

9.4 Refinance of Sewer Fund Loan

REPORT BY THE ACCOUNTANT REPORTING & ANALYSIS
TO 17 MARCH 2021 ORDINARY MEETING
GOV400088, A0140322

RECOMMENDATION

That Council:

1. **receive the report by the Accountant Reporting and Analysis on the Refinance of Sewer Fund Loan; and**
2. **authorise the General Manager to refinance the Sewer loan with National Australia Bank for another 10 years at a forward starting fixed rate subject to the rate supplied being no more than of 2.9%.**

Executive summary

The Sewer loan has a 10 year fixed rate which is due to expire as at 27 October 2021 and requires refinancing. The National Australia Bank (NAB) has provided 3 options on refinancing for this loan. Option 2 is considered the better option as it means that there is no break cost to pay and a fixed rate will ensure certainty of cash flows. This option involves refinancing for another 10 years at a forward starting fixed rate that is agreed in March but commences on 27 October 2021 when the current fixed rate leg matures. On 4 March 2021 Council received a revised indicative fixed rate for Option 2 of 2.74%.

Disclosure of Interest

Nil.

Detailed report

The Mudgee Sewer Augmentation project loan which commenced in 2011/12, for \$10 million, is budgeted for 20 year repayments. Due to the global financial instability at the time, a 10 year fixed interest rate loan with the option to refinance after 10 years was entered into as the rates were lower than that of a 20 year loan. This 10 year fixed rate is due to expire on 27 October 2021 and revert back to a floating rate and thus NAB has provided us with options on refinancing the loan.

In July 2020 NAB suggested the following options in regards to the sewer loan:

Option 1 – terminate now and incur the break cost of \$357,000 and embed it back into a fixed rate leg for the remaining term out to December 2031.

Fixed amount - \$7,663,573

Fixed Term - October 2020 to December 2031, semi-annual rolls

The indicative fixed rate for the term - 3.17% all up with margin of 0.36% and break cost embedded

The indicative semi-annual P&I payment - \$399,960

Option 2 – consider a forward starting fixed rate leg that is agreed today to commence on Oct 27 2021 (in 1 year) when the current fixed rate leg matures, no break cost to pay.

Fixed amount - \$7,317,300

Fixed Term - October 2021 to December 2031, semi-annual rolls

The indicative fixed rate for the term – 2.54% all up with margin of 0.36% and break cost embedded

The indicative semi-annual P&I payment - \$399,070

Option 3 – do nothing and wait for the fixed leg to mature and allow it to go back to the floating rate (currently 2.07%) on October 2021.

A move from a fixed rate of 6.53% to an indicative floating rate of 2.07% will be beneficial to cash flow, on \$7,500,000 that is a saving of \$334k/year. However it does leave exposure to a rise in the floating rate over the remaining term of the loan while a fixed rate of 2.54% would be set for the life of the loan.

Option 2 is recommended as it would mean that there is no break cost to pay and a fixed rate will ensure certainty of cash flows. The fixed rate has been requested to 2.74% on 4 March 2021 and the loan should only be entered into if the rate offered does not exceed 2.85%.

As loan interest rates have increased slightly since January it is recommended to enter into a forward starting fixed rate now rather than risk exposure to a further rise in rates between now and October 2021.

Community Plan implications

Theme	Good Governance
Goal	An effective and efficient organisation
Strategy	Pursue efficiencies and ongoing business improvement

Strategic implications

Council Strategies

Not applicable.

Council Policies

The Council's Borrowing Policy, adopted on the 15 April 2020, allows that:

- Council may borrow at any time for any purpose permitted under the Local Government Act 1993, and
- Any borrowings shall be considered as a mechanism to assist in achieving the goals Council as set out in the adopted Management Plan and Strategy Plan
- Council is committed to maintaining a Debt Service Ratio of less than 15% for General Fund

The recommendation complies with the Council's Policy, including maintaining a satisfactory level of Debt Service Ratio.

Legislation

Council may borrow at any time for any purpose allowed under the Local Government Act 1993 (LG Act S 621).

The Local Government (General) Regulation 2005 allows that the repayment of money borrowed by a council (whether by way of overdraft or otherwise), and the payment of any interest on that money, is a charge on the income of the council (LG Regulation 229). The Deemed Charge over Council Rates complies with this regulation by securing the loan over council income.

The Local Government Ministerial Borrowing Order limits council not to borrow from any source outside the Commonwealth of Australia nor in any other currency other than the Australian currency.

The recommendation complies with statutory requirements.

Financial implications

The estimated semi-annual principal and interest repayments for the loan over 10 years at 2.74% are:

Current loan Repayments	Estimated loan repayments	Savings
420,525	403,210	17,315

Should the recommendation be approved Council staff will account for these repayment changes when preparing the draft Operational Plan 21/22.

Associated Risks

Refinancing into a fixed interest rate loan has risks that the Council will not be able to benefit from falling interest rates, however it also means that the Council will be protected if the interest rates increase.

Entering into a fixed rate loan also has risks that if amounts are drawn down or early repayments are made then economic costs may incur to compensate NAB.

The interest rate markets over January and February 2021 have seen some aggressive increases and volatility. We are advised this is due to the possibility of higher inflation in developed economies. This has settled somewhat which may give Council the opportunity to lock in better rates than recently quoted. The recommendation to this report will allow Council staff some flexibility to assess these movements and aim to achieve a better result, whilst also setting an upper limit rate of 2.9%. A further report would be presented if staff cannot secure rate under the upper limit.

AMANDA COVER
ACCOUNTANT REPORTING & ANALYSIS

LEONIE JOHNSON
CHIEF FINANCIAL OFFICER

16 February 2021

Attachments: Nil

APPROVED FOR SUBMISSION:

BRAD CAM
GENERAL MANAGER