LGFA New Zealand Local Government Funding Agency

New Zealand Local Government Funding Agency Limited

Annual Report
2011 – 2012

New Zealand Local Government Funding Agency Limited

Annual Report 2011 – 2012

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Genesis of the New Zealand Local Government Funding Agency Ltd

There have been several attempts to establish a collective borrowing vehicle for the local government sector in New Zealand. These attempts ultimately failed, due in part to a lack of strong and unified support from local authorities.

At the Jobs Summit in 2009, another proposal for a local government debt vehicle was put forward. On this occasion, the Global Financial Crisis (GFC) ensured that stronger support for the proposal was forthcoming.

"The GFC focused everyone, including the local authorities, on the capital markets – pricing and security of access in particular" [Hugo Ellis, Borrowing Together for Better Balance Sheets, INFINZ Journal, May 2012].

The "infrastructure deficit" in New Zealand was another factor supporting the Local Government Funding Agency's (LGFA) development. It was clearly recognised by both central and local government that infrastructure spending would need to increase significantly over the next decade to maintain New Zealand's international competitiveness. To balance this cost between current and future generations, it was inevitable that local government borrowing was set to rise considerably. Having a more efficient funding vehicle on hand would minimise the cost of this additional borrowing.

A group of nine councils strongly supported LGFA's development, and formed a steering group with Local Government New Zealand to turn the concept into reality. Key advisors, Cameron Partners and Asia Pacific Risk Management, were appointed to work on a range of structural issues.

In May 2011, an Establishment Board chaired by Craig Stobo was formed to negotiate with key stakeholders and provide day-to-day guidance to the advisors. Over two years of work by the steering group and Establishment Board (funded by the nine councils and central government) resulted in a proposed structure for LGFA that shared some features with peer local government funding agencies in Scandinavia, but with a uniquely kiwi element.

For example, LGFA's capital structure includes Borrower Notes (debt securities that can be converted to equity under specific circumstances) and investors in LGFA are supported by a joint and several guarantee from participating local authorities and an initial $500 million liquidity facility from New Zealand Debt Management Office (NZDMO). Furthermore, start-up operating expenses were minimised via an outsourced services agreement with NZDMO.

Overall, the robustness of LGFA's structure is best measured by the outcome of its request for credit ratings from two of the leading credit rating agencies in the world. In September 2011, Standard and Poor's and Fitch both assigned LGFA a preliminary domestic currency credit rating of AA+; the same rating they assign to the New Zealand Government.

During the same month, the Local Government Borrowing Act 2011 received royal assent.

From the Jobs Summit in February 2009, almost three years of dedicated work by a large cast of committed stakeholders culminated in the incorporation of LGFA on 1 December 2011.

LGFA Establishment Board

- Craig Stobo. Chairman
- Paul Anderson. Christchurch City Council
- Eugene Bowen. Local Government New Zealand
- Mark Butcher. Auckland Council
- Matthew Walker. Hamilton City Council

Advisors to the Establishment Board

- Cameron Partners. Lead: Hugo Ellis
- Asia Pacific Risk Management. Lead: Stuart Henderson

The LGFA Establishment Board and their advisors won the 2011 KangaNews Achievement Award for their contribution to the development of capital markets in New Zealand

Governance Structure

Shareholders, governance and management structure for the LGFA as at 30 June 2012.

LGFA Shareholders

- Auckland Council
- Bay of Plenty Regional Council
- Christchurch City Council
- Hamilton City Council
- Hastings District Council
- Masterton District Council
- New Plymouth District Council
- Otorohanga District Council
- Selwyn District Council
- South Taranaki District Council
- Tasman District Council
- Taupo District Council
- Tauranga City Council
- Waipa District Council
- Wellington City Council
- Wellington Regional Council
- Western Bay of Plenty District Council
- Whangarei District Council
- New Zealand Government

LGFA Shareholders Council

- Matthew Walker. Hamilton City Council. Chairman
- Alan Adcock. Whangarei District Council
- Mohan De Mel. Tauranga City Council
- Warwick Hayes. Wellington City Council
- Douglas Marshall. Selwyn District Council
- Matt Potton. Western Bay of Plenty District Council
- Murray Staite. Tasman District Council
- Mike Timmer. Wellington Regional Council
- Brian Trott. Bay of Plenty Regional Council
- Damian Zelas. New Zealand Government

LGFA Board

- Craig Stobo. Independent Chairman
- Paul Anderson. Christchurch City Council
- John Avery. Independent
- Mark Butcher. Auckland Council
- Philip Cory-Wright. Independent
- Abigail Foote. Independent

LGFA Executive

Philip Combes. Chief Executive Officer

Neil Bain. Chief Financial Officer

About Local Government

Every day all New Zealanders are affected in some way by decisions made by city, district or regional councils. The work of local authorities is essential to the social, economic, environmental and cultural well-being of our communities.

While Parliament is elected to deal with issues relevant to New Zealand and its people as a nation, local government enables democratic local decision-making.

Local government makes decisions about local issues and services, having regard to local needs and priorities. This recognises that not all communities are the same, nor do they have the same issues.

There are 78 local authorities representing all areas of New Zealand.

New Zealand has –

- 11 Regional Councils
- 12 City Councils (which are largely urban)
- 54 District Councils, and
- 1 Auckland Council, (which amalgamated 8 former councils on 1 November 2010).

Auckland Council, as well as the city and district councils, are collectively referred to as "territorial authorities" - there are 67 in total.

New Zealand has 108 regional councillors, 716 territorial authority councillors, 149 Auckland local board members and 67 mayors. Local government also employs nearly 23,000 staff.

Many of the everyday activities of New Zealanders are dependent on services provided by local city, district or regional councils. These range from water flowing freely from taps, applying for a building permit, finding a car park outside the library, visiting the park, putting out the rubbish for collection, to walking at night along well-lit streets.

Other important local government activities include –

- Writing and managing plans for area development, including management of the natural and urban environment.
- Making bylaws and enforcing them.
- Participating in community partnerships and initiatives such as reducing crime, increasing jobs or access to housing.
- Civil defence planning and emergency preparedness.
- Local councils' economic contribution to New Zealand

Together, local authorities (both the regional councils and the territorial authorities) make a significant contribution to New Zealand's economy. Altogether, councils accounted for the following:

Contribution to New Zealand's gross domestic product (as at March 2010)	4% of the total GDP
Net worth (total public equity) of combined councils (as at June 2010)	$93.3 billion
Annual Operating Income (as at June 2010)	$6.9 billion
Annual Operating Expenditure (as at June 2010)	$7.1 billion
Annual Capital Expenditure (as at June 2010)	$4.1 billion
Value of Fixed Assets (as at June 2010)	$92.3 billion
Employed - (for reporting councils as at June 2010)	22,738 Full-Time Equivalent staff

Source: http://www.localcouncils.govt.nz

Directors Report

The LGFA was incorporated on 1 December 2011. The incorporation followed almost three years of work led by a group of nine local authorities and Local Government New Zealand.

Support for the new entity from councils around the country resulted in 18 local authorities (around two thirds of the local government sector by rates revenue) becoming foundation members of LGFA. Central government also played a key role in the successful establishment of LGFA, with Parliament passing the Local Government Borrowing Act 2011 to enable its formation. The Crown continues to be involved as the largest single shareholder in the LGFA and NZDMO provides operational support and a significant liquidity facility.

LGFA's inaugural bond tender on 15 February 2012 was an outstanding success. A total volume of $300 million was offered, attracting bids amounting to $1.32 billion.

During 2011/12, four bond tenders were undertaken, raising $835 million in just over four months.

LGFA measures the pricing performance of bond tenders against two key benchmarks:

1. LGFA aims to reduce its margin over New Zealand Government bonds (NZGBs) to 50 basis points (bps) or less, as set out in our Statement of Intent (SOI) 2011/12.

   In this regard, following the success of the first bond tender there has been a steady improvement in the pricing of our benchmark 15 December 2017 bond. From a margin over NZGBs of 113 bps at the inaugural tender, our December 2017 bonds narrowed to around 90 bps over NZGBs by financial year end.

2. To provide cost effective funding to councils, LGFA also aims to minimise its margin over swap rates.

   By 30 June 2012, our December 2017 bonds were trading at just 57 bps over swap; a reduction of 32 bps from the margin achieved at the first bond tender (89 bps over swap).

The pricing improvement obtained has enabled LGFA to provide considerable savings in interest costs to participating local authorities. By financial year end, LGFA was estimated to be saving AA rated councils approximately 30 bps in annual interest costs on a five year security. For unrated councils, the estimated saving was approximately 40 bps.

In turn, these savings have encouraged strong support from member councils for our on-lending activities. By 30 June 2012, 14 out of the 18 participating local authorities had borrowed a total of $819 million (principal value) from LGFA. The flexibility of our borrowing arrangements with councils was also enhanced with each successive bond tender. To date, local authorities have borrowed to three maturity dates (15 April 2015, 15 December 2017 and 15 March 2019), in either fixed or floating rate format, and with a choice of rate settings dates.

Maintaining operational efficiency is one of LGFA's key objectives. It is therefore pleasing to note that overheads were contained to just $1.384 million in the first seven months of operation. This represents annualised overheads of just $2.373 million; well within the performance target set out in SOI 2011/12 (<$3 million).

As a start-up organisation, LGFA scaled up its operations rapidly with two staff joining in January 2012. By financial year end the Company had doubled its staffing complement to four.

In its first seven months of operation, LGFA recorded a loss of $4.243 million. Excluding pre-establishment expenses ($3.843 million), LGFA's operating loss was $400,000.

While this outcome appears to be considerably less favourable than the profit of $110,000 forecast in the SOI 2011/12, the timing and treatment of overhead expenditure varied significantly from forecast. Adjusting for these timing and treatment differences, LGFA would have recorded a profit of $7,000, as outlined in the table below.

Operating profit for the 7 months to 30 June 2012 Adjusted to align with forecast in Statement of Intent		*In $000s*
Operating loss		(4,243)
Add back: implementation costs		3,843
Operating loss, excluding implementation costs		(400)
Add back:		407
Rating agency fees[1]	290	
Borrower note interest[2]	117	
Adjusted operating profit		7

1. *Rating agencies fees were originally forecast to be paid as part of pre-establishment expenses.*
2. *Interest accrued on Borrower Notes was originally forecast as a return on equity (dividends).*

This adjusted operating profit result was lower than forecast primarily due to the delayed start in LGFA's operations. Financial forecasts contained in the SOI 2011/12 were based on the first bond issue being held in November 2011. As events transpired, the first LGFA bond issue did not take place until 15 February 2012, a delay of almost four months.

Including pre-establishment expenses of $3.84 million (compared with a forecast of $4.55 million), LGFA's retained deficit at 30 June 2012 was $4.24 million. This represents an 8% improvement on the retained deficit ($4.59 million) forecast in the SOI 2011/12.

New Zealand Local Government Funding Agency Limited

Statement of service performance

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PERFORMANCE AGAINST OBJECTIVES AND PERFORMANCE TARGETS

1 Primary objective

LGFA operates with the **primary objective** of optimising the debt funding terms and conditions for participating local authorities. Among other things this includes:

1.1 **Providing debt to participating local authorities at the lowest possible interest rates commensurate with the relevant maturity**

LGFA has met its primary objective by achieving a significant improvement in the pricing of the benchmark 15 December 2017 bond, particularly over the last quarter of the financial year.

Following the inaugural tender held on 15 February 2012, there has been an improvement of 32 bps in the margin to swap for the December 2017's (as outlined in the following table):

Margins	15 Feb 2012 (bps)	30 Jun 2012 (bps)	Pricing improvement
LGFA margin to NZ Government Bonds	113	90	23
NZGB margin to swap	(24)	(33)	9
LGFA margin to swap	89	57	32

To support the inaugural tender and subsequent issues up until 30 June 2012, LGFA has undertaken the following marketing activities:

- An investor roadshow to Melbourne, Sydney, Auckland and Wellington in January 2012. A second roadshow to Auckland and Wellington was undertaken in May 2012 to launch the new 15 March 2019 bond, and
- Participation as a speaker or panellist in major conferences. eg.Institute of Finance Professionals New Zealand Inc (INFINZ) Finance and Capital Markets Forum as part of ongoing promotion of LGFA bonds to investors and intermediaries.

1.2 **Making longer-term borrowings available to participating local authorities**

LGFA offers two maturities in excess of five years that are available to participating councils:

- 15 December 2017, first issued at the inaugural bond tender held on 15 February 2012, and
- 15 March 2019, first issued at the fourth bond tender held on 6 June 2012.

1.3 **Enhancing the certainty of access to debt markets for participating local authorities, subject always to operating in accordance with sound business practice**

Access to debt markets has been demonstrated by the cover ratios ie. ratio of total amount bid to total amount offered, achieved at the first four LGFA bond tenders. The LGFA cover ratio for each tender has been:

Tender		Volume bid ($m)	Volume offered ($m)	Cover ratio (times)
1	15 February 2012	1,320	300	4.4
2	21 March 2012	959	265	3.6
3	2 May 2012	855	140	6.1
4	6 June 2012	752	130	5.8

Key points to note are:

- Total bids received over the first four tenders amounted to $3.9 billion
- The average cover ratio has been 4.7 times

Statement of service performance

- The lowest cover ratio for the year was 3.6 times, and
- LGFA's average cover ratio compares favourably to the average cover ratio achieved by NZDMO over the past few years.

2 Additional objectives

LGFA has a number of additional objectives which complement the primary objective. These additional objectives are to:

2.1 **Operate with a view to making a profit sufficient to pay a dividend in accordance with its stated Dividend Policy set out in section 6 of the Statement of Intent**

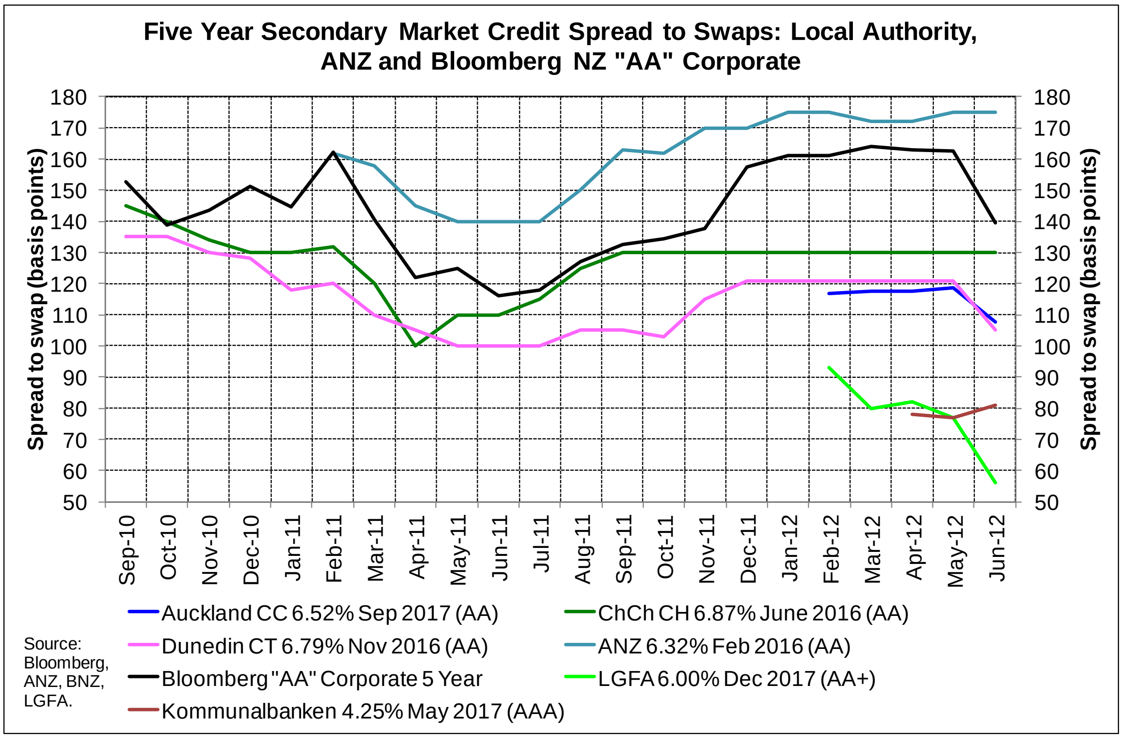
As noted in Section 6 of the 2011/12 SOI, no dividend was forecast for the part period to 30 June 2012.

2.2 **Become the primary source of debt funding for participating local authorities**

Councils have strongly supported LGFA to date. After the fourth bond tender in June, 14 (out of 18) participating councils had borrowed from LGFA.

2.3 **Operate in a manner to ensure LGFA is successful and sustainable in the long-term**

The key to LGFA's long-term sustainability is to ensure that it can always fund councils at lower rates than they can fund themselves. The chart below compares LGFA's spread to swap against a number of other issuers for five year maturities.



Source: Asia Pacific Risk Management

From the chart above, we estimate that by 30 June 2012 LGFA was saving AA rated councils approximately 30 bps in annual interest costs on a five year security.

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The basis for this estimate is set out in the table below:

Margins on 15 December 2017 bond	30 Jun 2012 (bps)
AA rated councils margin to swap	107
Less: LGFA margin to swap	(57)
LGFA Funding Advantage	50
Less*:* LGFA Base Margin	(30)
LGFA Net Funding Advantage	20
Add: 'LGFA Effect' *	10
Total saving for AA rated councils	30

* *The 'LGFA effect' represents the estimated conservative reduction in AA rated councils margin to swap as a result of LGFA operations. From May to June 2012, the margin to swap for AA rated councils fell by 10 bps, with no corresponding move in swap spreads for other borrowers. This suggests that potential access to cost effective LGFA funding has enabled these councils to reduce their borrowing margin by around 10 bps*

2.4 **Educate and inform all local authorities (both participating and non-participating) on matters within the scope of LGFA's operations**

During the period to 30 June 2012, LGFA:

- Discussed various issues (including monitoring arrangements, performance reporting, disclosure of borrower information and debt refinancing) at LGFA Shareholders' Council meetings
- Wrote to all non-participating councils seeking information on their plans to join LGFA (as shareholder, guarantor or borrower), and their desired timing in relation to becoming new borrowers
- Met with several South Island councils as part of a South Island roadshow in February 2012, and
- Arranged a New Borrowers Forum in Wellington on 31 July 2012 for all non-participating councils (and their advisors) to learn about the process involved in becoming a new borrower from LGFA.

2.5 **Become a leading participant in the New Zealand capital markets**

Market commentary from industry publications demonstrate interest in LGFA's activities from both the domestic market and our international peer organisations.

- KangaNews' articles on LGFA in the March 2012 edition and coverage of a roundtable discussion between LGFA and its Scandinavian municipal agency peers in its April 2012 edition, and
- INFINZ's feature article on the LGFA in its May 2012 Journal.

2.6 **Provide excellent service to participating local authorities**

Since the inaugural bond tender in February 2012, LGFA has continued to work with councils, NZDMO and Computershare on streamlining its settlement processes.

In addition to lending on a floating rate note basis, LGFA has also provided increasing levels of flexibility to councils in setting the terms of their LG securities, including lending on a fixed rate basis, as well as bespoke rate reset dates for floating rate loans.

2.7 **Ensure excellent communication exists and be professional in its dealings with all its stakeholders**

During the period to 30 June 2012, LGFA:

- Maintained regular communication with intermediaries and investors to review and revise its debt issuance strategies, and

Statement of service performance

- Conducted regular media interviews and contributed to articles from INFINZ and Kommuninvest Dialog to ensure that markets (both domestically and internationally) were well informed about LGFA's activities and operations.

2.8 Ensure its products and services are delivered in a cost-effective manner

During the period to 30 June 2012, LGFA:

- Charged a 'base' on-lending margin to councils that averaged 0.30%, below the maximum permitted of 0.40%, and
- Restricted operating costs (excluding establishment costs) to less than $200,000 per month, below the monthly target of $250,000.

2.9 Consult with Shareholders regarding the potential requirement for LGFA Borrowers to obtain comprehensive insurance cover

LGFA's current credit assessment approach is to consider insurance cover along with various business interruption risks (including risks to physical assets) as part of an overall credit risk assessment of individual councils. In this regard, LGFA is aware that self-insurance arrangements eg. via the accumulation of financial assets, may be as effective as external insurance cover.

LGFA will undertake future consultation with shareholders on the appropriate level of insurance cover for borrowers.

2.10 Review the appropriateness of LGFA's 'broker' business model

The appropriateness of the 'broker' business model was demonstrated by three key factors during LGFA's first period of operations:

- Overall profitability ie. the retained earnings position, has exceeded budget in the first six months of operations
- Profitability has been achieved without the need for LGFA to take on significant interest rate risk eg. Value-at-Risk[1] is currently running at only 10% of policy limits, and
- Significant improvement in the pricing of LGFA bonds has generated corresponding savings for council borrowers of around 30 bps in annual interest costs.

2.11 Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency

This has been achieved to date. LGFA's credit rating remains AA+ with both Standard and Poor's and Fitch.

2.12 Achieve the Financial Forecasts set out in section 4 of the Statement of Intent

LGFA's financial results for key items set out in Section 4 of the SOI for the period 30 June 2012 are:

In $m	30 Jun 2012	Forecast
Total Net Income	1.1	1.5
Overheads, excluding pre-establishment costs	(1.4)	(1.4)
Pre-Establishment Costs	(3.8)	(4.6)
Borrower Notes Interest	(0.1)	(0.1)
Retained Deficit	**(4.2)**	**(4.6)**

1 Value-at-Risk (VaR) is a statistical market risk management tool which seeks to determine the largest dollar loss likely to be suffered by LGFA over a 1 day period with a 95% confidence level.

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2.13 **Achieve the Dividend Policy set out in section 6 of the SOI**

Refer to comments in 2.1

3 Performance Targets

Six performance targets are specified for LGFA in the SOI. Progress against each of these targets is discussed below, including an explanation of any material variances.

Current performance targets		Target	Result	Outcome
1	Average cost of funds relative to NZGS	<0.50%	1.03%	No
2	Average base on-lending margin above LGFA's cost of funds	<0.40%	0.30%	Yes
3	Annualised operating overheads	<$3.0 million	$2.4 million	Yes
4	Lending to participating councils	>$500 million	$819 million	Yes

There are three key reasons for LGFA's relative cost of funds averaging above the target level of 50bps:

- The European debt crisis has increased the margins of all other issuers above sovereign borrowers, particularly in countries like New Zealand where the sovereign is highly rated.
- A very high proportion (81%) of five and seven year bonds have been issued in the first four bond tenders. While this reflected council demand for funding, longer dated bonds price at a relatively higher margin above NZGS than shorter dated bonds.
- Higher costs are incurred when bonds are initially issued, due to market uncertainty about pricing and the relative illiquidity of new bond maturities.

Future performance targets		Target	Result	Outcome
5	Number of shareholder councils	>30	18	Target date* 30 Nov 2012
6	Number of eligible borrowers	>40	19	Target date* 30 Nov 2012

* *The 2012/13 SOI has amended the original target dates of 30 September 2012 to 30 November 2012.*

In relation to performance targets 5 & 6, a programme to sign up new council shareholders and borrowers is planned ahead of a Second Opening for councils scheduled for November 2012. Key elements of the work program include:

- A New Borrowers Forum was held at Wellington Airport on 31 July 2012 for all councils wishing to become new borrowers from LGFA. A total of 18 councils attended.
- Work on the credit assessments and documentation required to enable new councils to commence borrowing from LGFA from September 2012.
- Progressing a variety of issues with existing shareholders and new councils wishing to become shareholders and/or guarantors to facilitate the Second Opening by November 2012.

New Zealand Local Government Funding Agency Limited

Financial statements

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Directors' declaration

In the opinion of the directors of the New Zealand Local Government Funding Agency Limited, the financial statements and notes on pages 17 to 31:

- comply with New Zealand generally accepted accounting practice and give a true and fair view of the financial position of the Company as at 30 June 2012, and
- have been prepared using appropriate accounting policies, which have been consistently applied and supported by reasonable judgements and estimates.

The directors believe that proper accounting records have been kept which enables, with reasonable accuracy, the determination of the financial position of the Company and facilitates the compliance of the financial statements with the Financial Reporting Act 1993.

The directors consider that they have taken adequate steps to safeguard the assets of the Company, and to prevent and detect fraud and other irregularities. Internal control procedures are also considered to be sufficient to provide a reasonable assurance as to the integrity and reliability of the financial statements.

For and on behalf of the Board of Directors:

C. Stobo
Director
21 September 2012

A. Foote
Director
21 September 2012

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED

Statement of comprehensive income

For the 7 months ended 30 June 2012

in $000s

	Note	2012
Interest income from		
Cash and cash equivalents		173
Loans to local government		8,090
Marketable securities		152
Deposits		373
Derivatives	2(d)	2,106
Total interest income		**10,894**
Interest expense on		
Bonds	2(d)	9,793
Borrower notes		117
Total interest expense		**9,910**
Net interest income		**984**
Operating expenses		
Issuance and on-lending expenses	3	567
Pre-establishment expenses	4(a)	3,843
Operating expenses	4(b)	817
Total expenses		**5,227**
Net operating profit (loss)		**(4,243)**
Total comprehensive income (deficit) for the period		**(4,243)**

Statement of changes in equity

For the 7 months ended 30 June 2012

in $000s

	Note	Share Capital	Retained earnings	Total equity
Opening balance at 1 December 2011		**-**	**-**	**-**
Deficit for the period		-	(4,243)	(4,243)
Total comprehensive income / (deficit) for the period		**-**	**(4,243)**	**(4,243)**
Share capital		25,000	-	25,000
Closing balance at 30 June 2012	9	**25,000**	**(4,243)**	**20,757**

These statements are to be read in conjunction with the notes to the financial statements

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED

Statement of financial position

As at 30 June 2012

in $000s

	Note	2012
Assets		
Financial assets		
Cash and cash equivalents		18,363
Trade and other receivables		87
Loans to local government	5	832,715
Marketable securities		10,708
Deposits		23,693
Derivatives in gain	2	57,261
Non-financial assets		
Prepayments		179
Property, plant and equipment		13
Total assets		**943,019**
Equity		
Share capital		25,000
Retained earnings		(4,243)
Total equity		**20,757**
Liabilities		
Financial liabilities		
Trade and other payables		79
Accrued expenses		98
Bonds	6	908,864
Borrower notes	7	13,221
Total liabilities		**922,262**
Total equity and liabilities		**943,019**

These statements are to be read in conjunction with the notes to the financial statements

Statement of cash flows

For the 7 months ended 30 June 2012

in $000s

	Note	2012
Cash flow from operating activities		
Cash applied to loans to local government		(830,094)
Interest paid on bonds issued		(7,708)
Interest received from cash and cash equivalents		169
Interest received from loans to local government		5,470
Interest received from marketable securities		237
Interest received on deposits		81
Net interest on derivatives		2,557
Payments to suppliers and employees		(5,317)
Net cash flow from operating activities	8	**(834,605)**
Cash flow from investing activities		
Purchase of marketable securities		(10,793)
Purchase of deposits		(23,400)
Purchase of plant and equipment		(13)
Net cash flow from investing activities		**(34,206)**
Cash flow from financing activities		
Cash from initial equity		25,000
Cash proceeds from borrower notes		13,104
Cash proceeds from bonds issued		892,566
Cash applied to derivatives		(43,496)
Net cash flow from financing activities		**887,174**
Net (decrease) / increase in cash		**18,363**
Cash and cash equivalents at beginning of year		-
Cash and cash equivalents at end of year		**18,363**

These statements are to be read in conjunction with the notes to the financial statements

Notes to the financial statements

1 Statement of accounting policies

a Reporting Entity

The New Zealand Local Government Funding Agency Limited (LGFA) is a company registered under the Companies Act 1993 and is subject to the requirements of the Local Government Act 2002.

LGFA is controlled by participating local authorities and is a council-controlled organisation as defined under section 6 of the Local Government Act 2002. LGFA is a limited liability company incorporated and domiciled in New Zealand.

The primary objective of LGFA is to optimise the debt funding terms and conditions for participating local authorities.

The registered address of LGFA is c/- Russell McVeagh, Vero Centre, 48 Shortland Street, Auckland.

The financial statements are for the 7 month period ended 30 June 2012.

These financial statements were authorised for issue by the Directors on 21 September 2012.

b Statement of compliance

NZ LGFA is registered under the Companies Act 1993 and is a reporting entity as defined by the Financial Reporting Act 1993. NZ LGFA is a profit orientated entity as defined under the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements and accounting policies comply with the specific recognition, measurement and disclosure requirements of NZ IFRS and New Zealand Generally Accepted Accounting Practice (NZGAAP). The financial statements comply with International Financial Reporting Standards.

c Basis of Preparation

Measurement base

The financial statements have been prepared on a historical cost basis modified by the revaluation of certain assets and liabilities.

The financial statements are prepared on an accrual basis.

Functional and presentation currency

The financial statements are presented in New Zealand dollars rounded to the nearest thousand, unless separately identified. The functional currency of LGFA is New Zealand dollars.

Foreign currency conversions

Transactions denominated in foreign currency are translated into New Zealand dollars using exchange rates applied on the trade date of the transaction.

Changes in accounting policies

As these are LGFA's first set of financial statements, there have been no changes in accounting policies.

Early adoption standards and interpretations

The following accounting standard has been early adopted by LGFA.

NZ IFRS 9: *Financial Instruments*. The first two of three phases of this new standard (which is incomplete as at 30 June 2012) were approved by the Accounting Standards Review Board in November 2009 and November 2010. The standard addresses the issues of classification and measurement of financial assets and financial liabilities and becomes effective for annual reporting periods commencing on or after 1 January 2015.

Standards not yet adopted

LGFA does not consider any standards or interpretations in issue but not yet effective to have a significant impact on its financial statements. Those which may be relevant to LGFA are as follows:

Notes to the financial statements

- Amendments to NZ IFRS 7: Financial Instruments: Disclosures. Effective for periods beginning on or after 1 January 2013. This amendment includes disclosure requirements for financial instruments that are offset.
- NZ IFRS 13: Fair Value Measurement. Effective for periods beginning on or after 1 January 2013. The standard establishes a single framework for measuring fair value where that is required by other standards.
- Amendments to NZ IAS 32: Financial Instruments: Disclosures. Effective for periods beginning on or after 1 January 2014. This amendment provides clarification on the ability to set-off financial instruments.

d Financial instruments

Financial assets

Financial assets, other than derivatives, are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method.

Cash and cash equivalents include cash on hand; cash in transit, bank accounts and deposits with an original maturity of no more than three months.

Purchases and sales of all financial assets are accounted for at trade date.

At each balance date an assessment is made whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Financial liabilities

Financial liabilities, other than derivatives, are recognised initially at fair value less transaction costs and subsequently measured at amortised cost using the effective interest rate method.

Derivatives

Derivative financial instruments are recognised both initially and subsequently at fair value. They are reported as either assets or liabilities depending on whether the derivative is in a net gain or net loss position respectively.

Fair value hedge

Where a derivative qualifies as a hedge of the exposure to changes in fair value of an asset or liability (fair value hedge) any gain or loss on the derivative is recognised in profit and loss together with any changes in the fair value of the hedged asset or liability.

The carrying amount of the hedged item is adjusted by the fair value gain or loss on the hedged item in respect of the risk being hedged. Effective parts of the hedge are recognised in the same area of profit and loss as the hedged item.

e Other assets

Property, plant and equipment (PPE)

Items of property, plant and equipment are initially recorded at cost.

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its remaining useful life.

f Other liabilities

Employee entitlements

Employee entitlements to salaries and wages, annual leave and other similar benefits are recognised in the profit and loss when they accrue to employees.

Notes to the financial statements

g Revenue and expenses

Revenue

Interest income

Interest income is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest income each period.

Expenses

Expenses are recognised in the period to which they relate.

Interest expense

Interest expense is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash payments through the expected life of the financial liability to that liability's net carrying amount. The method applies this rate to the principal outstanding to determine interest expense each period.

Income tax

LGFA is exempt from income tax under Section 14 of the Local Government Borrowing Act 2011.

Goods and services tax

All items in the financial statements are presented exclusive of goods and service tax (GST), except for receivables and payables, which are presented on a GST-inclusive basis. Where GST is not recoverable as input tax, then it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the IRD is included as part of receivables or payables in the statement of financial position.

The net GST paid to, or received from the IRD, including the GST relating to investing and financing activities, is classified as a net operating cash flow in the statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

h Segment reporting

LGFA operates in one segment being funding of participating local authorities in New Zealand.

i Judgements and estimations

The preparation of these financial statements requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. For example, the present value of large cash flows that are predicted to occur a long time into the future depends critically on judgements regarding future cash flows, including inflation assumptions and the risk free discount rate used to calculate present values. Refer note 2b for fair value determination for financial instruments.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Where these judgements significantly affect the amounts recognised in the financial statements they are described below and in the following notes.

Notes to the financial statements

2 Analysis of financial assets and financial liabilities

a Categories of financial instruments

The fair value of financial assets and financial liabilities, together with the carrying amounts shown in the Statement of Financial Position, are as follows:

As at 30 June 2012 *in $000s*	Financial liabilities at amortised cost	Financial assets at amortised cost	Financial assets measured at fair value in accordance with IFRS 9	Fair value
Financial assets				
Cash and bank	-	18,363	-	18,363
Trade & other receivables	-	87	-	87
Loans to local government	-	832,715	-	844,147
Marketable securities	-	10,708	-	10,712
Deposits	-	23,693	-	23,717
Derivatives in gain	-	-	57,261	57,261
		885,566	**57,261**	**954,287**
Financial liabilities				
Trade & other payables	79	-	-	79
Bonds	908,864	-	-	918,553
Borrower notes	13,221	-	-	13,299
Derivatives in loss	-	-	-	-
	922,164	**-**	**-**	**931,931**

Marketable securities and bonds

The fair value of marketable securities and bonds is determined using the quoted price for the instrument.

Loans to local government

The fair value of loans to local government authorities is determined using a discounted cash flow analysis. The interest rates used to discount the estimated cash flows are based on LGFA bond yields at the reporting date plus an appropriate credit spread to reflect the counterparty's credit risk.

Borrower notes

The fair value of borrower notes is determined using a discounted cash flow analysis. The interest rates used to discount the estimated cash flows are based on LGFA bond yields at the reporting date.

Derivative financial instruments

The fair value of derivative financial instruments is determined using a discounted cash flow analysis. Interest rates represent the most significant assumption used in valuing derivative financial instruments. The interest rates used to discount estimated cash flows are based on the New Zealand dollar swap curves at the reporting date.

b Fair value

The fair values of financial instruments recognised in the Statement of Financial Position are determined according to the following hierarchy:

- *Level 1* - Quoted market prices: Fair value based on quoted prices in active markets for identical assets or liabilities.
- *Level 2* - Valuation techniques using observable market inputs: Fair value based on a valuation technique using other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

Notes to the financial statements

- *Level 3* - Valuation techniques using significant non-observable market inputs: Fair value based on a valuation technique using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in the fair value hierarchy within which the fair value is categorised shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

As at 30 June 2012 *in $000s*	Level 1	Level 2	Level 3	Total fair value
Financial assets				
Derivatives	-	57,261	-	57,261
	-	**57,261**	**-**	**57,261**

c Financial risk management

The Board of Directors has overall responsibility for carrying out the business of LGFA in accordance with risk management policies, including those relating to investing, lending, borrowing and treasury activities. The use of financial instruments exposes LGFA to a number of financial risks, the most significant being market risk, credit risk, and liquidity risk. The exposure and management of these risks is outlined below.

Market risk

Market risk is the risk that changes in market prices will affect LGFA's income or value of financial instruments. The most significant market risk which LGFA is exposed to is interest rate risk. LGFA has no significant exposure to foreign exchange risk.

Interest rate risk

Interest rate risk is the risk that future cash flows or the fair value of financial instruments will decrease because of a change in market interest rates. LGFA is exposed to interest rate risk through its interest-bearing financial assets and liabilities. Interest rate risk is managed by matching the interest rate repricing profile of its assets against the repricing profile of its liabilities. Where mismatches occur, interest rate swaps are used to economically convert the repricing profile of financial liabilities.

The table below indicates the effective interest rate and the earliest period in which interest-bearing financial instruments reprice.

As at 30 June 2012 *in $000s*	Effective interest rate	Total nominal value	Less than 6 months	6 months to 1 year	1 year to 2 years	2 years to 5 years	More than 5 years
Financial assets							
Cash and bank	2.5%	18,363	18,363	-	-	-	-
Loans to local government	3.56–5.21%	819,000	616,000	-	-	25,000	178,000
Marketable securities	2.50%	10,250	-	10,250	-	-	-
Deposits	3.49–3.80%	23,400	23,400		-	-	-
Financial liabilities							
Bonds	3.43–4.91%	(835,000)	-	-	-	(155,000)	(680,000)
Borrower notes	3.21–4.91%	(13,104)	(9,856)	-	-	(400)	(2,848)
Derivatives		-	(634,000)	-	-	130,000	504,000
Total		**22,909**	**13,907**	**10,250**	**-**	**(400)**	**(848)**

Interest rate sensitivity

Changes in interest rates impact the fair value of fixed rate assets and liabilities, cash flows on floating rate assets and liabilities, and the fair value and cash flows of interest rate swaps. A change of 100 basis points in interest rates at the reporting date would have increased/(decreased) profit or loss and equity by the amounts shown in the table below. This analysis assumes that all other variables remain constant.

Notes to the financial statements

As at 30 June 2012 *in $000s*	Profit and loss 100 bps increase	 100 bps decrease
Fair value sensitivity analysis		
Derivatives	(28,366)	29,995
Fixed rate liabilities	28,366	(29,995)
	-	**-**
Cash flow sensitivity analysis		
Variable rate assets	6,160	(6,160)
Variable rate liabilities	(99)	99
Derivatives	(6,340)	6,340
	(279)	**279**

Credit risk

Credit risk is the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations. LGFA is exposed to credit risk through its lending and investing activities.

Credit risk associated with lending activities is managed by requiring local authorities that borrow from LGFA to meet specific credit lending criteria and to provide security against the borrowing. The LGFA's credit risk framework restricts credit exposures to specific counterparties.

Credit risk associated with investing activities, excluding on-lending, is managed by only investing with New Zealand Government Agencies or counterparties that meet a minimum credit rating of A (Standard & Poor's equivalent). The LGFA's credit risk framework limits concentrations of credit risk for any particular counterparty.

Exposure to credit risk

LGFA monitors the concentration of credit risk by the type of counterparty. The carrying value and maximum exposure to credit risk at the reporting date, before taking account of collateral or other credit enhancements, for significant counterparty types are shown in the table below.

As at 30 June 2012 *in $000s*	NZ Government agencies	NZ local authorities	NZ registered banks	Other counter-parties	Total carrying value
Financial assets					
Cash and bank balances	17,930	-	433	-	18,363
Trade & other receivables	-	-	-	87	87
Loans to local government	-	832,715	-	-	832,715
Marketable securities	10,708	-	-	-	10,708
Deposits	-	-	23,693	-	23,693
Derivatives	57,261	-	-	-	57,261
	85,899	**832,715**	**24,126**	**87**	**942,827**

Collateral and credit enhancements

LGFA holds collateral against borrowings from local authorities in the form of debenture securities and guarantees.

Credit quality of financial assets

All financial assets are neither past due or impaired. The carrying value of the financial assets is expected to be recoverable.

Liquidity risk

Liquidity risk is the risk that LGFA will encounter difficulty in meeting the obligations of its financial liabilities. LGFA manages liquidity risk by holding cash and a portfolio of liquid assets to meet obligations when they fall due.

Notes to the financial statements

The New Zealand Debt Management Office also provide a committed liquidity facility that LGFA can draw upon to meet any exceptional and temporary liquidity shortfall. As at the 30 June 2012, the committed liquidity facility was $500 million.

Contractual cash flows of financial instruments

The contractual cash flows associated with financial assets and liabilities are shown in the table below.

As at 30 June 2012 *in $000s*	On demand	Up to 3 months	3 months to 1 year	1 to 5 years	More than 5 years	Total contract cash flows	Total carrying value
Financial assets							
Cash	18,363	-	-	-	-	18,363	18,363
Trade & other receivables	-	87	-	-	-	87	87
Loans to local government	-	7,300	27,691	273,850	713,359	1,022,200	832,715
Marketable securities	-	-	10,916	-	-	10,916	10,708
Deposits	-	23,781	-	-	-	23,781	23,693
Financial liabilities							
Trade & other payables		(79)				(79)	(79)
Bonds	-	(1,875)	(47,475)	(333,800)	(705,650)	(1,088,800)	(908,864)
Borrower notes	-	-	-	(2,303)	(13,693)	(15,996)	(13,221)
Derivatives	-	(4,975)	21,108	42,879	2,909	61,921	57,261
Total	**18,363**	**24,239**	**12,240**	**(19,374)**	**(3,075)**	**32,393**	**20,663**

d Hedge accounting

LGFA is exposed to interest rate risk from fixed rate borrowing and variable rate lending to Councils. LGFA manages this interest rate risk through the use of interest rate swaps. For hedge accounting purposes, LGFA has designated these swaps in fair value relationships to its fixed rate borrowing.

The gain or loss on the hedging instrument and the hedged item attributable to the hedged risk for fair value hedge relationships is shown in the table below.

For the period ended 30 June 2012 *in $000s*	Gain/(loss)
Hedging instruments – interest rate swaps	14,242
Hedged item attributable to the hedged risk – fixed rate bonds	(14,242)
Ineffectiveness recognised in profit or loss arising from fair value hedges	**-**

3 Issuance and on lending expenses

For the period ended 30 June 2012 *in $000s*	**2012**
NZDMO processing fees	61
NZDMO standby facility fee	83
Rating agencies fees	290
Registry fees	8
Legal fees for issuance	101
Trustee fees	24
	567

Notes to the financial statements

4 Operating expenses

a Pre-establishment expenses

The Company incurred certain pre-establishment expenses which were funded by advanced equity contributions.

For the period ended 30 June 2012 *in $000s*	**2012**
Pre-establishment expenses	1,390
Consultants completion fee	1,495
Legal fees	472
Rating agencies fees	351
Directors and executive recruitment fees	109
Other	182
Pre-establishment expenses as reported at 1 December 2011	**3,999**
NZDMO outsourced services implementation fee	210
GST on consultants completion fee	(195)
Rating agencies fees prepayments	(171)
Pre-establishment expenses as at 30 June 2012	**3,843**

b Operating expenses

For the period ended 30 June 2012 *in $000s*	**2012**
Consultants	35
Directors fees	142
Insurance	32
Legal fees	28
Other expenses	177
Auditor’s remuneration	
Statutory audit	77
Advisory services*	25
Personnel	238
Recruitment	63
	817

* *Auditor’s remuneration for advisory services relates to work performed over accounting policy options*

Notes to the financial statements

5 Loans to local government

As at 30 June 2012 *in $000s*	Face value	Unamortised discount/ premium	Accrued interest	Total
Auckland Council	350,000	10,627	1,585	362,212
Christchurch City Council	50,000	-	79	50,079
Greater Wellington Regional Council	50,000	-	225	50,225
Hamilton City Council	100,000	-	231	100,231
Hastings District Council	15,000	-	24	15,024
Masterton District Council	10,000	-	17	10,017
Otorohanga District Council	3,000	181	7	3,188
Selwyn District Council	20,000	-	33	20,033
Tasman District Council	16,000	-	26	16,026
Taupo District Council	50,000	-	240	50,240
Tauranga City Council	50,000	-	142	50,142
Wellington City Council	15,000	-	2	15,002
Western Bay of Plenty District Council	45,000	-	74	45,074
Whangarei District Council	45,000	-	222	45,222
	819,000	10,808	2,907	**832,715**

6 Bonds issued

As at 30 June 2012 *in $000s*		Face value	Unamortised discount/ premium	Accrued interest	Fair value hedge adjustment	Total
15 April 2015	6% coupon	155,000	8,849	1,931		
15 December 2017	6% coupon	605,000	42,253	1,488		
15 March 2019	5% coupon	75,000	4,011	1,090		
		835,000	55,113	4,509	14,242	**908,864**

Notes to the financial statements

7 Borrower notes

Borrower notes are subordinate debt instruments (which are required to be held by each local authority that borrows from LGFA in an amount equal to 1.6% of the aggregate borrowings by that local authority).

LGFA may convert borrower notes into redeemable shares if it has made calls for all unpaid capital to be paid in full and the LGFA Board determines it is still at risk of imminent default.

As at 30 June 2012 *in $000s*	Face value	Accrued interest	Total
Auckland Council	5,600	54	5,654
Christchurch City Council	800	8	808
Greater Wellington Regional Council	800	10	810
Hamilton City Council	1,600	10	1,610
Hastings District Council	240	0	240
Masterton District Council	160	2	162
Otorohanga District Council	48	0	48
Selwyn District Council	320	2	322
Tasman District Council	256	2	258
Taupo District Council	800	7	807
Tauranga City Council	800	7	807
Wellington City Council	240	-	240
Western Bay of Plenty District Council	720	10	730
Whangarei District Council	720	5	725
	13,104	117	**13,221**

8 Reconciliation of net profit/(loss) to net cash flow from operating activities

For the period ended 30 June 2012 *in $000s*	**2012**
Net profit/(loss) for the year	**(4,243)**
Cash applied to loans to local government	(830,094)
Non-cash adjustments	
Amortisation and depreciation	(179)
Working capital movements	
Net change in trade debtors and receivables	(8)
Net change in prepayments	(179)
Net change in accruals	98
Net cash flows from operating activities	**(834,605)**

Notes to the financial statements

9 Share capital

Share capital

As at 30 June 2012 LGFA had 45 million ordinary shares on issue, 20 million of which remain uncalled. All ordinary shares rank equally with one vote attached to each ordinary share.

Shareholder information
Registered holders of equity securities as at 30 June 2012

New Zealand Government	5,000,000	11.2%
Auckland Council	4,000,000	8.9%
Bay of Plenty Regional Council	4,000,000	8.9%
Hamilton City Council	4,000,000	8.9%
Tasman District Council	4,000,000	8.9%
Tauranga City Council	4,000,000	8.9%
Wellington City Council	4,000,000	8.9%
Wellington Regional Council	4,000,000	8.9%
Western Bay of Plenty District Council	4,000,000	8.9%
Christchurch City Council	4,000,000	8.9%
Whangarei District Council	1,600,000	3.6%
Hastings District Council	800,000	1.8%
Selwyn District Council	400,000	0.9%
Masterton District Council	200,000	0.4%
New Plymouth District Council	200,000	0.4%
Otorohanga District Council	200,000	0.4%
South Taranaki District Council	200,000	0.4%
Taupo District Council	200,000	0.4%
Waipa District Council	200,000	0.4%
	45,000,000	**100%**

Capital management

LGFA's capital is equity, which comprises share capital and retained earnings. LGFA's equity is largely managed as a result of its revenues, expenses, assets and liabilities incurred in the normal day to day operations of the entity. The objective of managing LGFA's equity is to ensure LGFA achieves its goals and objectives for which it has been established, whilst remaining a going concern.

10 Capital commitments

As at 30 June 2012, there are no capital commitments which have not been accounted for.

11 Contingencies

There are no material contingent liabilities at balance date.

12 Related parties

Identity of related parties

The Company is related to the local authorities set out in the Shareholder Information by shareholding.

The Company operates under a Statement of Intent with the respective local authorities that requires the Company to provide debt to them at the lowest possible interest rates and to enhance their certainty of access to debt markets.

Shareholding local authorities, and non-shareholder local authorities who borrow more than $20 million, are required to enter into a guarantee when they join or participate in LGFA. The guarantee is in respect of the payment obligations of other guaranteeing local authorities to the LGFA (cross guarantee) and of the LGFA itself.

Notes to the financial statements

Related party transactions

LGFA was established for the purpose of raising funds from the market to lend to participating councils. The lending to individual councils is disclosed in note 5, and interest income recognized on this lending is shown in the Statement of Comprehensive Income.

The purchase of LGFA borrower notes by participating councils is disclosed in note 7, and the interest expense on these is shown in the Statement of Comprehensive Income.

LGFA has contracted the NZDMO to provide outsourced treasury services for LGFA. Services include operational processing associated with debt issuance, lending to local authorities, settlement services, investments, hedging and measuring risk. In addition, NZDMO provide some accounting services.

OCG were contracted during the financial year to provide recruitment and payroll services.[2]

Transactions with key management personnel

Salaries	$181,207

Fees paid to Directors are disclosed in operating overheads in Note 4.

13 Subsequent events

There have been no significant events after balance date that have affected the accuracy of these financial statements.

Subsequent to balance date, LGFA has issued $220 million in bonds through two tenders.

2 C Stobo, Director, is a Director of OCG Consulting Ltd.

Auditor's report

INDEPENDENT AUDITOR'S REPORT

**TO THE READERS OF
NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED'S
FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE
FOR THE PERIOD ENDED 30 JUNE 2012**

The Auditor-General is the auditor of New Zealand Local Government Funding Agency Limited (the company). The Auditor-General has appointed me, Graeme Edwards, using the staff and resources of KPMG, to carry out the audit of the financial statements and statement of service performance of the company on her behalf.

We have audited:
- the financial statements of the company on pages 17 to 31, that comprise the statement of financial position as at 30 June 2012, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the period ended on that date and the notes to the financial statements that include accounting policies and other explanatory information; and
- the statement of service performance of the company on pages 9 to 13.
-

Opinion

Financial statements and statement of service performance

In our opinion,
- the financial statements of the company on pages 17 to 31:
    - comply with generally accepted accounting practice in New Zealand;
    - comply with International Financial Reporting Standards; and
    - give a true and fair view of the company's:
        - financial position as at 30 June 2012; and
        - financial performance and cash flows for the period ended on that date; and
- the statement of service performance of the company on pages 9 to 13:
    - complies with generally accepted accounting practice in New Zealand; and
    - gives a true and fair view of the company's service performance achievements measured against the performance targets adopted for the period ended 30 June 2012.

Other legal requirements

In accordance with the Financial Reporting Act 1993 we report that, in our opinion, proper accounting records have been kept by the company as far as appears from an examination of those records.

Our audit was completed on 21 September 2012. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board of Directors and our responsibilities, and explain our independence.

Basis of opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements and statement of service performance are free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements and statement of service performance. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements and statement of service performance whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the company's financial statements and statement of service performance that give a true and fair view of the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Board of Directors;
- the adequacy of all disclosures in the financial statements and statement of service performance; and
- the overall presentation of the financial statements and statement of service performance.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and statement of service performance. In accordance with the Financial Reporting Act 1993, we report that we have obtained all the information and explanations we have required. We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Board of Directors

The Board of Directors is responsible for preparing financial statements and a statement of service performance that:

- comply with generally accepted accounting practice in New Zealand;
- give a true and fair view of the company's financial position, financial performance and cash flows; and
- give a true and fair view of its service performance.

The Board of Directors is also responsible for such internal control as it determines is necessary to enable the preparation of financial statements and a statement of service performance that are free from material misstatement, whether due to fraud or error.

The Board of Directors' responsibilities arise from the Local Government Act 2002 and the Financial Reporting Act 1993.

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001 and section 69 of the Local Government Act 2002.

Independence

When carrying out the audit, we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants.

Other than the audit and accounting policy advisory work, which are compatible with those independence requirements, we have no relationship with or interests in the company.

Graeme Edwards
KPMG
On behalf of the Auditor-General
Wellington, New Zealand

Matters relating to the electronic presentation of the audited financial statements and statement of service performance

This audit report relates to the financial statements and statement of service performance of New Zealand Local Government Funding Agency Limited for the period ended 30 June 2012 included on the New Zealand Local Government Funding Agency Limited's website. New Zealand Local Government Funding Agency Limited's Board of Directors is responsible for the maintenance and integrity of the New Zealand Local Government Funding Agency Limited's website. We have not been engaged to report on the integrity of the New Zealand Local Government Funding Agency Limited's website. We accept no responsibility for any changes that may have occurred to the financial statements and statement of service performance since they were initially presented on the website.

The audit report refers only to the financial statements and statement of service performance named above. It does not provide an opinion on any other information which may have been hyperlinked to or from the financial statements and statement of service performance. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and statement of service performance and the related audit report dated 21 September 2012 to confirm the information included in the audited financial statements and statement of service performance presented on this website.

Legislation in New Zealand governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

Board of Directors

Interests Register

Name of Director	Nature and extent of interest
Craig Stobo (Chair)	General disclosure: Director AMP NZ Office Limited OCG Consulting Limited Elevation Capital Management Limited Saturn Portfolio Management Limited Stobo Group Limited
Paul Anderson	General disclosure: Officer Christchurch City Council General disclosure: Director Ellerslie International Flower Show Limited CCC One Limited Ecocentral Limited Tuam Limited
John Avery	General disclosure: Director The New Zealand Guardian Trust Company Ltd Signify Ltd Spider Tracks Ltd Fund Managers Auckland Ltd Comprehensive Health Services Ltd Regional Facilities Auckland Limited General disclosure: Trustee The New Zealand School of Dance Stinger Trust
Mark Butcher	General disclosure: Officer Office of Auckland Council.
Philip Cory-Wright	General disclosure: Director South Port New Zealand Limited
Abigail Foote	General disclosure: Director Transpower New Zealand Limited General disclosure: Other Gambling Commissioner

Remuneration

Non-Executive Directors	2012 ($)
Craig Stobo (Chair)	127,965 [1]
Paul Anderson	24,792
John Avery	30,625
Mark Butcher	- [2]
Philip Cory-Wright	30,625
Abby Foote	32,366
Total	**246,373** [3]

Staff Total remuneration	Staff Numbers 2012
$140,000 to $149,999	1
$200,000 to $209,999	1
$290,000 to $299,999	1
Total staff receiving $100,000 or more	3

1 Pre-establishment 54,843
Post establishment 43,750
Acting Chief Executive 29,372

2 Director fees for the Auckland Council representative had not been finalised as at balance date. These will be reported in the 2012/13 year.

3 Pre-establishment 75,259
Post establishment 141,742
Acting Chief Executive 29,372