

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



<b>Contents</b>	<b>Page</b>
<b>A. Quarter issuance and highlights summary</b>	<b>2</b>
<b>B. Tenders during quarter</b>	<b>3</b>
<b>C. Key performance indicators</b>	<b>5</b>
<b>D. Summary financial information (provisional)</b>	<b>6</b>
<b>E. Quarterly compliance summary</b>	<b>7</b>
<b>F. Performance against SOI objectives</b>	<b>8</b>
1. Providing savings in annual interest costs for all Participating Local Authorities	8
2. Making longer-term borrowings available to Participating Local Authorities	10
3. Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice	10
4. Offering more flexible lending terms to Participating Local Authorities	11
5. Operate with a view to making a profit sufficient to pay a dividend in accordance with its stated Dividend Policy	12
6. Provide at least 50% of aggregate long-term debt funding for Participating Local Authorities	12
7. Ensure its products and services are delivered at a cost that does not exceed the forecast for issuance and operating expenses	12
8. Take appropriate steps to ensure compliance with the Health and Safety at Work Act 2015	13
9. Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency	13
10. Achieve the Financial Forecasts	13
<b>G. Investor relations / outlook</b>	<b>14</b>
<b>H. Key trends</b>	<b>15</b>

# Quarterly Report



Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016

## A. Quarter issuance and highlights summary

Quarter	Total	Bespoke	2017	2019	2020	2021	2023	2025	2027
Bonds issued \$m	<b>215</b>	N/A	-	-	25	-	20	125	45
Loans to councils \$m	<b>184</b>	61	3	2	-	-	-	118	-
Loans to councils – No.	<b>13</b>	6	1	1	-	-	-	5	-

Year to date	Total	Bespoke	2017	2019	2020	2021	2023	2025	2027
Bonds issued \$m	<b>215</b>	N/A	-	-	25	-	20	125	45
Loans to councils \$m	<b>184</b>	61	3	2	-	-	-	118	-
Loans to councils – No.	<b>13</b>	6	1	1	-	-	-	5	-

### Key points and highlights for the September quarter:

- The September quarter was a more positive period for credit markets following the difficult previous three quarters. Yields declined and spreads to NZGB narrowed by 2 bps to 16 bps but widened slightly on a spread to swap. Market conditions and sentiment for fixed income investments improved as investors viewed that interest rates will remain lower for longer in New Zealand and both our nominal and real yields remain attractive for global investors.
- LGFA issued a modest \$215 million of bonds during the quarter and this is well below the quarterly historical average of \$371 million and the quarterly average for the 2015-16 financial year of \$318 million. The average term of issuance of 8.35 years was significantly longer than the 6.59 years for the previous quarter. Outstandings across the seven LGFA maturities now total \$6.435 billion.
- The slope of the LGFA bond yield curve was relatively unchanged over the quarter. The 2017 bond yield declined 22 bps while the 2027 bond yield declined 25 bps. Yields on all LGFA bonds reached historic lows during the quarter, in line with the decline in NZGB yields.
- LGFA margins to NZGB narrowed on all LGFA bond maturities by between 5bps on the 2017 to 17 bps on the 2023 and 2027 maturities. This partially reversed the widening in spreads to NZGB in the June quarter but spreads remain elevated, reflecting the stronger relative demand for Government securities and the improving fiscal position of Central Government.
- On-lending to council borrowers was \$199 million including \$66 million of bespoke issuance (33% of total lending) during the quarter. The average term of on-lending to councils during the quarter was 8.17 years which was in line with the average term of 8.08 years for the 2015-16 year.
- The short term council borrowing product launched in November 2015 remains well supported by councils with loans outstanding of \$179.7 million as at 30 September 2016. This was an increase of \$21 million over the quarter.
- LGFA Net Operating Gain for the three months to September 2016 on an unaudited management estimate is \$2.89 million or \$0.108 million above budget.
  - Net Interest Income estimated at \$4.186 million was \$0.146 million above budget due to a positive amortisation benefit that we expect to reduce over the course of the financial year.
  - Issuance and Operating expenses estimated at \$1.295 million were \$37k over budget due to additional legal and listing costs associated with the introduction of bond lending to bank price makers in LGFA bonds and additional short term loans to new councils. Approved Issuer levy (AIL) payments were also slightly higher than expected.

# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



## B. Tenders during quarter

Tender 39: 20 July 2016 \$125 million

<b>Tender 39</b>	<b>Apr-20</b>	<b>Apr-25</b>	<b>Apr-27</b>	
Tender date: 20 July 2016				<p>LGFA bond issuance yields continued to decline with the weighted average yields 13 bps lower on the 2025's compared to the June tender. All LGFA bonds were issued at their historic lows reflecting the recent falls in global bond yields.</p> <p>While margins over NZGBs were 3 bps wider on the 2025s, in general spreads to NZGB improved by 3 bps across the LGFA curve since the June tender.</p> <p>Margins over swap were approximately 4bps wider across the curve since the June tender.</p> <p>The average maturity of the LGFA bonds issued was 98 months (i.e. 8.14 years). This was significantly longer than the 65-month term of the June tender and reflected the emphasis on the issuing of 2025s.</p> <p>Coverage ratio of 2.2 times was an improvement on the June tender's ratio of 1.7 times but still well below the long term average. The 2020s only received bids totalling \$27.4 million for the \$25 million offered and all seven individual bids were accepted.</p> <p>While LGFA issued \$125 million of bonds, loans of \$100 million were undertaken with councils. Much of the difference was used to fund previous loans made by LGFA to councils.</p> <p>Total LGFA outstandings across the seven maturities following the tender was \$6.345 billion.</p>
Total amount offered \$m	25	75	25	
Total amount allocated \$m	25	75	25	
Total number bids received	7	25	16	
Total amount of bids received \$m	27.4	172.45	76	
Total number of successful bids	7	13	8	
Highest accepted yield %	2.595	3.055	3.28	
Lowest yield accepted %	2.550	3.005	3.26	
Highest yield rejected %	2.595	3.19	3.37	
Lowest yield rejected %	2.595	3.055	3.28	
Weighted average accepted yield %	2.581	3.036	3.271	
Weighted average rejected yield %	2.595	3.091	3.307	
Coverage ratio	1.10	2.30	3.04	
<b>NZGB spread at issue bps</b>	<b>61.0</b>	<b>90.0</b>	<b>100.0</b>	
<b>Swap spread at issue bps</b>	<b>43.0</b>	<b>58.0</b>	<b>70.0</b>	
<b>Swap spread: AA council bps</b>	<b>63.0</b>	<b>69.25</b>	<b>88.0</b>	
<b>Swap spread: AA- council bps</b>	<b>68.0</b>	<b>74.25</b>	<b>93.0</b>	
<b>Swap spread: A+ council bps</b>	<b>73.0</b>	<b>79.25</b>	<b>98.0</b>	
<b>Swap spread: unrated council bps</b>	<b>83.0</b>	<b>89.25</b>	<b>108.0</b>	

# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



Tender 40: 24 August 2016

\$90 million

<b>Tender 40</b>			
Tender date: 24 August 2016	<b>Apr-23</b>	<b>Apr -25</b>	<b>Apr-27</b>
Total amount offered \$m	20	50	20
Total amount allocated \$m	20	50	20
Total number bids received	13	20	19
Total amount of bids received \$m	62.5	126	80
Total number of successful bids	4	7	8
Highest accepted yield %	2.750	2.995	3.20
Lowest yield accepted %	2.72	2.97	3.17
Highest yield rejected %	2.825	3.085	3.285
Lowest yield rejected %	2.75	2.995	3.20
Weighted average accepted yield %	2.741	2.998	3.184
Weighted average rejected yield %	2.773	3.023	3.216
Coverage ratio	3.13	2.52	4.00
<b>NZGB spread at issue bps</b>	<b>83.0</b>	<b>89.0</b>	<b>95.0</b>
<b>Swap spread at issue bps</b>	<b>53.0</b>	<b>64.0</b>	<b>72.0</b>
<b>Swap spread: AA council bps</b>	<b>71.25</b>	<b>75.75</b>	<b>90.25</b>
<b>Swap spread: AA- council bps</b>	<b>76.25</b>	<b>80.75</b>	<b>95.25</b>
<b>Swap spread: A+ council bps</b>	<b>81.25</b>	<b>85.75</b>	<b>100.25</b>
<b>Swap spread: unrated council bps</b>	<b>91.25</b>	<b>95.75</b>	<b>110.25</b>

The tender size of \$90 million was the equal smallest tender compared to the historic average size of \$167 million.

New historic lows for issuance yields with weighted average yields 4 bps lower on the 2025's and 8 bps lower on the 2027's compared to the July tender.

Margins over NZGBs were 1 bps to 5 bps narrower as NZGBs were offered in expectation of the NZGB 2037 syndication that occurred on the same day as the LGFA tender.

Margins over swap (after DMO charges) was 2 bps to 6.5 bps wider compared to the July tender.

The average maturity of the LGFA bonds issued was 104 months (i.e. 8.65 years). This was the longest average maturity since February 2016.

Coverage ratio of 3.0 times improved on the previous tenders but still below the long term average. Tight successful ranges (2 bps to 3 bps) for each maturity and issuance yields close to prevailing market mid rates was positive.

While LGFA issued \$90 million of bonds there was only \$64 million of direct loans to councils. The balance was used to cover bespoke lending transactions during the previous five weeks.

Total LGFA outstandings across the seven maturities following the tender was \$6.435 billion.

# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



## C. Key performance indicators

Measure		Prior full year to June 2016	Q1	Q2	Q3	Q4
			30 Sep 16	31 Dec 16	31 Mar 17	30 Jun 17
Average cost of funds relative to NZ Government Stock and NZ Treasury Bills for issuance in the 12-month period to 30 June 2017	Target %		0.50%	0.50%	0.50%	0.50%
	Actual %	0.74%	0.646% (0.874% for bonds and 0.32% for bills)	-	-	-
Average base margin over cost of funds for short term and long term lending	Target %		0.10%	0.10%	0.10%	0.10%
	Average actual %	0.106%	0.098% (0.109% for long term and 0.082% for short term lending)	-	-	-
Estimated interest cost savings %	Target %		Improvement on prior year	Improvement on prior year	Improvement on prior year	Improvement on prior year
	2019 actual %	17 bps	15 bps	-	-	-
	2021 actual %	27 bps	22 bps	-	-	-
	2025 actual %	33 bps	24 bps	-	-	-
Issuance and operating expenses (excluding AIL) YTD	Target (\$ m)		\$1.10 m	\$2.40 m	\$3.60 m	\$4.80 m
	Actual (\$ m)	\$5.98 m	\$1.11 m	-	-	-
Lending (short and long term) to participating councils YTD	Target (\$ b)		\$6.516 b	\$6.791 b	\$7.066 b	\$7.341 b
	Actual (\$ b)	\$6.241 b	\$6.605 b	-	-	-

# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016

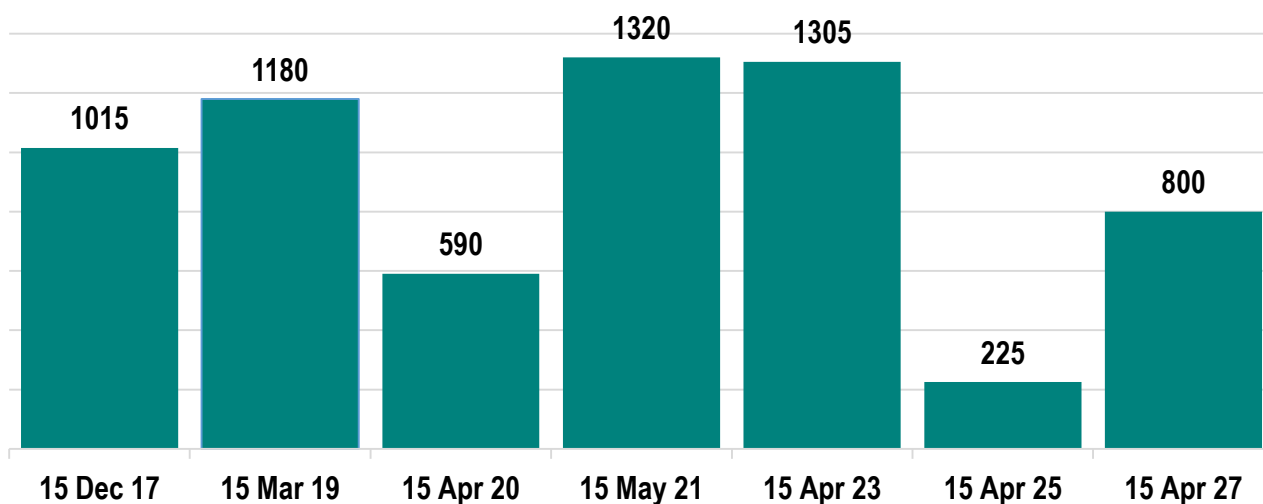


## D. Summary financial information

Financial Year (\$m)	YTD as at Q1	YTD as at Q2	YTD as at Q3	YTD as at Q4
Comprehensive income	30-Sep-16	31-Dec-16	31-Mar-17	30-Jun-17
Interest income	76.54	-	-	-
Interest expense	72.35	-	-	-
<b>Net interest revenue</b>	<b>4.19</b>	-	-	-
Issuance and On-lending costs	0.45	-	-	-
Approved issuer levy	0.18	-	-	-
Operating expenses	0.66	-	-	-
<b>Issuance and operating expenses</b>	<b>1.29</b>	-	-	-
<b>Net Profit</b>	<b>2.89</b>			

Financial position (\$m)	30-Sep-16	31-Dec-16	31-Mar-17	30-Jun-17
Retained earnings	19.22	-	-	-
Total assets (nominal)	6,835.90	-	-	-
Total LG loans (nominal)	6,605.23	-	-	-
Total LGFA bills (nominal)	225.00	-	-	-
Total LGFA bonds (nominal)	6,435.00	-	-	-
Total borrower notes (nominal)	102.80	-	-	-
Total equity	47.12	-	-	-

LGFA bond outstandings as 30 September 2016 (\$ million)



# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



## E. Quarterly compliance summary

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	Yes
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 \$75m 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

### Details for compliance breaches over quarter.

There were no breaches over the quarter.

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



## F. Performance against SOI objectives and performance targets

### Primary objectives

#### 1. Providing savings in annual interest costs for all Participating Local Authorities

Our base on-lending margins have been held at a constant level since August 2015 of 9 bps (2017s and 2019s), 10 bps (2020s and 2021s) and 11 bps (2023s and 2027s). Our average base lending margin offered to council borrowers across all LGFA maturities is now 10 bps.

Our estimated annual savings to councils based upon the secondary market levels at 30 September 2016 of LGFA bonds compared to bonds issued by Auckland and Dunedin councils is between 15 bps and 28.5 bps depending upon the term of borrowing. The estimated savings have reduced by 2 to 5 bps over the past quarter as LGFA bonds cheapened slightly to swap while non LGFA council paper was unchanged in month end valuations due to low levels of activity.

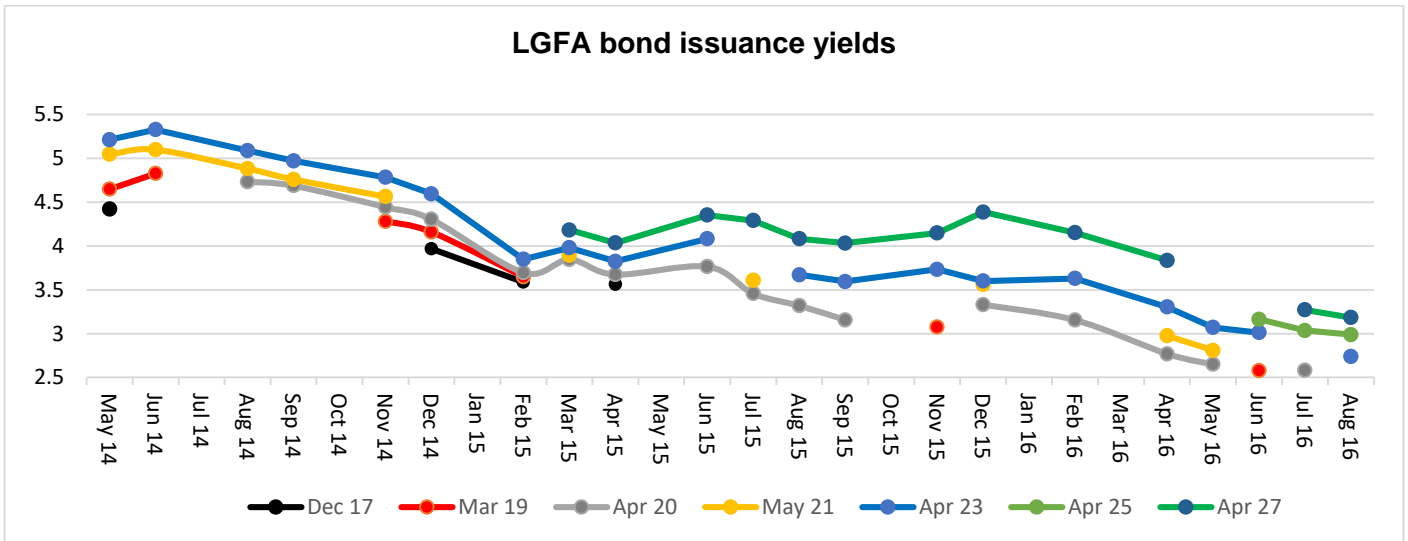
30-Sept-16	Savings to AA rated councils (bps)				
	Auckland 2019	Dunedin 2020	Dunedin 2021	Auckland 2022	Auckland 2025
AA rated councils margin to swap	48	63	69	77	89
Less LGFA margin to swap	-34	-41	-47	-49	-64
LGFA Gross Funding Advantage	14	22	22	28	25
Less LGFA Base Margin	-9	-10	-10	-10.5	-11
LGFA Net Funding Advantage	5	12	12	18.5	14
Add 'LGFA Effect'	10	10	10	10	10
<b>Total Saving</b>	<b>15</b>	<b>22</b>	<b>22</b>	<b>28.5</b>	<b>24</b>

LGFA bond nominal yields remain at their record historic lows, reflecting the low inflation and interest rate environment in New Zealand. LGFA is close to delivering on the 30 bps savings target for councils as outlined in the original business case for LGFA and has provided councils with access to long dated tenors at these record lows in yields.

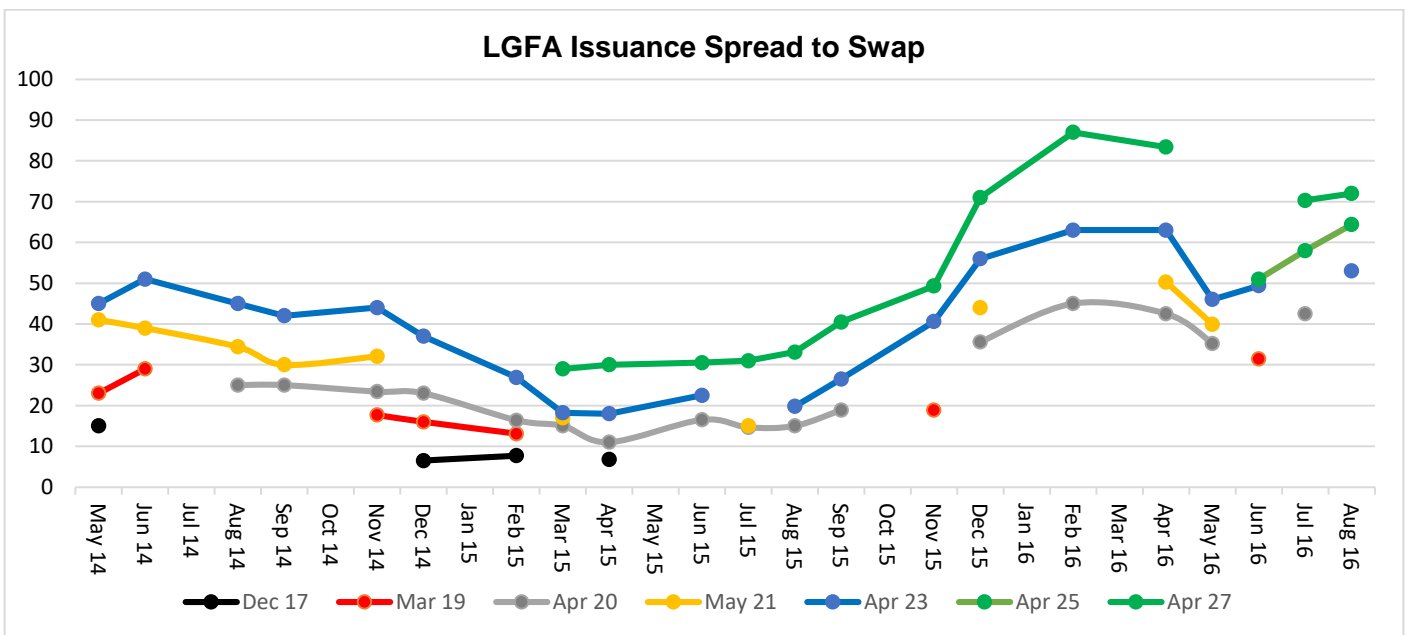


# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



There were only two tenders held during the quarter as we deliberately avoided holding a tender in September as three of the four largest New Zealand banks have a 30 September balance date. Spreads to swap widened by 1 bps to 7 bps over the quarter (after a modest narrowing in the prior). While credit market activity remains positive, this is more concentrated in the lower credit or unrated sector of the market as investors continue to seek higher yield. Reflecting this tepid demand for very strongly rated (but lower yielding) credit is highlighted in the kauri market with one AAA rated issue for \$50 million and two issues from a AA- rated Korean bank issuer. Our issuance of predominantly long dated LGFA bonds over the past eighteen months into this weak market environment has led to wider spreads.



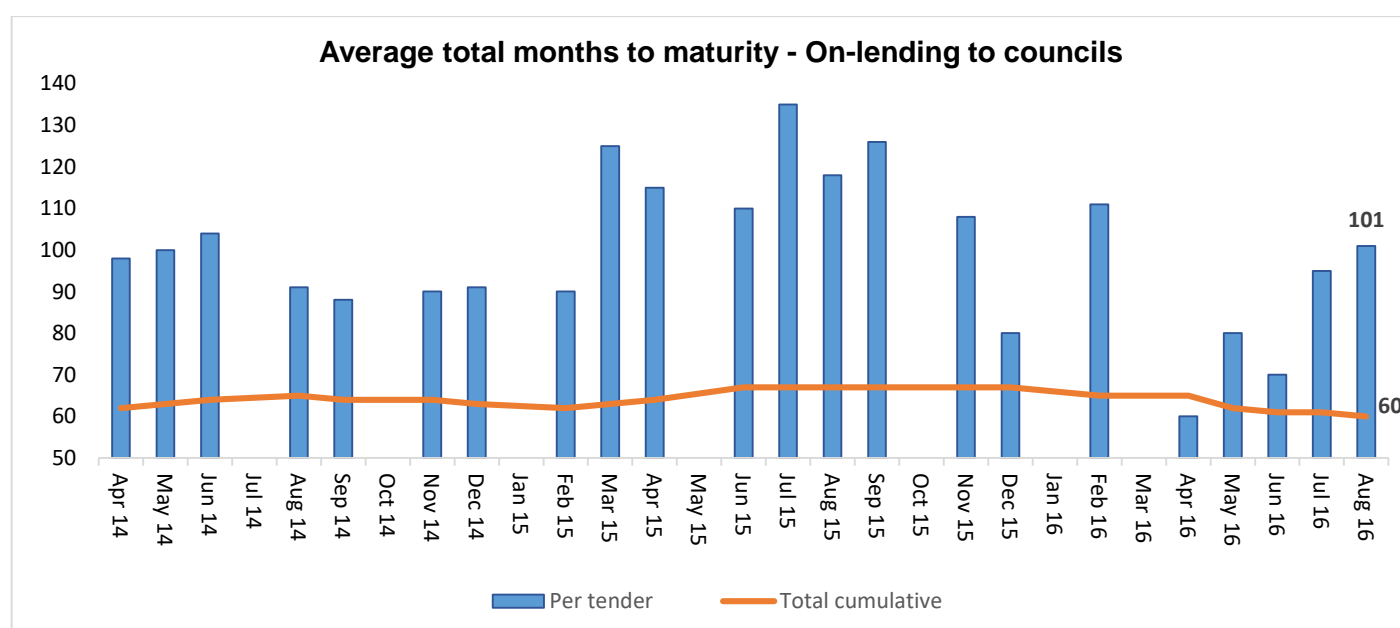
# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



## 2. Making longer-term borrowings available to Participating Local Authorities

The average borrowing term (excluding short dated borrowing) for the September 2016 quarter by council members was 8.17 years and this was 2.14 years longer than the previous quarter and slightly longer than the 8.08 years for the 2015-16 year. The average issuance term of LGFA bonds during the September quarter was 8.35 years compared to 6.59 years for the June quarter and 8.10 years for the 2015-16 year. LGFA issued a 2025 bond in June 2016 and will consider a new long dated maturity in the 2016-17 year.



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

The listing of LGFA bonds on the NZX Debt Market in November 2015 has led to greater investor awareness of LGFA bonds. Average turnover on the NZX Debt market since listing has been \$16.1 million per month or 11.4% of the total turnover of the NZX Debt Market.

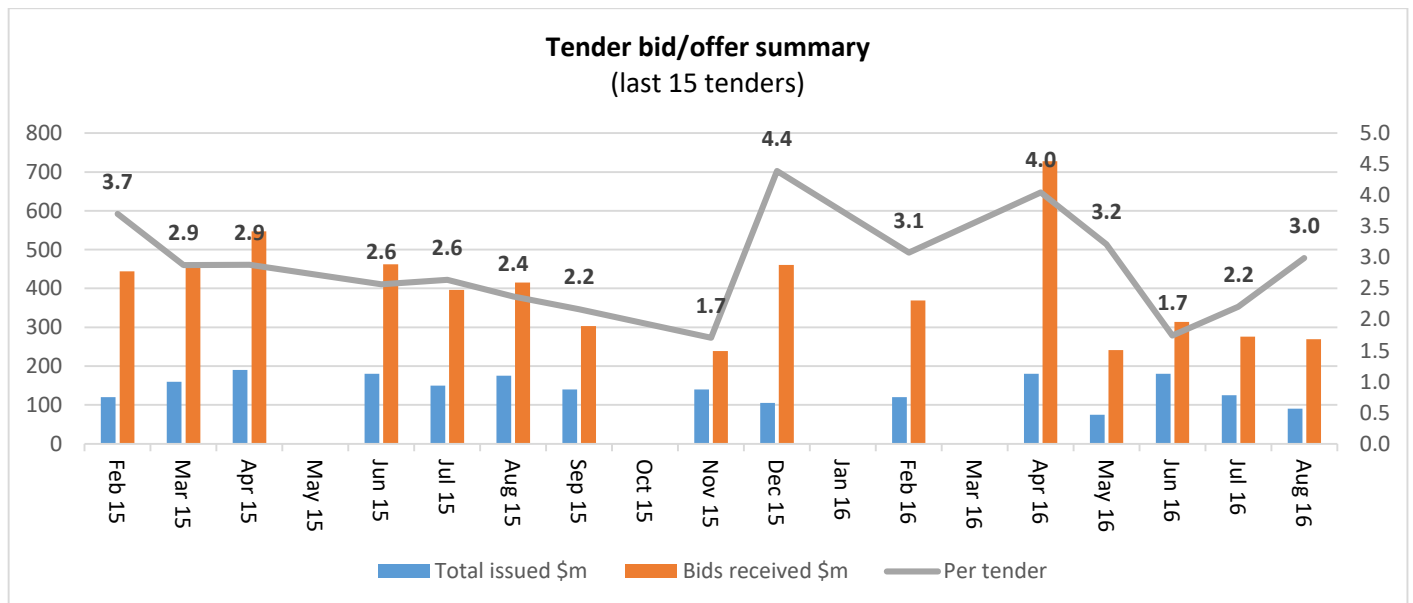
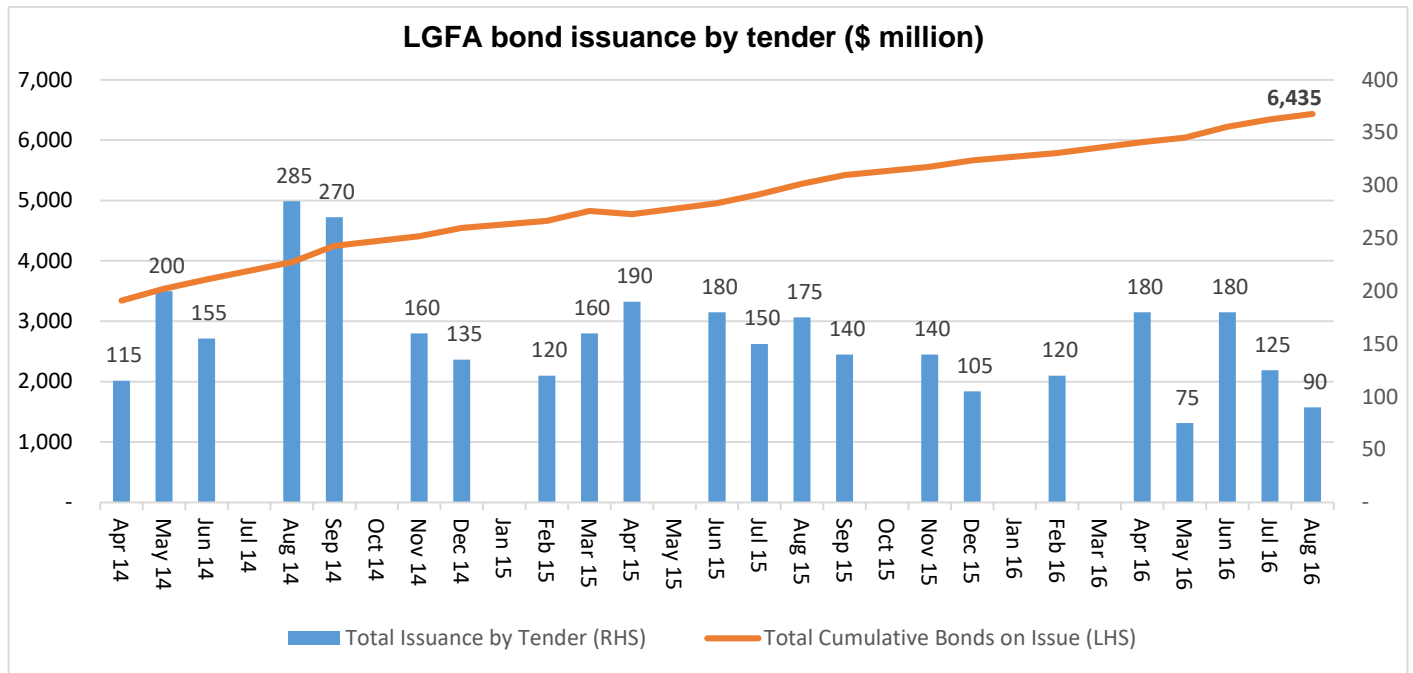
LGFA began issuing 3-month and 6-month LGFA Bills in October 2015 and commenced short dated (less than 1 year) lending to councils in November 2015. LGFA has short term loans to fifteen councils of \$179.7 million outstanding as at 30 September 2016. We continue to receive enquiry from councils as to this product and would expect the number of participating councils and volume to grow over the next six months.

LGFA bond tenders continued to be supported by the market with the two tenders held during the September quarter attracting a 2.53 times coverage ratio. This is lower than what we prefer (the long term average is 3.2 times) but reflects the current low yield environment. While we are receiving fewer bids than previous tenders, the price tension remains very good as we issue between 1 bps and 3 bps above

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016

secondary market levels at the time of each tender. We continue to offer three or four LGFA maturities at each tender and try to maintain the volume offered within the \$100 million to \$150 million range.



## 4. Offering more flexible lending terms to Participating Local Authorities

Bespoke lending continues to be a popular borrowing option for council members. Since we introduced the ability for councils to choose their preferred maturity and date of drawdown in February 2015 we have lent

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



\$556 million in bespoke transactions. During the September 2016 quarter, we lent \$61 million on a bespoke basis to five councils. This comprised 33% of total lending by LGFA to its members.

As mentioned previously, short term borrowing by councils has also become popular with loan terms to date of between 3 months and 6 months on \$179.7 million of loans.

## Additional objectives

### 5. 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 basis was \$2.89 million for the quarter compared to the management budget of \$2.782 million. The LGFA board declared a dividend for the 2015-16 year of 5.57% on 20 September 2016. Our 2016-17 year to date cost of funds is 2.76% which would suggest a lower projected dividend rate of 4.76% for the coming year.

### 6. Provide at least 50% of aggregate long-term debt funding for Participating Local Authorities

LGFA estimates market share from the PwC Local Government Quarterly Debt Report and the most recent report is for the June 2016 period. LGFA market share of total sector borrowing for the June 2016 quarter was 69.5% and for the year to June 2016 was 69.7%. Adjusting both the LGFA share and the total market share estimate for Auckland Council borrowing in its own name (as Auckland Council is restricted in the amount that it can borrow through LGFA) then LGFA market share for the June quarter was 60.5% and for the year to June 2016 was 74.8%. Our market share declined from previous quarters due to Auckland Council issuing in its own name and both Dunedin and Invercargill Councils undertaking larger than normal issuances.

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

Expenses on a year to date unaudited basis are \$1.295 million which is \$37k above budget. This variance is the consequence of:

- Issuance and on-lending costs (excluding AIL) at \$449k were \$31k above budget with higher legal fees and NZX costs relating to additional short term lending and costs associated with the introduction of the bond lending facility.
- Approved Issuer Levy (AIL) costs of \$183k or \$21k above budget due to higher than forecast holdings of bonds by offshore investors.
- Operating costs at \$664k were \$24k below budget and reflected lower travel, governance and personnel costs than forecast.

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



## **8. Take appropriate steps to ensure compliance with the Health and Safety at Work Act 2015**

LGFA has established 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.

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

LGFA met with both S&P and Fitch rating agencies in September 2016 as part of their annual review process. S&P subsequently affirmed the long-term rating of LGFA at AA+ (stable outlook) on 20 October 2016 and we are expecting the outcome of the Fitch review by mid-November 2016.

The current rating from Fitch is AA+ (stable outlook) that we received on 1 February 2016.

## **10. Achieve the financial forecasts**

As at the end of first quarter, Net Interest Income is \$146k above budget while expenses are \$37k above budget. Net Operating Gain of \$2.891 million was \$109k above budget and is 8.6% above the Net Operating Gain for the prior year period.

While it is a strong start to the year in terms of financial position, we are cautious on extrapolating this positive first quarter result into the full year outlook in terms of outperformance to SOI forecast. There will be a softer impact from lower interest rates on the returns from investment of LGFA share capital and retained earnings. Furthermore, lending volumes are lower than we expected due to reduced council borrowing requirements and our average on-lending margin is expected to reduce as more councils are receiving credit rating upgrades. While this is positive for the sector (and enhances LGFA's credit profile), it does reduce LGFA earnings.

# Quarterly Report

Quarter 1: 2016 - 2017  
Period ended: 30 September 2016



## G. Investor relations / outlook

Managing relations with our investor base is very important as we have yet to reach peak debt. Our projections are for additional funding for each of the next three years of approximately \$1.0 billion p.a. so we require both existing investors to increase their holdings and to also find new investors. Our focus is on growing the offshore investor and domestic retail investor base as these groups have the most potential given that we already received strong support from the domestic banks and institutional investors. The recent NZX listing and marketing in the next six months is targeted at these investor groups.

Over the past fifteen months we have met with thirty-four out of our forty largest holders (we have been unable to identify three holders as they hold their LGFA bands through a custodian). Over the quarter we met with current holders and prospective investors in New Zealand and presented at conferences and roundtable discussions. In the coming quarter we will hold our first domestic investor group update and scheduled to meet with Australian, Japanese, US and Canadian investors.

Offshore investors, banks and domestic investors all increased their holdings of LGFA bonds during the quarter by a similar amount

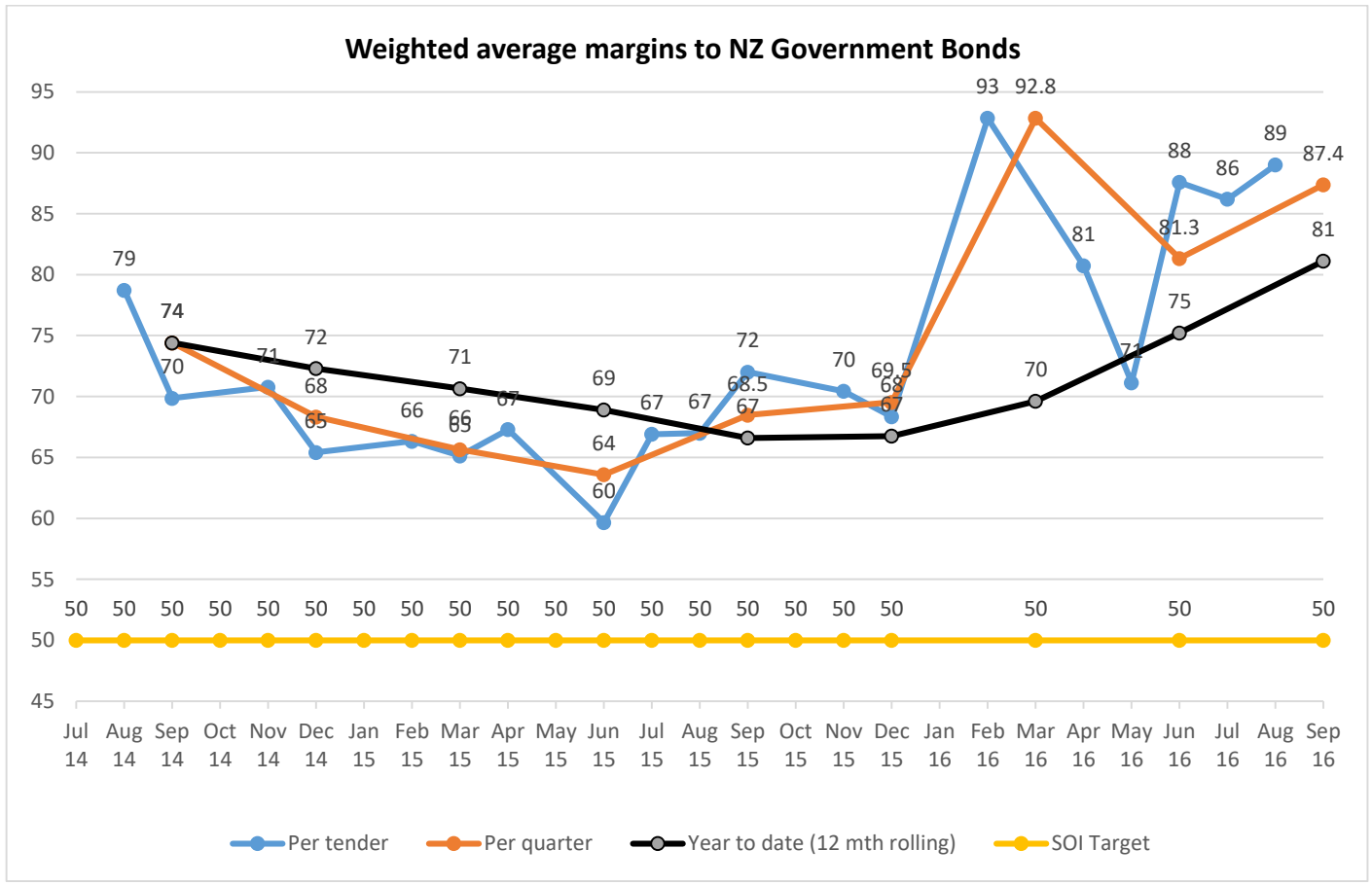
- Domestic banks increased their holdings by \$75 million over the September quarter and were estimated to hold \$2.02 billion (31.4% of outstandings) compared to \$1.55 billion (28.6% of outstandings) as at 30 September 2015. Bank liquidity books and a number of smaller New Zealand registered banks have been increasing their holdings as LGFA bonds appear attractive on a spread to NZGB.
- Domestic institutional and retail investors increased their holdings by \$85 million over the September quarter and were estimated to hold \$2.72 billion (42.2% of outstandings) compared to \$2.40 billion (44.3% of outstandings) as at 30 September 2015. LGFA bonds are being purchased for inclusion in Kiwisaver funds by managers.
- Offshore investors increased their holdings by \$55 million over the September quarter and were estimated to hold \$1.69 billion (26.3% of outstandings) compared to \$1.47 billion (27.1% of outstandings) as at 30 September 2015.

# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016



## H. Key trends



# Quarterly Report

Quarter 1: 2016 - 2017  
 Period ended: 30 September 2016

