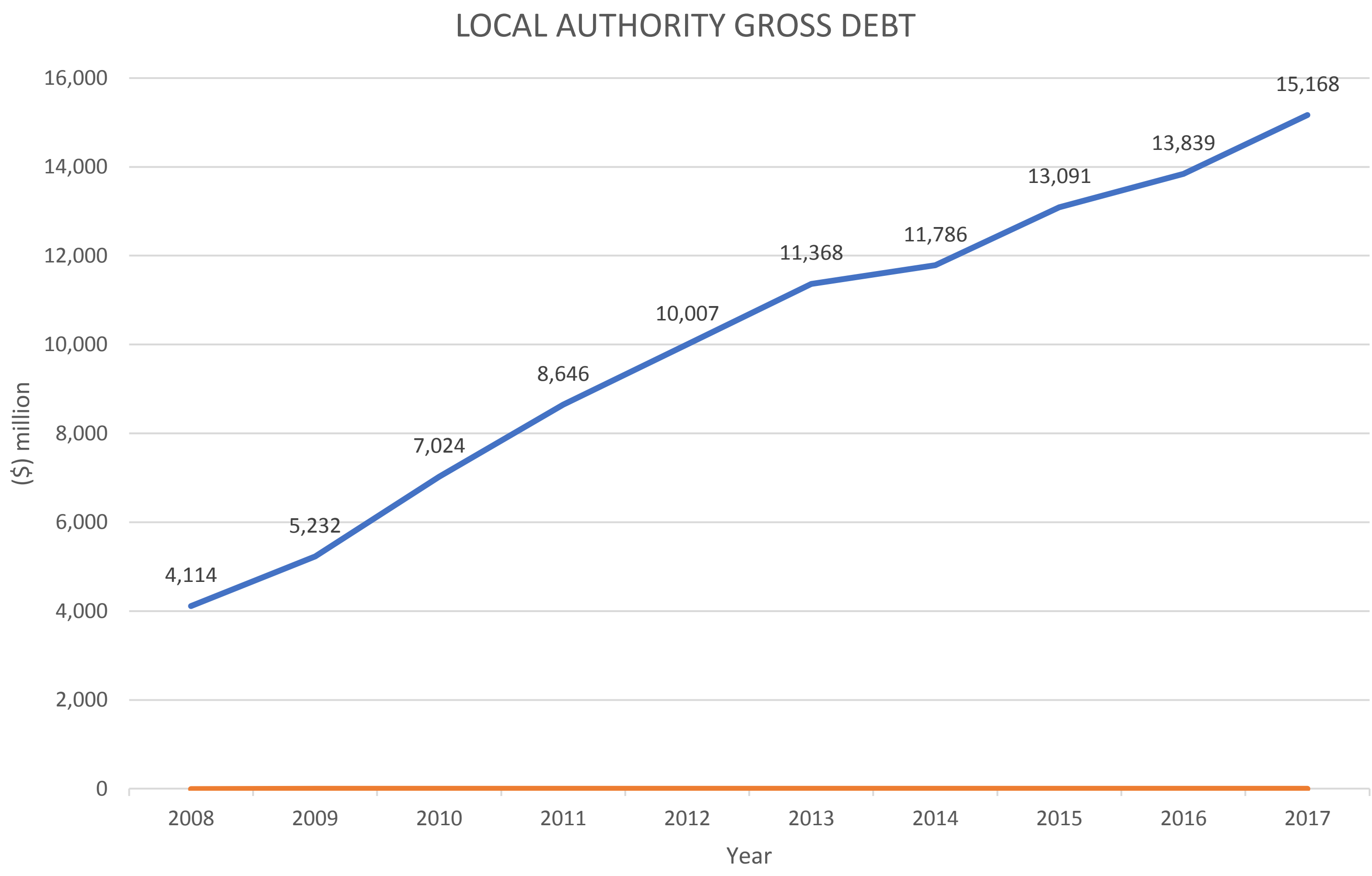
LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

COUNCIL CREDIT

July 2018

HISTORICAL COUNCIL GROSS DEBT



Note: Debt is at parent level except for Auckland Council which is at group level.
2015/25 LTP's forecast gross debt at June 2017 of $16.5 billion (actual was $1.35 billion lower).

NEW ZEALAND COUNCILS WITH CREDIT RATINGS

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

Council	S&P	Fitch	Moodys
Auckland Council	AA		Aa2
Dunedin City Council	AA		
Bay of Plenty Regional Council	AA		
Greater Wellington Regional Council	AA		
Hastings District Council	AA		
Hutt City Council	AA		
Invercargill City Council		AA	
Marlborough District Council	AA		
Nelson City Council	AA		
New Plymouth District Council	AA		
Palmerston North City Council	AA		
Porirua City Council	AA		
Taupo District Council	AA		
Waimakariri District Council	AA Negative		
Wellington City Council	AA		
Whanganui District Council	AA		
Whangarei District Council	AA		
Western Bay of Plenty District Council	AA		
Hamilton City Council		AA-	
Queenstown Lakes District Council		AA-	
Rotorua Lakes District Council		AA-	
South Taranaki District Council	AA-		
Tasman District Council	AA- Positive		
Timaru District Council		AA-	
Christchurch City Council	A+		
Horowhenua District Council	A+		
Kapiti Coast District Council	A+		
Tauranga City Council	A+		

28 councils in New Zealand have credit ratings – 26 are members of LGFA

Over 2014, 2015, 2016, 2017,2018

- **Taupo, Nelson, South Taranaki, Western Bay of Plenty (twice), Whanganui and Whangarei District Councils were upgraded**
- **No Council ratings were downgraded**

Source: S&P, Fitch, LGFA

S&P RATING CHANGES OVER THE PAST THREE YEARS

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

Council	Action	Date
Whangarei District Council	Outlook Revised from Stable to Positive	May 19, 2015
Taupo District Council	Upgraded from AA- to AA	May 25, 2015
South Taranaki District Council	Outlook Revised from Stable to Positive	May 29, 2015
Christchurch City Council	Outlook Revised from Negative to Stable	Dec 7, 2015
Nelson City Council	Upgraded from AA- to AA	Nov 23, 2015
Whangarei District Council	Upgraded from AA- to AA	May 19, 2016
Western Bay of Plenty District Council	Outlook Revised from Stable to Positive	Sep 26, 2016
Tasman District Council	Outlook Revised from Stable to Positive	Oct 27, 2016
Invercargill Council	Outlook Revised from Stable to Negative	Dec 02, 2016
South Taranaki District Council	Upgraded from A+ to AA-	May 19, 2017
Whanganui District Council	Outlook revised from Stable to Positive	June 28 2017
Western Bay of Plenty District Council	Upgraded from AA- to AA	Sep 22, 2017
Invercargill Council	Outlook Revised from Negative to Stable	Dec 05, 2017
Waimakariri District Council	Outlook Revised from Stable to Negative	April 11, 2018
Whanganui District Council	Upgraded from AA- to AA	June 7, 2018

As at July 2018

Source: S&P, Moodys, Fitch

CHANGE IN NET DEBT LEVELS

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

Group	2017 ($ million)	2016 ($ million)	2015 ($ million)	2014 ($ million)	Per Head Pop 2017 ($)	Per Head Pop 2016 ($)	Per Head Pop 2015 ($)	Per Head Pop 2014 ($)
All Councils	**10,609**	**9,727**	**9,494**	**8,769**	2,213	2,072	2,066	1,944
Rural	131	157	168	169	421	516	546	558
Provincial	868	847	965	1,074	644	636	761	860
Metro (excl Auckland)	2,164	1,905	2,054	1,926	1,651	1,480	1,627	1,549
Regional	-232	-282	-422	-421	-79	-98	-151	-154
Unitary	255	234	251	248	1,293	1,206	1,316	1,330
Auckland Council	7,424	6,866	6,478	5,773	4,480	4,254	4,127	3,781

Source: LGFA using data from individual council annual reports / Statistics NZ

2012-22 AND 2015-25 LTP GROSS DEBT FORECASTS FOR LOCAL GOVERNMENT SECTOR

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

NZ$ millions

2012-22 LTP	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross Debt	10,073	11,755	13,584	14,967	15,659	16,641	17,499	18,266	19,240	19,653	20,135
% Change		16.7%	15.6%	10.2%	4.6%	6.3%	5.2%	4.4%	5.3%	2.2%	2.5%

2015-25 LTP	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross Debt	14,119	14,941	16,527	17,440	17,821	18,445	18,943	19,554	19,913	20,031	20,036
% Change		5.8%	10.6%	5.5%	2.2%	3.5%	2.7%	3.2%	1.8%	0.6%	0.0%

	2015	2016	2017	2018	2019	2020	2021	2022
Gross Debt Difference between the two LTPs	-848	-718	-114	-59	-445	-795	-710	-581

Note: 2016-2022 numbers adjusted to incorporate Christchurch which only produced a 3 year plan

Source: LGFA using data from individual council Long Term Plans (LTPs)

2012-22, 2015-25, 2018-2028 LTP GROSS DEBT FORECASTS FOR METROPOLITAN COUNCILS

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

NZ$ millions

2012-22 LTP	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross Debt	7,040	8,440	9,990	11,175	11704	12,580	13,346	14,128	15,284	15,810	16,308
% Change		19.9%	18.4%	11.9%	4.7%	7.5%	6.1%	5.9%	8.2%	3.4%	3.1%

2015-25 LTP	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross Debt	10.755	11.443	12,719	13,343	13,568	14,066	14,543	15,207	15,683	15,941	16,075
% Change		6.4%	11.1%	4.9%	1.7%	3.7%	3.4%	4.6%	3.1%	1.6%	0.8%

2018-28 LTP	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Gross Debt	12,183	13,331	14,675	16,122	17,120	17,934	18,458	19,102	19,960	19,891	20,087
% Change		9.4%	10.1%	9.9%	6.2%	4.8%	2.9%	3.5%	2.9%	1.2%	1.0%

2018-2028 LTP ANALYSIS

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

- Metro councils comprised 78.5% of sector debt at June 2017
- Based on this ratio, total forecast debt for the sector is likely to be around $25 billion for 2028 and $24 billion for 2025
- This compares to a debt forecast of $20 billion for 2025 under the 2015-2025 LTP's
- Forecast net debt levels in 2028 for metro councils are around $1.3 billion lower than gross debt levels
- In recent years sector debt has risen as a result of debt increasing at Auckland and Christchurch.
- The percentage change in debt levels for the 10 metro councils from 2017 (actual debt) to 2028 forecast debt ranges between 52% and 278%
- In the 2015-2025 LTP's the percentage change in debt levels for the metro councils ranged between -37% and 113%
- The change is driven by the impact of higher growth rates and political developments eg: National Policy Statement on Urban Development Capacity
- Not all councils are forecasting a rise in debt levels. Councils that have already undertaken significant investment in the 3 waters have less capital expenditure to undertake.

2018-2028 LTP ANALYSIS

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

- Actual debt for the sector was $15.17 billion at June 2017 (around $1.4 billion lower than forecast under the 2012 and 2015 LTP's)
- Actual debt for the sector as at June 2018 is almost certain to be below the $17.4 billion forecast for 2018 in the 2015-2025 LTP's
- Revenue is also growing quite strongly – for the financial year to June 2017 adjusted revenue grew by 6.4% to $10.18 billion
- Even if debt increases by 65% over next 10 years, revenue is likely to increase by about the same percentage
- There is the likelihood of additional revenue sources (regional fuel tax, extra NZTA funding, Regional Development Fund, tourist tax)
- Possibility of some additional debt being financed through SPV's (although these would have their own revenue source)
- What will the impact be as a result of the 3 waters review?

LGFA FINANCIAL COVENANTS – MEMBER COUNCIL OUTCOMES FOR JUNE 2017 YEAR

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

LGFA Financial Covenants – member councils as at 30 June 2017 with an external credit rating (22)

Foundation Policy Covenant	Net Debt / Total Revenue <250%	Net Interest / Total Revenue <20%	Net Interest / Rates <30%
Range of councils compliance	-129.5% to 202.2%	0.9% to 10.8%	1.0% to 18.5%

LGFA Financial Covenants – member councils as at 30 June 2017 without an external credit rating (28)

Lending Policy Covenant	Net Debt / Total Revenue <175%	Net Interest / Total Revenue <20%	Net Interest / Rates <25%
Range of councils compliance	-154.7% to 146.2%	-8.6% to 6.6%	-21.9% to 10.1%

- **Note some negative outcomes due to some councils having negative Net Debt i.e. financial assets and investments > borrowings**

- LGFA councils operating within financial covenants
- Ranges highlights the differences between councils
- Sufficient financial headroom for most councils
- Improvement from 2014 for most councils
    - Revenue increased
    - Interest rates lower
    - Capex and debt restrained

Source: LGFA using data from individual council annual reports

PERFORMANCE UNDER LGFA COVENANTS

LGFA Member Councils with an external credit rating (23 in 2017, 22 in 2016, 20 in 2015 and 17 in both 2014 and 2013)

Financial Covenant	2017	2016	2015	2014	2013
Net Debt to Revenue	86.0%	87.9%	96.4%	104.7%	111.8%
Net Interest to Revenue	5.3%	6.1%	6.8%	6.6%	7.3%
Net Interest to Rates	8.1%	9.1%	10.0%	9.6%	11.1%

LGFA Member Unrated Councils (30 in 2017, 28 in 2016, 25 in 2015, 26 in 2014 and 21 in 2013)

Financial Covenant	2017	2016	2015	2014	2013
Net Debt to Revenue	29.9%	32.4%	38.2%	42.6%	52.5%
Net Interest to Revenue	1.8%	2.2%	2.4%	2.9%	3.2%
Net Interest to Rates	2.6%	2.9%	3.1%	4.0%	4.1%

PARENT VERSUS GROUP COVENANTS

- LGFA's financial covenants are part of LGFA's "Foundation Policy"
- The Foundation Policy can only be changed by a vote by shareholders

Financial covenant	Lending policy covenants	Foundation policy covenants
Net Debt / Total Revenue	<175%	<250%
Net Interest / Total Revenue	<20%	<20%
Net Interest / Annual Rates Income	<25%	<30%
Liquidity	>110%	>110%

Financial covenants are measured on Council only not consolidated group.

WHY HAVE FINANCIAL COVENANTS?

- Financial covenants benefit a borrower as it reduces their cost of borrowing
- In the case of LGFA this is because investors have transparency over the amount of debt a council can borrow, and a councils ability to service that debt
- Having financial covenants also benefits the lender. By restricting the actions a borrower can take it controls the level of risk for the lender
- For LGFA this is important for the 47 guarantors, councils that have issued borrower notes and for the longevity of LGFA

WHAT ARE THE COVENANTS TRYING TO MEASURE?

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

- The original intention was for the financial covenants to be applied to the finances of core council activities (infrastructure and local public services)
- As an example, you would not use a net interest to rates covenant for a commercial operation such as a Port (as it has no rating income)
- This has worked well over the past six years as councils do not have their core council activities within CCO's
- The one exception is Auckland Council. Auckland Council has six substantive CCO's which hold many of the Council's core operations including Watercare and Auckland Transport
- Dunedin City Council (non-LGFA member council) has its stadium and the related debt in Dunedin Stadium Property Limited
- Had Waikato Water proceeded, it would have been a multiply owned CCO. LGFA would have wanted to consolidate this balance sheet for the purpose of measuring covenants

PROPOSED CHANGE

- LGFA will continue to measure the financial covenants at parent level
- However, a council can apply to LGFA to have its covenants calculated on a different basis
- LGFA Directors would have the approval to allow a council to:
  - Calculate its covenants on a group basis
  - Calculate its covenants on an agreed bespoke basis (a combination of the parent plus CCOs which include core council activities but excluding CCTOs)
- This would only be done on a forward looking basis (not retrospectively).
- LGFA would be transparent where a council is being measured on a different basis (Shareholders and Guarantors would be formally advised)

WHY CAN'T ALL COUNCILS BE MONITORED AT GROUP?

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

- LGFA have a number of member councils where their assets at parent or revenue at parent is less than 90% of group assets or revenue
- This particularly applies to Regional Councils that typically have a lower level of infrastructure assets but external investments (port companies)
- As an example LGFA could lend Bay of Plenty Regional Council $350 million at the parent level but only $85 million at group level
  - At group level debt from CCTO's is consolidated even though a council may not guarantee it
  - There is insufficient rates income to support the net interest to rates covenant
- If all councils were to be measured at group level LGFA would need to redesign the covenants (possibly have two sets of covenants depending on whether a council had a substantial CCTO)
- Councils (other than Auckland Council) produce accounts at parent level. This means it is not possible to forecast forward looking financial covenants at group level

THE IMPACT ON AUCKLAND COUNCIL

LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

- While covenants for all councils are formally monitored at parent level, LGFA informally calculates covenants at group level for council with substantive CCO's (for example Christchurch City Council)
- If Auckland Council are measured at Group level:
  - This fundamentally makes sense (capturing core council activities)
  - It will simplify things for Auckland Council (rating agencies use group accounts)

Financial Covenants - Parent Level

Measure	Limit	2017	2016
Net debt as a percentage of total revenue*	<250%	✓ 190.9%	✓ 185.7%
Net interest as a percentage of total revenue*	<20%	✓ 10.7%	✓ 9.1%
Net interest as a percentage of annual rates income	<30%	✓ 18.5%	✓ 15.5%
Liquidity	>110%	✓ 118.7%	✓ 121.0%

Financial Covenants - Group Level

Measure	Limit	2017	2016
Net debt as a percentage of total revenue*	<250%	! 220.2%	! 220.9%
Net interest as a percentage of total revenue*	<20%	✓ 13.0%	✓ 12.4%
Net interest as a percentage of annual rates income	<30%	✓ 26.8%	✓ 24.7%
Liquidity	>110%	✓ 123.1%	✓ 123.5%

LGFA'S ABILITY TO LEND TO THE SECTOR

- LGFA's success has been due to its flexible approach to sector lending
- There is a lot going on in the sector – how LGFA needs to evolve will depend on how the landscape changes
- LGFA is considering whether it should be able to lend directly to council CCO's or CCTO's
  - Some council's have structured their CCTO's with uncalled capital that exceeds the CCTO's debt (which is essentially a guarantee)
  - Dunedin Council structure is that all debt is borrowed by Dunedin City Treasury
  - Where Councils have a multiply owned CCO, it would simplify things if LGFA could lend directly to the CCO eg: water assets
- LGFA may need to consider lending to other entities secured by rates or charges e.g. Crown Infrastructure Partners and SPVs
- LGFA is interested in getting feedback