Quarterly Report

Quarter 4: 2019 - 2020
Period ended: 30 June 2020

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

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A. June quarter issuance and highlights summary

Quarter	**Total**	Bespoke Maturity	May 2021	April 2022	April 2023	April 2024	April 2025	April 2026	April 2027	April 2029	April 2033
Bonds issued $m	**1,400**	N/A	-	100	50	60	-	1,000	50	60	80
Term Loans to councils $m	**793.5**	137.7	40.0	257.7	74.0	71.1	70.0	47.0	31.0	65.0	-
Term Loans to councils #.	**71**	18	2	11	9	12	8	6	3	2	-

Year to date	**Total**	Bespoke Maturity	May 2021	April 2022	April 2023	April 2024	April 2025	April 2026	April 2027	April 2029	April 2033
Bonds issued $m	**2,905.0**	N/A	-	445	100	298	30	1,000	50	692	290
Term Loans to councils $m	**2,330.9**	1,161.8	40.0	324.7	90.0	227.1	386.2	91.8	117.0	254.0	24.5
Term Loans to councils #.	**205**	77	2	16	13	30	27	13	13	12	2

Key points and highlights for the June quarter:

- The LGFA bond curve flattened and fell during the quarter with front end yields falling less than back end yields e.g. 2022 yields down 0.64% and 2033 yields down 1.23%. Markets reversed the prior curve steepening as the RBNZ substantially increased its quantitative easing programme to match the forecast increased NZGB issuance and central banks globally committed to keeping interest rates low for as long as it takes to ensure a post COVID-19 economic recovery.
- LGFA issued a record $1.4 billion of bonds across seven maturities during the quarter via two tenders of $200 million and a $1 billion syndication of a new April 2026 bond. The average term of issuance during the quarter of 6.07 years was longer than the previous quarter at 4.79 years; and 6.74 years for the financial year is slightly longer than the average term of 6.62 years for the prior 2018-19 year.
- LGFA margins to swap narrowed between 20 bps (2022s) and a large 79 bps (2033s) over the quarter and reversed almost exactly the widening in the March quarter. Increased NZGB issuance continues to push swap spreads into negative territory relative to NZGB (swap yields below NZGB yields). LGFA spreads to NZGB narrowed between 29 bps (2025s) bps and 57 bps (2033s) again reversing the previous quarters losses.
- Long dated lending to council borrowers during the quarter was the second largest on record at $793.5 million and followed on from the $800.3 million in the March quarter. The average term of lending during the quarter at 3.94 years was shorter than the 2019-20 financial year average of 5.42 years.
- LGFA has estimated market share of 85.7% of total council borrowing for the rolling twelve-month period to June 2020 (compared to a historical average since 2012 of 74%). We provided 89.3% of council borrowing during the quarter.
- Short-term lending remains strongly supported by councils with loans outstanding of $315.5 million as at 30 June 2020. This was a decrease of $145 million over the quarter as councils extended their borrowing into longer tenors or repaid ahead of the 30 June balance date. The number of councils using this product reduced by two to twenty-seven.
- LGFA Net Operating Gain (unaudited) for the twelve-month period to 30 June 2020 was $10.6 million which is $586k above budget, comprising net interest income at $398k above budget and expenses at $188k under budget.
- No new councils joined LGFA during the quarter with the number of councils unchanged at sixty-seven councils. There are fifty-three council guarantors as at 30 June 2020. However, we are expecting a further five councils to join over the next twelve months.

- The Reserve Bank of New Zealand (RBNZ) added LGFA bonds to the Large-Scale Asset Purchase (LSAP) programme on 6 April. As at 30 June the RBNZ had purchased $1.004 billion of LGFA bonds.
- Shareholders approved a change to the Foundation Policy covenant relating to Net Debt/Total Revenue for councils with a single 'A' minimum credit rating at an SGM on 30 June.

B. LGFA bond issuance during quarter

LGFA held two bond tenders and one syndication during the quarter amounting to a record $1.4 billion of issuance.

Syndication of 15 April 2026 Bonds: 9 April 2020 $1 billion

LGFA issued $1 1 billion (including $100 million of treasury stock) of a new 15 April 2026 bond on 9th April to match the settlement of the maturing April 2020 bond. Market conditions were difficult with LGFA being the first non-government issuer to come to market during the COVID crisis. The Reserve Bank of New Zealand had assisted the issue by extending the Large-Scale Asset Purchase (LSAP) programme to LGFA bonds on 6th April.

Tender 71: 6 May 2020 $200 million

Tender 71 - 6 May 2020	14-Apr-22	15-Apr-23	15-Apr-27	14-Apr-33
Total Amount Offered ($million)	50	50	50	50
Total Amount Allocated ($million)	75	50	50	50
Total Number of Bids Received	9	10	18	19
Total Amount of Bids Received ($million)	195	165	170.5	159
Total Number of Successful Bids	3	2	5	4
Highest Yield Accepted (%)	0.375	0.465	0.980	1.750
Lowest Yield Accepted (%)	0.375	0.465	0.970	1.750
Highest Yield Rejected (%)	0.420	0.520	1.045	1.960
Lowest Yield Rejected (%)	0.375	0.465	0.980	1.750
Weighted Average Accepted Yield (%)	0.375	0.465	0.979	1.750
Weighted Average Rejected Yield (%)	0.400	0.488	1.000	1.863
Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield*	76.9	83.3	71.1	78.1
Coverage Ratio	3.90	3.30	3.41	3.18
NZGB Spread at Issue (bps)	24.00	34.00	58.00	94.00
Swap Spread at Issue (bps)	16.50	27.25	58.00	99.75
Swap Spread: AA council (bps)	39	47.25	78	119.75
Swap Spread: AA- council (bps)	44	52.25	83	124.75
Swap Spread: A+ council (bps)	49	57.25	88	129.75
Swap Spread: Unrated council (bps)	59	67.25	98	139.75
Coverage Ratio	3.90	3.30	3.41	3.18

The tender size of $200 million was the same size as the February and March tenders and equal largest since November 2018 and above the historical average tender size ($165 million). Council borrowing demand was the historical lowest amount on record at $21 million as councils had aggressively prefunded during the February-March-April period. Average term of council borrowing was also very short at 4.33 years (52 months).

We tendered four tranches in order to capture as much demand as possible given that the RBNZ had been buying LGFA bonds across the curve through its LSAP. The 2033s were in scarce supply and this was where the strongest demand was at the tender. Price support was strong however for all four maturities e.g. the weighted successful average yield of each bond relative to market was flat (2022s) to 3 bps below market (2033s) so it was one of the better tender results in terms of price tension. Bidding volume was also very strong with the overall bid coverage ratio of 3.45x the highest for over a year and contrasted with the March tender ratio of 1.32x.

The average maturity of the LGFA bonds issued was 6.19 years so the tender was larger in terms of volume and slightly shorter in terms of duration.

Tender 72: 3 June 2020 $200 million

Tender 72 - 3 June 2020	14-Apr-22	15-Apr-24	20-Apr-29	14-Apr-33
Total Amount Offered ($million)	50	60	60	30
Total Amount Allocated ($million)	50	60	60	30
Total Number of Bids Received	7	8	11	15
Total Amount of Bids Received ($million)	79	84	65	63
Total Number of Successful Bids	5	3	10	7
Highest Yield Accepted (%)	0.400	0.595	1.310	1.670
Lowest Yield Accepted (%)	0.390	0.580	1.250	1.570
Highest Yield Rejected (%)	0.410	0.615	1.345	1.735
Lowest Yield Rejected (%)	0.400	0.600	1.345	1.670
Weighted Average Accepted Yield (%)	0.399	0.594	1.272	1.644
Weighted Average Rejected Yield (%)	0.402	0.610	1.345	1.691
Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield*	70.2	100	100	60
Coverage Ratio	1.58	1.40	1.08	2.10
NZGB Spread at Issue (bps)	22.00	27.00	54.00	66.00
Swap Spread at Issue (bps)	17.90	30.90	56.70	69.00
Swap Spread: AA council (bps)	40	53.75	79.25	103.25
Swap Spread: AA- council (bps)	45	58.75	84.25	108.25
Swap Spread: A+ council (bps)	50	63.75	89.25	113.25
Swap Spread: Unrated council (bps)	60	73.75	99.25	123.25
Coverage Ratio	1.58	1.40	1.08	2.10

The tender result was average but was expected given the recent backdrop of additional high-grade bond supply, recent compression in LGFA bond spreads, NZGB remaining relatively expensive on a global basis and a decline in yields to near historic lows. Bidding volumes and price tension were soft for the longer end while issuance yields were just above the historic lows seen in the May tender except for the 2033s which made new lows.

The tender size of $200 million was the same size as the February, March and May tenders and the record $1.4 billion of bonds in the quarter meant that the market had become slightly saturated with LGFA credit as the RBNZ had purchased “only” $804 million under the LSAP. There was also a resurgence in Kauri issuance by “AAA” rated issuers with our Norwegian equivalent agency KBN issuing $250 million of 5-year bonds an hour before our tender. KBN issued 10 bps wider than where we issued. Kauri issuance over the previous month had been $1.365 billion and

Kainga Ora also issued $1 billion of bonds in April so there has been a large amount of high-grade issuance over the past three months.

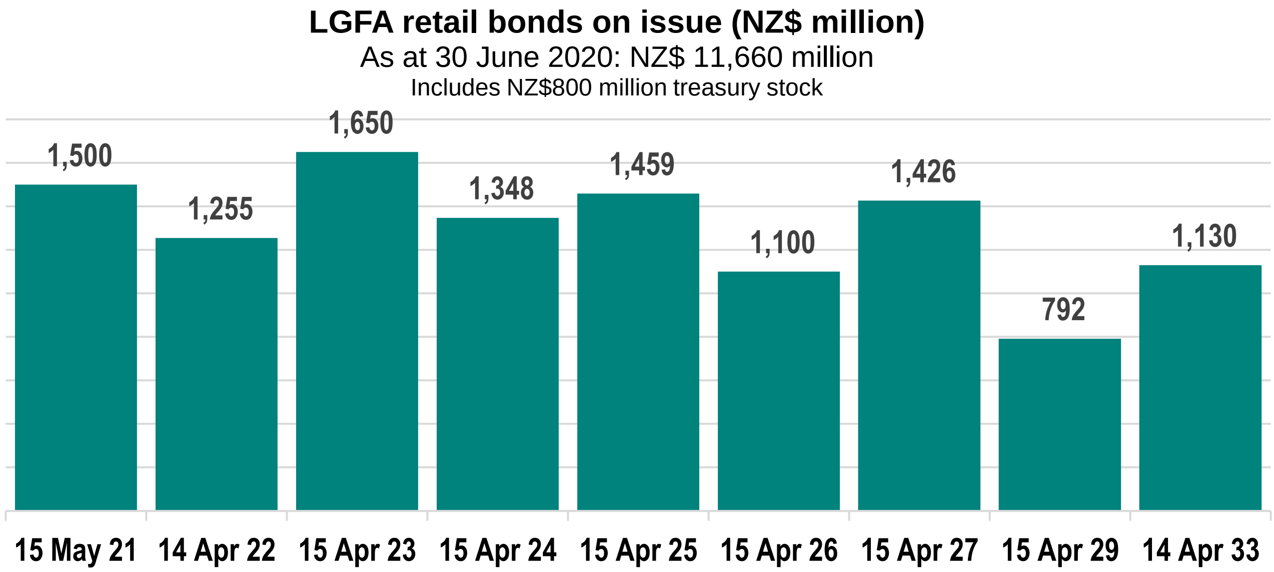
Given the higher volume than normal, we tendered four tranches in order to capture as much demand as possible. Price support was strongest for the 2022 and 2024 maturities with the weighted successful average yield of each bond relative to market 2 bps above mid yields but 6 to 7 bps wider in the 2029s and 2033s.

Bidding volume was modest with the overall bid coverage ratio of 1.46x the second lowest on record (after the March 2020 tender shocker of 1.32x) and contrasted starkly to the 3.5x ratio in May 2020. Successful bid ranges were between 2 bps (2022s) and a wide 10 bps (2033s).

The average maturity of the LGFA bonds issued was 6.22 years compared to the average for the 2019/20 financial year of 6.74 years, so the tender was again larger in terms of volume and slightly shorter in terms of duration.

While we issued $200 million of LGFA bonds we on-lent $153 million to ten councils with the start of the May 2021 loans refinancing and some extending of the tenor of debt from short term to the longer end of the curve. Average term of lending to councils was a longish 7.5 years (90 months).

Bonds on issue including treasury stock of $800 million as at 30 June 2020 was $11.66 billion across nine tranches.



In addition to the retail bonds listed on the NZDX, LGFA has NZ$130 million of Wholesale Floating Rate Notes on issue

C. Key performance indicators (Section 5 of SOI)

Section 5 of the SOI sets out the ten key performance targets

We have met eight out of our ten performance targets. We unfortunately had two minor compliance breaches during the COIVD-19 crisis and did not achieve the council visit target given travel restrictions.

Measure		Prior full year to June 2019	Q1 30 Sept 2019	Q2 31 Dec 2019	Q3 31 Mar 2020	Q4 30 June 2020
LGFA net interest income for the period to June 2020 will be greater than $17.88 million	Target ($)		**$4.79 m (YTD as at Q1)**	**$9.38 m (YTD as at Q2)**	**$14.57 m (YTD as at Q3)**	**$17.88 m (FULL YEAR)**
	Actual ($)	$18.76 m	$4.08 m ✗	$9.81 m ✓	$14.14m ✗	$18.28 m ✓
Annual issuance and operating expenses (excluding AIL) will be less than $6.30 million	Target ($)		**$1.45 m (YTD as at Q1)**	**$3.08 m (YTD as at Q2)**	**$4.70 m (YTD as at Q3)**	**$6.30 m (FULL YEAR)**
	Actual ($)	$5.85 m	$1.47 m ✗	$3.05 ✓	$4.50m ✓	$6.28m ✓
Total lending (short and long term) to participating councils to be at least $9.79 billion	Target ($)		**$9.63 b (YTD as at Q1)**	**$9.90 b (YTD as at Q2)**	**$10.04 b (YTD as at Q3)**	**$9.79 b (FULL YEAR)**
	Actual ($)	$9.26 b	$9.737 b ✓	$10.106 b ✓	$10.658b ✓	$10.899b ✓
Conduct an annual survey of councils and achieve 80% satisfaction score as to the value added by LGFA to council borrowing activities	Target ($)		**Annual Survey in July each year**			
	Actual (%)	80%	July 2019 survey outcome of 100% ✓			
Meet all lending requests from PLAs	Target (%)		**100%**	**100%**	**100%**	**100%**
	Actual (%)	100%	100% ✓	100% ✓	100% ✓	100% ✓
Achieve 75% market share of all council borrowing in New Zealand	Target (%) Rolling annual average		**>75%**	**>75%**	**>75%**	**>75%**
	Actual (%)	87.3%	87.1% ✓	87.7% ✓	83.0% ✓	85.7% ✓
	Target (number)		**Council visits to total 65 over one year**			

Review each PLA financial position, its headroom under LGFA policies and arrange to meet each PLA at least annually			**Financial Position + Headroom Review Undertaken in December Quarter**			
	Actual		2 council visits but on track to achieve annual target In progress	29 council visits year to date and on track to achieve annual target In progress	53 council visits year over past 12 months. In progress	Not be achieved diue to COViD-19 restrictions on visits. 31 councils visits. ✗
No breaches of Treasury Policy, any regulatory or legislative requirements including H&S	Target (zero breaches)		**nil**	**nil**	**nil**	**nil**
	Actual	One	Nil ✓	Nil ✓	Nil ✓	2 breaches ✗
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+ ✓	AA+/AA+ ✓	AA+/AA+ ✓

D. Summary financial information (provisional and unaudited)

Financial Year ($m)	YTD as at Q1	YTD as at Q2	YTD as at Q3	YTD as at Q4
Comprehensive income	**30-Sep-19**	**31-Dec-19**	**31-Mar-20**	**30-June-20**
Interest income	90.86	185.07	278.46	370.22
Interest expense	86.78	175.26	264.75	351.94
Net interest revenue	**4.08**	**9.81**	**13.71**	**18.28**
Issuance and On-lending costs	0.61	1.20	1.79	2.58
Approved issuer levy	Nil	0.65	0.67	1.39
Operating expenses	0.86	1.86	2.71	3.71
Issuance and operating expenses	**1.47**	**3.70**	**5.17**	**7.68**
Net Profit	**2.61**	**6.11**	**8.54**	**10.60**

Financial position ($m)	30-Sep-19	31-Dec-19	31-Mar-20	30-Jun-20
Retained earnings + comprehensive income	50.61	54.10	56.53	58.59
Total assets (nominal)	10,310.80	10,705.14	11,592.31	13,174.37
Total LG loans (nominal)	9,737.23	10,110.90	10,653.28	10,899.75
Total LGFA bills (nominal)	463.00	403.50	635.50	647.5
Total LGFA bonds (nominal)	9,555.00	10,040.00	10,440.00	10,990.00
Total borrower notes (nominal)	148.81	153.31	163.07	168.84
Total equity	75.61	79.10	81.53	83.59

E. Performance against SOI objectives and performance targets

Primary objectives (Section 3 of SOI)

1. Providing savings in annual interest costs for all Participating Local Authorities on a relative basis to other sources of financing

LGFA lending base margins are 20 bps for all borrowing terms between May 2021 and April 2033 following an increase of 10 bps in March. We had previously reduced margins in June 2018 but the LGFA Board decided at its March 2020 Strategy Day to increase capital following its biennial Capital Structure Review. The base margin charge covers our operating costs and provides for our capital to grow in line with the growth in our balance sheet to maintain a satisfactory capital buffer. 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 not a guarantor.

Our estimated annual savings to councils that are based upon the secondary market levels at 30 June 2020 of LGFA bonds compared to bonds issued by Auckland and Dunedin councils are between -4 bps and 10 bps of savings depending upon the term of borrowing. A cautious approach needs to be taken in drawing conclusions from the data as it is based upon an implied level in the secondary market and not on actual issuance costs. LGFA is a constant issuer of debt and the size of debt tranches are also an important factor e.g. the Dunedin 2021 bond is relatively scarce in the market with $70 million on issue compared to $1.55 billion of the comparable LGFA bond. Borrowing margins of all issuers have narrowed over the past quarter but LGFA borrowing margins have moved less than other borrowers due to our large volume of issuance. LGFA bonds are generally priced over New Zealand Government

Bonds (NZGB) and it has been unhelpful that the spread between swap and NZGB has turned negative (swap yields below NZGB yields).

30-Jun-20	**Savings to AA rated councils (bps)**			
	Dunedin 2021	Auckland 2022	Auckland 2025	Dunedin 2026
AA rated councils margin to swap (bps)	36	33	56	75
Less LGFA margin to swap (bps)	-8	-18	-40	-45
LGFA gross funding advantage (bps)	28	15	16	30
Less LGFA base margin (bps)	-20	-20	-20	-20
Total savings (bps) *	8	-5	-4	10

Note that from 30 June 2017 we removed the implied "LGFA effect" of 10 bps of additional savings in borrowing costs from the above analysis. The LGFA effect was the assessment of immediate savings to councils when LGFA first commenced lending to councils in February 2012.

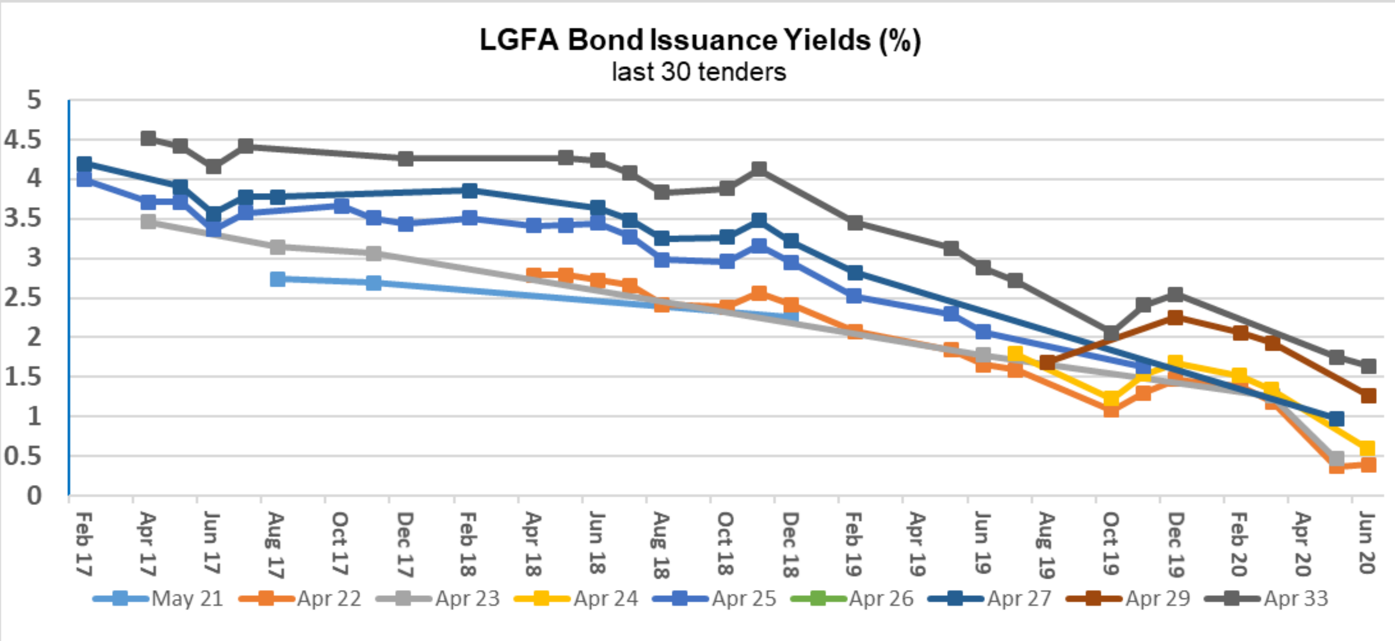
LGFA continues to borrow at very competitive spreads compared to the AAA rated SSA issuers (who borrow in the New Zealand debt capital markets) and to the domestic banks.

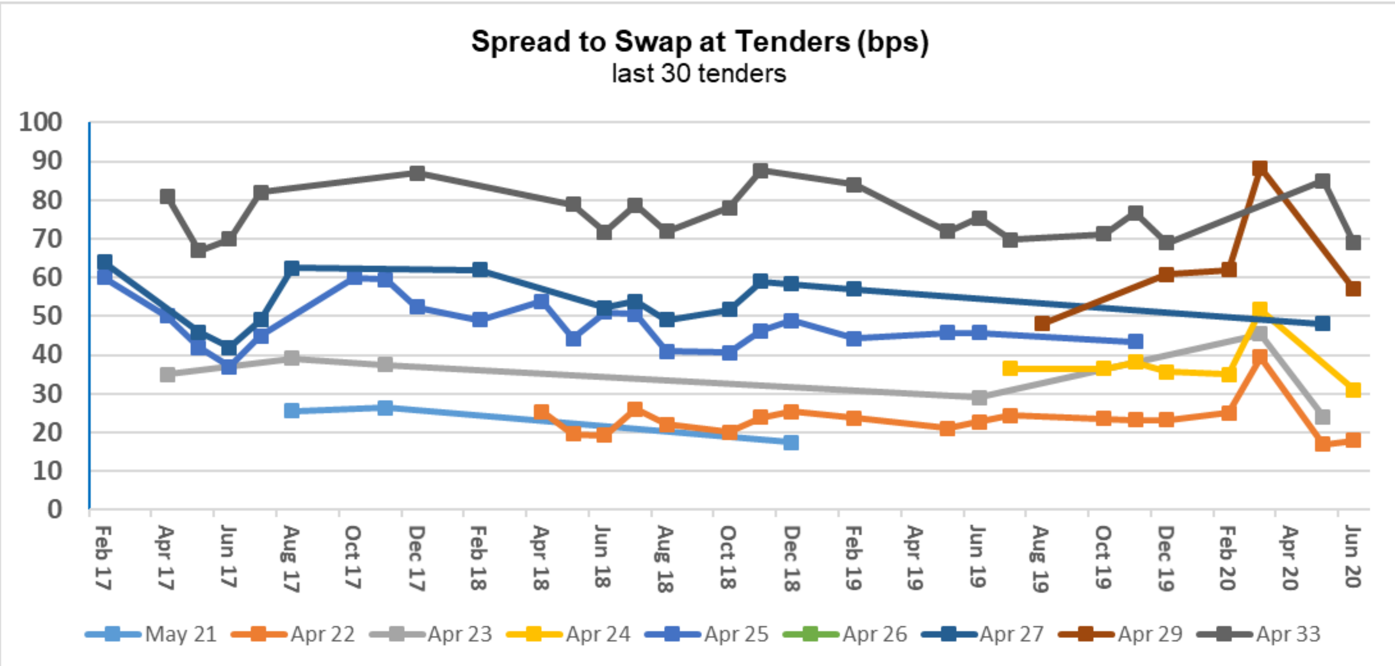
As at 30 June 2020	**Comparison to other borrowers - Secondary Market Spread to Swap (bps)**									
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
LGFA (AA+)	9	18	25	32	40	45	48		57	57
Asian Development Bank (AAA)	15		29	37	42	47				
Inter American Development Bank (AAA)	20		30	39	42			65		
International Finance Corp (AAA)	15		31	39			49			
KBN (AAA)	19		35	39	51					69
Rentenbank (AAA)	17	25	29	39	47					
World Bank (AAA)	11	24	29	38	42					
Nordic Investment Bank (AAA)	11		30		43					
ANZ (AA-)	21		55	63						
BNZ (AA-)			51		73					
Westpac Bank (AA-)		44	53	66	72					

The LGFA bond curve flattened and fell during the quarter with front end yields falling (2022 yields 0.64%) less than the back-end yields (2033 yields down 1.23%). Bond markets reversed the prior quarters curve steepening as the RBNZ substantially increased its quantitative easing programme to match the forecast increased NZGB issuance and central banks globally commit to keeping interest rates low for as long as it takes to ensure a post COVID-19 economic recovery.

LGFA margins to swap narrowed between 20 bps (2022s) and a large 79 bps (2033s) over the quarter and reversed almost exactly the widening in the March quarter. Increased NZGB issuance continues to push swap spreads into negative territory relative to NZGB (swap yields below NZGB yields). LGFA spreads to NZGB narrowed between 29 bps (2025s) bps and 57 bps (2033s) again reversing the previous quarters losses.
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

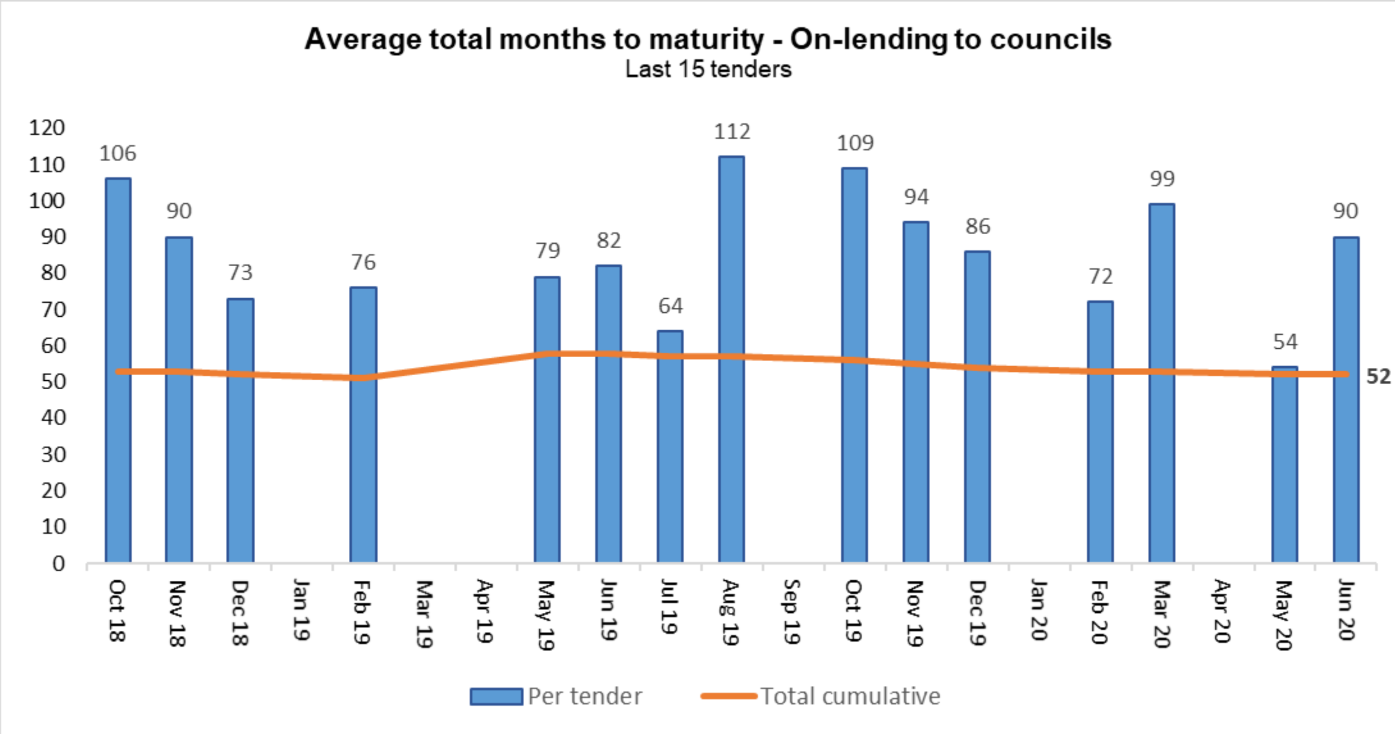
(IADB) and the Asian Development Bank (ADB) influences LGFA demand and pricing. These borrowers are our peer issuers in the NZD market and have the most influence on our pricing. The June quarter was a very busy period for Kauri bond issuance with issuance of $2.615 billion compared to $900 million in the March quarter. Issuance activity increased on renewed investor demand as NZ yields rose above both Australian and US yields and domestic bank balance sheets sought high grade liquid assets.





2. Offering short and long-term borrowings with flexible lending terms

The average borrowing term (excluding short dated borrowing) for the June quarter by council members was 3.94 years and this was shorter than the average term of 5.42 years for the year to June 2020 and 6.0 years average term for the previous 2018-19 year. This reflected the rush by councils to borrow cash for liquidity purposes during the COVID-19 crisis.



Short term borrowing by councils has been well received with loan terms of between one month and 12 months of $315.5 million outstanding as at 30 June 2020 to twenty-seven councils. The small decline in the number of councils using this product (by two) and fall in total amount ($145 million) over the quarter is due to councils extending their term of borrowing beyond one year given the low underlying level of interest rates and the seasonality of council borrowing resulting in lower debt levels.

3. Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice

LGFA bonds were listed on the NZX Debt Market in November 2015 and average turnover on the NZX Debt market has been $11.1 million per month or 8.3% of the total turnover of the NZX Debt Market. Turnover on the NZX remains light as retail investors are more attracted to high term deposit rates and higher yielding bond issues by lower credit quality borrowers. We have however noticed an increase in volume over the past six months (averaging $15.3 million per month) and this is due to the lack of retail bond issuance by corporate borrowers in NZD during this time period.

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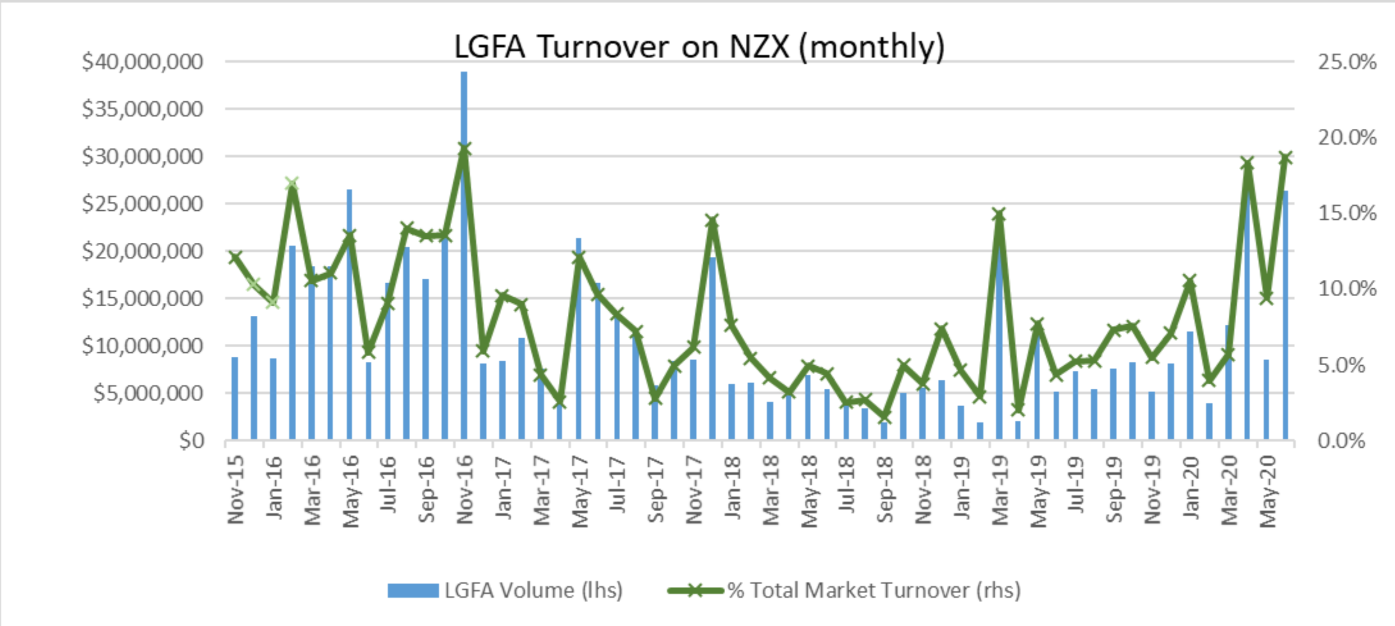
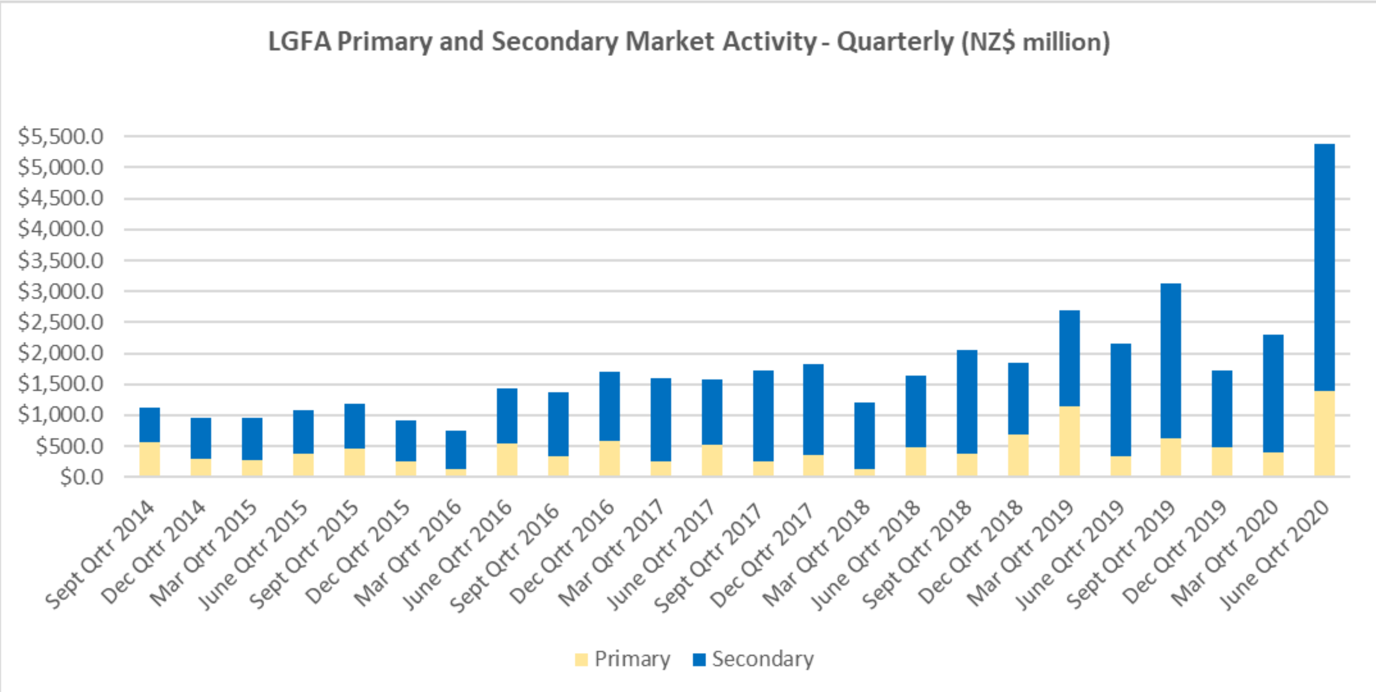
TE PŪTEA KĀWANATANGA Ā-ROHE



Activity in LGFA bonds in both the primary market (tender or syndicated issuance) and secondary market (between banks and investors) during the quarter set a record of $5.4 billion and was 1.7 times the previous record quarter in September 2019. There was $1.4 billion of primary issuance and we estimate there was $3.99 billion of secondary market activity in LGFA bonds during the quarter.



LGFA started issuing LGFA Bills and short dated (less than 1 year) lending to councils in late 2015. As at 30 June 2020 there were LGFA Bills of $647.5 million on issue and short-term council loans of $315.5 million.

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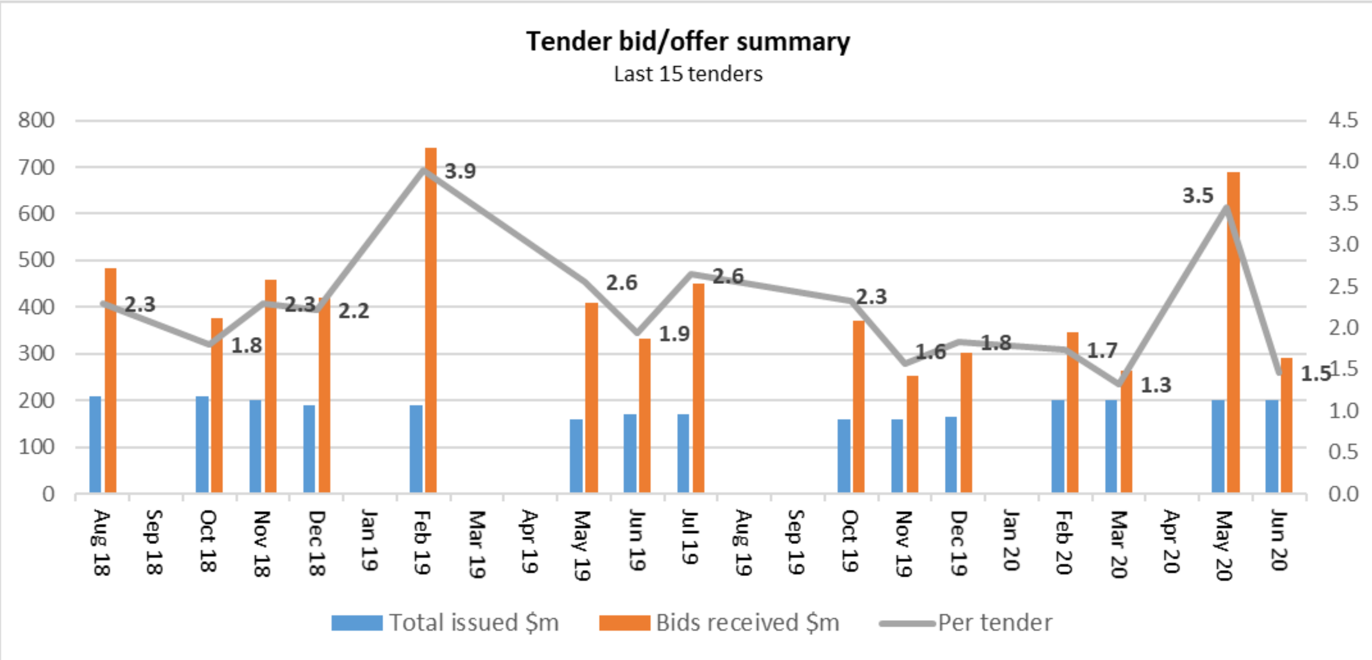
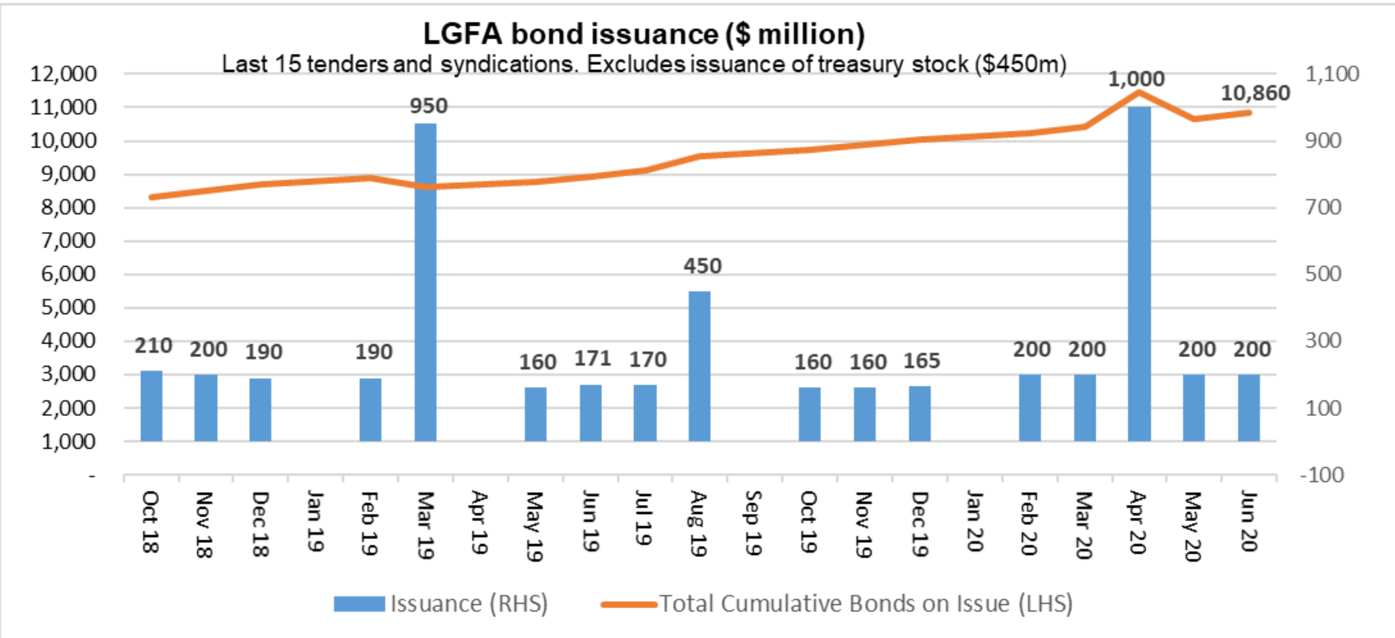
LGFA documented an Australian Medium-Term Notes Programme in November 2017 and we have refreshed the programme documents in March 2020. We have no immediate intention to use this programme, but it provides flexibility if there is a significant market disrupting event in the future.

We issued a record $1.4 billion of bonds during the quarter with one syndication and two LGFA bond tenders. Market support was mixed with a positive syndication outcome (achieving the largest non-Central-Government single tranche issue in NZD) and a strong May tender result, but the June bond tender was poor. The impact from the RBNZ adding LGFA bonds to its Large-Scale Asset Purchase (LSAP) programme was positive but the large amount of Kauri bond and Kainga Ora bond issuances was negative.





4. Being the debt funder of choice for New Zealand local government

We use the Local Government Debt Report compiled by PwC as our source of market share. Our estimated market share of council borrowing for the June quarter was 89.3% and for the rolling twelve-month period to 30 June 2020 was 85.7%. This compares to a historical average since 2012 of 73.7%.

We survey our council members each year and the latest stakeholder survey result in July 2019 was a 100% result to the question "How would you rate LGFA in adding value to your borrowing requirements?". We also received a 99% result to the question "How satisfied are you with the pricing that LGFA has provided to your Council?"

5. LGFA will monitor the quality of the asset book so that it remains of a high standard by ensuring it understands each Participating Local Authority's financial position and the general issues confronting the Local Government sector. This includes

(i) LGFA will review each Participating Local Authority's financial position, its financial headroom under LGFA policies and endeavour to visit each Participating Local Authority on an annual basis
(ii) Implement the changes to the Foundation Policies that were approved at the November 2018 AGM to allow for lending to CCOs. Changes to operational policies and practices need to ensure that no additional risk is borne by lenders, guarantors or the Crown and
(iii) LGFA will analyse finances at the Council group level where appropriate and report to the Shareholder Council and shareholders as to which Participating Local Authorities are measured on a group basis.

Travel restrictions due to the COVID-19 shutdown restricted our ability to meet with councils during the quarter although we did have thirty-eight visits to thirty-one different councils for the twelve-month period to June 2020 to discuss their financial performance and any developments with the underlying council operations. LGFA reviews council agendas and management reports on an ongoing basis for those councils on the LGFA borrower watch-list.

At the November 2019 AGM, shareholders approved the changes to the Shareholder Agreement, Notes Subscription Agreement ("NSA"), Multi Issuer Deed ("MID") and Guarantee and Indemnity Deed ("GID") and Foundation Policies to allow for lending to CCOs and to offer standby facilities. The Borrower Notes percentage will also rise from 1.6% to 2.5% and this will help improve our capital position. The NSA, MID and GID are currently with our sixty-seven council members for signing (where relevant) which is required before we can rollout these products[1].

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

6. LGFA will take a proactive role to enhance the financial strength and depth of local government debt market and work with key central government and local government stakeholders on sector and individual council issues

During the quarter, LGFA management had virtual meetings with representatives from Treasury, Reserve Bank of New Zealand, OECD, banks and Department of Internal Affairs. We held two conference calls for investors and banks relating to bond issuance and provided updates on the likely impact on the local government sector from COVID-19.

We continue to assist the sector and the advisers in finding ways for LGFA to play a supporting role in providing solutions to off balance sheet financing for councils. We are currently providing technical input into the Cameron Partners Ratepayer Financing Scheme (RFS).

[1] Subsequent to the end of the June quarter we have successfully completed the signing of the Amendment Deeds to these documents on 6 July 2020.

LGFA has been a member of the Department of Internal Affairs led workstream on assessing the impact of COVID-19 on council finances.

We are currently finalising the terms of the extension to the Crown liquidity facility that is due to expire in December 2021 with Treasury. The Minister of Finance expressed the Crown's commitment to extend this in late March.

A Special General Meeting (SGM) of shareholders on 30 June passed a resolution to relax the Net Debt / Total Revenue covenant within the Foundation Policies for those councils with a minimum credit rating of "A". The change was made to allow councils some additional financial flexibility in dealing with the COVID-19 crisis and to allow councils to co-invest alongside Central Government to pursue an infrastructure led growth recovery response to the crisis. LGFA assessed the impact on guarantors to be negligible and had consulted with stakeholders including investors, banks and credit rating agencies.

Additional objectives (Section 3 of SOI)

7. Operate with a view to making a profit sufficient to pay a dividend in accordance with its stated Dividend Policy

LGFA's Net Operating Gain on an unaudited management account basis was $10.60 million for the financial year. The average cost of funds for the twelve-month period was 1.51%. This is lower than the 2.78% for the prior 2018-19 financial year due to the lower outright level of interest rates. The LGFA Board has the sole discretion to set the dividend.

8. Provide at least 75% of aggregate long-term debt funding for Participating Local Authorities

We use the Local Government Debt Report compiled by PwC as our source of market share. Our estimated market share of council borrowing for the rolling twelve-month period to 30 June 2020 was 85.7%. This compares to a historical average since 2012 of 73.7% and our market share remains strong compared to our global peers.

As at 30 June 2020, there are sixty-seven participating local authority members of LGFA. This was unchanged over the quarter but an increase of three from a year ago. We estimate a further five councils could become members in the next twelve months.

9. Achieve the financial forecasts (excluding the impact of AIL) set out in Section 4

For the twelve-month period to 30 June 2020, Net Interest Income ("NII") was estimated by management on an unaudited basis to be $398k above budget while expenses are $188k below budget. Net Operating Gain of $10.60 million was $586k 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 and the year to date revaluation is a loss of $1.3 million.

10. Ensure its products and services are delivered at a cost that does not exceed the forecast for issuance and operating expenses

Expenses for the twelve-month period on an unaudited basis were $7.677 million which is $188k below budget. This variance is the consequence of:

- Issuance and on-lending costs (excluding AIL) at $2.575 million were $133k above budget. A larger amount of bond issuance and short-term lending increased these costs relative to budget, primarily in relation to higher NZX costs and legal costs. These were offset to some extent from lower fees than budgeted relating to the NZDM facility.

- Operating costs at $3.705 million were $150k below budget due to lower IT, personnel, travel and general overhead costs offset by slightly higher legal costs relative to budget.

- Approved Issuer Levy (AIL) payments of $1.396k were $172k below SOI forecast. We pay AIL on behalf of offshore investors at the time of semi-annual coupon payment. During the twelve-month period, offshore investor holdings of LGFA bonds were less than forecast.

11. Take appropriate steps to ensure compliance 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. LGFA staff made a seamless transition to a work from home environment in late March as the country moved beyond Level 2 in the COVID-19 response and returned to offices under Level 1.

12. 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. Formal review meetings were last held in November 2019 with S&P and in September 2019 with Fitch.

On 28 February, S&P affirmed our long-term local currency credit rating as AA+ and our long-term foreign currency credit rating of AA. Both ratings remained on positive outlook. Both credit ratings and outlook are the same as the New Zealand Government

On 18 November 2019, Fitch reaffirmed our long-term local currency credit rating as AA+ and classified LGFA as a corporate mission, government related entity (GRE) under its GRE rating criteria. Fitch equalises our ratings with those of the New Zealand Government. On 28 January 2020 Fitch placed our foreign currency credit rating of AA on positive outlook. Fitch left the local currency credit rating unchanged at AA+ with a stable outlook.

13. Introduce CCO lending by December 2019 and report quarterly, the volume of lending to CCOs to both the Shareholder Council and shareholders

Council members approved the amendments to the Shareholder Agreement, Notes Subscription Agreement ("NSA"), Multi Issuer Deed ("MID"), Guarantee and Indemnity Deed ("GID") and Foundation Policies to allow for lending to CCOs on 6 July. This was delayed from the end of 2019 due to the need to have the changes initially approved by shareholders at the November 2019 AGM and then by the COVID-19 disruptions. We expect to undertake our first loan to a CCO by December.

14. Comply with its Treasury Policy as approved by the Board

Policy	Limit	Policy page ref	Continuous Compliance
One-month Liquidity Monitor	>120%	S1-1.1	Yes
Three Month Liquidity Monitor	>110%	S1-1.2	Yes
Twelve Month Liquidity Monitor	>110%	S1-1.3	Yes
Council Exposure (any 12-month period)	<10% of Balance Sheet	S1-1.5	Yes
Liquidity Buffer	>110%	S1-1.4	Yes
Partial Differential Hedge (PDH Interest Rate Gap Report	$40,000	S3-4.1	Yes
Value at Risk (VaR)	$250,000	S3-4.2	Yes
Council Maturity (any 12-month period)	$100m or 33% of LGFA borrowing	S1-1.6	No
Funding Largest Council Exposure	>100%	S1-1.7	Yes
Foreign Exchange Exposure	Nil	S7-3.1	Yes
NZDMO Facility Utilisation	Report monthly	S8-8.5	Yes
Counterparty Credit Limits	80% of Portfolio $125m Counterparty (category 3)	S4	Yes
Auckland Council Exposure (proportion of total Council exposure)	<40%	S1-1.8	Yes
Balance Sheet Maturity Mismatch	<15% of Balance Sheet	S2-2.1	Yes
Financial Covenants	Various (as set out on p13)	S9	Yes
Authorising Treasury transactions	Two approvers, one signature	S8-8.4	Yes

There were two compliance breaches during the three-month period ending 30 June 2020.

Breach One:
All council lending is subject to a Foundation Policy limit where a council borrowing can be “No more than the greater of NZ100 million or 33% of a Local Authority’s borrowings from the Company will mature in any 12-month period”.

On 14 April a breach occurred when a council borrowed $25 million with a loan maturity of 14 April 2022. This increased their total borrowing to $100.9 million across a rolling one-year period, exceeding the $100 million limit and/or 33% limit. This breach occurred due to human error when LGFA was operating in BCP due to COVID19 lockdown. The breach was identified when the End of Day Compliance reports were run and the LGFA Board were notified on 15 April. The breach was rectified on 15 April and the Shareholder Council was notified on 16 April.

There was no financial loss to LGFA, and reputational risk was assessed to be minimal.

Breach Two:
All category two assets in the Liquid Assets Portfolio cannot exceed a maturity limit of 3 years to maturity from settlement date. This is a Foundation Policy limit.

The breach occurred with the purchase of $20 million of a 12/6/2023 Kainga Ora Bond on 17 April and the breach occurred due to human error when LGFA was operating in BCP mode due to the COVID19 level 4 lockdown. The bond purchased was a category two asset with a maturity of 3.14 years from settlement date. The breach was identified on 17 April and the LGFA Board were notified on the same day. The breach was discussed by the LGFA Board on 22 April and the breach was rectified on 23 April.

There was no financial loss to LGFA, and reputational risk was assessed to be minimal.

Formal review of both breaches
A formal review of both breaches was led by the Chair of the Audit and Risk Committee. LGFA management have reviewed pre-dealing controls that could be put in place to reduce the possibility of further breaches.

F. Investor relations / outlook

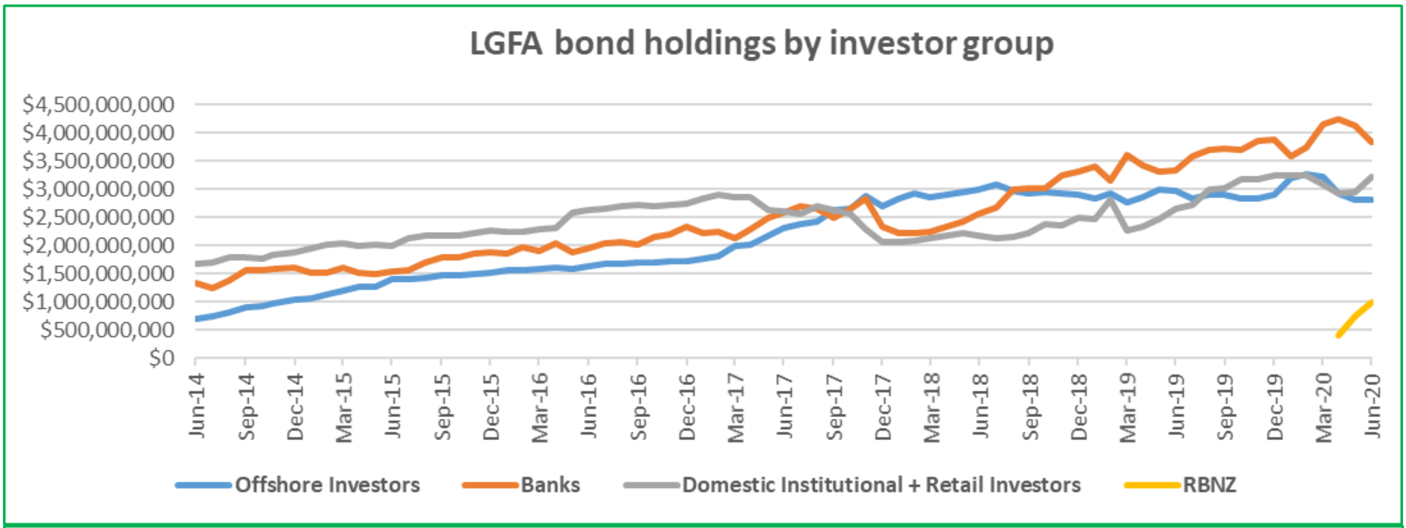
Managing relations with our investor base is very important as the amount of LGFA bonds on issue has yet to peak and we require investors and banks to support our ongoing tender issuance.

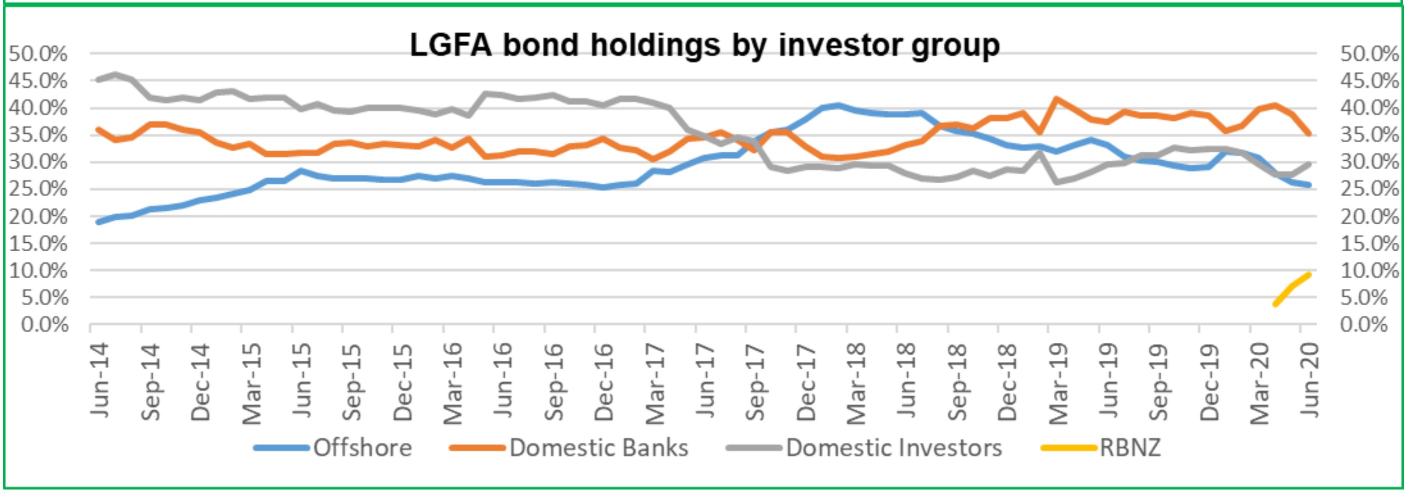
Over the past three months to 30 June we issued $1.4 billion of LGFA bonds and there were maturities of $1.05 billion. The change in holdings amongst our investor groups during that time were

- Offshore investor holdings decreased by $414 million (down by $164 million from 30 June 2019) and are estimated to hold $2.81 billion as at 30 June 2020
- Domestic bank holdings decreased by $315 million (up $491 million from 30 June 2019) and are estimated to hold $3.84 billion as at 30 June 2020
- Domestic institutional investor holdings increased by $125 million (up by $567 million from 30 June 2019) and are estimated to hold $2.88 billion as at 30 June 2020
- Domestic retail investor holdings were unchanged (and up by $3 million from 30 June 2019) and are estimated to hold $340 million as at 30 June 2020.

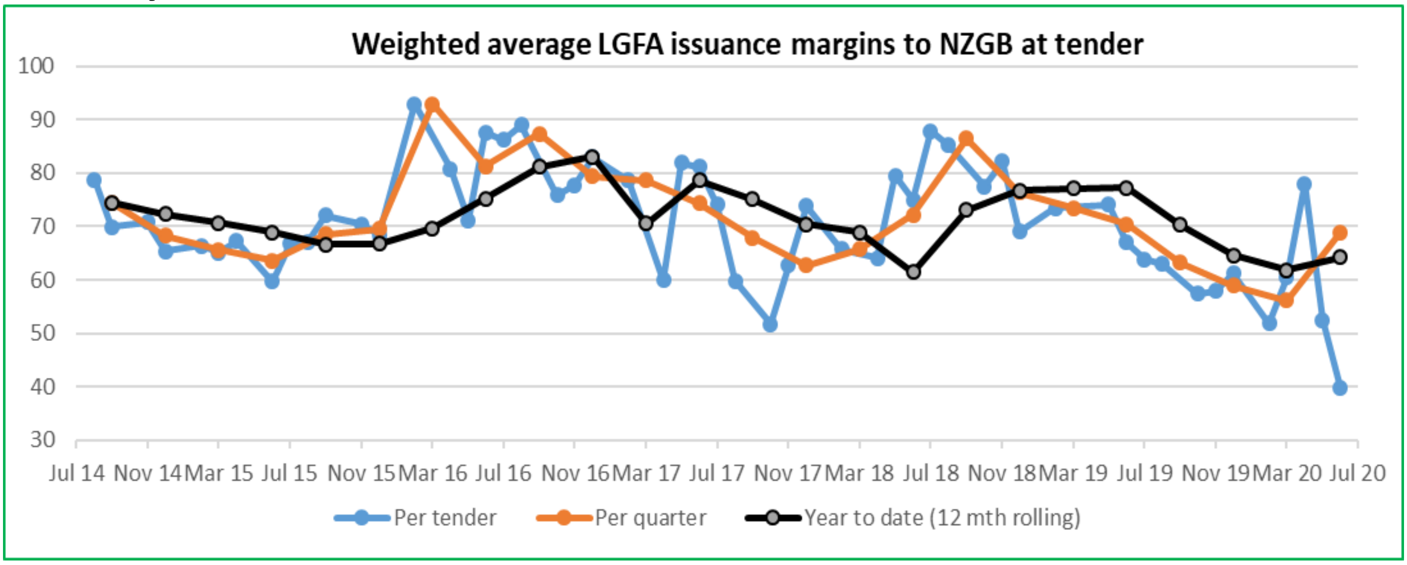
The recent importance of the Reserve Bank of New Zealand (RBNZ) is seen through RBNZ increased holdings by $1.004 billion over the past three months and now hold 9.2% of LGFA bonds on issue.

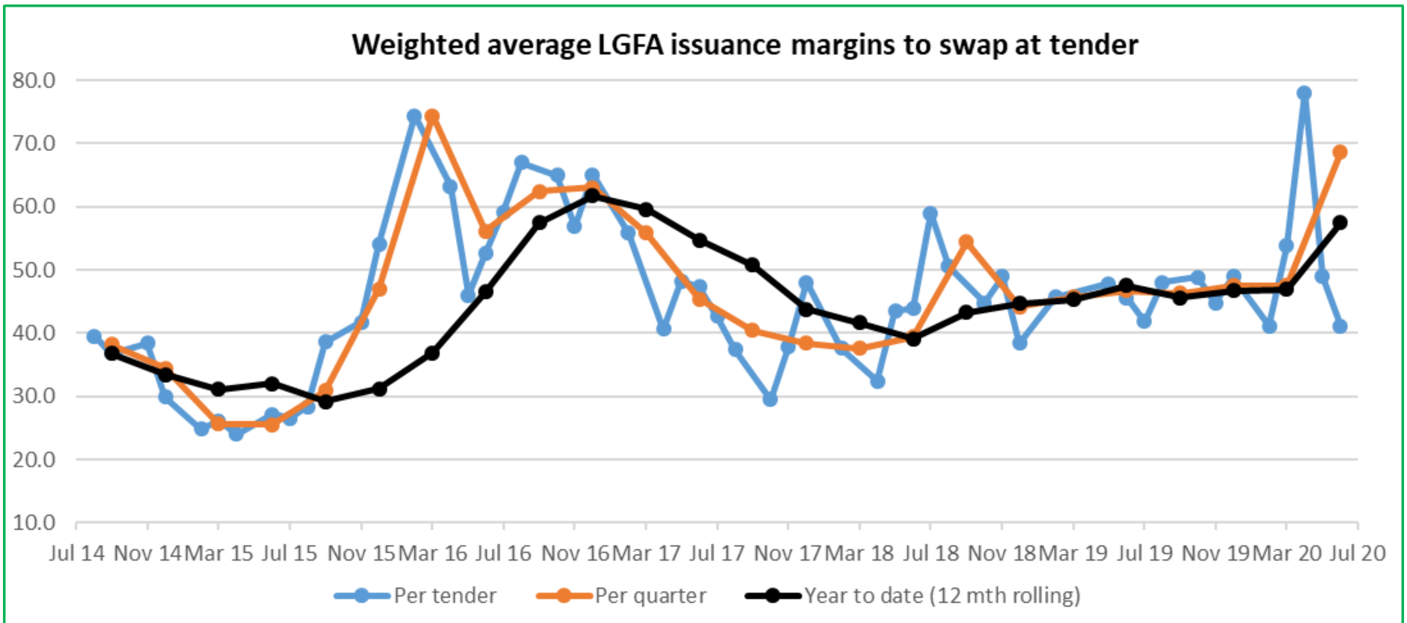
The reduction in offshore investor holdings is disappointing but understandable given the relative unattractiveness of NZ to other markets, the large increase in kauri bond issuance at spreads wider than LGFA bonds and recent issuance by Kainga Ora. Offshore investors owned $480 million (48.5%) of the April 2020 LGFA bond and have not reinvested the proceeds. Domestic investors increased their holdings over the June quarter as LGFA bonds provide a yield pickup over NZGBs.


LGFA bond holdings by investor group
$4,500,000,000
$4,000,000,000
$3,500,000,000
$3,000,000,000
$2,500,000,000
$2,000,000,000
$1,500,000,000
$1,000,000,000
$500,000,000
$0
Jun-14 Sep-14 Dec-14 Mar-15 Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18 Jun-18 Sep-18 Dec-18 Mar-19 Jun-19 Sep-19 Dec-19 Mar-20 Jun-20
Offshore Investors
Banks
Domestic Institutional + Retail Investors
RBNZ

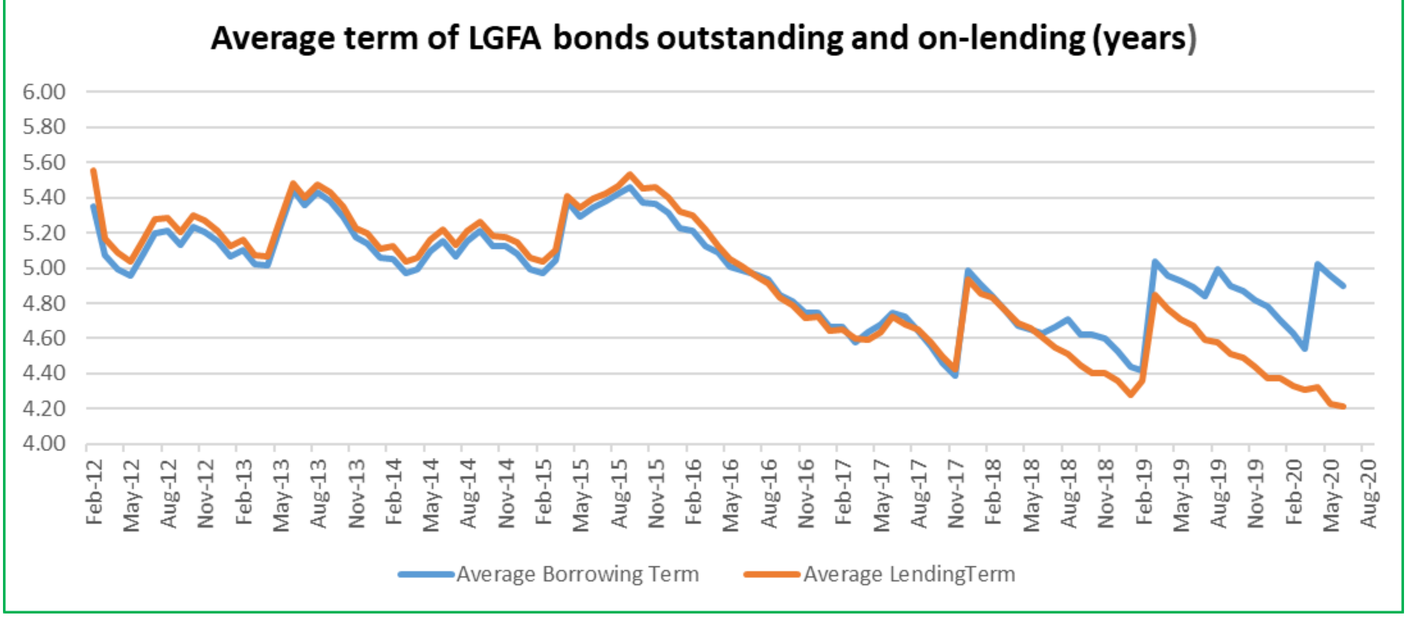

LGFA bond holdings by investor group
50.0%
45.0%
40.0%
35.0%
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
Jun-14 Sep-14 Dec-14 Mar-15 Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18 Jun-18 Sep-18 Dec-18 Mar-19 Jun-19 Sep-19 Dec-19 Mar-20 Jun-20
Offshore
Domestic Banks
Domestic Investors
RBNZ

G. Key trends


Weighted average LGFA issuance margins to NZGB at tender
100
90
80
70
60
50
40
30
Jul 14 Nov 14 Mar 15 Jul 15 Nov 15 Mar 16 Jul 16 Nov 16 Mar 17 Jul 17 Nov 17 Mar 18 Jul 18 Nov 18 Mar 19 Jul 19 Nov 19 Mar 20 Jul 20
Per tender
Per quarter
Year to date (12 mth rolling)



Weighted average LGFA issuance margins to swap at tender
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
Jul 14 Nov 14 Mar 15 Jul 15 Nov 15 Mar 16 Jul 16 Nov 16 Mar 17 Jul 17 Nov 17 Mar 18 Jul 18 Nov 18 Mar 19 Jul 19 Nov 19 Mar 20 Jul 20
Per tender
Per quarter
Year to date (12 mth rolling)



Average term of LGFA bonds outstanding and on-lending (years)
6.00
5.80
5.60
5.40
5.20
5.00
4.80
4.60
4.40
4.20
4.00
Feb-12 May-12 Aug-12 Nov-12 Feb-13 May-13 Aug-13 Nov-13 Feb-14 May-14 Aug-14 Nov-14 Feb-15 May-15 Aug-15 Nov-15 Feb-16 May-16 Aug-16 Nov-16 Feb-17 May-17 Aug-17 Nov-17 Feb-18 May-18 Aug-18 Nov-18 Feb-19 May-19 Aug-19 Nov-19 Feb-20 May-20 Aug-20
Average Borrowing Term
Average LendingTerm