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

# LGFA Quarterly Report to Shareholders

## June Quarter 2021

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# Quarterly Report

Quarter 4: 2020 - 2021
Period ended: 30 June 2021

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## A. June quarter highlights

| Quarter | Total | Bespoke Maturity | April 2022 | April 2023 | April 2024 | April 2025 | April 2026 | April 2027 | April 2029 | May 2031 | April 2033 | April 2037 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bonds issued $m | **970** | N/A | - | - | 80 | - | 40 | - | 120 | 650 | 40 | 40 |
| Term Loans to councils $m | **829.5** | 264.6 | - | 10.7 | 40.0 | 26.0 | 80.5 | 40.5 | 240.5 | 126.7 | - | - |
| Term Loans to councils #. | **86** | 36 | - | 1 | 6 | 5 | 11 | 7 | 17 | 3 | - | - |

| Financial Year to Date | Total | Bespoke Maturity | April 2022 | April 2023 | April 2024 | April 2025 | April 2026 | April 2027 | April 2029 | May 2031 | April 2033 | April 2037 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bonds issued $m | **3,270** | N/A | 450 | 110 | 280 | 60 | 240 | 160 | 480 | 650 | 140 | 700 |
| Term Loans to councils $m | **2,858** | 1022.2 | 6.0 | 59.7 | 90.8 | 138.2 | 409.5 | 224.5 | 723.5 | 126.7 | 4.4 | 50.0 |
| Term Loans to councils #. | **240** | 97 | 2 | 6 | 17 | 23 | 34 | 25 | 30 | 3 | 1 | 1 |

**Key points and highlights for the June quarter:**

- The LGFA bond yield curve flattened significantly over the quarter as markets brought forward estimates of the first tightening in monetary policy. LGFA 2037 bond yields fell 20 bps while the 2024 yields rose 20 bps.
- LGFA issued $970 million of bonds during the quarter across two tenders of $160 million each and a $650 million syndication of a new May 2031 bond. The average term of issuance during the quarter was 9.28 years.
- LGFA borrowing margins were mixed with spreads to swap narrower by 9 bps (2024s through 2026s) and wider by 1 bps (2033s) during the quarter. LGFA spreads to NZGB narrowed between 3 bps (2024s) and 13 bps (2037s) as net issuance of NZGBs began to increase following the RBNZ tapering purchases of NZGBs under the LSAP.
- Long dated lending to councils during the quarter of $829.5 million was more than twice the amount in the previous quarter, while the average term of lending at 6.65 years was longer than the previous quarter's 5.97 years. For the 202-21 financial year LGFA lent $2.858 billion with an average term of 6.65 years.
- LGFA has estimated market share of 81.6% of total council borrowing for the rolling twelve-month period to June 2021 (compared to a historical average since 2012 of 74%).
- Short-term lending to councils has remained unchanged at $287.6 million of loans outstanding on 30 June 2021 to twenty-five councils.
- LGFA Net Operating Gain (unaudited management estimate) for the twelve-month period to 30 June 2021 was $12.007 million which was $1.146 million above budget, comprising total operating income at $892k above budget and expenses at $255k below budget.
- We achieved nine out of our ten performance objectives over the financial year with only our market share outcome below our target.
- After a busy first nine months (where five councils joined) we had no new councils join during the June quarter. We signed the accession documents for our first CCO, but they were delayed at their end unfortunately, so we expect them to accede in July 2021. We are expecting another three councils to join in the 2021-22 year.
- Nick Howell was appointed Head of Sustainability and is in the process of rolling out several sustainability initiatives across the organisation. LGFA received carbonzero certification from Toitu Envirocare on 30 June 2021.

## B. LGFA bond issuance during quarter

LGFA held two bond tenders and one syndication during the quarter amounting to $970 million of issuance.

**Tender 80: 15 April 2021 $160 million**

| Tender 80 - 15 April 2021 | 15-Apr-24 | 15-Apr-26 | 20-Apr-29 | 15-Apr-37 |
|---|---|---|---|---|
| Total Amount Offered ($million) | 40 | 40 | 40 | 40 |
| Total Amount Allocated ($million) | 40 | 40 | 40 | 40 |
| Total Number of Bids Received | 7 | 12 | 18 | 16 |
| Total Amount of Bids Received ($million) | 75 | 145 | 168 | 78 |
| Total Number of Successful Bids | 3 | 3 | 8 | 11 |
| Highest Yield Accepted (%) | 0.740 | 1.275 | 1.925 | 2.835 |
| Lowest Yield Accepted (%) | 0.735 | 1.265 | 1.905 | 2.770 |
| Highest Yield Rejected (%) | 0.765 | 1.310 | 1.970 | 2.860 |
| Lowest Yield Rejected (%) | 0.740 | 1.275 | 1.930 | 2.835 |
| Weighted Average Accepted Yield (%) | 0.739 | 1.274 | 1.918 | 2.805 |
| Weighted Average Rejected Yield (%) | 0.749 | 1.293 | 1.957 | 2.845 |
| Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield* | 77.8 | 77.8 | 100 | 40 |
| Coverage Ratio | 1.88 | 3.63 | 4.20 | 1.95 |
| NZGB Spread at Issue (bps) | 31.00 | 41.00 | 51.00 | 55.00 |
| Swap Spread at Issue (bps) | 10.50 | 19.50 | 29.00 | 50.75 |
| Swap Spread: AA council (bps) | 32.75 | 41.5 | 49.25 | 68 |
| Swap Spread: AA- council (bps) | 37.75 | 46.5 | 54.25 | 73 |
| Swap Spread: A+ council (bps) | 42.75 | 51.5 | 59.25 | 78 |
| Swap Spread: Unrated council (bps) | 52.75 | 61.5 | 69.25 | 88 |
| Coverage Ratio | 1.88 | 3.63 | 4.20 | 1.95 |

The smaller than normal bond tender of $160 million achieved a good outcome with all four tranches well supported and tight pricing achieved. We had held $200 million bond tenders for the previous eleven tenders, so a smaller tender size was welcomed by the market and achieved a higher than usual volume of bids and improved price tension from recent tenders.

We had delayed the tender by a day to avoid the RBNZ Monetary Policy Review but the downside to this deferral was that it coincided with a NZGB tender of $300 million. However the large coupon payments being made on 15th April to investors and lack of high-grade bond supply helped sentiment and ensured a good outcome.

LGFA issuance spreads to swap were 8 bps tighter (2029s and 2037s) and 5 bps tighter on the 2026s compared to the previous March 2021 tender so it was a very strong result for our council borrowers. Outright borrowing yields were also 20 bps lower than the previous tender.

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Bidding volume was good with a coverage ratio of 2.91x compared to the 2.3x average for the previous two years despite the average maturity of the LGFA bonds issued being a lengthy 8.01 years.

While we issued $160 million of LGFA bonds we on-lent $218.7 million to nine councils with an average term of lending to councils of 6.7 years

**Syndication of May 2031 LGFA Bond: 13 May 2021 $650 million**

LGFA successfully issued $650 million (and a further $100 million of treasury stock) of a new 15 May 2031 bond via syndication. Syndication is where we use a group of banks to place bonds with investors rather than use a tender. Market conditions were ideal for the launch of a new long dated maturity with a steep curve and coinciding with the maturity of LGFA and NZGBs on 15 May 2021.

This was the largest ten-year bond issue by a borrower other than the New Zealand Government and was well supported by offshore investors, banks and domestic investors.

We lent $326 million of the proceeds to twenty councils who were refinancing their May 2021 loan maturities although their borrowing term was 7.41 years compared to our issuance term of 10 years.

**Tender 81: 9 June 2021 $160 million**

| Tender 81 - 9 June 2021 | 15-Apr-24 | 20-Apr-29 | 15-Apr-33 |
|---|---|---|---|
| Total Amount Offered ($million) | 40 | 80 | 40 |
| Total Amount Allocated ($million) | 40 | 80 | 40 |
| Total Number of Bids Received | 15 | 22 | 24 |
| Total Amount of Bids Received ($million) | 165 | 195 | 185 |
| Total Number of Successful Bids | 5 | 8 | 6 |
| Highest Yield Accepted (%) | 0.795 | 1.905 | 2.395 |
| Lowest Yield Accepted (%) | 0.775 | 1.875 | 2.390 |
| Highest Yield Rejected (%) | 0.850 | 1.955 | 2.430 |
| Lowest Yield Rejected (%) | 0.795 | 1.905 | 2.395 |
| Weighted Average Accepted Yield (%) | 0.785 | 1.893 | 2.294 |
| Weighted Average Rejected Yield (%) | 0.806 | 1.920 | 2.404 |
| Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield* | 25 | 12.5 | 31.8 |
| Coverage Ratio | 4.13 | 2.44 | 4.63 |
| NZGB Spread at Issue (bps) | 28.50 | 42.00 | 45.50 |
| Swap Spread at Issue (bps) | 5.00 | 23.00 | 36.25 |
| Swap Spread: AA council (bps) | 26.5 | 43.25 | 63.75 |
| Swap Spread: AA- council (bps) | 31.5 | 48.25 | 68.75 |
| Swap Spread: A+ council (bps) | 36.5 | 53.25 | 73.75 |
| Swap Spread: Unrated council (bps) | 46.5 | 63.25 | 83.75 |
| Coverage Ratio | 4.13 | 2.44 | 4.63 |

Given the small size of the bond tender we only issued three tranches, and all tranches were well received. Pricing was tight despite a large amount of competing issuance (more than $6 billion of high-grade bonds) over the previous six weeks.

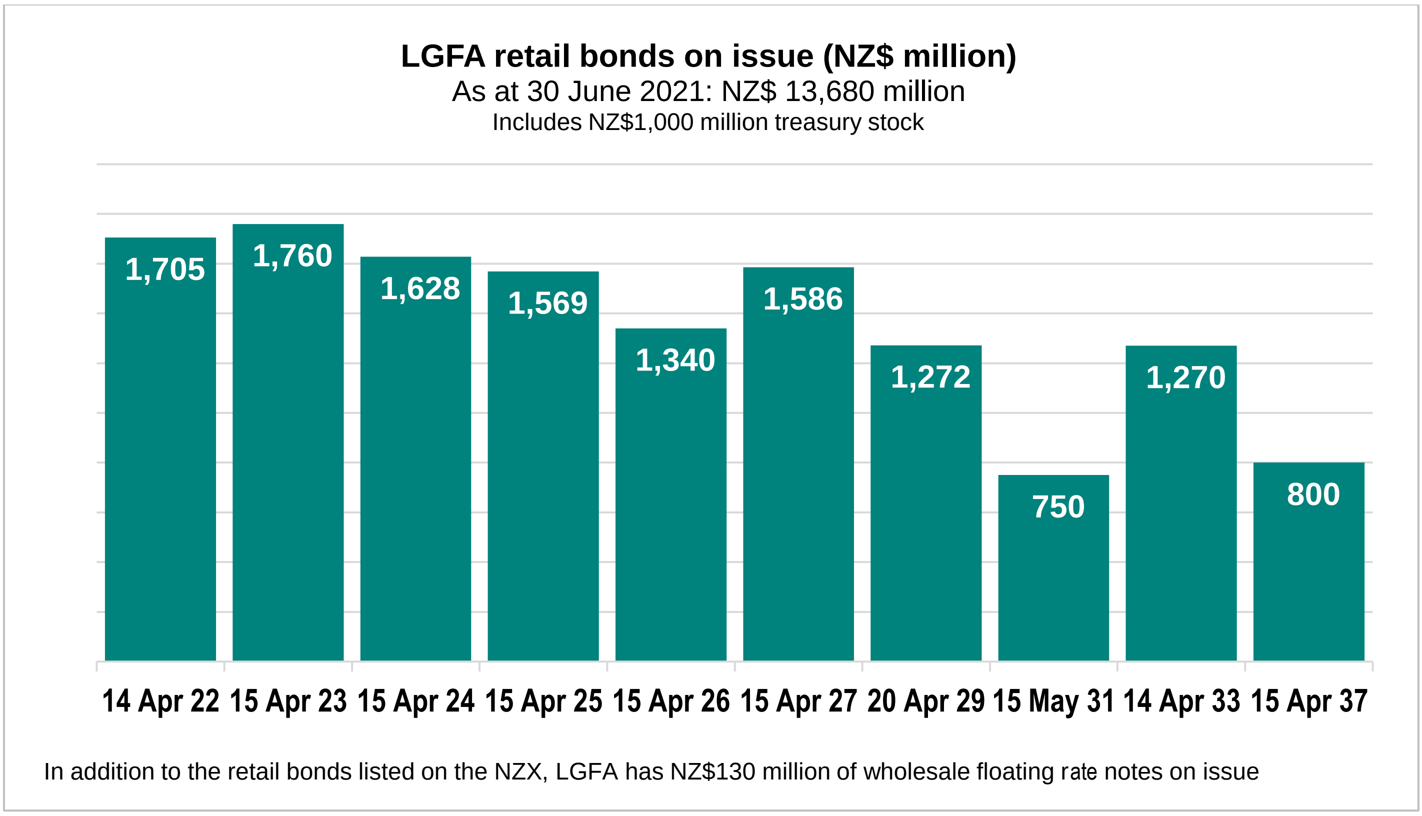
We tendered three tranches to spread the offerings across the curve but also to meet recent demand for 2029s and 2033s from offshore investors.

Price support was strong for all maturities with successful yields 1 bps to 1.5 bps below prevailing mid rates at the time of the tender. Bidding volume was also strong with a coverage ratio of 3.41x which was the second highest coverage over the previous two years and the bid coverage ratios varied between 2.44x (for the larger amount of 2029s) to 4.63x (2033s).

LGFA issuance spreads to swap were 5 bps to 6 bps tighter than the previous April 2021 tender and set new historic lows. Outright yields had been relatively stable over the past two months and were almost unchanged from the April tender.

The average maturity of the LGFA bonds issued was a moderate 7.61 years compared to the average for the 2020-21 financial year of 8.67 years, but this was still longer than the 6.74 years in the prior 2019-20 financial year.

While we issued $160 million of LGFA bonds we on-lent $149.6 million to twelve councils with an average term of lending to councils of 6.72 years (81 months), so our issuance term was again longer than the term of our lending.



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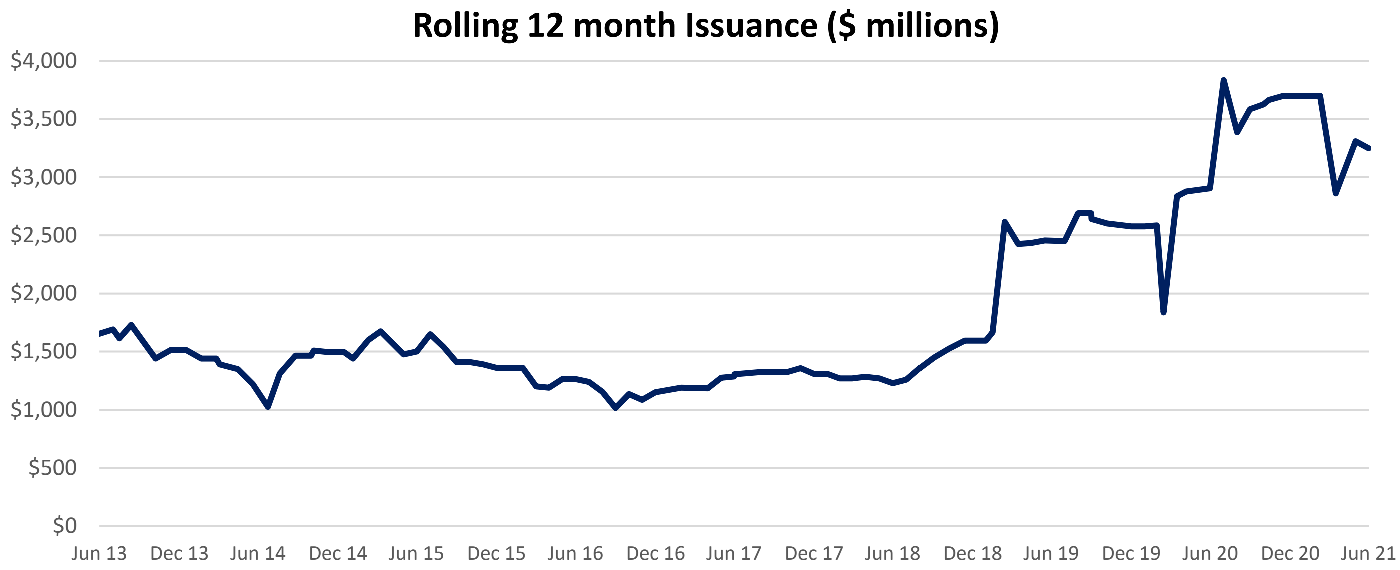
Our issuance volume on a rolling 12-month basis of $3.25 billion remains just below historic high levels and over twice the long-term average.




## C. Summary financial information (provisional and unaudited)

The following results are management estimates only and are unaudited.

| Financial Year ($m) | YTD as at Q1 | YTD as at Q2 | YTD as at Q3 | YTD as at Q4 |
|---|---|---|---|---|
| **Comprehensive income** | **30-Sep-20** | **31-Dec-20** | **31-Mar-21** | **30-June-21** |
| Interest income | 93.38 | 190.41 | 287.12 | 377.22 |
| Interest expense | 82.22 | 180.52 | 271.24 | 357.69 |
| **Net interest revenue** | **4.16** | **9.89** | **15.88** | **19.54** |
| Other operating Income | | | **0.07** | **0.18** |
| **Total operating income** | **4.16** | **9.89** | **15.96** | **19.72** |
| | | | | |
| Issuance and On-lending costs | 0.73 | 1.40 | 1.95 | 2.62 |
| Approved issuer levy | Nil | 0.59 | 0.59 | 1.055 |
| Operating expenses | 0.93 | 1.95 | 2.84 | 4.04 |
| **Issuance and operating expenses** | **1.66** | **3.94** | **5.38** | **7.71** |
| | | | | |
| **Net Profit** | **2.51** | **5.95** | **10.58** | **12.01** |

| Financial position ($m) | 30-Sep-20 | 31-Dec-20 | 31-Mar-21 | 30-Jun-21 |
|---|---|---|---|---|
| Retained earnings + comprehensive income | 60.25 | 63.69 | 68.32 | 69.75 |
| Total assets (nominal) | 13,317.68 | 13,852.05 | 14,285.22 | 13,841.21 |
| Total LG loans (nominal) | 11,906.65 | 12,289.67 | 12,349.38 | 12,029.28 |
| Total LGFA bills (nominal) | 594.50 | 612.50 | 620.00 | 610.00 |
| Total LGFA bonds (nominal) | 12,290.00 | 12,890.00 | 13,290.00 | 12,810.00 |
| Total borrower notes (nominal) | 195.92 | 207.10 | 210.91 | 221.75 |
| Total equity | 85.24 | 88.69 | 93.32 | 94.76 |

# D. Key performance indicators (Section 5 of SOI)

Section 5 of the SOI sets out the ten key performance targets for LGFA.

We met nine out of our ten performance targets with our market share target the only target we missed. Our market share is slightly lower than expected due to Auckland Council, Christchurch City Holdings and Dunedin City Treasury issuing bonds over the past twelve-month period. It should be noted that we increased this target in this year's SOI and we would have exceeded the previous year's lower target.

| Measure | | Prior full year to June 2020 | Q1 30 Sept 2020 | Q2 31 Dec 2020 | Q3 31 Mar 2021 | Q4 30 June 2021 |
|---|---|---|---|---|---|---|
| LGFA net interest income for the period to June 2021 will be greater than $18.8 million | Target ($) | | **$4.6 m (YTD as at Q1)** | **$9.2 m (YTD as at Q2)** | **$14.4 m (YTD as at Q3)** | **$18.8 m (FULL YEAR)** |
| | Actual ($) | $18.28 m | $4.2 m ✗ | $9.9 m ✓ | $15.89 m ✓ | $19.72 m ✓ |
| Annual issuance and operating expenses (excluding AIL) will be less than $6.30 million | Target ($) | | **$1.63 m (YTD as at Q1)** | **$3.4 m (YTD as at Q2)** | **$5.0 m (YTD as at Q3)** | **$6.8 m (FULL YEAR)** |
| | Actual ($) | $6.28 m | $1.65 m On track | $3.35 m ✓ | $4.79 m ✓ | $6.66 m ✓ |
| Total nominal lending (short and long term) to participating councils to be at least $11.66 billion | Target ($) | | **$11.45 b (YTD as at Q1)** | **$12.19 b (YTD as at Q2)** | **$12.62 b (YTD as at Q3)** | **$11.66 b (FULL YEAR)** |
| | Actual ($) | $10.899 b | $11.91 b ✓ | $12.33 b ✓ | $12.35 b On track | $12.04 b ✓ |
| Conduct an annual survey of councils and achieve 85% satisfaction score as to the value added by LGFA to council borrowing activities | Target ($) | | **Annual Survey in August each year** | | | |
| | Actual (%) | 100% | August 2020 survey outcome of 98.8% ✓ | | | |
| Meet all lending requests from PLAs | Target (%) | | **100%** | **100%** | **100%** | **100%** |
| | Actual (%) | 100% | 100% ✓ | 100% ✓ | 100% ✓ | 100% ✓ |
| Achieve 85% market share of all council borrowing in New Zealand | Target (%) Rolling annual average | | **>85%** | **>85%** | **>85%** | **>85%** |
| | Actual (%) | 85.7% | 76.5% ✗ | 81.8% ✗ | 81.8% ✗ | 81.6% ✗ |
| Review each PLA financial position, its headroom under LGFA policies and arrange to | Target (number) | | **Council visits to total 67 over one year**<br>**Financial Position + Headroom Review Undertaken in December Quarter** | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| meet each PLA at least annually | Actual | 31 | no council visits due to COVID travel difficulties ✗ | 22 council visits but behind plan due to COVID travel difficulties ✗ | 35 council visits but behind plan due to COVID travel difficulties ✗ | All council visited ✓ |
| No breaches of Treasury Policy, any regulatory or legislative requirements including H&S | Target (zero breaches) | | **nil** | **nil** | **nil** | **nil** |
| | Actual | Two | Nil ✓ | Nil ✓ | Nil ✓ | Nil ✓ |
| Successfully refinance of existing loans to councils and LGFA bond maturities as they fall due | Target (%) | | **100%** | **100%** | **100%** | **100%** |
| | Actual (%) | 100% | 100% ✓ | 100% ✓ | 100% ✓ | 100% ✓ |
| Maintain a credit rating equal to the New Zealand Government rating where both entities are rated by the same credit rating entity | Target (equivalence) | | **AA+/AA+** | | | |
| | Actual | AA+/AA+ | AA+/AA+ ✓ | AA+/AA+ ✓ | AAA/AA+ ✓ | AAA/AA+ ✓ |

# E. Performance against SOI objectives

## Primary objectives (Section 3 of SOI)

**Primary Objective:**
**LGFA will optimise the debt funding terms and conditions for Participating Borrowers. Among other things, this includes:**

- **Providing interest cost savings relative to alternative sources of financing;**
- **Offering flexible short and long-term lending products that meet Participating Borrowers' borrowing requirements;**
- **Delivering operational best practice and efficiency for its lending services;**
- **Ensuring certainty of access to debt markets, subject always to operating in accordance with sound business practice.**

LGFA lending base margins are 20 bps for all borrowing terms[1]. The base margin covers our operating costs and provides for capital to grow in line with the growth in our balance sheet. There is an additional credit margin added to the base margin depending upon whether a council has a credit rating or is a guarantor or non-guarantor of LGFA.

LGFA continues to borrow at very competitive spreads compared to the AAA rated SSA issuers (who borrow in the New Zealand debt capital markets), the domestic banks and our closest peer issuer Kainga Ora.

[1] On 30 June 2021 LGFA announced a 5-bps reduction in its base margin for all short and long-term maturities to take effect from 1 July 2021.

| As at 30 June 2021 | Comparison to other high- grade issuers - secondary market spread to swap (bps) | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2035 | 2037 |
| LGFA (AA+) | 0 | -1 | 2 | 7 | 13 | 15 | 20 | 25 | 29 | 32 | 36 | 39 | 47 | 51 |
| Kainga Ora (AA+) | | 1 | | 10 | 18 | | 23 | | 30 | | | | 47 | |
| Asian Development Bank (AAA) | | 1 | 4 | 10 | 15 | | 23 | | | 33 | | | | |
| IADB (AAA) | | 0 | 5 | 11 | | | 30 | | | | | | | |
| International Finance Corp (AAA) | | 2 | 5 | 12 | | 20 | | | | | | | | |
| KBN (AAA) | | 2 | 8 | 15 | | | | | 39 | | | | | |
| Rentenbank (AAA) | 1 | 1 | 5 | 13 | | | | | | | | | | |
| World Bank (AAA) | 0 | 1 | 3 | 10 | 16 | 21 | 24 | | 32 | | | | | |
| Nordic Investment Bank (AAA) | | 1 | | 11 | | | | | | | | | | |
| ANZ (AA-) | | 21 | 26 | | | | | | | | | | | |
| BNZ (AA-) | | 16 | | 22 | | | | | | | | | | |
| Westpac Bank (AA-) | 11 | 17 | 32 | 37 | 52 | | | | | | | | | |
| SSA Average | 1 | 1 | 5 | 12 | 16 | 21 | 26 | | 36 | | | | | |
| Bank Average | 11 | 18 | 29 | 30 | | | | | | | | | | |

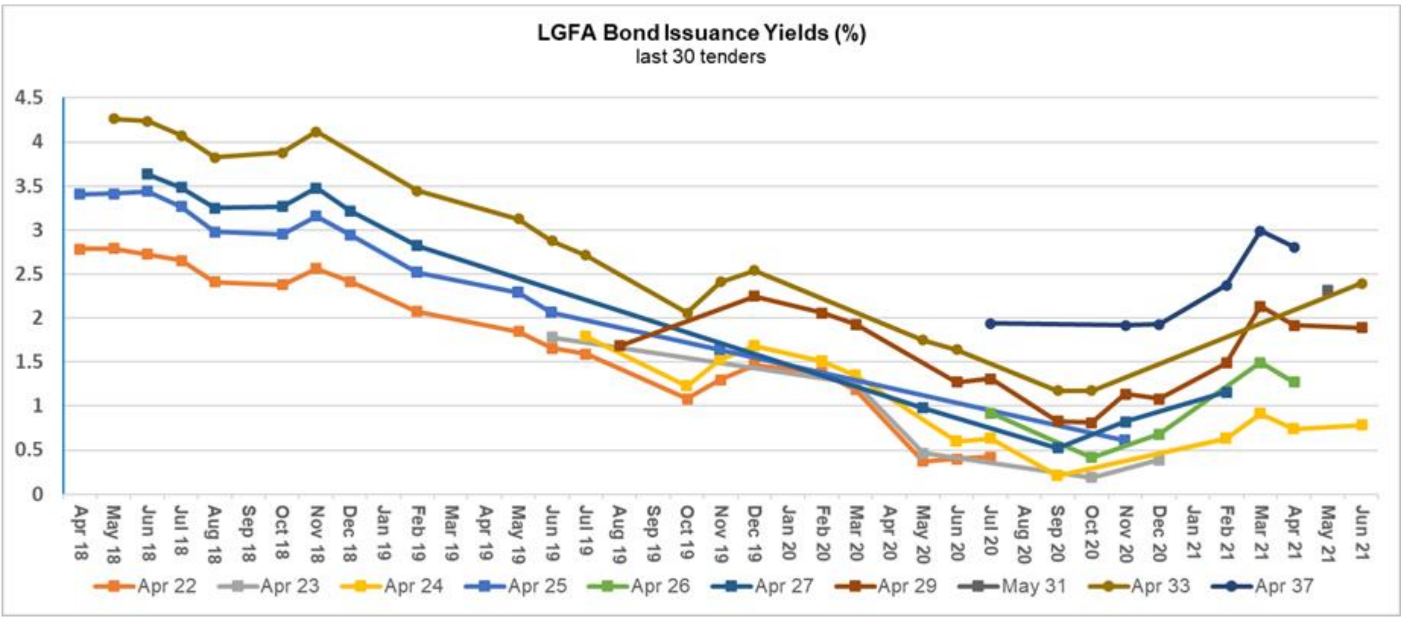
During the quarter LGFA issued a new May 2031 bond maturity by syndication that now bridges the gap between the 2029 and 2033 bonds and provides councils with a new benchmark bond maturity to borrow into. We continued to issue long dated bonds (April 2033s and 2037s) providing councils with the opportunity to extend their borrowing if desired. Both bond tenders were successful.

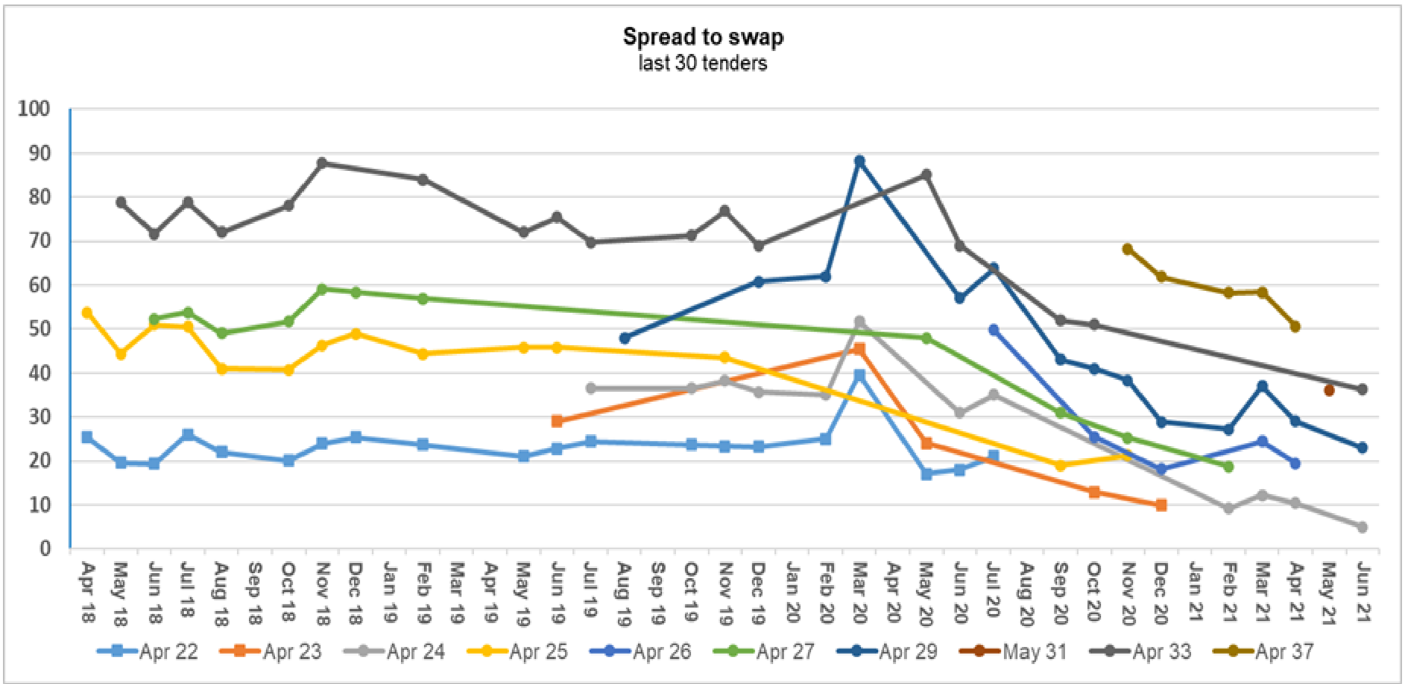
LGFA entered into standby facility agreements of $420 million during the quarter, bringing total standby facilities outstanding to $520 million.

The LGFA bond yield curve flattened over the quarter, reversing the steepening that had occurred over the previous six months. Front end yields (2024s) rose by 20 bps while long dated yields (2037s) fell by 20 bps with the curve pivoting near the 2027s. The curve flattening led by a fall in long end rates was the same movements for global bond markets as most central banks began considering tapering Quantitative Easing and markets began pricing in rate hikes by Central Banks.

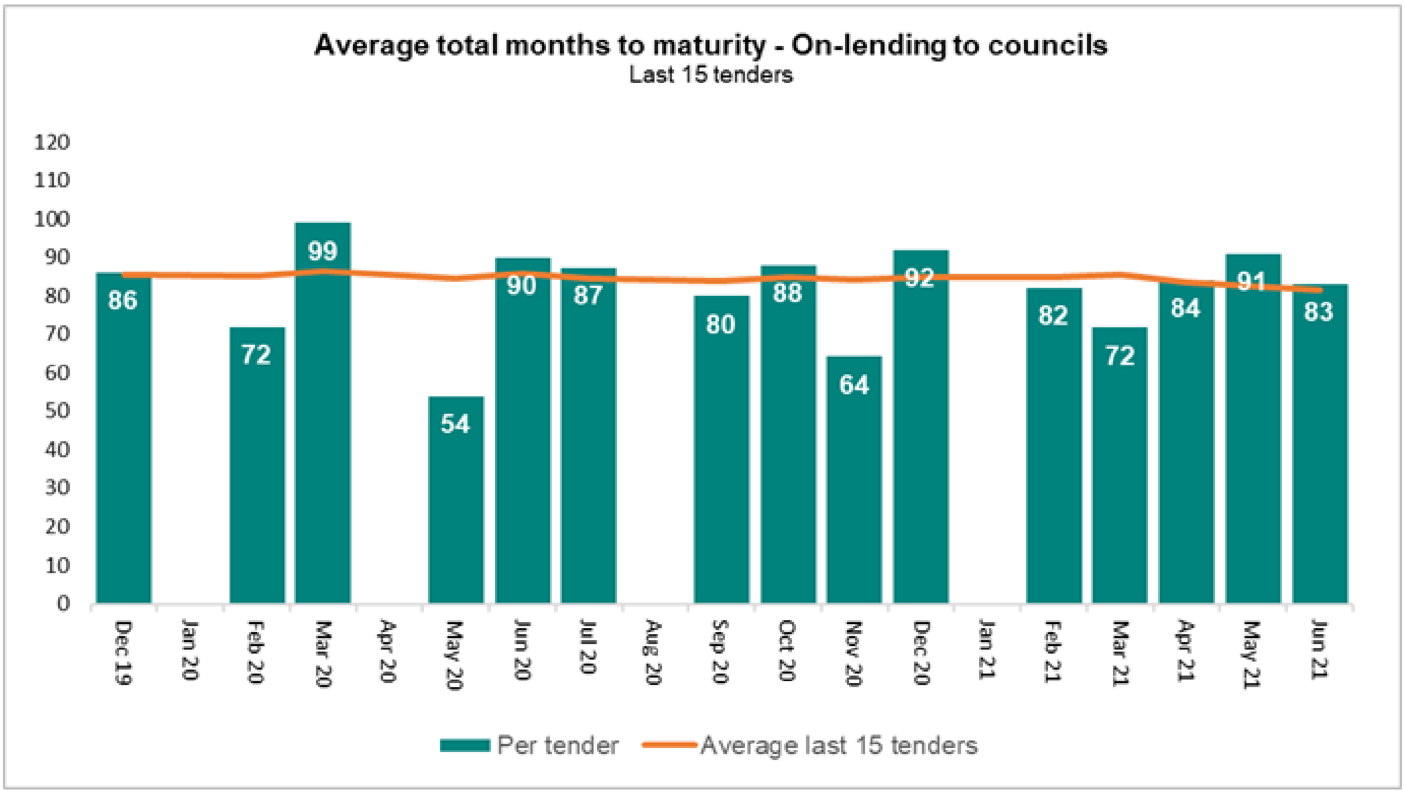
LGFA borrowing margins to swap were mixed with spreads on the 20204 through 2026 maturities narrowing by 9 bps but the spread to swap on the 2037s widened by 1 bps over the quarter. LGFA spreads to NZGB narrowed over the quarter as the RBNZ reduced its weekly purchases of NZGBs bonds through the Large-Scale Asset Purchase (LSAP) programme resulting in net issuance of NZGBs for the first time in over a year.

We closely monitor the Kauri market for ongoing supply and price action as this other high-grade issuance by "AAA" rated Supranational issuers such as the International Finance Corporation (IFC), Inter-American Development Bank (IADB) and the Asian Development Bank (ADB) influences LGFA demand and pricing. These borrowers are our peer issuers in the NZD market and have the most influence on our pricing. The June quarter was a busy period for Kauri bond issuance with $3.025 billion of issuance with maturities ranging from 2 years to 10 years. Both the World Bank and our Norwegian peer agency (KBN) issued $1 billion of bonds each during the quarter. Issuance activity improved on the previous quarters as there were a large amount of maturing Kauri bond issues during the quarter and there had been a smaller than normal amount of issuance the previous quarter.



The average borrowing term (excluding short-dated borrowing) for the March quarter by council members was 5.97 years which was longer than the average term of 5.42 years for the year to June 2020 but shorter than the prior two quarters. Councils for several reasons remain reluctant to borrow beyond ten years despite tight credit spreads.




Short-term borrowing by councils with loan terms of between one month and 12 months remains well supported with $287.6 million outstanding as of 30 June 2021 to twenty-five councils. The number of councils using this product declined by one over the quarter while the total amount outstanding decreased by $10 million.

For LGFA to provide certainty of access to markets for our council borrowers we need to have a vibrant primary and secondary market in LGFA bonds. The primary market is the new issuance market, and we measure strength with participation by investors at our tenders through bid-coverage ratios and successful issuance yield ranges. The secondary market is the trading of LGFA bonds following issuance and a high turnover implies a healthy market.

Activity in LGFA bonds in both the primary market (tender or syndicated issuance) and secondary market (between banks and investors) during the quarter was the second highest on record and just ahead of the March 2021 quarter. There was $970 million of primary issuance and $2.45 billion of secondary market activity in LGFA bonds during the quarter.

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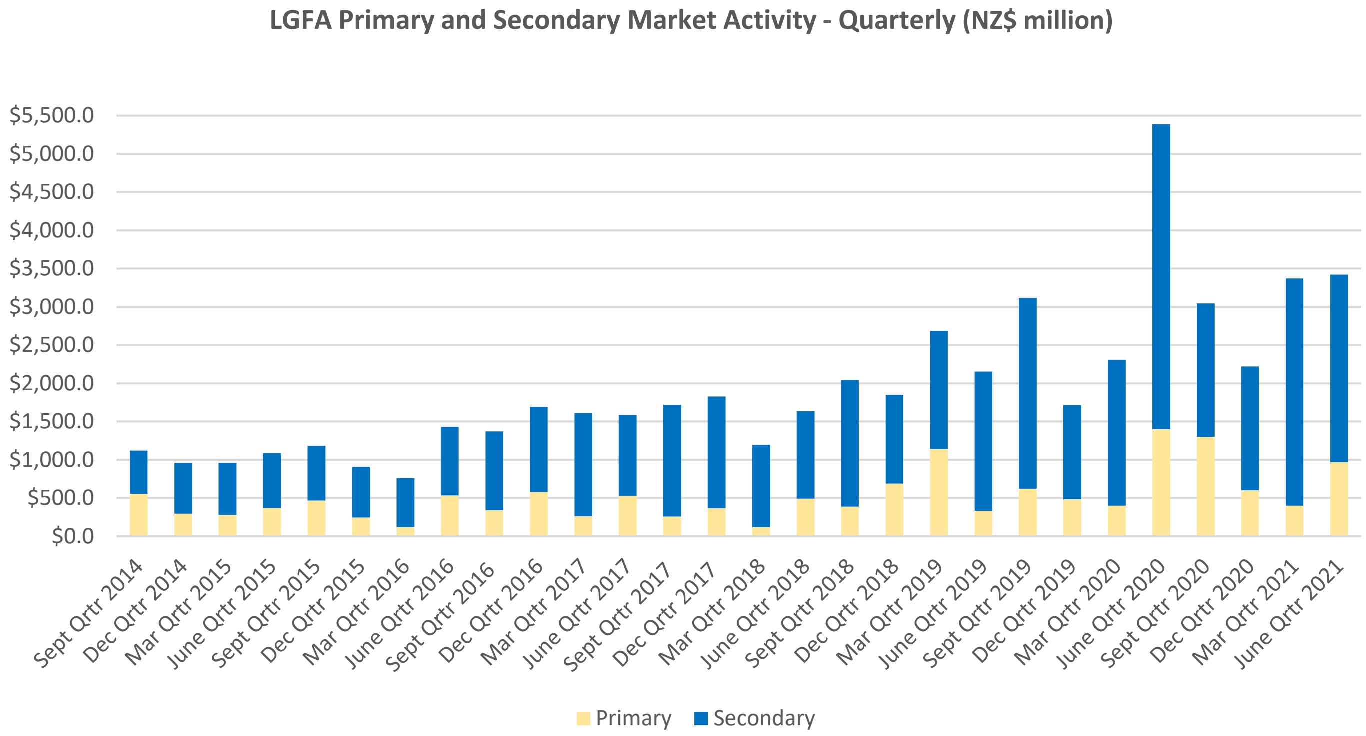
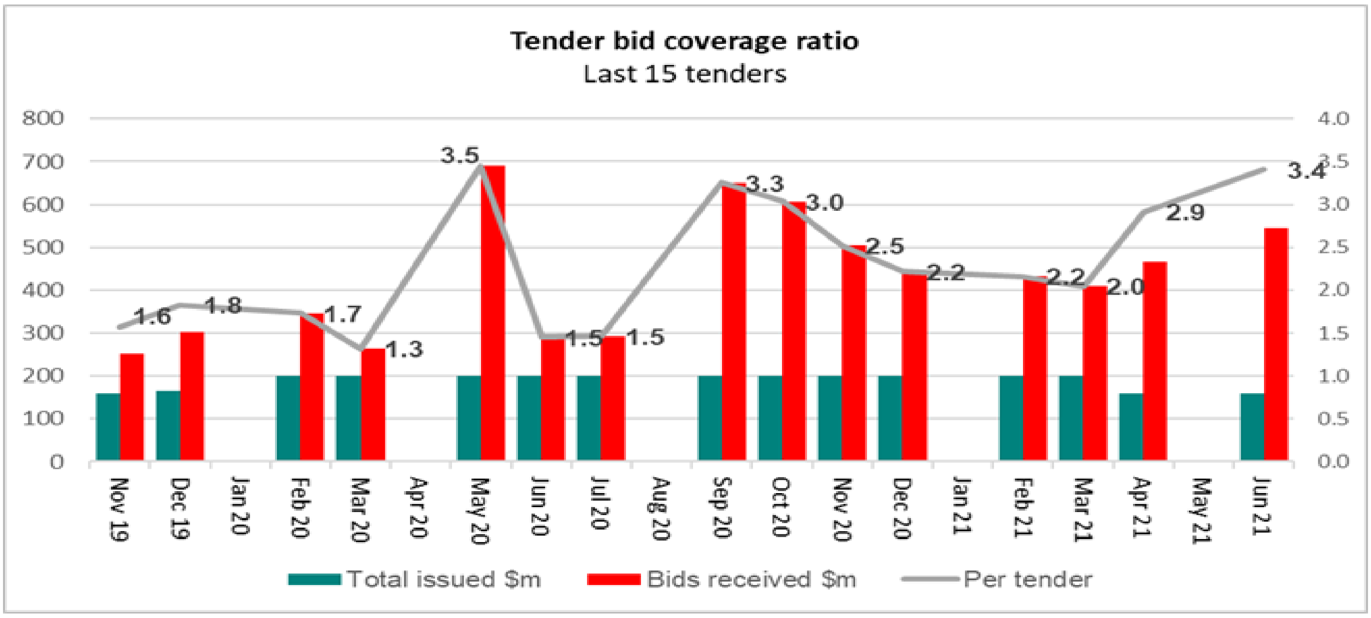



LGFA commenced issuing LGFA Bills and short dated (less than 1 year) lending to councils in late 2015. As at 30 June 2021 there were $610 million of LGFA Bills on issue. We use proceeds from LGFA bills to fund short term lending to councils and invest the balance in our liquid asset portfolio.

LGFA documented an Australian Medium-Term Notes Programme in November 2017. We have no immediate intention to use this programme, but it provides flexibility if there is a market disrupting event in the future.

Over the past quarter we have seen strong support for our bond tenders with higher-than-normal bid coverage ratios.



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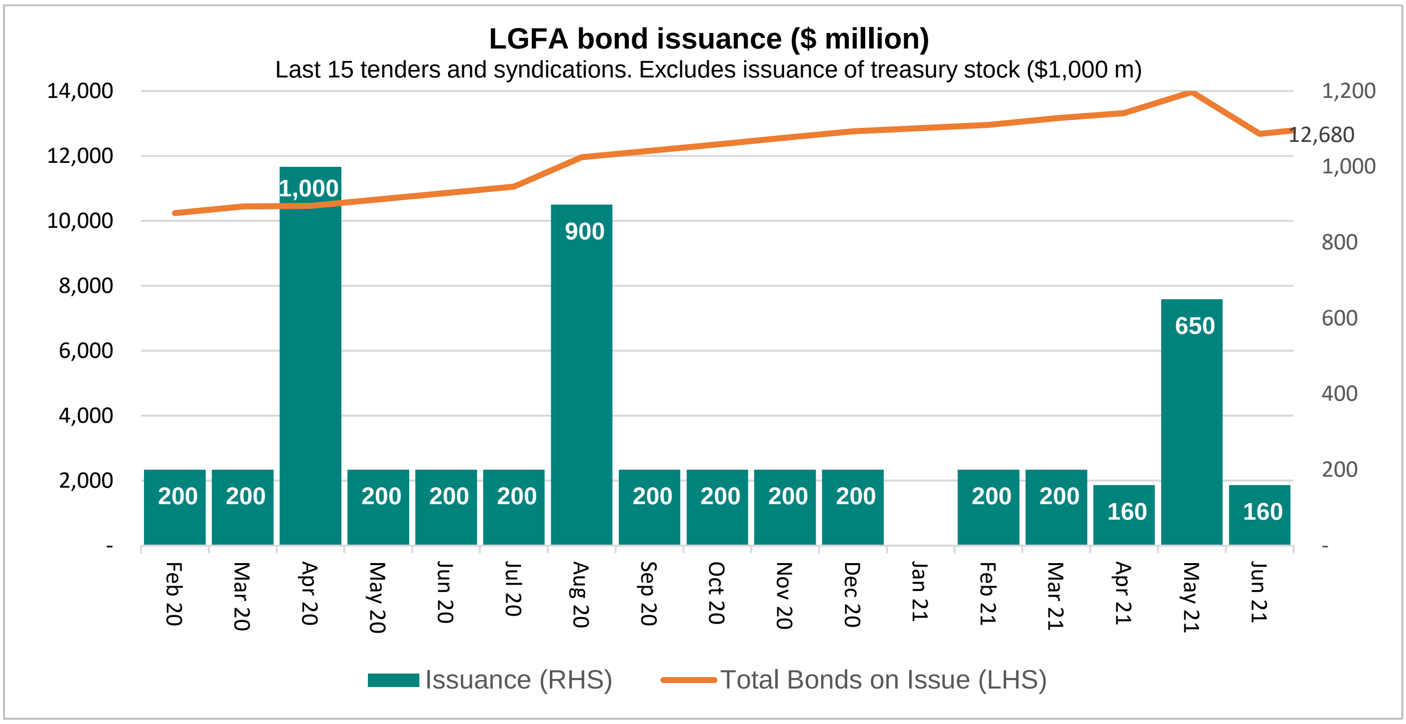



We survey our council members each year on their satisfaction with LGFA and the latest stakeholder survey result in August 2020 was a 99% result to the question "How would you rate LGFA in adding value to your borrowing requirements?". We also received a 97% result to the question "How satisfied are you with the pricing that LGFA has provided to your Council?"

**Primary Objective:**
**LGFA will ensure its asset book remains at a high standard by ensuring it understands each Participating Borrower's financial position, as well as general issues confronting the Local Government sector. Amongst other things, LGFA will:**

- **Proactively monitor and review each Participating Borrower's financial position, including its financial headroom under LGFA policies;**
- **Analyse finances at the Council group level where appropriate and report to shareholders;**
- **Endeavour to visit each Participating Borrower annually, including meeting with elected officials as required, or if requested; and**
- **Take a proactive role to enhance the financial strength and depth of the local government debt market and work with key central government and local government stakeholders on sector and individual council issues.**

We have met with all seventy-two councils over the past fifteen months to June 2021. LGFA continues to review council agendas and management reports on an ongoing basis for those councils on the LGFA borrower watch-list. We have been engaging with councils as they released their Draft and Final Long-Term Plans if we had any concerns with them.

No council has yet to request to LGFA that they be measured on a group basis.

During the quarter, we continued to focus on exploring opportunities in the Green, Social and Sustainable ("GSS") lending to councils. We appointed Nick Howell to a newly created position as Head of Sustainability and Nick is working on introducing a GSS lending programme for councils and establishing a Sustainability Committee within LGFA. LGFA was also certified as carbonzero by Toitu Envirocare on 30 June 2021.

The Board and management met with representatives from Central Government on the proposed water reforms and provided feedback. We held investor conference calls for investors and banks relating to bond issuance and provided updates on the impact on the local government sector from COVID-19. We met with NZTA and NZ Green Investment Finance during the quarter to share ideas on local government sector funding and financing.

We continue to assist the sector and their advisers in finding ways for LGFA to play a supporting role in providing solutions to off balance sheet financing for councils. LGFA continues to provide technical expertise to the proposed Ratepayer Financing Scheme (RFS).

## Additional objectives (Section 3 of SOI)

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

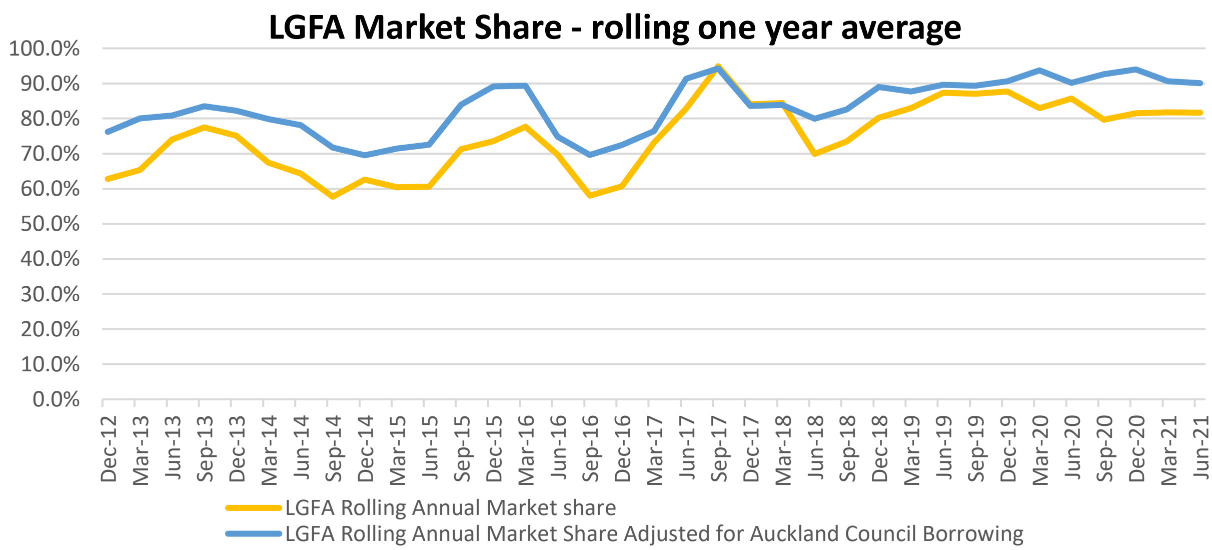
LGFA has an annual review process regarding our credit ratings from Standard and Poor's ("S&P") and Fitch Ratings ("Fitch") and meets with both agencies at least annually.

On 22 February 2021, S&P upgraded our long-term local currency credit rating to AAA and our long-term foreign currency credit rating to AA+. Both ratings are the same as the New Zealand Government.

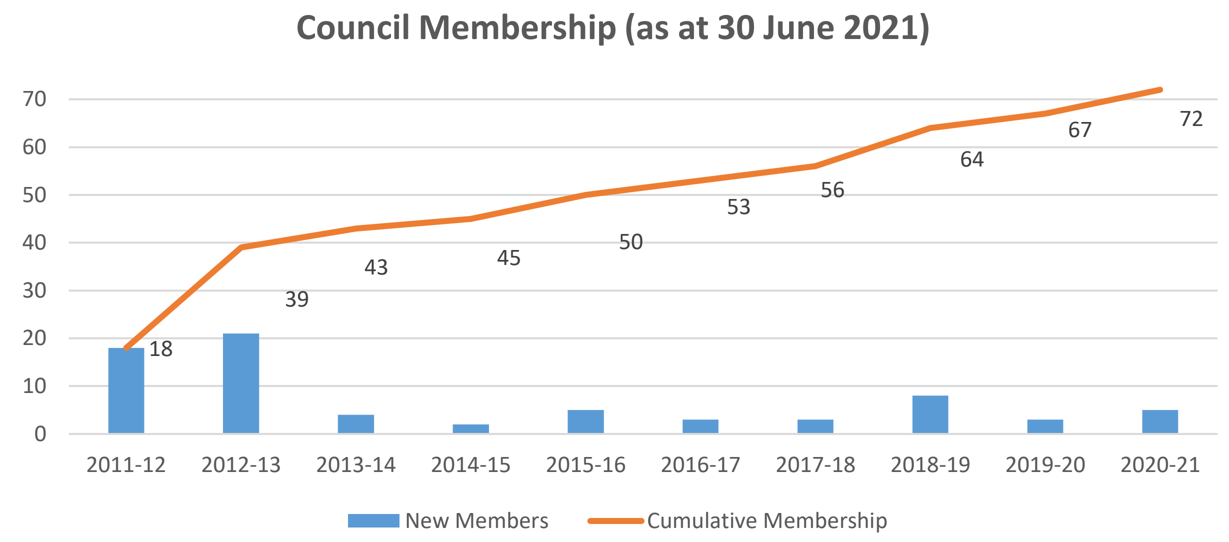
On 28 January 2020 Fitch placed our foreign currency credit rating of AA on positive outlook but left the local currency credit rating unchanged at AA+ with a stable outlook.

**2. Provide at least 85% of aggregate long-term debt funding to the Local Government sector.**

We use the PwC Local Government Debt Report as our source of market share. Our estimated market share for the rolling twelve-month period to 30 June 2021 was 81.6%. If we adjust for Auckland Council borrowing, then it increases to 90.1%. This compares to a historical average of 73.7% and our market share remains high compared to our global peers.



As at 30 June 2021, there are seventy-two participating local authority members of LGFA. No councils joined LGFA during the quarter, but we expect a further three councils to become members in the next twelve months. The number of guarantors remained unchanged at sixty-three.




**3. Achieve the financial forecasts outlined in section 4 for net interest income and operating expenses, including provision for a shareholder dividend payment in accordance with approved dividend policy.**

For the twelve-month period to 30 June 2021, Net Interest Income ("NII") was estimated by management on an unaudited basis to be $708k above budget while expenses are $255k below budget. Net Operating Gain of $12.01 million was $1.15 million above budget.

Included in the NII is the unrealised mark to market movement in fixed rate swaps that are not designated effective for hedge accounting purposes. We have used these swaps to reduce exposure to fixed rate loans made outside of the normal tender process and to reduce mismatches between borrowing and on-lending terms in our balance sheet. The unrealised loss increases as interest rates fall but turns to a profit if interest rates rise. Due to a rise in interest rates since June 2020, the year-to-date revaluation is a profit of $1.19 million.

Expenses for the twelve-month period forecast by management and on an unaudited basis were $7.714 million which is $255k below budget. This variance is the consequence of:

- Issuance and on-lending costs (excluding AIL) at $2.62 million were $90k below budget. A larger amount of bond issuance and short-term lending increased these costs relative to budget, primarily in relation to higher NZX, registry and legal costs. These were offset from lower fees than budgeted relating to the NZ Government Liquidity Facility.

- Operating costs at $4.04 million were $13k below budget due to lower travel and IT consulting costs offset by higher legal and personnel costs relative to budget. We have added two part time staff positions in the past year that were not budgeted for.

- Approved Issuer Levy (AIL) payments of $1.055 million were $152k below budget. We pay AIL on behalf of offshore investors at the time of semi-annual coupon payment for a small number of LGFA bond maturities and offshore investor holdings are slightly below our SOI forecasts.

**4. Meet or exceed the Performance Targets outlined in section 5.**

See Section D on page 6 of this report.

For the financial year ended 30 June 2021 we achieved nine out of the ten performance targets.

**5. Comply with the Health and Safety at Work Act 2015**

LGFA has a Health and Safety staff committee and reporting on Health and Safety issues are made to the LGFA board on a regular basis by the Risk and Compliance Manager. There were no Health and Safety incidents during the quarter.

**6. Comply with Shareholder Foundation Polices and the Board-approved Treasury Policy at all times.**

There were no compliance breaches during the twelve-month period ending 30 June 2021.

**7. Assist the local government sector with their COVID-19 response.**

Shareholders on 30 June 2020 approved a change to the Foundation Policy covenants. For the financial year ending 30 June 2021 the net debt/total revenue covenant for council borrowers with an external credit rating of at least 'A+' has been increased from 250% to 300%. This is to provide short term relief from a temporary reduction in revenue and allows councils to coinvest alongside central Government in infrastructure projects in response to COVID-19

As mentioned previously, LGFA has been contributing expertise to the Ratepayer Financing Scheme project that if successful could offer temporary financial relief to ratepayers via rates postponement.

LGFA has introduced a new lending Standby Facility product that will provide greater certainty of access to emergency funding for councils at a lower cost than going to the traditional bank provider. This has been well supported by councils with $515 million of standbys written with eight councils.

LGFA has extended the longest dated lending maturity for councils from 2033 to 2037 to enable councils to be better match assets with liabilities and to benefit from record lows in interest rates and borrowings spreads.

## F. Investor relations

Managing relations with our investor base is very important as the amount of LGFA bonds on issue has yet to peak and we require investors and banks to support our ongoing tender issuance.

Over the three-month period to 30 June 2021 we issued $970 million of LGFA bonds while the May 2021 LGFA bond maturity of $1.45 billion was repaid. The change in holdings amongst our investor groups during the quarter was

- Offshore investor holdings decreased by $147 million (but increased by $308 million from 30 June 2020) and holdings are estimated to be $3.11 billion on 30 June 2021.
- Domestic bank holdings decreased by $178 million (and down $118 million from 30 June 2020), and holdings are estimated to be $3.72 billion on 30 June 2021.
- Domestic investor (retail and institutional) holdings increased by $78 million (and up $947 million from 30 June 2020), and holdings are estimated to be $4.22 billion as of 30 June 2021.

- The Reserve Bank of New Zealand (RBNZ) reduced their holdings by $216 million over the quarter as the May 2021 bonds matured and held $1.69 billion as of 30 June 2021.

The change in holdings data is distorted by the May 2021 bond maturity with offshore and domestic bank holding a large proportion of this maturity and they did not reinvest all the maturity proceeds into the new ten-year bond (May 2031) on the maturity date. The additional supply of Kauri bonds did however reduce investor demand for LGFA bonds, but LGFA had been the beneficiary of very little Kauri bond issuance in the previous two quarters.