



NEW ZEALAND LOCAL  
GOVERNMENT FUNDING AGENCY  
TE PŪTEA KĀWANATANGA Ā-ROHE

4 May 2020

An aerial photograph of a New Zealand landscape. In the foreground, a wide, rocky riverbed flows through a lush green forest. A paved road curves along the edge of the forest. In the middle ground, there are rolling green fields and a small cluster of buildings. In the background, there are more green fields and a range of blue mountains under a clear sky.

# INVESTOR UPDATE AND PROPOSED CHANGES TO FOUNDATION POLICY



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- ❑ Appendices



- Council funding revenue is forecast to fall between 2.3 and 11 percent in the 2020/21 financial year relative to a 20% forecast decline in the DIA's Local Government Sector COVID-19 Financial Report 1 (14 April 2020)
- In dollar terms this equates to a loss of revenue to the sector of between \$355 million and \$1.5 billion
- Core scenario is based upon remaining in Level 2 until March 2021 and then back to Level Zero in June 2021
- Reduced level of funding will come from:
  - Rates Income (primarily from zero or lower than forecast rate increases for the 2020/21 financial year)
  - Fee Income (less parking revenue, revenue from community facilities, regulatory services income)
  - Investment income (lower dividends and / or lower returns from investment funds)
  - Development contributions
- Lost fee income from public transport is currently being reimbursed by the NZ Transport Agency (NZTA)
- Subsidies and grants likely to be as forecast although the funding level from NZTA is still yet to be confirmed

Source: DIA Local Government Sector COVID-19 Financial Implications Report 2

- The sector's rates income for 2020/21 is expected to be between 2 and 4 percent lower than originally forecast.
- The sector's non-collection assumption for rates is forecast to be between 2 and 6 percent for 2020/21.
- It is forecast that this will need to be debt financed until such time as the rates are collected.
- Some councils may offer rates postponement schemes.
- As an example Christchurch City Council will offer businesses with an actual 30 percent decline in revenue an up to six month extension on rates payments.
- In addition, penalty fees for late payment of rates are likely to be waived.
- Councils are also likely to offer rent or lease holidays for some tenants of council facilities. Many of these will be community groups.

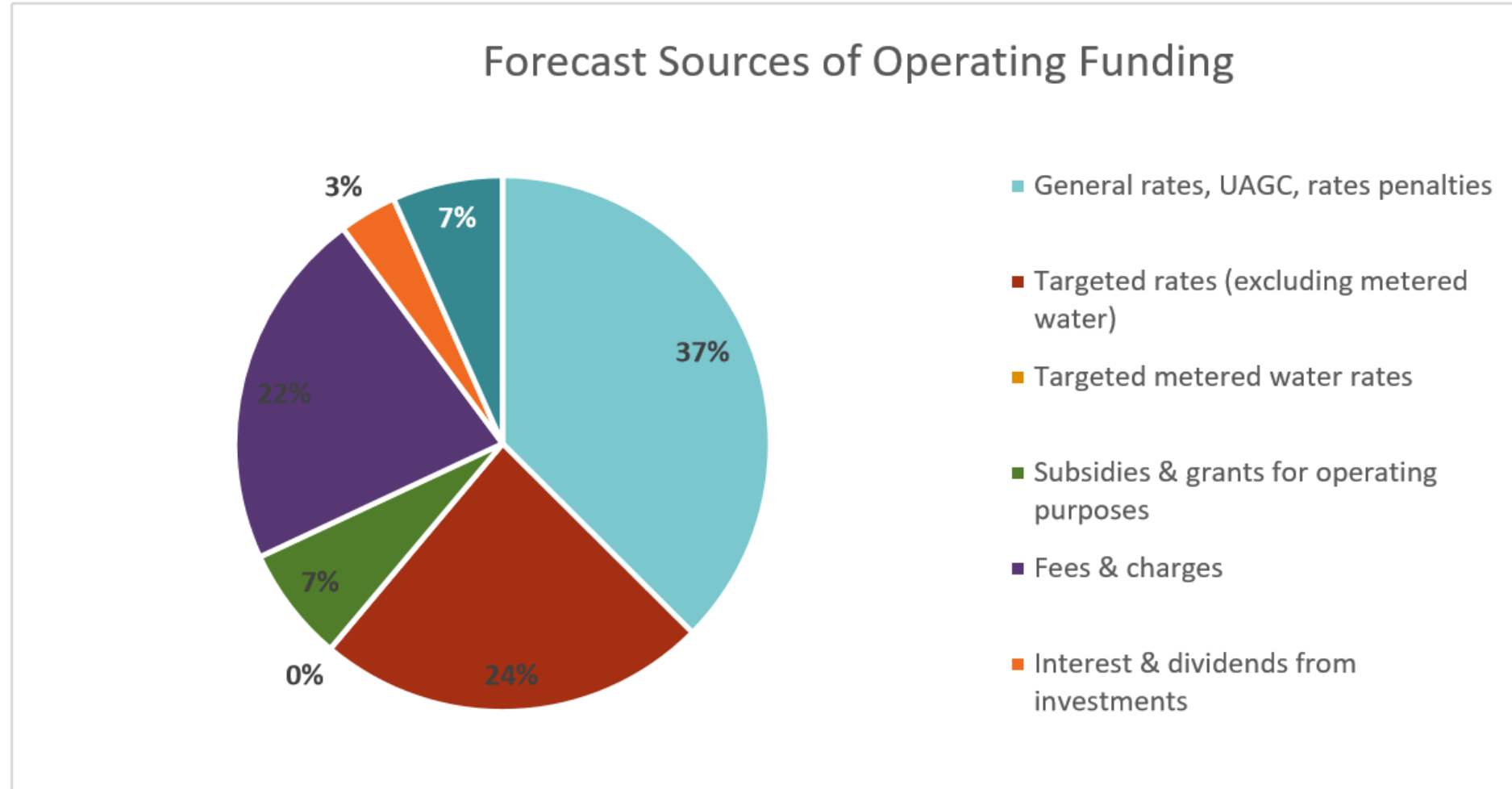
Source: DIA Local Government Sector COVID-19 Financial Implications Report 2 and Christchurch City Council's website [ccc.govt.nz/services/rates-and-valuations/ratesextension/](https://ccc.govt.nz/services/rates-and-valuations/ratesextension/)



- Councils are currently re-evaluating their 2020/21 capital expenditure programmes.
- Some councils are forecasting that their capital expenditure programmes will be unchanged. Others are reprioritising non-essential capital expenditure.
- Councils expect to make some reductions in operational expenditure.
- Cuts in operational expenditure will be easiest for councils that outsource contracts for some of their services (for example on April 7 Auckland Council announced that it was immediately cutting 1100 jobs for staff it has been employing as temps, or on contracts).
- Limited savings will be made on community facilities that are not open (less maintenance, less power, less cleaning).
- While councils currently intend to maintain service levels, staffing levels will adjust over time depending on demand.

Source: DIA Local Government Sector COVID-19 Financial Implications Reports 1 and 2

- Level 4 restrictions were imposed on 26 March.
- Councils are forecasting that there will be some loss in 4<sup>th</sup> quarter revenue.
- The average forecast loss in revenue from fees and charges is 12 percent.
- Construction work stopped during level 4 restrictions on all but essential projects.
- Councils now expect to spend 73 percent of planned 2019/20 capital expenditure budgets. This compares to an actual spend of 81 percent for the year ended June 2019 compared to budget.
- While some councils were expecting to borrow for the reduction in revenue, on average it was expected to be largely offset by a reduction in borrowing required for capital expenditure.
- On LGFA modelling, it is expected that all member councils will be compliant with the LGFA financial covenants as at 30 June 2020.



Source: DIA analysis of council LTPs for the 2019/20 financial year from the DIA Local Government Sector COVID-19 Financial Implications Report 2



- The Government has asked councils to identify “shovel ready projects” that are ready to start as soon as the construction industry returns to normal.
- The Infrastructure Industry Reference Group will put forward to Ministers projects from the public and private sector that will be ready to start within the next six months.
- These projects will be in addition to the Government’s \$12 billion New Zealand Upgrade Programme and existing Provincial Growth Fund Infrastructure investments.
- “Infrastructure projects designated crucial to the country’s economic recovery will be fast-tracked through the planning process to ensure they start as soon as possible” (Environment Minister - David Parker, 3<sup>rd</sup> May 2020 National Business Review).
- Nearly all councils have submitted “shovel ready projects” for consideration. For example on April 14 Auckland Council announced they had submitted 73 key projects.
- Provincial Growth Fund projects are continuing. On 30 April, the Minister announced a further \$48 million of funding for nine new initiatives.

# COVID-19 IMPACT ON LGFA BONDS IN SECONDARY MARKET

## Initially

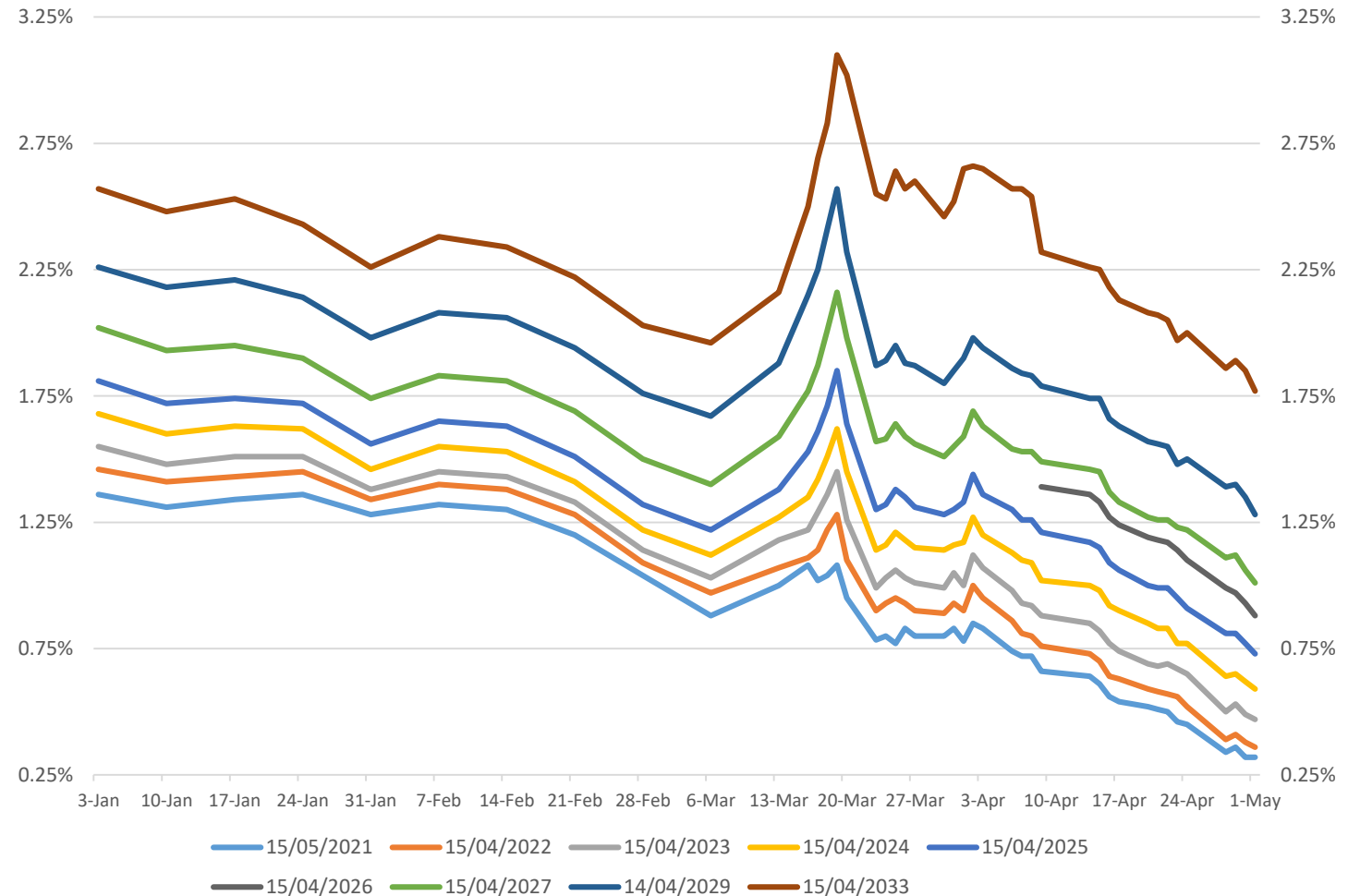
- Higher outright yields, steeper yield curve and wider spreads to NZGB and Swap
- Wider bid ask spreads in secondary market
- Secondary market turnover in line with 12 month average

## Following RBNZ Large Scale Asset Purchase Programme

- Downward decline in yields continued
- Spreads to Swap and NZGB tighter
- Tighter bid ask spreads
- Record secondary market volume in April
- Positive flow on impact to other high grade issuers

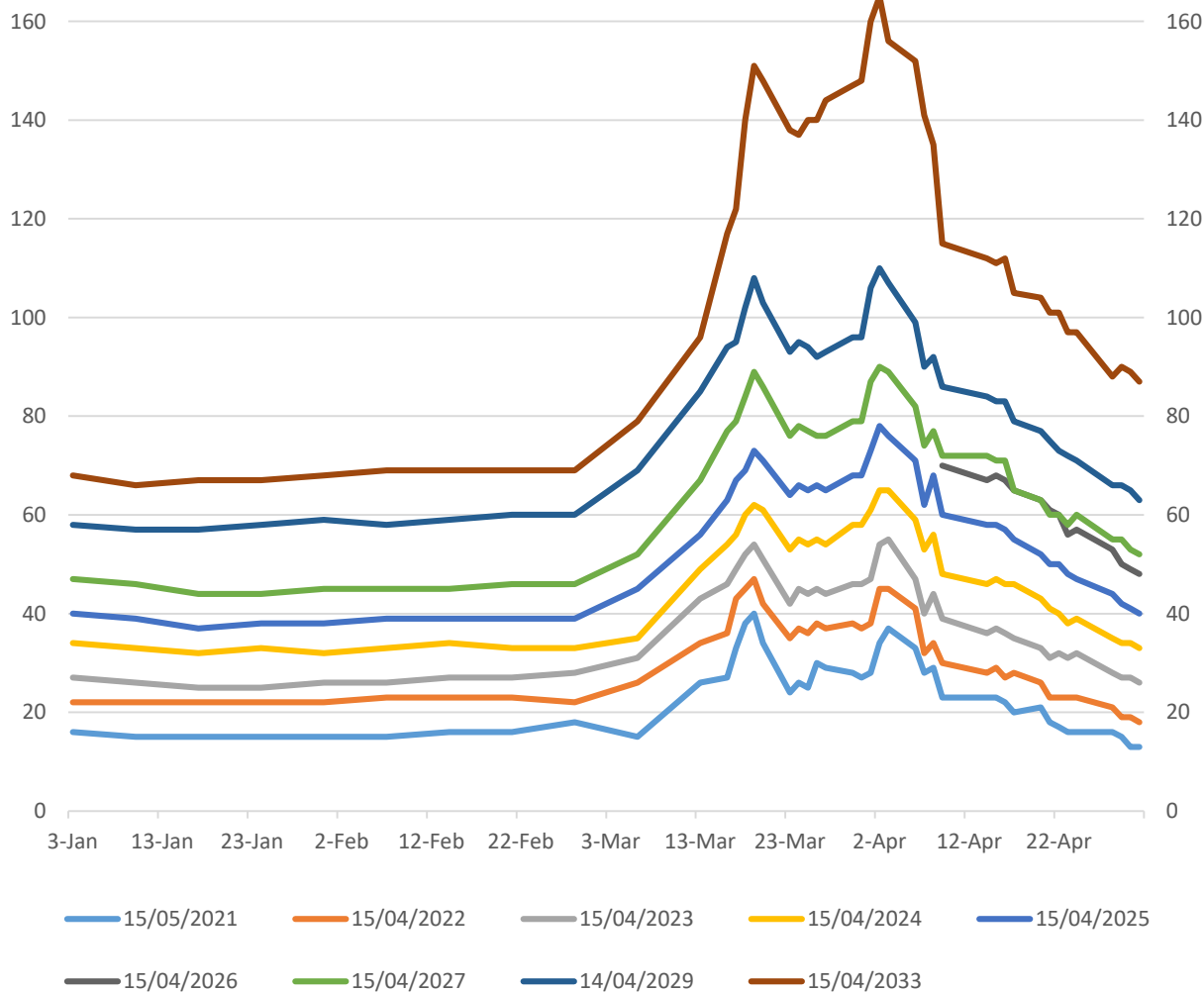
**Source: LGFA secondary market end of day yields sourced from BNZ and Bloomberg**

LGFA Bond Yields

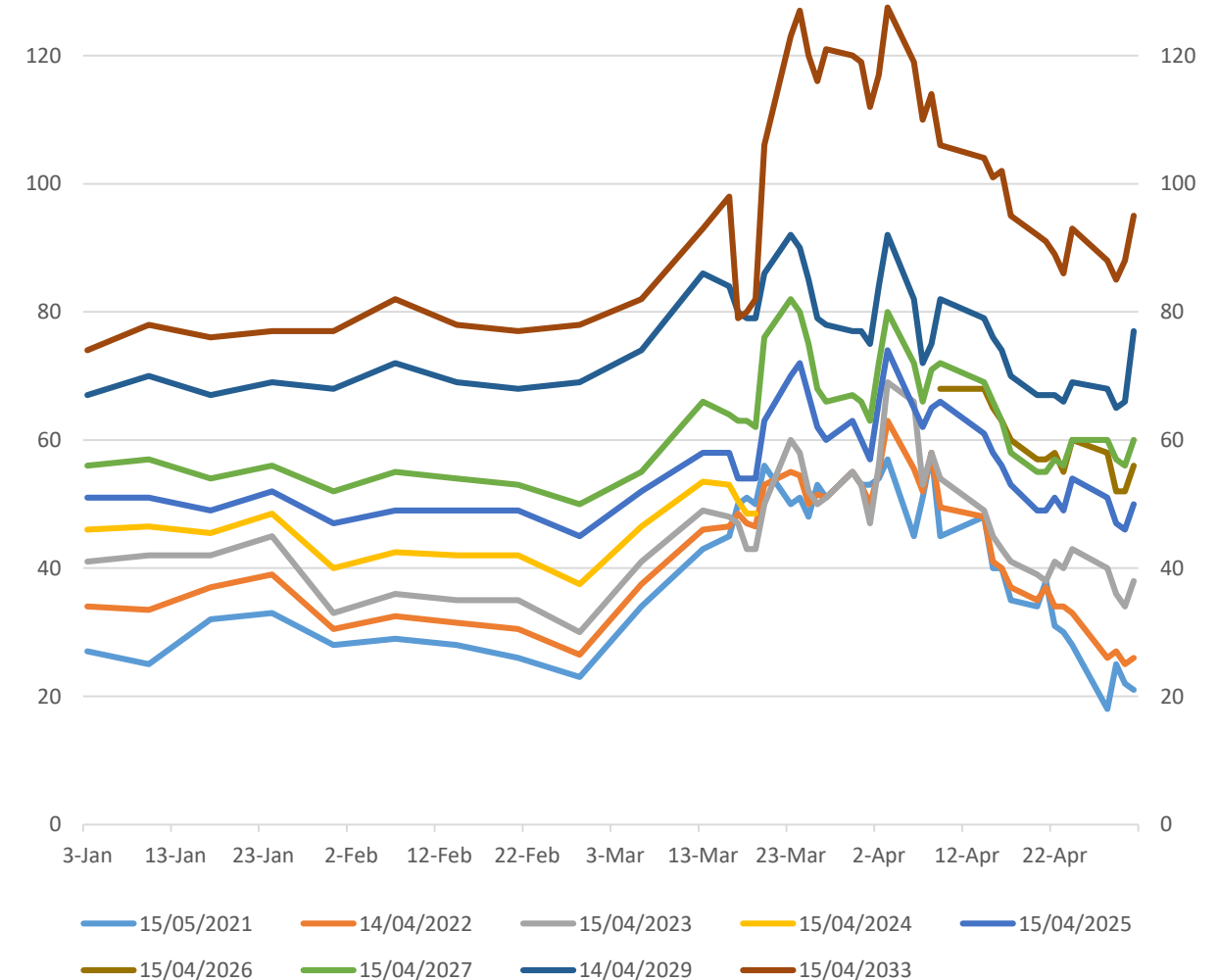


# COVID-19 IMPACT ON LGFA BONDS IN SECONDARY MARKET

LGFA Spreads to Swap (bps)



LGFA Spreads to NZGB (bps)



Source: LGFA calculated secondary market end of day spreads sourced from BNZ and Bloomberg



Seamless transition to remote working environment

Placed rollout of standby facility to Councils on hold pending increase in Liquid Assets Portfolio

Increased soft cap on LGFA bond maturities from NZ\$1.5 billion to NZ\$1.75 billion

Issued 2.5 year Floating Rate Note by private placement

Increased on-lending margin to councils by 10 bps

Increase Treasury Stock holding per LGFA bond maturity by NZ\$50 million (to NZ\$100 million per series) at next issuance opportunity

Seeking Councils' approval to increase Borrower Notes percentage from 1.6% to 2.5%

Councils providing best estimate of future borrowing requirement on monthly basis for next six months

Worked with Department of Internal Affairs, Treasury and Office of Auditor General on implications for councils including stress testing the financial impact

Proposed changes to Foundation Policy regarding Net Debt / Total Revenue covenant for councils with a long-term credit rating of 'A' equivalent or higher.

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LGFA's policy to minimise financial risks and carefully identify, manage and control all risk.

## Market Risk

PDH limit of NZ\$100,000 – current exposure (as at 1 May 2020) is -\$1,400

VAR limit of NZ\$1,000,000 – current exposure (as at 1 May 2020) is \$299,000

## Credit Risk

All Councils that borrow from LGFA are obliged to:

Provide security in relation to their borrowing from LGFA and related obligations.

Issue securities (bonds/FRN/CP) to LGFA.

Comply with their own internal borrowing policies.

Comply with the LGFA financial covenants within either the Lending Policy or Foundation Policy

Auckland Council is limited to a maximum of 40% of LGFA's total Local Authority assets.

No more than the greater of NZ\$100 million or 33% of a Council's borrowings from LGFA will mature in any 12 month period.

## Liquidity and Funding Risk

### Cash and Investments

LGFA manages liquidity risk by holding cash and a portfolio of liquid assets to meet obligations when they fall due.

Only invest in NZD senior debt securities, money market deposits and registered certificates of deposits within strict counterparty limits.

### NZ Government liquidity facility

The New Zealand Government provides a committed liquidity facility up to NZ\$1 billion in size that LGFA can draw upon to meet any exceptional and temporary liquidity shortfall.

Facility size is set by LGFA at NZ\$700 million (as at 1 May 2020)

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%

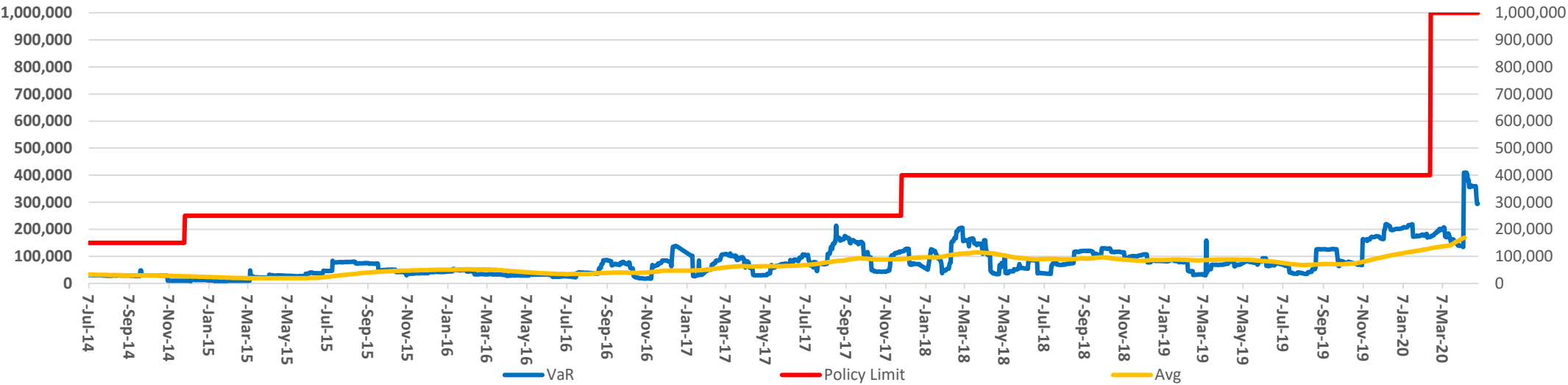
Liquidity position as at 1 May 2020	NZ\$ million
Cash and cash equivalents	\$88.1
Deposits and Marketable Securities	\$772.7
NZ Government Liquidity Facility (amount available)	\$700.0
<b>Total</b>	<b>\$1,560.8</b>

Source: LGFA

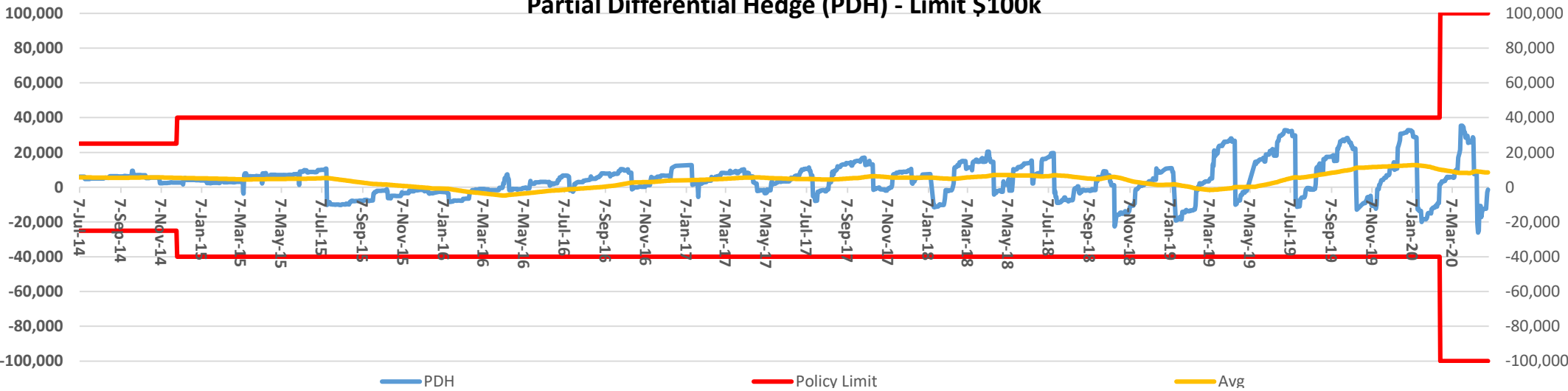


# MINIMAL VaR AND PDH EXPOSURES

Value at Risk (VaR) - Limit \$1m

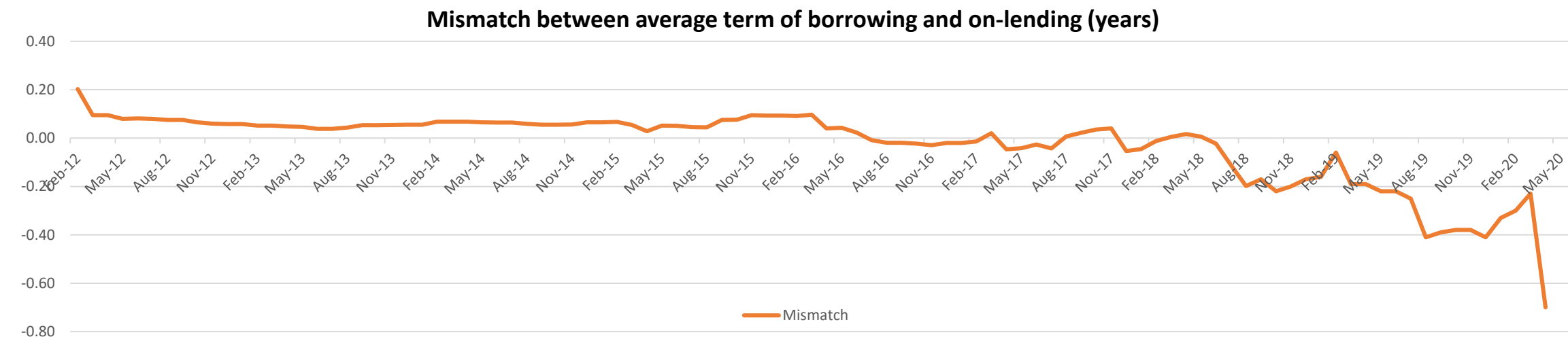
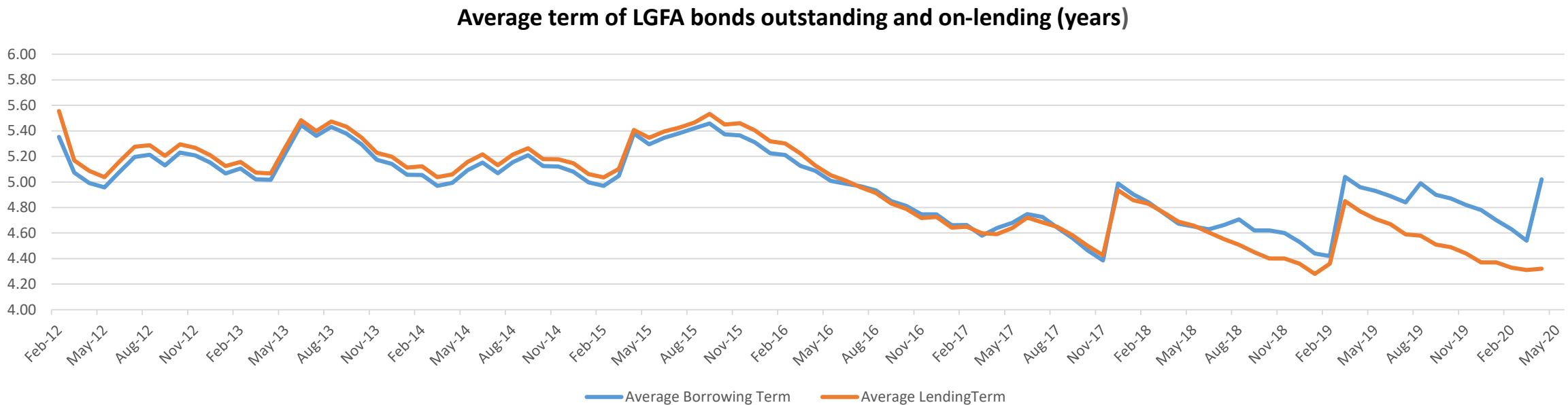


Partial Differential Hedge (PDH) - Limit \$100k



Source: LGFA

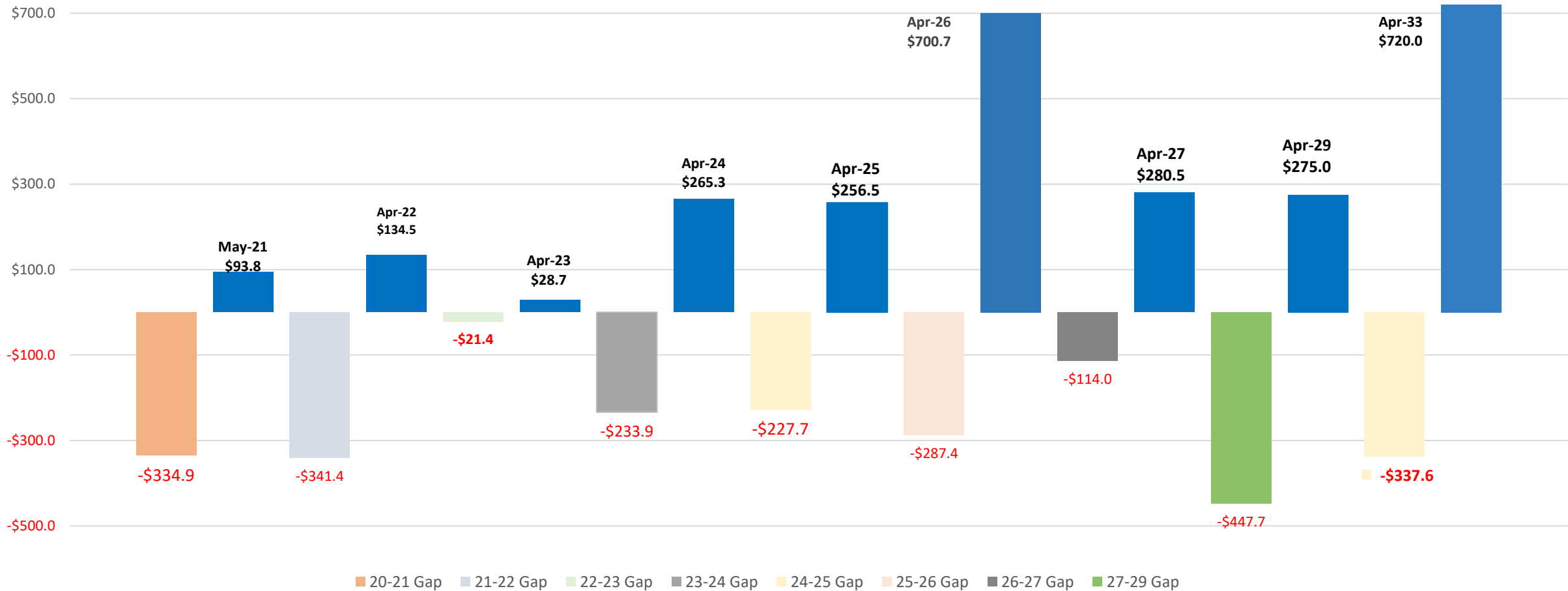
# MISMATCH BETWEEN LGFA BONDS AND LOANS



Negative = longer term of bond issuance than on-lending

Source: LGFA

# ASSET LIABILITY MISMATCHES



The asset liability mismatch is the difference between LGFA bonds issued and loans to Councils for each date or period. The positive outcomes show more LGFA bonds have been issued than loans made to Councils for that date or period. The negative outcomes show loans made to Councils with maturity dates between LGFA bond maturities.

As at 1 May 2020

Source: LGFA



# LGFA LENDING AND GUARANTEE BREAKDOWN

Council Borrower	Amount Borrowed (NZ\$ million)	% of Total Borrowing
Auckland Council	\$2,757	25.5%
Christchurch City Council	\$1,920	17.7%
Wellington City Council	\$635	5.9%
Tauranga City Council	\$515	4.8%
Hamilton City Council	\$480	4.4%
Wellington Regional Council	\$400	3.7%
Rotorua District Council	\$217	2.0%
Hutt City Council	\$216	2.0%
Kapiti Coast District Council	\$200	1.8%
Bay of Plenty Regional Council	\$191	1.8%
57 other member councils	\$3,290	30.4%

Council Borrowing	Volume (NZ\$ million)
Short Term (loan terms less than 12 months)	\$420
Long Term	\$10,399
<b>Total</b>	<b>\$10,820</b>

Borrower Type	Number of councils	Amount Borrowed (NZ\$ million)	% of Total Borrowing
Guarantors	54	\$10,687	98.8%
Non guarantors	13	\$132	1.2%
<b>Total</b>	<b>67</b>	<b>\$10,820</b>	<b>100%</b>

## Note:

**Auckland Council borrowing is capped at 40% of total LGFA lending**

**Three member councils have yet to borrow from LGFA**

**Guarantee contains provisions apportioning share to each council based upon their relative share of total rates revenue of all guarantors. A council's obligation under the guarantee is secured against rates revenue.**

Council Guarantor	% share of Guarantee
Auckland	31.6%
Christchurch City	8.7%
Wellington City	5.4%
Hamilton City	3.2%
Tauranga City	2.9%
Wellington Regional	2.9%
Hutt City	1.9%
Canterbury Regional	1.8%
Whangarei District	1.7%
Palmerston North City	1.7%
44 other council guarantors	38.1%

**As at 1 May 2020**

**Source: LGFA**

- ❑ 90.1% of LGFA loans to councils with credit ratings
- ❑ 89.1% of LGFA loans to AA- rated councils or better
- ❑ Average credit quality is above AA-
- ❑ Improving trend in underlying credit quality of local government sector over the past seven years
  - ❑ 9 councils on positive outlook (NZ\$1.77 billion or 17.5% loan book)
  - ❑ no councils on negative outlook
- ❑ Not all councils have credit ratings due to cost of obtaining a rating vs benefits
  - ❑ Average total lending to unrated councils is NZ\$29 million per council
  - ❑ NZ\$45 million of debt is approximate breakeven for a borrower to obtain a credit rating
- ❑ LGFA undertakes detailed credit analysis of all member councils separate to the external credit rating process performed by S&P, Fitch and Moody's
- ❑ Unrated councils are assessed by LGFA as having in general, better credit quality than those councils with credit rating

External Credit Rating (S&P, Fitch)	Lending (NZ\$ millions)	Lending (%)	Number of Councils
AA+	\$170	1.6%	3
AA	\$5,929	54.8%	18
AA-	\$3,494	32.3%	8
A+	\$106	1.0%	1
Unrated	\$1,121	10.4%	37
<b>Total</b>	<b>\$10,820</b>	<b>100%</b>	<b>67</b>

As at 1 May 2020

Source: LGFA

**Note: Three member councils have yet to borrow from LGFA (includes long and short term lending)**

# LGFA MEMBERS (As at 1 May 2020)

Shareholders	Total Shares (NZ\$)	Shareholding (%)	Amount borrowed (NZ\$ million)	Borrowing (%)	Share Guarantee (%)
New Zealand Government	5,000,000	11.1%			
Auckland Council	3,731,960	8.3%	2,757.0	25.5	31.6
Christchurch City Council	3,731,960	8.3%	1,919.5	17.7	8.7
Wellington City Council	3,731,958	8.3%	634.5	5.9	5.4
Tauranga City Council	3,731,958	8.3%	515.0	4.8	2.9
Hamilton City Council	3,731,960	8.3%	480.0	4.4	3.2
Wellington Regional Council	3,731,958	8.3%	400.0	3.7	2.9
Kapiti Coast District Council	200,000	0.4%	200.0	1.8	1.1
Hutt City Council	200,000	0.4%	216.0	2.0	1.9
Bay of Plenty Regional Council	3,731,958	8.3%	191.4	1.8	0.9
Tasman District Council	3,731,958	8.3%	182.8	1.7	1.3
Waimakariri District Council	200,000	0.4%	160.1	1.5	1.0
Hastings District Council	746,392	1.7%	150.0	1.4	1.4
Whangarei District Council	1,492,784	3.3%	152.0	1.4	1.7
Palmerston North City Council	200,000	0.4%	142.0	1.3	1.7
New Plymouth District Council	200,000	0.4%	139.5	1.3	1.5
Horowhenua District Council	200,000	0.4%	106.1	1.0	0.7
Taupo District Council	200,000	0.4%	115.0	1.1	1.2
South Taranaki District Council	200,000	0.4%	101.0	0.9	0.7
Marlborough District Council	400,000	0.9%	100.3	0.9	1.2
Whanganui District Council	200,000	0.4%	101.5	0.9	1.1
Western Bay of Plenty District Council	3,731,958	8.3%	90.0	0.8	1.2
Manawatu District Council	200,000	0.4%	77.0	0.7	0.6
Whakatane District Council	200,000	0.4%	67.0	0.6	0.8
Waipa District Council	200,000	0.4%	57.6	0.5	1.0
Gisborne District Council	200,000	0.4%	58.6	0.5	1.1
Thames-Coromandel District Council	200,000	0.4%	61.0	0.6	1.1
Masterton District Council	200,000	0.4%	50.0	0.5	0.5
Hauraki District Council	200,000	0.4%	44.0	0.4	0.5
Selwyn District Council	373,196	0.8%	35.0	0.3	1.0
Otorohanga District Council	200,000	0.4%	3.0	0.0	0.2
<b>Total</b>	<b>45,000,000</b>		<b>9,307.0</b>	<b>86.0</b>	<b>80.2</b>

As at 1 May 2020

Source: LGFA



# LGFA MEMBERS continued (As at 1 May 2020)

Borrowers and Guarantors	Amount borrowed (NZ\$ million)	Borrowing (%)	Share of Guarantee (%)
Ashburton District Council	42.0	0.4	0.6
Canterbury Regional Council	54.0	0.5	1.8
Far North District Council	76.7	0.7	1.6
Gore District Council	22.5	0.2	0.3
Hawke's Bay Regional Council	2.5	0.0	0.4
Hurunui District Council	35.0	0.3	0.3
Manawatu-Whanganui Regional Council	44.0	0.4	0.8
Invercargill City Council	92.7	0.9	0.9
Kaipara District Council	44.0	0.4	0.6
Matamata-Piako District Council	26.5	0.2	0.6
Nelson City Council	65.0	0.6	1.3
Porirua City Council	131.5	1.2	1.1
Queenstown-Lakes District Council	115.1	1.1	1.3
Rotorua District Council	216.6	2.0	1.6
Ruapehu District Council	25.0	0.2	0.4
Tararua District Council	35.0	0.3	0.4
Taranaki Regional Council	4.0	0.0	0.2
Timaru District Council	89.6	0.8	0.9
South Wairarapa District Council	21.9	0.2	0.2
Stratford District Council	15.5	0.1	0.2
Upper Hutt City Council	51.0	0.5	0.7
Waikato District Council	100.0	0.9	1.5
Waikato Regional Council	32.0	0.3	1.6
Waitomo District Council	38.1	0.4	0.4
<b>Total</b>	<b>1380.3</b>	<b>12.8</b>	<b>19.8</b>

As at 1 May 2020

Source: LGFA

# LGFA MEMBERS continued (As at 1 May 2020)

Borrowers Only	Amount borrowed (NZ\$ million)	Borrowing (%)	Share of Guarantee (%)
Buller District Council	20.0	0.2	Nil
Central Hawkes Bay District Council	20.0	0.2	Nil
Carterton District Council	0.0	0.0	Nil
Clutha District Council	9.0	0.1	Nil
Grey District Council	19.0	0.2	Nil
Kaikoura District Council	7.0	0.1	Nil
Northland Regional Council	9.6	0.1	Nil
Mackenzie District Council	0.0	0.0	Nil
Opotiki District Council	8.5	0.1	Nil
Rangitikei District Council	3.0	0.0	Nil
Wairoa District Council	9.0	0.1	Nil
Westland District Council	19.6	0.2	Nil
West Coast Regional Council	7.6	0.1	Nil
<b>Total</b>	<b>132.3</b>	<b>1.2</b>	<b>Nil</b>
<b>Total Borrowing from LGFA</b>	<b>10,819.6</b>	<b>100.0</b>	<b>100.0</b>

As at 1 May 2020

Source: LGFA

LGFA undertakes its own internal credit assessment and rating process for all member councils using most recent annual reports (June 2019)

## Primary Criteria

- Debt levels relative to population – affordability
- Debt levels relative to asset base
- Ability to repay debt
- Ability to service debt – interest cover
- Population trend

LGFA member councils by internal rating category

LGFA Internal Ratings	2012	2013	2014	2015	2016	2017	2018	2019
AA+	1	2	2	4	4	6	7	8
AA	12	12	12	10	12	13	19	17
AA-	13	13	16	15	19	17	19	23
A+	8	6	3	11	10	12	13	10
A	6	10	11	6	6	3	4	4
A-	5	2	1	1	0	2	2	2

## Secondary Criteria

- 30 Year Infrastructure Strategy
  - Quality of Assets
  - Capital Expenditure Plan
- Risk Management
  - Insurance
- Governance
- Financial flexibility
- Cashflow
- Budget performance (balanced budget)
- Affordability of rates / Deprivation Index
- Natural hazards
- Group activities (CCO's)

Source: LGFA internal models

As at 30 June each year

# LGFA FINANCIAL COVENANTS – MEMBER COUNCIL OUTCOMES FOR JUNE 2019 YEAR

## LGFA Financial Covenants – Councils as at 30 June 2019 with an external credit rating (29)

Foundation Policy Covenant	Net Debt / Total Revenue <250%	Net Interest / Total Revenue <20%	Net Interest / Rates <30%
Range of Councils' compliance	-149.8% to 180.3%	-5.9% to 9.4%	-9.6% to 19.4%

## LGFA Financial Covenants – Councils as at 30 June 2019 without an external credit rating (35)

Lending Policy Covenant	Net Debt / Total Revenue <175%	Net Interest / Total Revenue <20%	Net Interest / Rates <25%
Range of Councils' compliance	-92.6% to 121.0%	-1.0% to 5.0%	-1.9% to 8.3%

- 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 highlight the differences between Councils
- Sufficient financial headroom for most Councils
- Improvement from 2013 for most Councils
  - Revenue increased
  - Interest rates lower
  - Capex and debt constrained

Source: LGFA using data from individual council annual reports

Source: LGFA



# PERFORMANCE UNDER LGFA COVENANTS

LGFA Councils with an external credit rating (29 in 2019, 26 in 2018, 23 in 2017, 22 in 2016, 20 in 2015 and 17 in both 2014 and 2013)

Financial Covenant	2019	2018	2017	2016	2015	2014	2013
Net Debt to Total Revenue	68.8%	76.0%	86.0%	87.9%	96.4%	104.7%	111.8%
Net Interest to Total Revenue	3.5%	4.0%	5.3%	6.1%	6.8%	6.6%	7.3%
Net Interest to Annual Rates Income	5.5%	6.1%	8.1%	9.1%	10.0%	9.6%	11.1%

LGFA unrated Councils (35 in 2019, 29 in 2018, 29 in 2017, 28 in 2016, 25 in 2015, 26 in 2014 and 21 in 2013)

Financial Covenant	2019	2018	2017	2016	2015	2014	2013
Net Debt to Total Revenue	30.0%	32.3%	29.9%	32.4%	38.2%	42.6%	52.5%
Net Interest to Total Revenue	1.7%	1.9%	1.8%	2.2%	2.4%	2.9%	3.2%
Net Interest to Annual Rates Income	2.8%	2.9%	2.6%	2.9%	3.1%	4.0%	4.1%

Calculated by simple average of Councils in each group

Source: LGFA using data from individual Council annual reports

## ❑ Fitch Ratings - November 2019 / January 2020

Local Currency AA+ / Stable/ F1+ Foreign currency rating AA / Positive / F1+

### Fitch notes:

- strong links to the sovereign – classified as a credit linked Public Sector Entity;
- deemed to be of strategic importance;
- sound underlying asset quality of its shareholders, local councils;
- long-term rating is capped by the ratings of the sovereign;
- support of a joint and several liability guarantee.

Long-term foreign-currency Issuer Default Rating placed on positive outlook on 27<sup>th</sup> January 2020

## S&P Global Rating's – February 2020

Local Currency AA+ / Positive / A-1+ Foreign Currency AA / Positive / A-1+



Both long-term ratings placed on “positive outlook” on 4<sup>th</sup> February 2019

### Strengths:

- dominant market position as source of funding for New Zealand local government;
- high credit quality of underlying lending;
- extremely strong likelihood of support from the New Zealand Government in a stress scenario;
- robust and experienced management and governance.

### Weaknesses:

- highly concentrated loan portfolio;
- modest risk adjusted capital ratio;
- reliance upon domestic market funding.

Rating Agency	Domestic Currency	Foreign Currency	Date of Report
	AA+ (positive outlook)	AA (positive outlook)	27 February 2020
	AA+ (stable outlook)	AA (positive outlook)	27 January 2020

Source: S&P, Fitch, LGFA

- ☐ Important Notice and Disclaimer
- ☐ COVID-19 Update
- ☐ LGFA Risks
- ☐ Proposed Changes to Foundation Policy
- ☐ Appendices



**Clause 5.1 of the LGFA Shareholders' Agreement and comprises various policies**

**Any changes to Foundation Policies requires shareholder approval**

## Lending policy

Local authorities when borrowing from LGFA must

- provide security when borrowing
- comply with own internal borrowing policies
- comply with LGFA financial covenants
- be a party to the Deed of Guarantee and Equity Commitment Deed if borrowings or entered into facility agreement with LGFA with commitments exceeding NZ\$20 million

Auckland Council exposure limited to no more than 40% of LGFA total local authority assets

Limit on a local authority or CCO borrowing no more than the greater of NZ\$ 100 million or 33% of its borrowing from LGFA maturing in any 12 month period

Outlines requirements for a CCO to borrow from LGFA. Process for allowing CCOs to borrow from LGFA underway but not yet completed.

## Other policies within the Foundation Policies

Cash and liquid investment

Derivatives

Market risk (PDH and VaR limits)

Foreign exchange risk

Operational risk

Dividend

**A copy of the current Foundation Policies is available here**

[lgfa.co.nz/about-lgfa/governance](https://lgfa.co.nz/about-lgfa/governance)



## Current Financial Covenants

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%

## Proposed Financial Covenants

Financial covenant	Lending policy covenants	Foundation policy covenants
Net Debt / Total Revenue	<175%	<280%
Net Interest / Total Revenue	<20%	<20%
Net Interest / Annual Rates Income	<25%	<30%
Liquidity	>110%	>110%

Alternative Net Debt / Total Revenue Covenant	
Financial Year ending	Net Debt / Total Revenue
30 June 2020	<250%
30 June 2021	<300%
30 June 2022	<300%
30 June 2023	<295%
30 June 2024	<290%
30 June 2025	<285%

## Proposed change to Foundation Policy covenant

These apply to councils with a long-term credit rating of 'A' equivalent or higher

- Increase Net Debt / Total Revenue to 300% for financial year to June 2021 and June 2022
- Taper back to 280% by financial year ending June 2026

## Note there are no proposed changes to

- Lending policy covenants (for councils without a credit rating or with a long-term credit rating lower than 'A' equivalent)
- Net Interest / Total Revenue covenants
- Net Interest / Annual Rates Income covenants
- Liquidity covenants

- ☐ Only applies to current 30 council borrowers who have a long-term credit rating of 'A' equivalent or higher
- ☐ All council borrowers have headroom under current Foundation policy covenants so starting position is strong
- ☐ Increase covenant limit then a taper to a level higher than the current level is a conservative approach to allowing greater borrowing capacity to sector
  - ☐ Recognises short term COVID-19 impact
  - ☐ Recognises structural changes to local government sector since 2011 with regard to
    - ☐ Council requirements to meet additional growth infrastructure due to increased population growth
    - ☐ Council response to climate change
    - ☐ Council response to water quality issues
- ☐ Provide flexibility for councils to co-invest alongside Central Government in infrastructure going forward
- ☐ Provide short term comfort to councils with short term revenue declines
- ☐ LGFA has undertaken analysis on impact on additional council borrowing headroom under a revenue shortfall scenario
- ☐ Higher Net Debt / Total Revenue limit of 280% does not add significant additional risk to council borrowers, guarantors or LGFA
  - Sufficient mitigants to ensure probability of default is low
  - Council lending backed by security of rates
  - Even if a default occurred the probability of recovery is high so becomes a timing issue for LGFA
  - Central Government and Local Government have become closer to COVID-19 situation
  - LGFA obligations backed by security of guarantee from guarantors
- ☐ S&P Global Ratings and Fitch Ratings have been consulted on these proposed changes

Source: LGFA

# ADDITIONAL BORROWING CAPACITY IF COVENANT INCREASED

Externally Rated Councils Subject to Foundation Policy Covenant (ranked highest to lowest indebted)	No Change to Revenue (all amounts NZ\$000)							Impact of 10% revenue decline (all amounts NZ\$000)			
	Credit Rating as at 1 May 2020	Net Debt / Revenue at June 2019 <250% limit	Adjusted Revenue at June 2019	Actual Net Borrowing at June 2019	Maximum Borrowing at 250%	Existing Headroom at June 2019	Additional Headroom between 250% and 280%	-10% Revenue Shock	Max Borrowing at 250%	Headroom at June 2019	Additional Headroom between 250% and 280%
Kapiti Coast District Council	AA	180.3%	\$81,851	\$147,554	\$204,628	\$57,074	\$24,555	\$73,666	\$184,165	\$36,611	\$22,100
Auckland Council	AA	173.0%	\$3,701,696	\$6,405,489	\$9,254,240	\$2,848,751	\$1,110,509	\$3,331,526	\$8,328,816	\$1,923,327	\$999,458
Tauranga City Council	AA-	166.7%	\$260,082	\$433,685	\$650,205	\$216,520	\$78,025	\$234,074	\$585,185	\$151,500	\$70,222
Horowhenua District Council	A+	164.1%	\$53,385	\$87,619	\$133,463	\$45,844	\$16,016	\$48,047	\$120,116	\$32,497	\$14,414
Rotorua District Council	AA-	144.4%	\$136,394	\$196,924	\$340,985	\$144,061	\$40,918	\$122,755	\$306,887	\$109,963	\$36,826
Waimakariri District Council	AA	140.6%	\$87,485	\$122,984	\$218,713	\$95,729	\$26,246	\$78,737	\$196,841	\$73,857	\$23,621
Hamilton City Council	AA-	124.3%	\$272,428	\$338,575	\$681,070	\$342,495	\$81,728	\$245,185	\$612,963	\$274,388	\$73,556
Christchurch City Council	AA-	105.9%	\$935,009	\$990,016	\$2,337,523	\$1,347,507	\$280,503	\$841,508	\$2,103,770	\$1,113,754	\$252,452
Wellington City Council	AA-	102.1%	\$525,135	\$536,214	\$1,312,838	\$776,624	\$157,541	\$472,622	\$1,181,554	\$645,340	\$141,786
Hutt City Council	AA	101.3%	\$169,677	\$171,918	\$424,193	\$252,275	\$50,903	\$152,709	\$381,773	\$209,855	\$45,813
Tasman District Council	AA	100.1%	\$135,446	\$135,544	\$338,615	\$203,071	\$40,634	\$121,901	\$304,754	\$169,210	\$36,570
Whanganui District Council	AA	99.9%	\$89,081	\$88,992	\$222,703	\$133,711	\$26,724	\$80,173	\$200,432	\$111,440	\$24,052
Wellington Regional Council	AA	92.9%	\$388,641	\$360,983	\$971,603	\$610,620	\$116,592	\$349,777	\$874,442	\$513,459	\$104,933
Porirua City Council	AA	92.5%	\$98,663	\$91,291	\$246,658	\$155,367	\$29,599	\$88,797	\$221,992	\$130,701	\$26,639
Palmerston North City Council	AA	84.1%	\$138,774	\$116,737	\$346,935	\$230,198	\$41,632	\$124,897	\$312,242	\$195,505	\$37,469
Western Bay of Plenty District Council	AA	81.8%	\$96,538	\$78,938	\$241,345	\$162,407	\$28,961	\$86,884	\$217,211	\$138,273	\$26,065
Hastings District Council	AA	80.9%	\$125,574	\$101,614	\$313,935	\$212,321	\$37,672	\$113,017	\$282,542	\$180,928	\$33,905
Nelson City Council	AA	74.8%	\$113,046	\$84,569	\$282,615	\$198,046	\$33,914	\$101,741	\$254,354	\$169,785	\$30,522
Whangarei District Council	AA	67.3%	\$149,801	\$100,818	\$374,503	\$273,685	\$44,940	\$134,821	\$337,052	\$236,234	\$40,446
Queenstown-Lakes District Council	AA-	58.4%	\$143,841	\$84,050	\$359,603	\$275,553	\$43,152	\$129,457	\$323,642	\$239,592	\$38,837
Ashburton District Council	AA+	38.4%	\$62,818	\$24,129	\$157,045	\$132,916	\$18,845	\$56,536	\$141,341	\$117,212	\$16,961
Timaru District Council	AA-	31.9%	\$117,203	\$37,428	\$293,008	\$255,580	\$35,161	\$105,483	\$263,707	\$226,279	\$31,645
Invercargill City Council	AA+	17.1%	\$101,847	\$17,375	\$254,618	\$237,243	\$30,554	\$91,662	\$229,156	\$211,781	\$27,499
Taupo District Council	AA	16.7%	\$92,075	\$15,406	\$230,188	\$214,782	\$27,623	\$82,868	\$207,169	\$191,763	\$24,860
Waipa District Council	AA-	16.2%	\$84,161	\$13,618	\$210,403	\$196,785	\$25,248	\$75,745	\$189,362	\$175,744	\$22,723
Marlborough District Council	AA	8.0%	\$136,024	\$10,908	\$340,060	\$329,152	\$40,807	\$122,422	\$306,054	\$295,146	\$36,726
South Taranaki District Council	AA-	-47.5%	\$68,318	-\$32,429	\$170,795	\$203,224	\$20,495	\$61,486	\$153,716	\$186,145	\$18,446
Bay of Plenty Regional Council	AA	-57.5%	\$131,995	-\$75,864	\$329,988	\$405,852	\$39,599	\$118,796	\$296,989	\$372,853	\$35,639
Selwyn District Council	AA+	-61.7%	\$101,772	-\$62,811	\$254,430	\$317,241	\$30,532	\$91,595	\$228,987	\$291,798	\$27,478
New Plymouth District Council	AA	-176.2%	\$113,615	-\$200,187	\$284,038	\$484,225	\$34,085	\$102,254	\$255,634	\$455,821	\$30,676
Total			\$8,712,375	\$10,422,087	\$21,780,938	\$11,358,851	\$2,613,713	\$7,841,138	\$19,602,844	\$9,180,757	\$2,352,341
Ten Highest Indebted Councils			\$6,223,142	\$9,430,978	\$15,557,855	\$6,126,877	\$1,866,943	\$5,600,828	\$14,002,070	\$4,571,092	\$1,680,248



- ☐ Important Notice and Disclaimer
- ☐ COVID-19 Update
- ☐ LGFA Risks
- ☐ Proposed Changes to Foundation Policy
- ☐ Appendices



## SHAREHOLDERS

- ❑ Central Government largest shareholder at 20%
- ❑ 30 councils hold 80% shareholding
- ❑ Can only sell shares to Central Government or local authorities

## GOVERNANCE

- ❑ Board of six directors with 5 Independent and 1 Non Independent
- ❑ Bonds listed on NZX so under listing rules
- ❑ Independent Trustee
- ❑ Issue of securities under the Financial Markets Conduct Act
- ❑ Audited by Audit NZ

## GUARANTORS

- ❑ 54 guarantors of LGFA
- ❑ Guarantors comprise:
  - All shareholders except the NZ Government
  - Any non shareholder who may borrow more than NZ\$20 million
- ❑ Security granted by each of the guarantors is over their rates income (property taxes)
- ❑ Guarantors cannot exit guarantee until
  - Repaid all their borrowings
  - Wait for longest outstanding LGFA bond to mature (currently 2033)
- ❑ Changes will be made requiring other councils to join guarantee when LGFA implements lending to CCOs

## LIQUIDITY

- ❑ NZ\$1 billion liquidity facility from NZ Government
- ❑ NZ\$857 million liquid assets portfolio
- ❑ NZ\$277 million of Treasury Stock currently available for repo

## BORROWERS

- ❑ 67 member councils
- ❑ Approx. 90% market share
- ❑ Under Local Government Act 2002 councils must manage finances prudently – implies must run balanced operating surplus and only borrow for capital expenditure
- ❑ Councils borrow secured against rates
- ❑ Must meet LGFA financial covenants

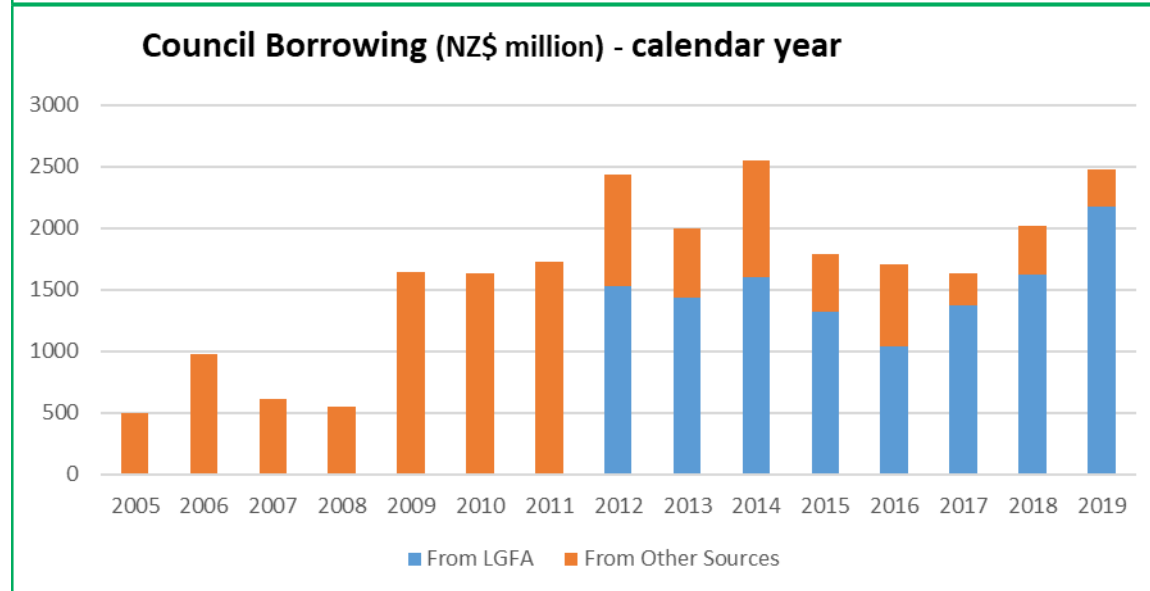
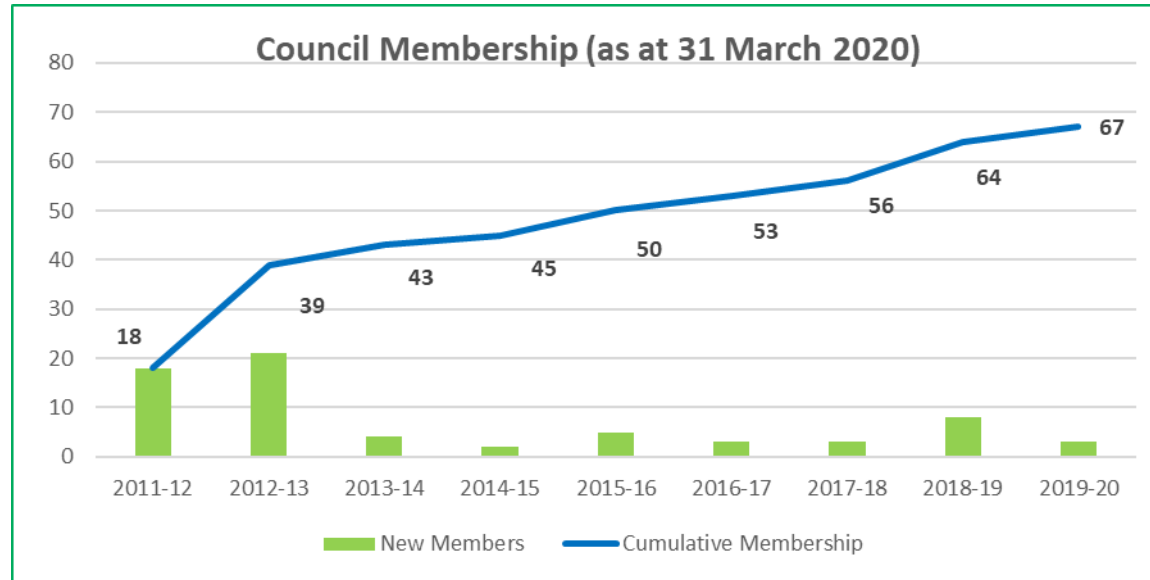
## CAPITAL STRUCTURE

- ❑ NZ\$25 million paid in capital
- ❑ NZ\$20 million uncalled capital
- ❑ NZ\$55 million retained earnings
- ❑ NZ\$166 million Borrower Notes that can be converted to equity
- ❑ Current capital ratio of 2.20% with policy of 2% minimum and target of 3%

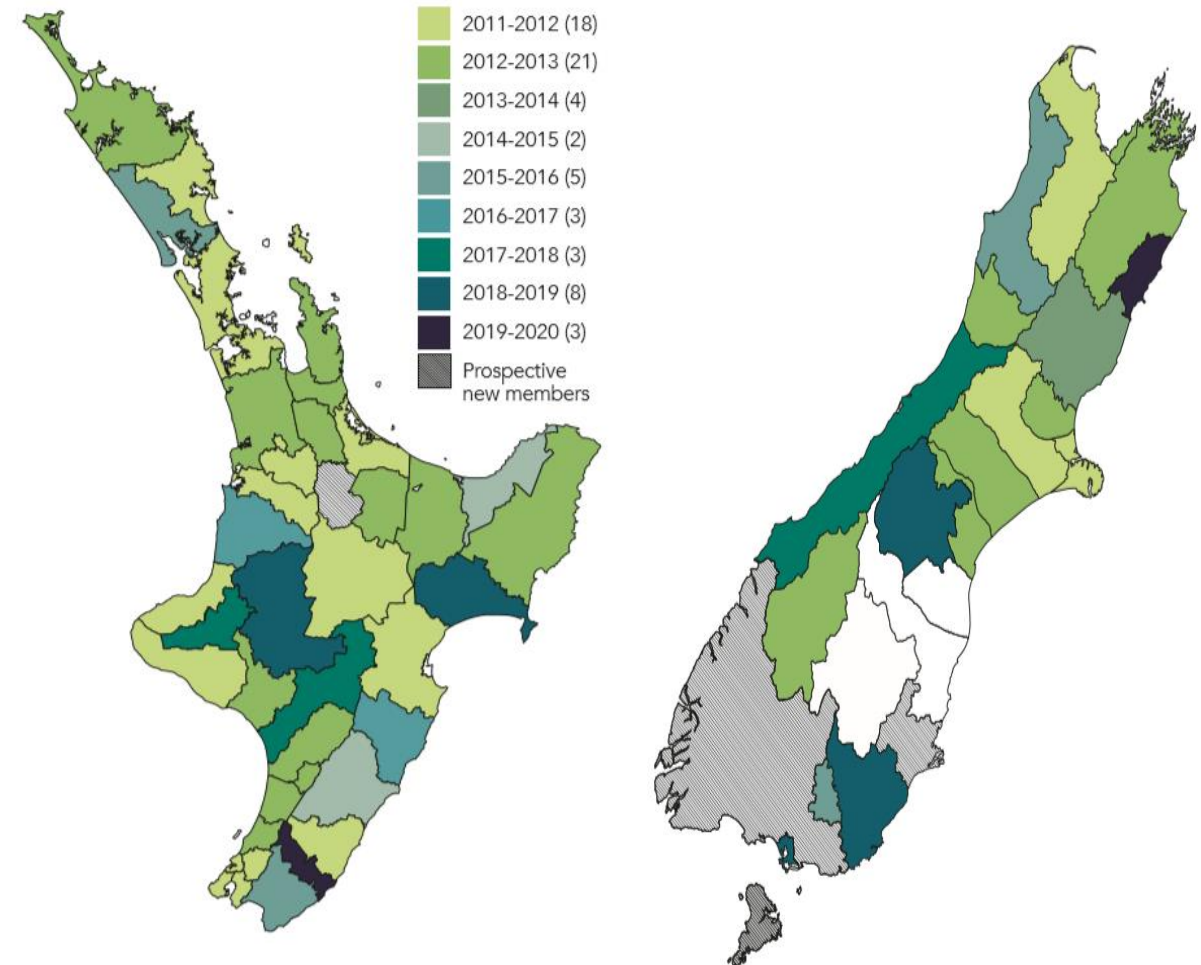
As at 1 May 2020

Source: LGFA



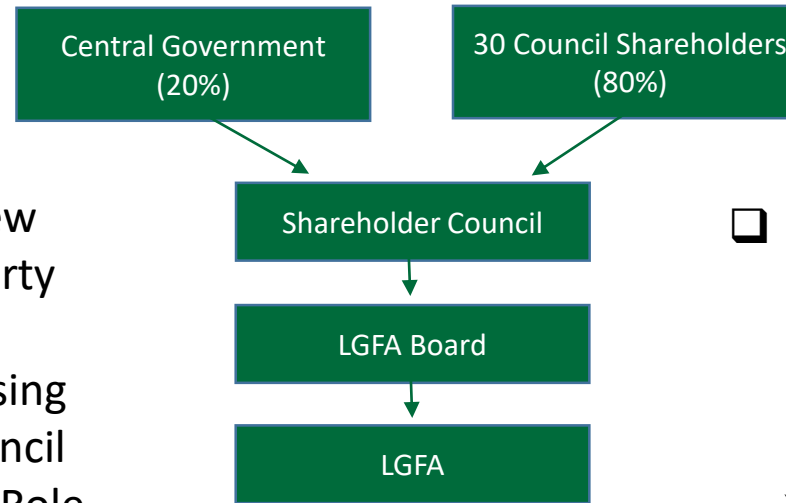


## LGFA member councils highlighted with year of joining



Note there are 11 councils not currently members of LGFA.  
Some of these (notably Regional Councils) may overlap on this map.

- ❑ **31 Shareholders**, comprising the New Zealand Government (20%)<sup>1</sup> and thirty councils (80%).
- ❑ **LGFA Shareholders Council**, comprising five to ten appointees from the Council Shareholders and the Government. Role of the Shareholders' Council is to:
  - Review and report performance of LGFA and the Board;
  - Recommendations to Shareholders as to the appointment, removal, replacement and remuneration of directors;
  - Recommendations to Shareholders as to any changes to policies, or the Statement of Intent, requiring their approval;
  - Update Shareholders on LGFA matters and to coordinate Shareholders on governance decisions.

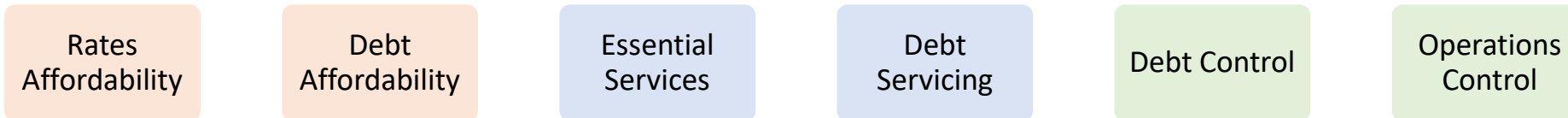


- ❑ **LGFA Board**, is responsible for the strategic direction and control of LGFA's activities. The Board guides and monitors the business and affairs of LGFA, in accordance with:
  - Local Government Act 2002;
  - Local Government Borrowing Act 2011;
  - Companies Act 1993;
  - Financial Markets Conduct Act 2013;
  - LGFA's Constitution;
  - LGFA Shareholder Agreement;
  - LGFA annual Statement of Intent.

The Board will comprise between four and seven directors with a majority of independent directors appointed by Shareholders.

<sup>1</sup> NZ Government shareholding reduces to 11.1% if a call is made on uncalled capital of the 30 council shareholders

- Local Government Framework reduces risk of financial distress – no historical default by a council
- Council have own Treasury Management and borrowing policies – most have independent advice
- Council financial oversight by Office of Auditor General (OAG), Audit NZ and Department of Internal Affairs
- Councils under Local Government (Financial Reporting and Prudence) Regulations 2014 required to report annually on performance against benchmarks including



## Six step intervention process possible by Central Government



- Council required to comply with LGFA lending covenants
  - Annual attestation by council
  - LGFA credit watch-list in place
  - LGFA credit analysis and monitoring performed through the year
  - LGFA not obligated to lend to council members
- Covenant breach is an Event of Review – after 30 days LGFA can seek repayment of loans

- 30 LGFA member councils have credit ratings (A+ to AA+ range)
- LGFA undertakes detailed credit analysis of each Council if they apply to join LGFA (and ongoing) - not every Council has been accepted as a member
- A Council default becomes a timing issue for LGFA
  - LGFA lending secured against rates revenue under Debenture Trust Deed
  - Unlikely to be other material claimants on rates revenue given LGFA is the dominant lender to Councils
  - Council's Debenture Trustee appoints receiver and a special rate (property tax) levied on all properties in the council region to meet secured obligations when due
  - Property taxes unavoidable and first ranking security over property
- Sources of LGFA liquidity and additional capital
  - \$1 billion liquidity facility from NZ Government
  - Liquid Assets Portfolio
  - Issuance of additional LGFA Bills and Bonds
  - Conversion of Borrower Notes into equity
  - Uncalled capital of \$20 million
- Beneficiaries of the Council guarantee (including LGFA bondholders) can also call upon the guarantee from councils
- **Central Government does not guarantee obligations of either LGFA or council members**

Source: LGFA

# LGFA HISTORIC FINANCIAL PERFORMANCE

Financials (NZ\$ million)	2012	2013	2014	2015	2016	2017	2018	2019
Interest Income	\$10.9	\$73.7	\$149.1	\$222.8	\$278.2	\$320.7	\$342.8	\$361.1
Interest Expense	\$9.9	\$68.1	\$138.9	\$208.9	\$262.6	\$303.2	\$323.9	\$342.3
Net Interest Income	\$1.0	\$5.7	\$10.2	\$13.9	\$15.5	\$17.5	\$18.9	\$18.8
<b>Total Income</b>	<b>\$1.0</b>	<b>\$5.7</b>	<b>\$10.2</b>	<b>\$13.9</b>	<b>\$15.5</b>	<b>\$17.5</b>	<b>\$18.9</b>	<b>\$18.8</b>
Operating Expenses	(\$5.2)	(\$3.0)	(\$3.2)	(\$4.7)	(\$6.0)	(\$6.5)	(\$7.1)	(\$7.6)
<b>Net Profit</b>	<b>(\$4.2)</b>	<b>\$2.6</b>	<b>\$7.0</b>	<b>\$9.2</b>	<b>\$9.5</b>	<b>\$11.0</b>	<b>\$11.8</b>	<b>\$11.2</b>
Liquid Assets Portfolio	\$52.8	\$66.3	\$101.7	\$107.9	\$266.3	\$327.5	\$482.8	\$448.1
Loans to Local Government	\$832.7	\$2,514.9	\$3,742.5	\$5,031.9	\$6,451.3	\$7,783.9	\$7,975.7	\$9,310.6
Other Assets	\$57.5	\$107.0	\$74.0	\$271.9	\$539.7	\$380.0	\$321.1	\$610.1
<b>Total Assets</b>	<b>\$943.0</b>	<b>\$2,688.2</b>	<b>\$3,918.2</b>	<b>\$5,411.8</b>	<b>\$7,257.3</b>	<b>\$8,491.4</b>	<b>\$8,779.6</b>	<b>\$10,382.3</b>
Bonds on Issue	\$908.9	\$2,623.6	\$3,825.3	\$5,247.3	\$6,819.7	\$7,865.4	\$8,101.0	\$9,612.4
Bills on Issue	\$ nil	\$ nil	\$ nil	\$ nil	\$223.9	\$348.2	\$473.4	\$503.2
Borrower Notes	\$13.2	\$40.7	\$61.9	\$85.1	\$108.4	\$131.6	\$135.1	\$154.2
Other Liabilities	\$0.2	\$0.6	\$2.1	\$16.1	\$61.0	\$92.3	\$5.8	\$38.5
<b>Total Liabilities</b>	<b>\$922.3</b>	<b>\$2,664.8</b>	<b>\$3,889.3</b>	<b>\$5,375.6</b>	<b>\$7,213.0</b>	<b>\$8,437.5</b>	<b>\$8,715.3</b>	<b>\$10,382.3</b>
<b>Shareholder Equity</b>	<b>\$20.8</b>	<b>\$23.4</b>	<b>\$28.8</b>	<b>\$36.3</b>	<b>\$44.2</b>	<b>\$53.9</b>	<b>\$64.3</b>	<b>\$74.1</b>

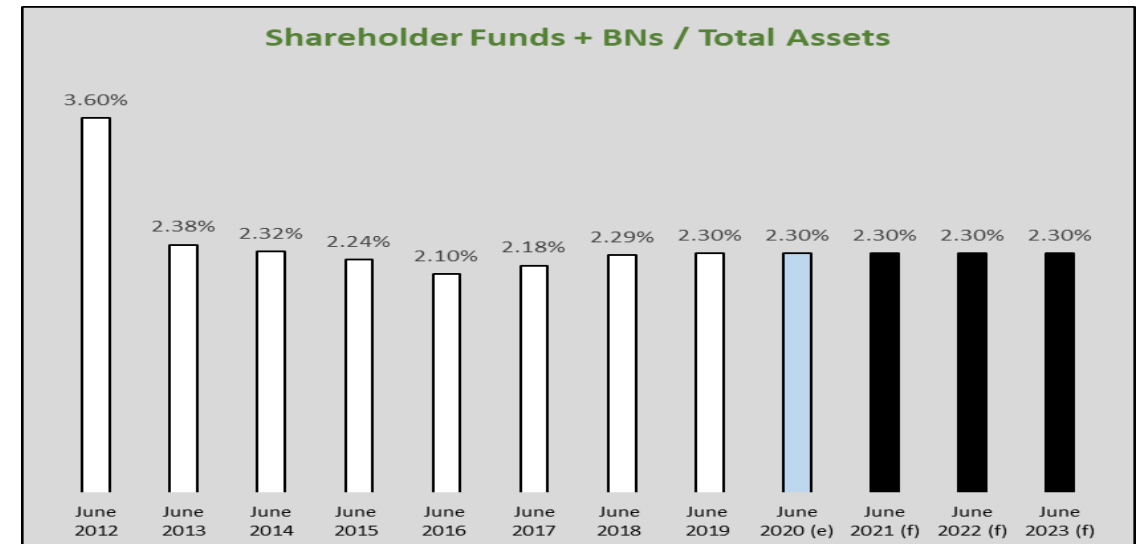
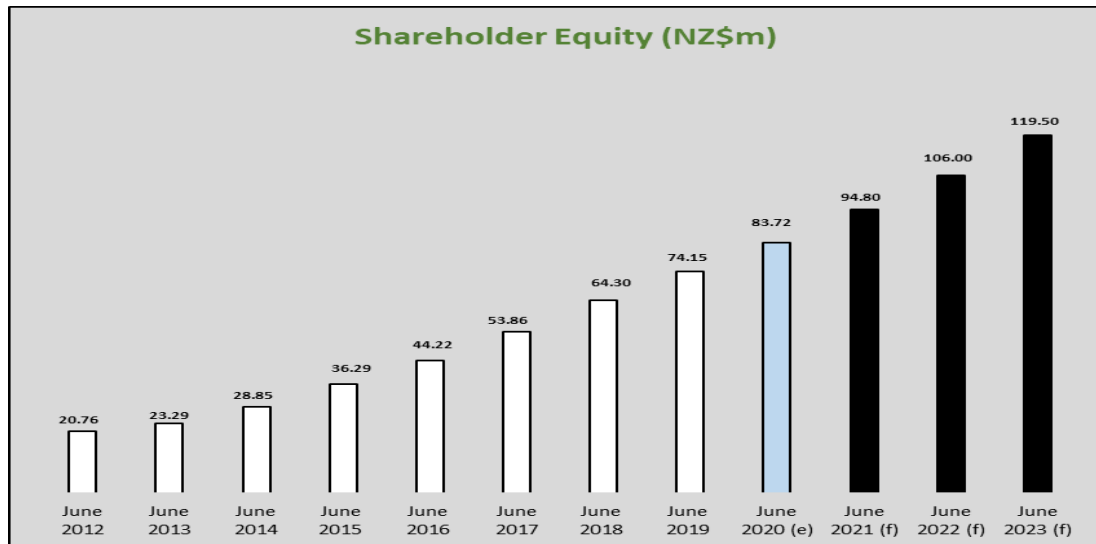
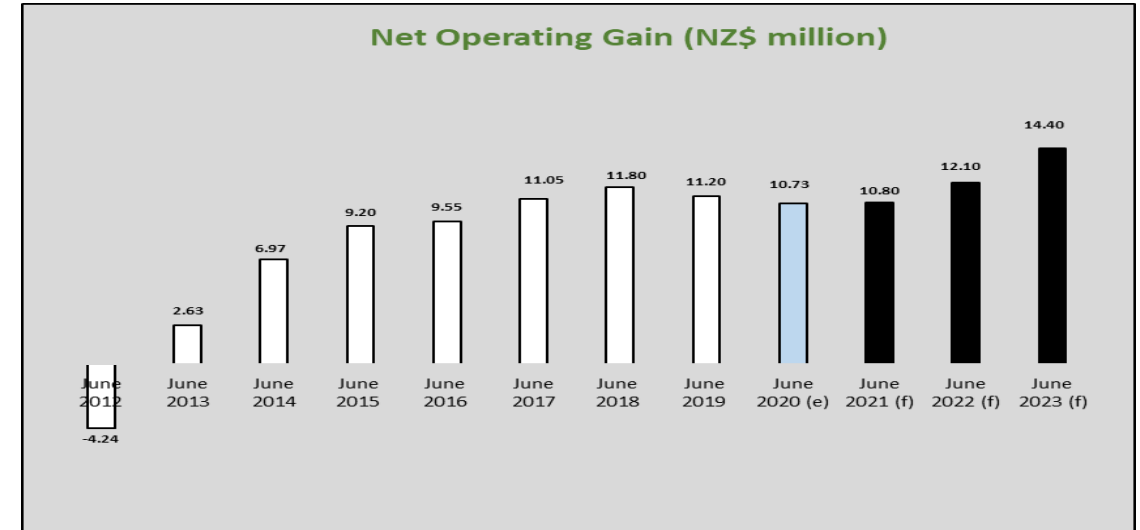
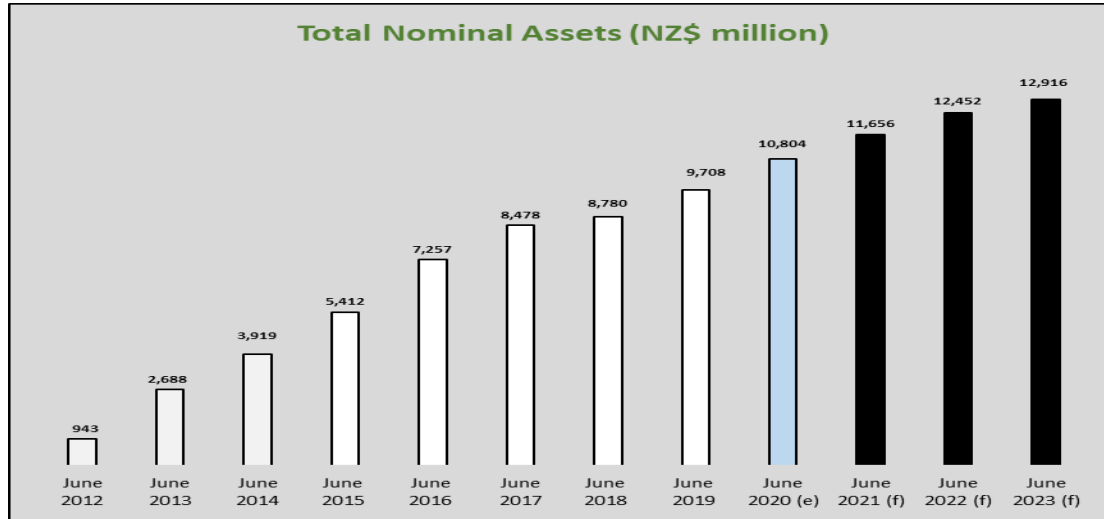
Note: As at 30 June each year or for the twelve month period ending 30 June each year. Source: LGFA Annual Reports



Ratios as at 30 June each year	2012	2013	2014	2015	2016	2017	2018	2019
Liquid Assets / Funding Liabilities	5.7%	2.5%	2.6%	2.0%	3.8%	4.1%	5.6%	4.4%
Liquid Assets / Total Assets	5.6%	2.5%	2.6%	2.0%	3.7%	3.9%	5.5%	4.3%
Net Interest Margin	0.12%	0.23%	0.27%	0.28%	0.24%	0.23%	0.22%	0.18%
Cost to Income Ratio	531.2%	53.6%	31.8%	33.8%	38.7%	37.1%	37.6%	40.4%
Return on Average Assets	-0.45%	0.10%	0.18%	0.17%	0.13%	0.13%	0.13%	0.11%
Shareholder Equity / Total Assets	2.2%	0.9%	0.7%	0.7%	0.6%	0.6%	0.7%	0.7%
Shareholder Equity + Borrower Notes / Total Assets	3.6%	2.4%	2.3%	2.2%	2.1%	2.2%	2.3%	2.2%
Asset Growth	n/a	185.1%	45.8%	38.1%	34.1%	17.0%	13.4%	18.3%
Loan Growth	n/a	202%	48.8%	34.5%	28.2%	20.7%	2.4%	16.7%
Return on Equity	n/a	12.7%	29.8%	31.9%	26.3%	25.0%	21.9%	15.1%
Capital Ratio	18.0%	11.9%	11.6%	11.2%	10.5%	10.9%	10.9%	10.9%

**Note: As at 30 June each year or for the twelve month period ending 30 June each year. Source: LGFA Annual Reports**

# HISTORIC & FORECAST FINANCIAL PERFORMANCE



Forecast performance based upon assumptions outlined in LGFA Draft SOI 2020-21 available at [www.lgfa.co.nz/for-investors/annual-reports-and-statement-of-intent](http://www.lgfa.co.nz/for-investors/annual-reports-and-statement-of-intent)

Note: Based upon nominal values and Draft SOI published 27 February 2020

Source: LGFA Annual Reports and Draft SOI

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