Quarterly Report

Quarter 2: 2018 - 2019
Period ended: 31 December 2018

NEW ZEALAND
LOCAL GOVERNMENT
FUNDING AGENCY

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A. December quarter issuance and highlights summary

Quarter	**Total**	Bespoke Maturity	2019	2020	2021	2022	2023	2025	2027	2033
Bonds issued $m	**600**	N/A		-	30	190	-	170	130	80
Term Loans to councils $m	**541.5**	463.5	-	2	5	14	16.5	8	32.5	-
Term Loans to councils #.	**57**	40	-	1	2	3	4	2	5	-

Year to date	**Total**	Bespoke Maturity	2019	2020	2021	2022	2023	2025	2027	2033
Bonds issued $m	**985**	N/A		-	30	270	-	260	180	245
Term Loans to councils $m	**1050**	748	-	43	6.5	99.5	54	55	44	-
Term Loans to councils #	**121**	71	-	6	3	13	9	11	8	-

Key points and highlights for the December quarter:

- The LGFA bond curve flattened and fell over the quarter with yields declining between 17 bps (2025s) and 4 bps (2021s). Over the past 12 months the yield on the 2025 LGFA bond has declined 55 bps (0.55%) while the 2020 LGFA bond yield has declined 28 bps (0.28%) closing at historic lows.
- LGFA issued $600 million of bonds during the quarter across three tenders. This was the second largest quarterly amount of issuance on record and reflected strong borrower demand by councils. The half year issuance of $985 million and annual rolling issuance of $1.595 billion were both issuance records. The average term of issuance during the quarter of 6.25 years was shorter than the previous quarter but still longer than the average term of 6.07 years for the prior 2017-18 year. LGFA bonds outstanding (including treasury stock) at December 2018 was a record $9.104 billion.
- LGFA margins to swap widened for all LGFA bond maturities by between 5 bps (2022s) and 11 bps (2033s) over the quarter. Domestic banks were buyers of the short to mid curve LGFA bonds over the quarter while offshore investors were net sellers. Widening global credit spreads amidst risk off sentiment did not help spreads nor did record council borrowing and LGFA bond issuance for the six-month period to December 2018. LGFA Spreads to NZGB widened between 1 bps (2022s) and 13 bps (2033s) over the quarter but had narrowed over the past 12-month period.
- Long dated on-lending to council borrowers was a strong $541.5 million including $463.5 million of bespoke maturity loans (86% of total lending) during the quarter. The average term of on-lending during the quarter at 6.72 years was slightly shorter than the 7.04 years for the prior year.
- LGFA market share of 80.2% of total council borrowing for the rolling 12-month period to December 2018 (up 6.7% from September 2018). We estimate that we provided 78.3% of council borrowing during the December 2018 quarter with only Christchurch City Holdings borrowing outside of LGFA.
- Short-term lending to councils remains well supported by councils with loans outstanding of a record $526.7 million as at 31 December 2018. This was an increase of $113 million over the quarter and the number of councils using this product increased by eight to thirty-one.
- LGFA Net Operating Gain (unaudited) for the six-month period was $6.075 million or $0.304 million above budget with Net Interest Income $174k above budget and expenses $130k under budget.
- Two new councils have joined LGFA over the quarter (Clutha and MacKenzie District Councils), increasing the number of councils over the past six months by five to sixty-one councils. We are expecting a further two councils to join over the next six months.

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B. LGFA bond tenders during quarter

LGFA held three bond tenders during the quarter.

Tender 59: 03 October 2018 $210 million

Tender 59	Apr-22	Apr-25	Apr-27	Apr-33
Total amount offered $m	70	50	40	50
Total amount allocated $m	70	50	40	50
Total number bids received	9	17	16	12
Total amount of bids received $m	126	94	107	50
Total number of successful bids	2	10	4	12
Highest accepted yield %	2.38	2.965	3.265	3.915
Lowest yield accepted %	2.38	2.935	3.260	3.855
Highest yield rejected %	2.43	2.990	3.330	n/a
Lowest yield rejected %	2.38	2.965	3.265	n/a
Weighted average accepted yield %	2.38	2.954	3.265	3.882
Weighted average rejected yield %	2.393	2.977	3.284	n/a
Coverage ratio	1.80	1.88	2.68	1.00
NZGB spread at issue bps	50	74	87	112
Swap spread at issue bps	20	40.7	51.7	78.0
Swap spread: AA council bps	31.75	52.75	67	88
Swap spread: AA- council bps	36.75	57.75	72	93
Swap spread: A+ council bps	41.75	62.75	77	98
Swap spread: unrated council bps	51.75	72.75	87	108

An unusual tender result with strong price support, but the amount bid was patchy e.g. we only received $50 million of bids for the 2033s available.

The tender size of $210 million was well above average ($128 million) while the overall bid coverage ratio of 1.8x (the lowest for a year) but this reflected the larger amount tendered, the longer duration of bonds tendered and difficult market environment.

Issuance conditions were made difficult following offshore selling of NZD bonds and the Asian Development Bank (ADB) issued a NZD400 million, 3-year bond on the tender day. The AAA rated bonds were priced at a spread of 10 bps wider to the equivalent LGFA bond.

The average maturity of the LGFA bonds issued was reasonably long at 7.82 years

The spread to NZGB compared to the prior tender were 6 bps tighter on the 2022s, unchanged on the 2025s, and 3 bps to 4 bps wider on the 2027s and 2033s. More importantly for council borrowers, the spread to swap were slightly narrower on the 2022s and 2025s but wider on the 2027s and 2033s.

We on-lent $65 million to six councils (the lowest amount lent since October 2017) and the average term of lending at almost nine years (106 months) was the longest since August 2017.

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Tender 60: 07 November 2018 $200 million

Tender 60	Apr-22	Apr-25	Apr-27	Apr-33
Total amount offered $m	60	60	50	30
Total amount allocated $m	60	60	50	40
Total number bids received	17	18	16	12
Total amount of bids received $m	171	175	73	40
Total number of successful bids	5	8	12	10
Highest accepted yield %	2.570	3.170	3.500	4.160
Lowest yield accepted %	2.550	3.150	3.460	4.070
Highest yield rejected %	2.630	3.265	3.545	4.180
Lowest yield rejected %	2.570	3.170	3.500	4.170
Weighted average accepted yield %	2.564	3.157	3.477	4.120
Weighted average rejected yield %	2.593	3.194	3.526	4.175
Coverage ratio	2.85	2.92	1.46	1.33
NZGB spread at issue bps	56	78	92	122
Swap spread at issue bps	24	46.3	59	87.7
Swap spread: AA council bps	36.75	58	75.25	96.5
Swap spread: AA- council bps	41.75	63	80.25	101.5
Swap spread: A+ council bps	46.75	68	85.25	106.5
Swap spread: unrated council bps	56.75	78	95.25	116.5

A mixed result with demand for the short-dated bonds but demand decreased the further along the curve. Bank balance sheets were happy to buy the 2022 and 2025s to replace upcoming NZGB, LGFA and Kauri maturities but investor demand for the long end of the curve is very soft despite the large steepening in the curve over the past few months.

Issuance conditions were made difficult with the steep selloff in bond yields in the morning following the large drop in the NZ unemployment rate combined with the uncertainty regarding the results of the US mid-term elections and the RBNZ MPS.

The tender size of $200 million continues to be well above average ($131 million) while the average maturity issued continued to be long at 7.24 years

It was the sixth successive tender of 2033s. Price support was satisfactory for the 2022s and 2025s at between 1.5 bps and 2.5 bps wider than prevailing secondary market levels but 4bps wider on the 2027s and 9 bps wider on the 2033s.

The spread to NZGB compared to the October 2018 tender were 6 bps wider on all maturities except the 2033s (10 bps wider). Reflecting the poor bidding appetite, the spreads to swap were between 5 bps wider (2022s) and 8.5 bps wider (2033s) compared to the previous tender.

While we issued $200 million of LGFA bonds we on-lent $205 million to ten councils. Average term of lending at almost nine years (90 months) was long by historical standards but slightly shorter than the October tender of 106 months.

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Tender 61: 12 December 2018 $190 million

Tender 61	May-21	Apr-22	Apr-25	Apr-27
Total amount offered $m	30	60	60	40
Total amount allocated $m	30	60	60	40
Total number bids received	12	16	17	21
Total amount of bids received $m	95	106	134	86
Total number of successful bids	1	6	7	10
Highest accepted yield %	2.255	2.425	2.955	3.230
Lowest yield accepted %	2.255	2.405	2.930	3.200
Highest yield rejected %	2.315	2.520	3.030	3.335
Lowest yield rejected %	2.260	2.425	2.955	3.240
Weighted average accepted yield %	2.550	2.414	2.949	3.217
Weighted average rejected yield %	2.275	2.462	2.972	3.265
Coverage ratio	3.17	1.77	2.23	2.15
NZGB spread at issue bps	47	54	81	90
Swap spread at issue bps	17.5	25.25	49	58
Swap spread: AA council bps	27.5	35.25	59	68
Swap spread: AA- council bps	32.5	40.25	64	73
Swap spread: A+ council bps	37.5	45.25	69	78
Swap spread: unrated council bps	47.5	55.25	79	88

Compared to previous tenders, it was a more constructive result with good demand for the 2021s,2022s and 2027s bonds but less demand for the 2025s. Bank balance sheets continue to buy the front-end maturities while offshore investors (the traditional buyers of the long end) have been net sellers of LGFA bonds recently.

The tender size of $190 million was above average ($163 million), and we have now issued a record $985 million across the past five tenders as councils refinance their upcoming March 2019 loans. The average maturity of the LGFA bonds issued was a relatively short 5.2-year term.

This was the first time we have not issued 2033s since May 2018 and we used todays tender as an opportunity to take outstandings of the 2021s up to the soft cap of $1.5 billion. Price support was strong for the 2021s and 2022s at 1 bps through prevailing secondary market levels but 1bps wider on the 2027s and 2 bps wider on the 2025s.

Bidding volume was okay in terms of the overall bid coverage ratio of 2.2x, reflecting the larger amount tendered and the soft market environment. The bid coverage ratios were highest for the 2021s (3.17x) and lowest for the 2022s (1.77x).

The spread to NZGB compared to the November 2018 tender were 2 bps tighter on the 2022s and 1bps to 2 bps wider on the 2025s and 2027s. NZGBs remain well bid given the outlook for reduced bond supply in 2019 and banks looking to increase their liquid asset holdings.

While we issued $190 million of LGFA bonds we on-lent $232 million to ten councils with an average term of lending at six years.

C. Key performance indicators

We have met three KPIs and partially met the fourth KPI as at the end of the December quarter.

We have maintained issuance and operating expenses (excluding AIL) below budget by approximately $35k for the six-month period to 31 December 2018.

We changed our base lending margin for long dated lending to a standard 10 bps margin regardless of the borrowing term from 1 July 2018. This ensures that we meet the average base margin target of 10 bps when we combine it with our short-dated lending e.g. in the December quarter the average margin was 9.5 bps which was helped by the record $526.7 million of short-term loans outstanding as at 31 December 2018.

We have improved our estimated interest cost savings for council borrowing through LGFA compared to councils borrowing in their own name for longer dated terms (beyond five years). We have not improved our borrowing savings for very short terms (less than one year) but this is expected given that the spread between what councils borrow at over LGFA borrowing cost will narrow as the borrowing term approaches maturity.

Our volume of council lending is currently well above the SOI forecast but this is due to both the larger amount of short-term lending and councils prefunding their March 2019 loans ahead of maturity. This provided a temporary boost to LGFA loans to councils outstanding, but our loan book will reduce by $1.2 billion in March 2019.

Measure		**Prior full year to June 2018**	**Q1 30 Sept 2018**	**Q2 31 Dec 2018**	**Q3 31 Mar 2019**	**Q4 30 June 2019**
Average base margin over cost of funds for short term and long-term lending	Target %		< 0.10%			
	Average actual %	0.105%	0.095% (0.10% for long term and 0.09% for short term) ✓	0.095% (0.10% for long term and 0.09% for short term) ✓		
Estimated interest cost savings to AA rated councils	Target Improvement on prior year as at each quarter		**Q1 30 Sept 2018**	**Q2 31 Dec 2018**	**Q3 31 Mar 2019**	**Q4 30 June 2019**
	2019 maturity At quarter end	11 bps	8 bps ✗	2 bps ✗		
	2021 maturity At quarter end	19 bps	20 bps	17 bps		

			✓	✗		
	2025 maturity At quarter end	10 bps	20 bps ✓	15 bps ✓		
Issuance and operating expenses (excluding AIL) YTD	Target ($)		**$1.42 m (YTD as at Q1)**	**$2.84 m (YTD as at Q2)**	**$4.26 m (YTD as at Q3)**	**$5.67 m (FULL YEAR)**
	Actual ($)	$5.16 m	$1.36 m ✓	$2.81 m ✓		
Lending (short and long term) to participating councils	Target ($)		**$8.378 b (YTD as at Q1)**	**$8.818 b (YTD as at Q2)**	**$7.898 b (YTD as at Q3)**	**$8.105 b (FULL YEAR)**
	Actual ($)	$7.927 b	$8.641 b ✓	$9.268 b ✓		

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-18**	**31-Dec-18**	**31-Mar-19**	**30-June-19**
Interest income	88.71	180.89		
Interest expense	83.43	171.12		
Net interest revenue	**5.29**	**9.77**		
Issuance and On-lending costs	0.57	1.17		
Approved issuer levy	0.19	0.89		
Operating expenses	0.79	1.64		
Issuance and operating expenses	**1.55**	**3.70**		
Net Profit	**3.74**	**6.08**		

Financial position ($m)	**30-Sep-18**	**31-Dec-18**	**31-Mar-19**	**30-Jun-19**
Retained earnings + comprehensive income	41.74	44.05		
Total assets (nominal)	8,857.01	9,434.82		
Total LG loans (nominal)	8,631.65	9,276.43		
Total LGFA bills (nominal)	470.00	485.00		
Total LGFA bonds (nominal)	8,104.00	8,704.00		
Total borrower notes (nominal)	131.20	139.86		
Total equity	66.74	69.05		

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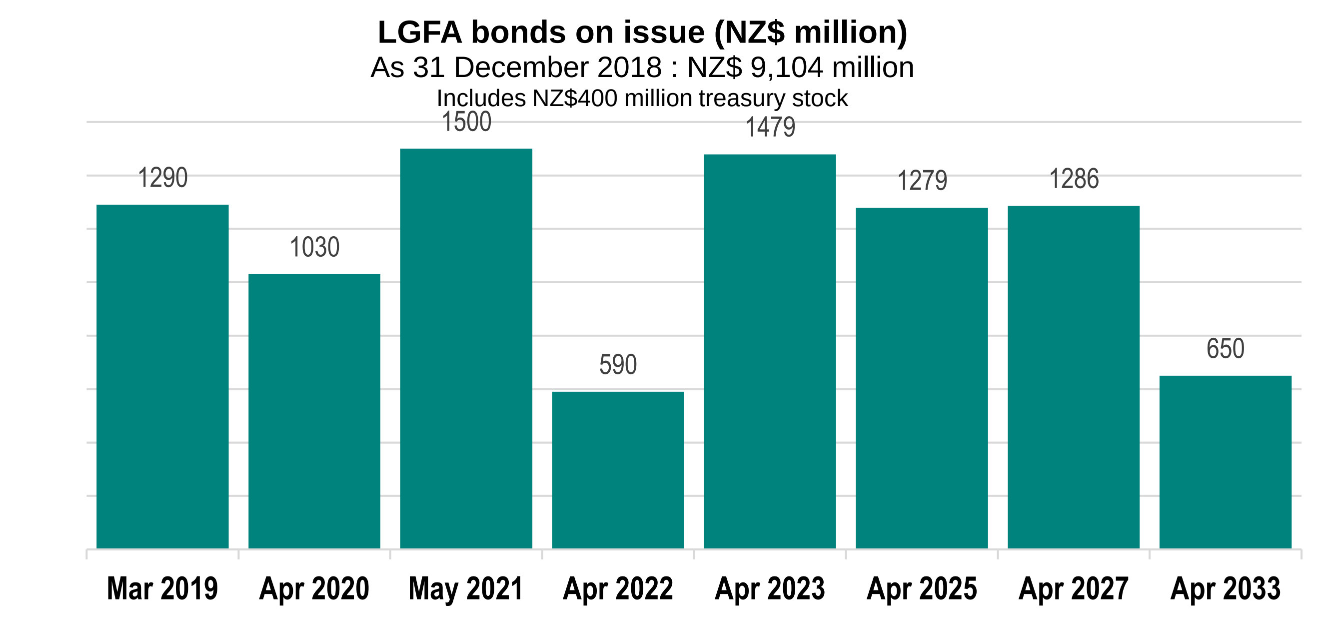

E. Quarterly compliance summary

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 $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

Details for compliance breaches over quarter.
There were no breaches over the quarter.

F. Performance against SOI objectives and performance targets

Primary objectives

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

The LGFA on-lending base margins are 10 bps for all terms between March 2019 and April 2033. We changed to a flat margin structure in June 2018. Previously the pricing methodology was a staggered margin schedule between 9 bps and 11 bps depending upon the term of borrowing. 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 capital buffer.

Our estimated annual savings to councils based upon the secondary market levels at 31 December 2018 of LGFA bonds compared to bonds issued by Auckland and Dunedin councils is between 2 bps and 17 bps depending upon the term of borrowing. The amount of savings has reduced over the past quarter from between 8 bps and 21 bps at the end of September 2018. The 2019s savings reduce quickly as we approach the maturity date of the LGFA bonds and council loans e.g. the savings on a 3-month loan are small compared to the savings on a ten-year loan. LGFA borrowing spreads have widened slightly over the quarter due to greater than expected supply of LGFA bonds because of increased council borrowing. There was no bond issuance by either Auckland Council or Dunedin City Treasury over the quarter.

31-Dec-18	**Savings to AA rated councils (bps)**				
	Auckland 2019	Dunedin 2020	Dunedin 2021	Auckland 2022	Auckland 2025
AA rated councils margin to swap	18	37	44	46	72
Less LGFA margin to swap	-6	-10	-17	-26	-47
LGFA Gross Funding Advantage	12	27	27	20	25
Less LGFA Base Margin	-10	-10	-10	-10	-10
Total Saving	2	17	17	10	15

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.

We held three bond tenders during the December quarter with total issuance of $600 million. This was the second largest quarterly amount of issuance undertaken and the rolling six-month issuance amount of $985 million and rolling twelve-month issuance annual amount of $1.595 billion were historic records. Credit market sentiment turned negative during the quarter as risk aversion increased across global markets with long dated spreads widening to both swap and NZGB. Outright yields declined to near historic lows on safe haven buying of fixed income as an asset class and continued expectation that the RBNZ is unlikely to adjust interest rates until 2020. The interest rate curve flattened with yields on short dated

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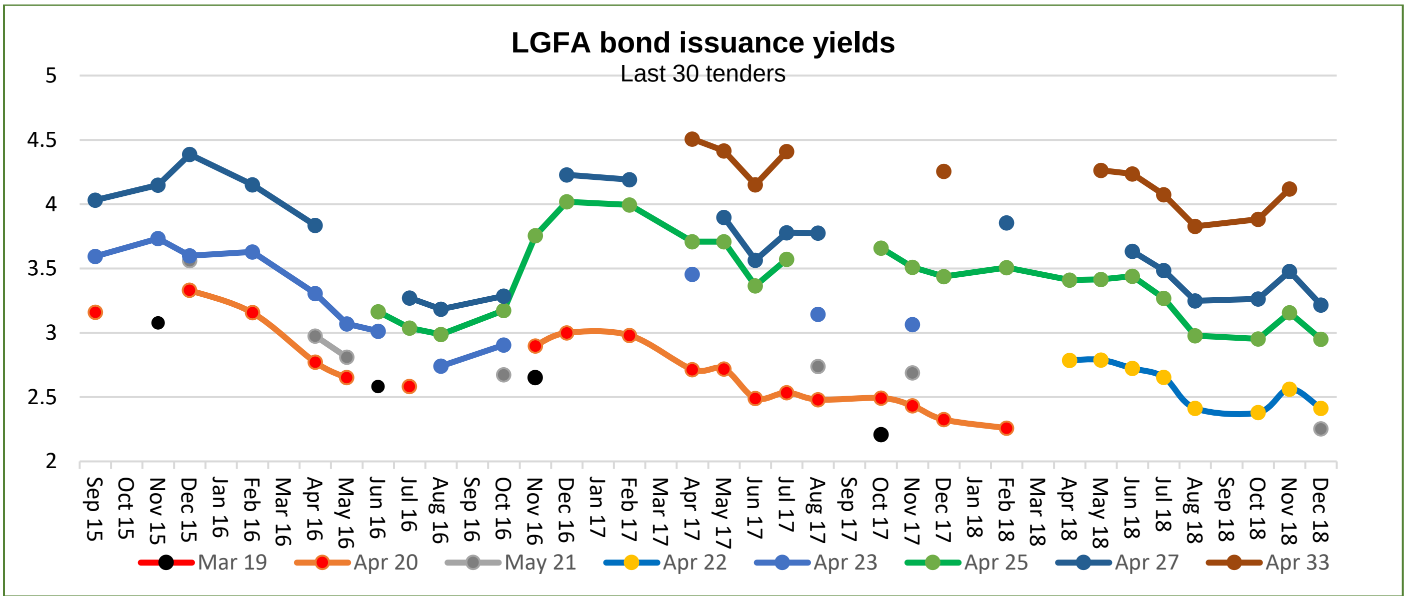
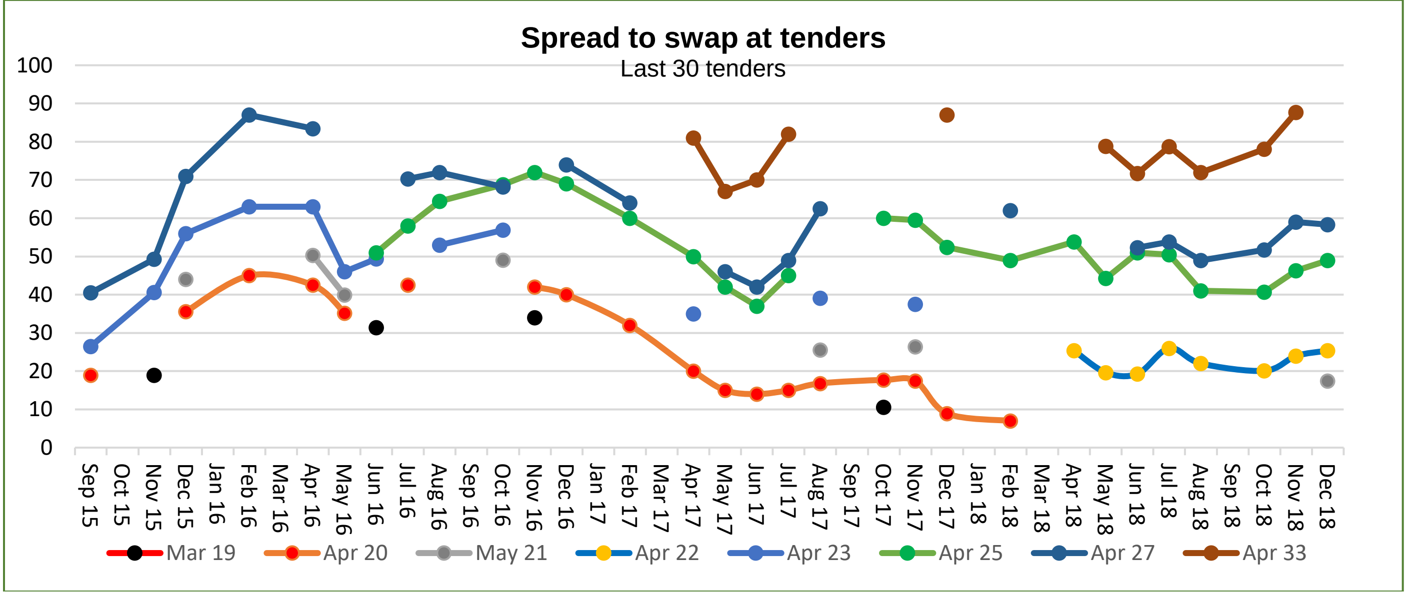
LGFA bond yields (2021s) declining by 4 bps over the quarter while long dated LGFA bond yields (2033s) declined 12 bps. The largest fall was in the mid curve maturities (2025s) with a decline of 17 bps (0.17%)

We closely monitor the Kauri market which is issuance by AAA rated Supranational issuers such as the World Bank, Nordic Investment Bank and the Asian Development Bank (ADB). These issuers are our peer issuers in the NZD market. The December quarter repeated the same pattern for Kauri issuance with only a $400 million 3-year issue by ADB. The September quarter was a strong period for Kauri bond issuance ($1.575 billion), following a record March quarter ($3.525 billion) but no issuance in the June quarter.

In general, secondary market credit spreads widened to both swap and NZGBs over the quarter. Over the past year spreads to swap have widened between 4 bps and 10 bps for all LGFA maturities and have narrowed on a spread to NZGB for maturities out to 2025 but widened on the 2027s and 2033s.





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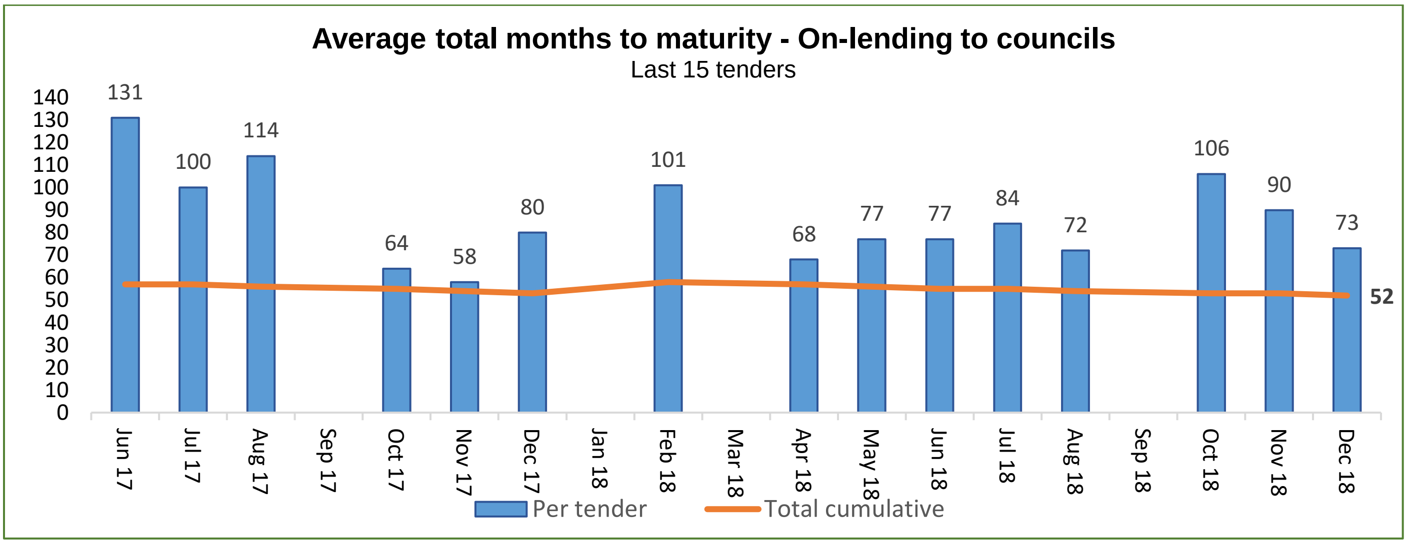
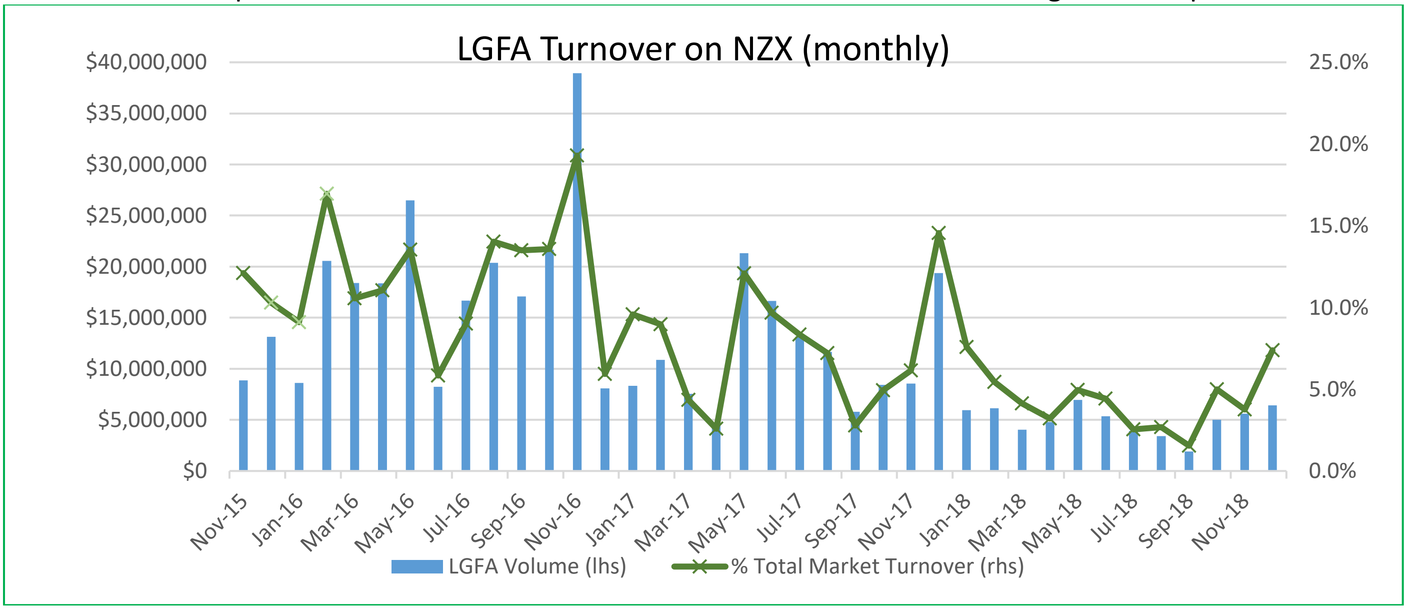
2. Making longer-term borrowings available to Participating Local Authorities

The average borrowing term (excluding short dated borrowing but including bespoke borrowing) for the December 2018 quarter by council members was 6.72 years and this was longer than the 6.33 years average term for the prior quarter. The average term of 6.53 years for the H1 2018-19 year is slightly shorter compared to the 7.04 average term for the 2017-18 year.



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

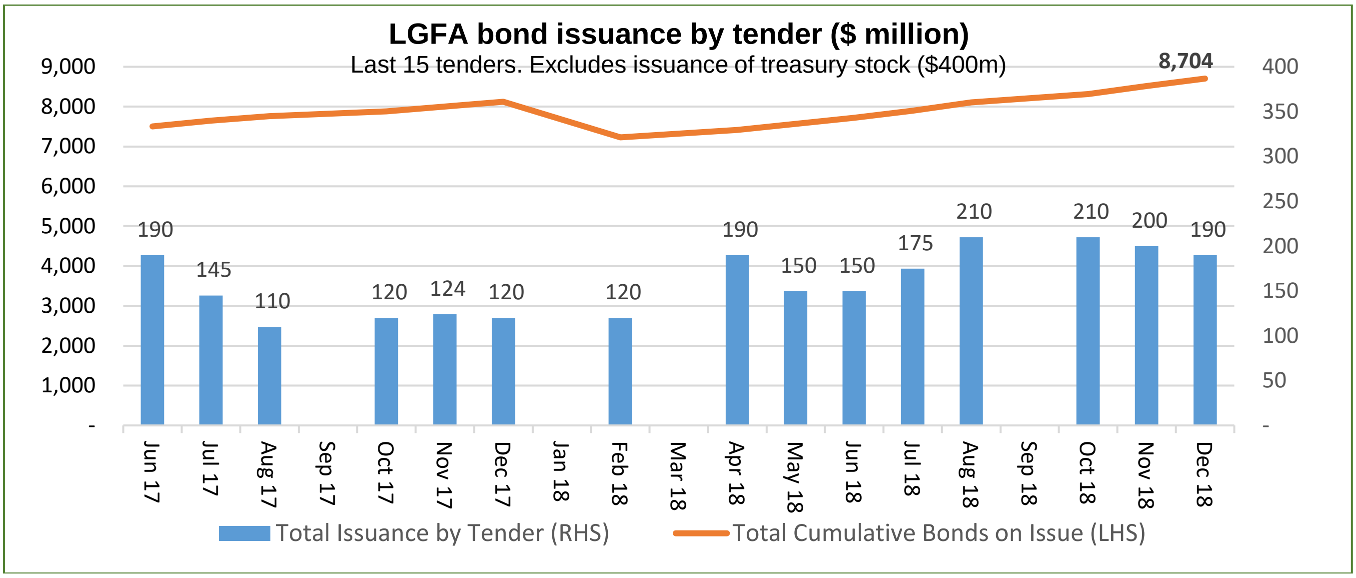
LGFA bonds were listed on the NZX Debt Market in November 2015 and average turnover on the NZX Debt market has been $12 million per month or 8.2% of the total turnover of the NZX Debt Market. Turnover has reduced over the past twelve months as retail investors are more attracted to high term deposit rates.

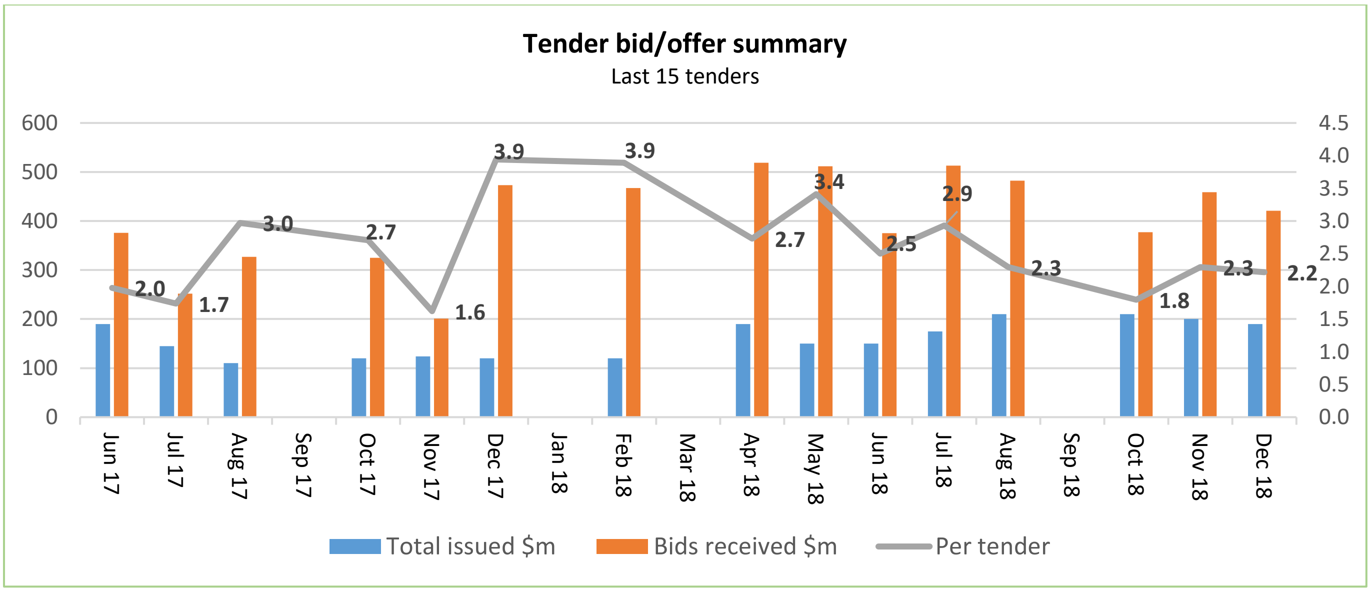


LGFA began issuing LGFA Bills and commenced short dated (less than 1 year) lending to councils in late 2015. As at December 2018 there were LGFA Bills of $485 million and short-term loans of $526.7 million.

LGFA documented an Australian Medium-Term Notes Programme in November 2017 to provide the ability to issue in currencies other than NZD. We have no intention to use this programme, but it provides some flexibility in case of the unlikely scenario of a significant market disrupting event in the future.

The three LGFA bond tenders during the quarter received subdued to average support from the market with a coverage ratio of between 1.8 times and 2.3 times for each tender but within tenders it ranged between 1.0x and 3.17x. The lower coverage ratio is lower than normal and a result of tendering larger amounts of longer dated bonds in each tender where market conditions are not optimal for issuance.





4. Offering more flexible lending terms to Participating Local Authorities

Bespoke lending continues to be a popular borrowing option for council members. During the quarter we lent $476 million on a bespoke basis to twenty-four councils comprising $436.5 million into bespoke maturity dates and $39.5 million into LGFA bond maturity dates but in between the normal tender dates. Bespoke lending comprised 88% of total term lending by LGFA to its members during the quarter.

Short term borrowing by councils has been well received with loan terms to date of between one month and 12 months on $526.7 million of loans outstanding as at 31 December 2018 to thirty councils. This is a record in terms of number of councils and amount lent and is a large increase compared to June 2018 where we had lent $244 million to nineteen councils.

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.

LGFA had meetings with sixteen councils during the December quarter (thirty-one for the six-month period to December 2018) 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.

We received and checked council compliance certificates for fifty-five councils out of the fifty -six members as at June 2018. One council (Hurunui District Council) has provided its unaudited financial statements only. This is due to ongoing discussions with their auditors over valuation treatment of inland roads, but we are confident that they remain compliant with LGFA financial covenants.

LGFA has commenced work on credit default assessment analysis of its member councils in preparation for adopting IFRS9 for accounting purposes.

LGFA management met representatives from Treasury, NZDMO, DIA, Trustees Executors, Productivity Commission and Infrastructure New Zealand to discuss the local government sector.

Additional objectives

6. 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 of $6.075 million for the six-month period to 31 December 2018 exceeded the SOI forecast of $5.771 million by $304k. The average cost of funds for the 2018-19 financial year to date is 3.08%. This is slightly lower than the 3.14% for the prior

2017-18 financial year due to the lower outright level of interest rates. The LGFA Board has the sole discretion to set the dividend.

7. 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 draft report is for the December 2018 quarter. LGFA market share of total sector borrowing for the December 2018 quarter was 78.3% and for the year to December 2018 was 80.2%. Adjusting for Auckland Council borrowing in its own name our market share for the year to December 2018 was 89%. Our market share remains strong compared to our global peers.

There are sixty-one participating local authority members of LGFA and we estimate a further two councils could become members in the next six months.

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

Expenses for the six-month period on an unaudited, management basis were $3.698 million which is $130k below budget. This variance is the consequence of:

- Issuance and on-lending costs (excluding AIL) at $1.162 million were $14k below budget. There were lower fees than budgeted relating to the NZDMO facility offset by higher NZX costs and legal costs than forecast. The larger amount of bond issuance and short-term lending has increased legal costs compared to budget.

- Operating costs at $1.644 million were $26k above budget due to timing of personnel and travel costs and additional legal costs relating to considering whether LGFA should lend to CCOs and to also test financial covenant compliance of councils at the group or parent level.

- Approved Issuer Levy payments of $893k were less than our forecast of $1.035 million by $141k due to a lower level of LGFA bonds holdings by offshore investors relative to budget.

9. 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.

10. 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. Meetings were held in July 2018 with S&P and in September 2018 with Fitch.

On 13 July 2018, S&P reaffirmed our long-term credit rating at AA+ under the new methodology for rating Public-Sector Funding Agency (PSFA) group.

On 18 November 2018, Fitch reaffirmed our long-term 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.

11. Achieve the financial forecasts

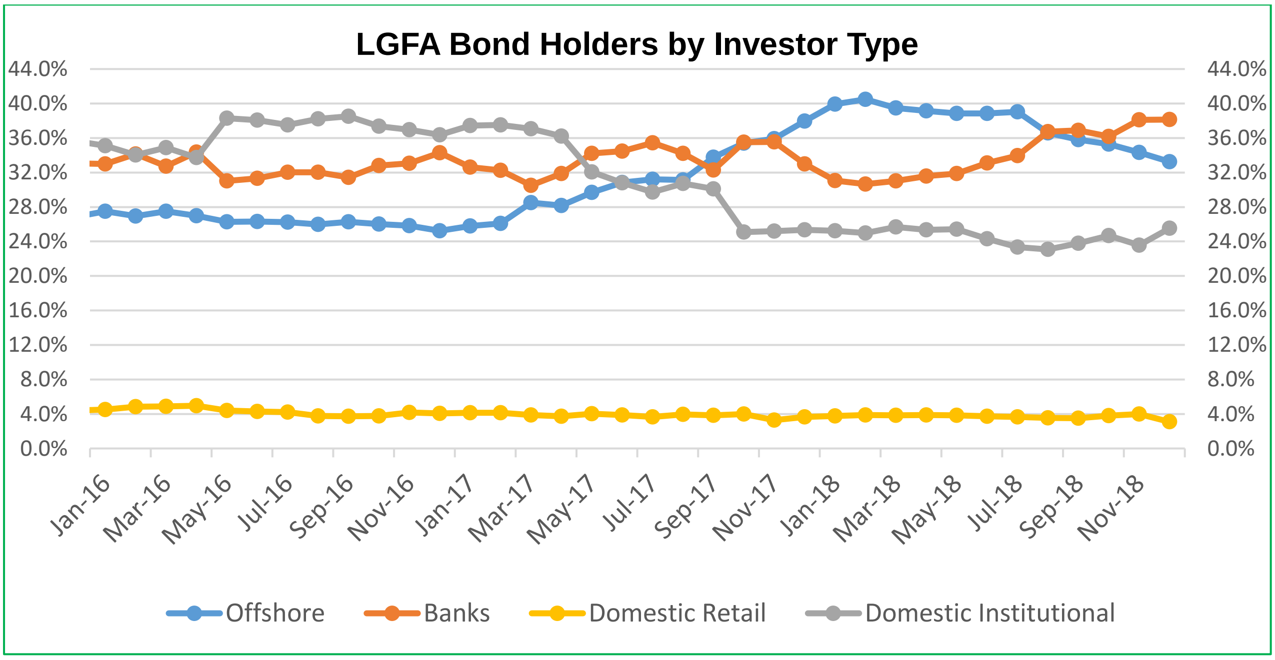
As at the end of the second quarter, Net Interest Income was estimated by management on an unaudited basis to be $174k above budget while expenses are $130k below budget. Net Operating Gain of $6.08 million was $304k above budget and 1.5% above the Net Operating Gain for the equivalent prior period.

G. 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 tender issuance. Our focus is on growing and diversifying the offshore investor group as these investors have the most growth potential given that we already receive strong support from the domestic banks and institutional investors.

There were some changes amongst the different investor groups during the December quarter.

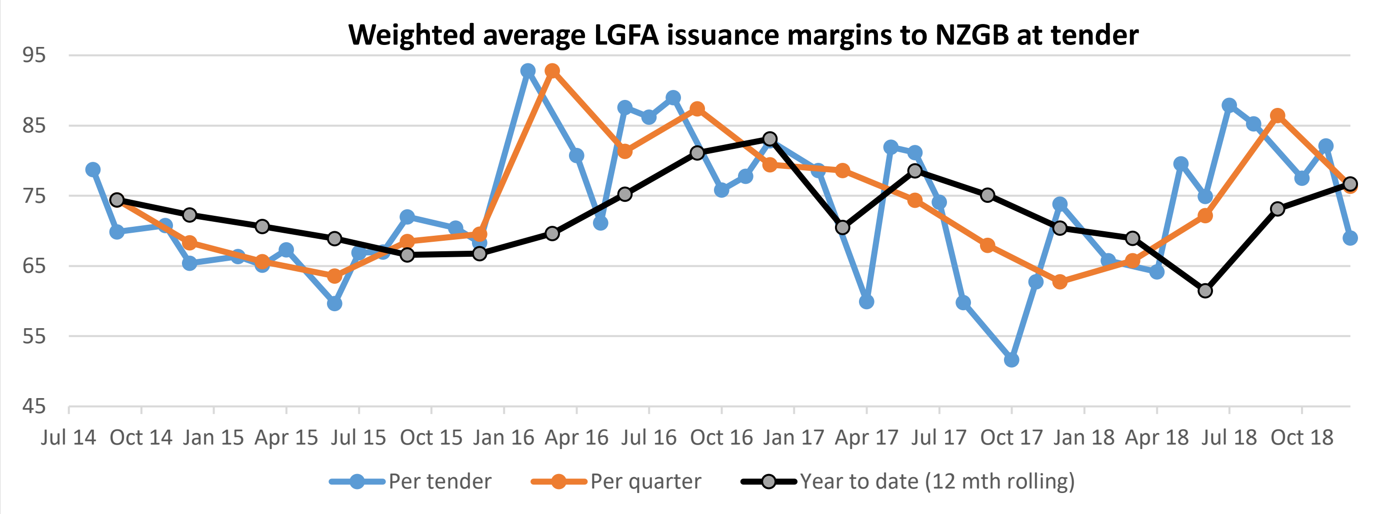
- Offshore investors reduced their holdings of LGFA bonds by $32 million over the quarter (and by $107 million over the past six months). The relative unattractiveness of NZ bond yields to other global markets has led to a decline in holdings of NZ Government Bonds (NZGB), NZD bonds issued by Supranational issuers (e.g. World Bank) and LGFA. LGFA bond yields out to 2027 are below the yield on the comparable US Treasury Bond. While positive for our council borrowers, it is more difficult to encourage offshore investors to buy LGFA bonds. They are estimated to hold $2.90 billion (33% of outstandings) compared to $2.7 billion (38% of outstandings) a year ago.
- Domestic institutional and retail investors increased their holdings by $263 million over the quarter and were estimated to hold $2.5 billion (28.6% of outstandings) compared to $2.1 billion (29.1% of outstandings) a year ago.
- Domestic banks continue to increase their holdings with a rise of $311 million over the quarter. This increased demand is in response to an outlook for reduced NZGB supply due to the strong fiscal position, reduced NZ Treasury Bill supply and a slowdown in bank lending. Bank holdings of $3.3 billion (38.1% of outstandings) are at a record high and compare to $2.35 billion (33% of outstandings) a year ago. Banks do hold $510 million of our March 2019 bond so their holdings will reduce when this bond matures early next year.

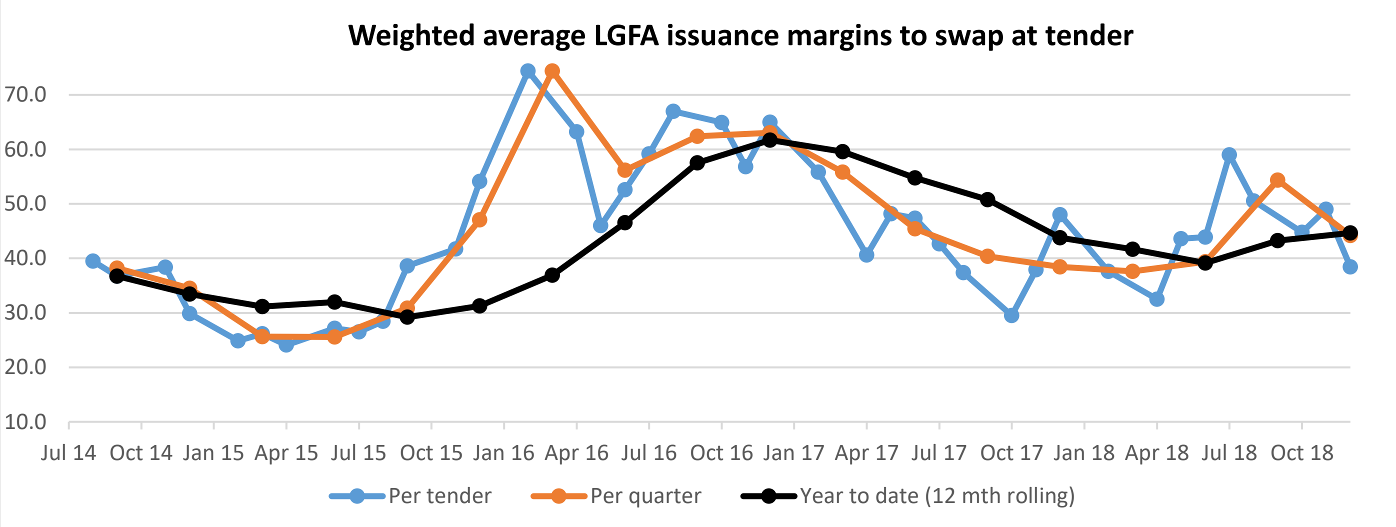


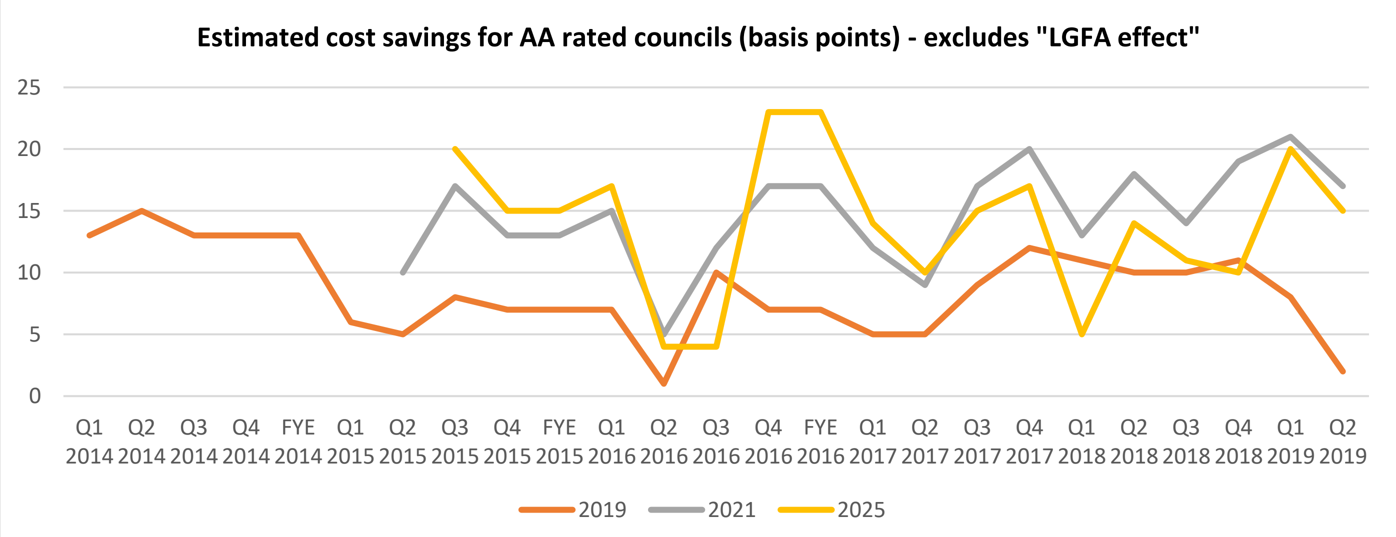
Quarterly Report

Quarter 2: 2018 - 2019
Period ended: 31 December 2018

H. Key trends







Note: Weighted average margins are a function of the term of issuance at each tender.