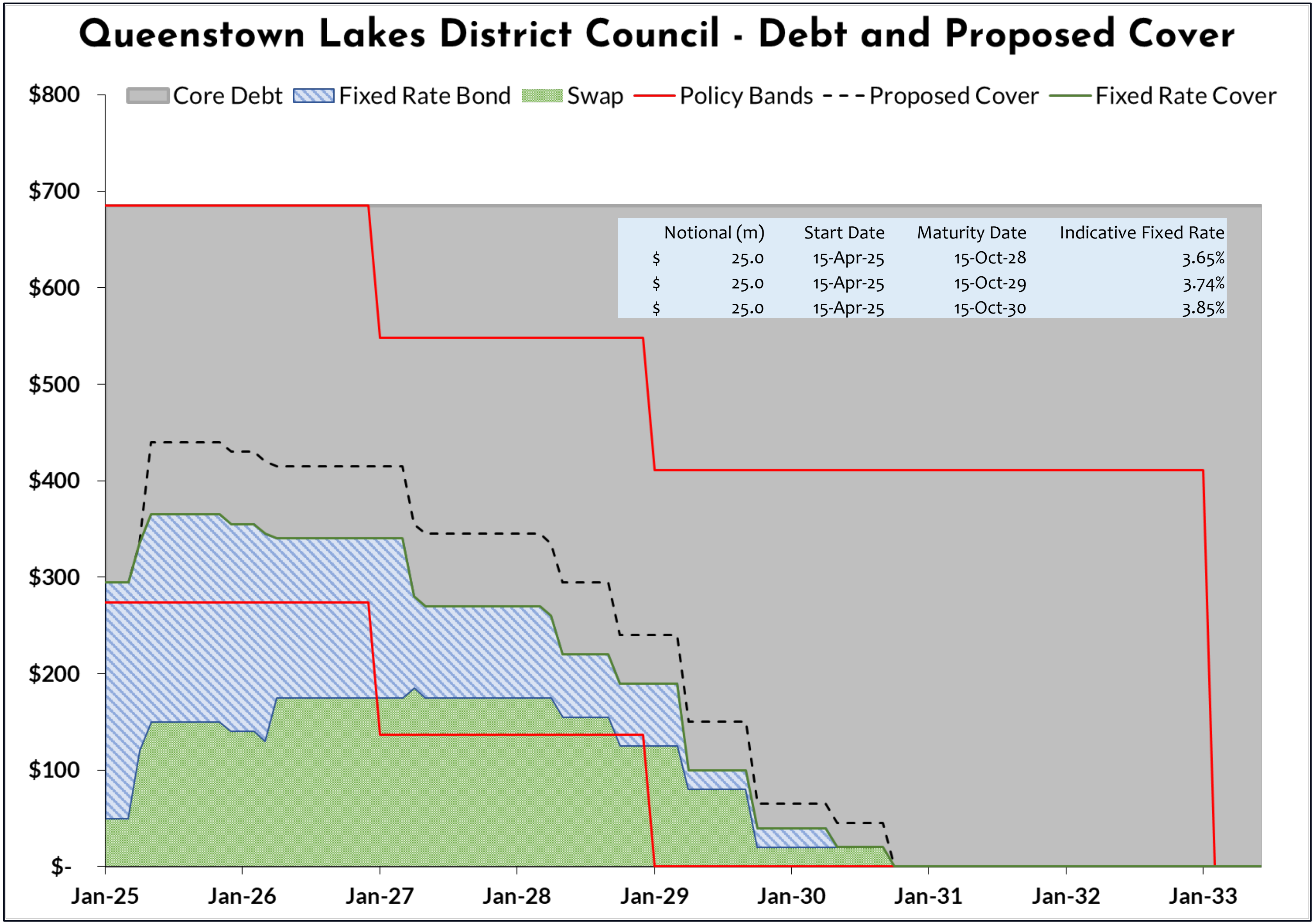
- QLDC's Treasury Policy contains the parameters for managing interest rate risk.
- It specifies the minimum and maximum levels of fixed rate cover spread over three timeframes.

Fixed Rate Cover Percentages		
Period	**Minimum**	**Maximum**
0 to 2 years	40%	100%
2 to 4 years	20%	80%
4 to 8 years	0%	60%

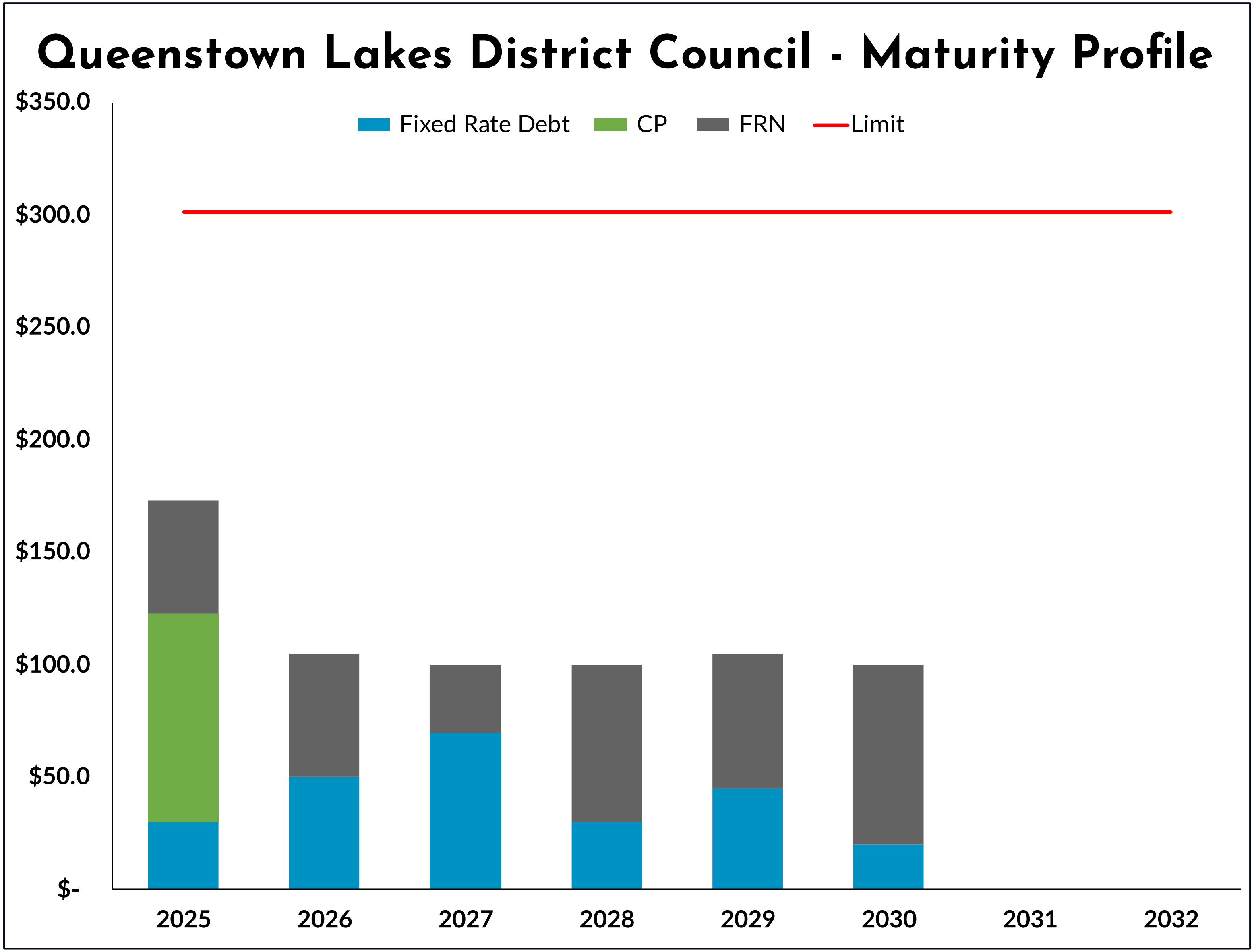
Queenstown Lakes DC - debt and cover profile



Queenstown Lakes DC- debt and cover profile with proposed swaps (see dotted line)



Queenstown Lakes DC- funding maturity profile



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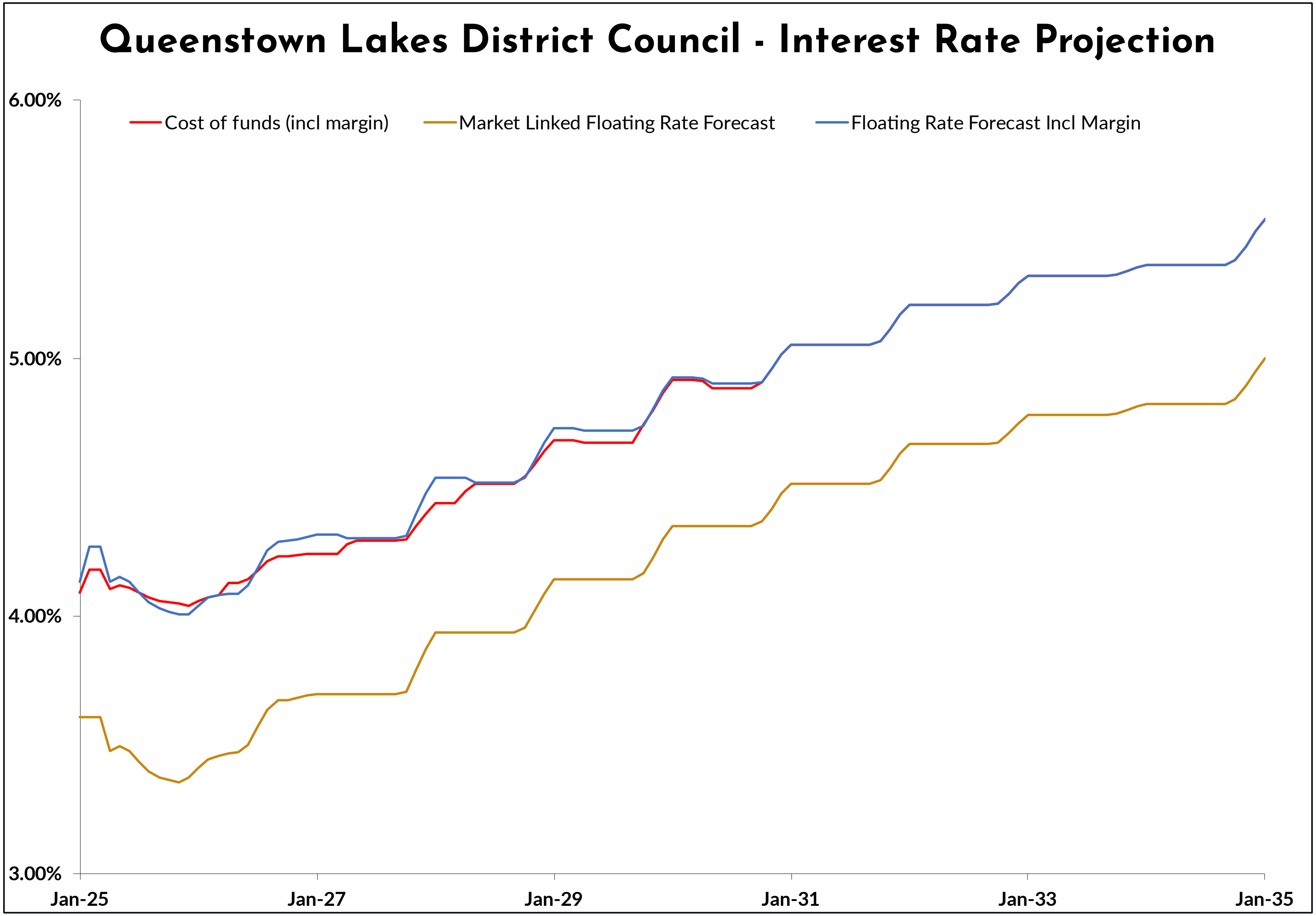
Queenstown Lakes DC - Interest rate projection (cost of funds)



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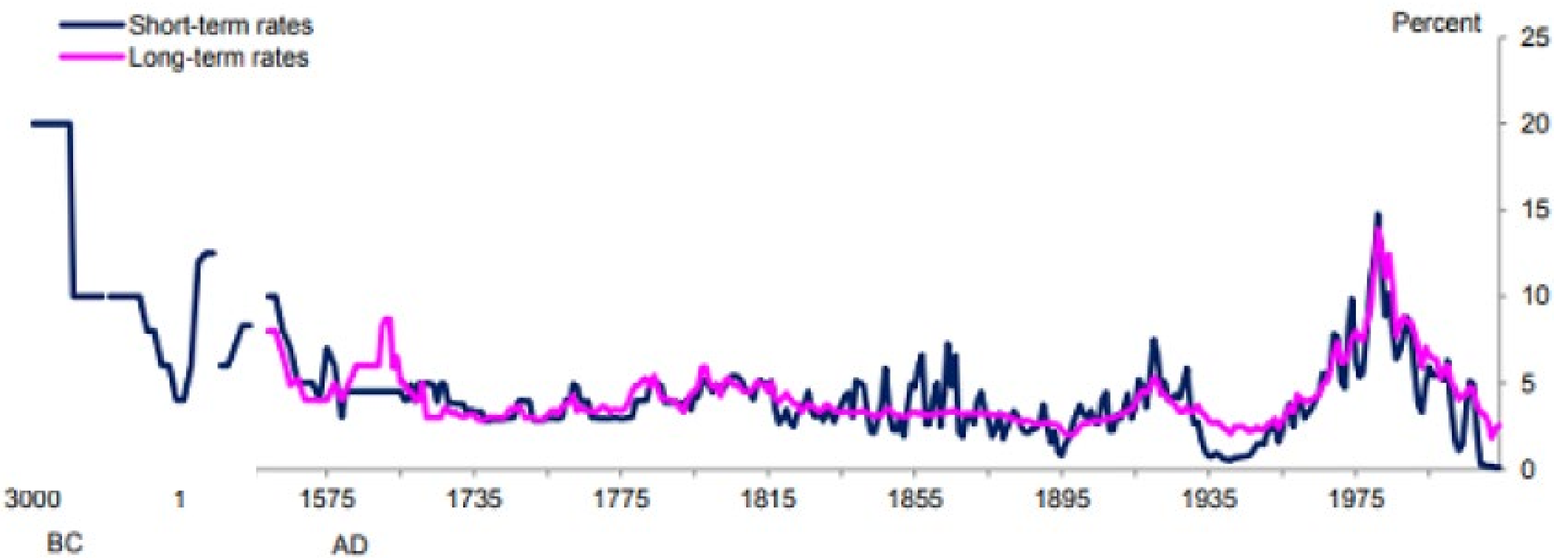
Interest rates going back 5,000 years

Short and long-term interest rates



Sources: Homer and Sylla (1991); Heim and Mirowski (1987); Weiller and Mirowski (1990); Hills, Thomas and Dimsdale (2015); Bank of England; Historical Statistics of the United States Millenial Edition, Volume 3; Federal Reserve Economic Database. Notes: the intervals on the x-axis change through time up to 1715. From 1715 onwards the intervals are every twenty years. Prior to the C18th the rates reflect the country with the lowest rate reported for each type of credit: 3000BC to 6th century BC - Babylonian empire; 6th century BC to 2nd century BC - Greece; 2nd century BC to 5th century AD - Roman Empire; 6th century BC to 10th century AD - Byzantium (legal limit); 12th century AD to 13th century AD - Netherlands ;13th century AD to 16th century AD - Italian states. From the C18th the interest rates are of an annual frequency and reflect those of the most dominant money market: 1694 to 1918 this is assumed to be the UK; from 1919-2015 this is assumed to be the US. Rates used are as follows: Short rates: 1694-1717- Bank of England Discount rate;1717-1823 rate on 6 month East India bonds; 1824-1919 rate on 3 month prime or first class bills; 1919-1996 rate on 4-6 month prime US commercial paper ; 1997-2014 rate on 3month AA US commercial paper to non-financials. Long rates: 1702-1919 - rate on long-term government UK annuities and consols; 1919-1953, yield on long-term US government bond yields; 1954-2014 yield on 10 year US treasuries.

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