LGFA
New Zealand Local Government Funding Agency
Te Pūtea Kāwanatanga ā-rohe

LGFA financing to local government for water services – April 2025 update

In December 2024, LGFA wrote to the Mayors and CEOs of councils to outline our involvement in the Local Water Done Well ("LWDW") work programme and outline our thinking on how LGFA could help councils with the financing of their water service delivery plans ("WSDPs").

Over recent months, LGFA has been asked by councils and their advisers for more specific information on the proposed bespoke financial covenants for water CCOs.

This information sets out:

- More detailed information on the how the proposed bespoke financial covenants will be calculated for a water CCO.
- How the LGFA financial covenants will be calculated for a council that transfers its water assets to a water CCO.
- Or alternatively, how the LGFA financial covenants will be calculated for a council that retains its water assets in-house.

Further support and information

LGFA continues to work closely with council finance teams, Department of Internal Affairs, and National Infrastructure Funding and Financing to provide information and support for councils as you consider your future water services delivery arrangements through the development of your WSDPs.

We encourage you to contact us directly by emailing andrew.michl@lgfa.co.nz if you would like further information or to discuss how additional financing from LGFA can benefit your council and communities.

LGFA is looking to assist you with your decision-making process. We look forward to continuing to support you to enable the successful delivery of water services.

1.0 Financial Covenants for Water CCOs.

LGFA expects that over time, water CCOs will reach a financial position that is equivalent to an investment grade credit rating (BBB at least).

LGFA has indicated that there will be two financial covenants and one additional revenue recognition adjustment for water CCOs that wish to join LGFA. The covenants are tiered based on the number of water connections that the water CCO has. These are:

- A Funds from Operation (FFO) to Gross Debt ratio of between 8% and 12%
- A Funds from Operation (FFO) to Cash Interest Coverage of between 1.5 times and 2.0 times.
- The percentage of development contributions recognised in operation revenue

A more detailed explanation of how these covenants will be applied is set out below:

Water Connections	FFO to Cash Interest Coverage Ratio (times)	FFO to Gross Debt Ratio	Percentage of Development Contributions recognised in operating revenue
Less than 5,000	2.00	12%	0%
5,000 - 10,000	2.00	11%	25%
10,000 - 20,000	1.75	10%	50%
20,000 - 50,000	1.50	9%	50%
Greater than 50,0000	1.50	8%	75%

Note: The above information is to be used as guidance. LGFA may consider factors such as future population growth when determining the ratios and operating revenue recognition.

1.1 Phase in period for water CCO Financial Covenants.

LGFA recognises that not all water CCOs will be able to comply with the financial covenants in the first year. This might be the case where the initial amount of water debt transferred to the water CCO is high.

A period will be agreed on a bespoke basis with each water CCO with interim targets in place to encourage an improving trend in ratios over time.

LGFA will allow a period of up to five years (from establishment) for the bespoke financial covenants negotiated with the water CCO to apply. Any request for a period longer than five years would need to be considered by the LGFA Board.

1.2 Definitions of the water CCO Financial Covenants.

Funds From Operations (FFO) to debt: FFO to debt is a leverage ratio that LGFA, rating agency or other investor can use to evaluate a water entity's financial risk. It measures a water entity's ability to pay off debt using its net operating income alone. The higher the ratio, the stronger the position the water entity is in to repay its debt.

Calculating FFO: Free cash flow is net operating income plus depreciation plus any non-cash flow items plus tax (although water entities will not pay any tax).

Calculating Debt: Gross debt is a combination of all short-term loans and long-term loans.

2.0 LGFA Financial Covenants for Councils.

The LGFA financial covenants that apply to councils are listed below.

- The “Lending Policy Covenants” apply to councils who do not have an external credit rating
- The “Foundation Policy Covenants” apply to councils who have an external credit rating. Currently there are 40 councils who have an external credit rating.

Financial covenant	Lending policy covenants	Foundation policy covenants
Net Debt / Total Revenue	<175%	<280%
Net Interest / Total Revenue	<20%	<20%
Net Interest / Annual Rates Income	<25%	<30%
Liquidity	>110%	>110%

Alternative Net Debt / Total Revenue Covenant	
Financial Year ending	**Net Debt / Total Revenue**
30 June 2020	<250%
30 June 2021	<300%
30 June 2022	<300%
30 June 2023	<295%
30 June 2024	<290%
30 June 2025	<285%

The LGFA financial covenants are measured at the “parent” level of a council and not a consolidated group basis unless a council applies to LGFA to have their financial covenants measured at a “group” basis.

Development contributions are excluded for the purposes of calculating the revenue number.

2.1 LGFA Financial Covenants for councils that transfer their water assets to a Water CCO (either 100% owned or multiply owned).

The LGFA financial covenants will apply to the parent council.

After a council transfers its water assets to a CCO, it will lose its water debt and its water revenue. LGFA assumes that in time, the water CCO will introduce direct billing of its water customers. But if a council is collecting water revenue for a water CCO, LGFA will deduct this from the council’s revenue to calculate the adjusted revenue number.

As LGFA is measuring the financial covenants at the parent level, it will not consolidate the debt of the water CCO. Note that the external credit rating agencies might use a different treatment. It is LGFA’s understanding that S&P and Fitch would consolidate the water debt where a council owns more than 50% of a water entity. Where a council owns less than 50%, it would be treated as a contingent liability. Any treatment by an external credit rating agency has no implications for the way LGFA will calculate its financial covenants.

A council water CCO will have its own bespoke covenants. These will not have any impact for the way the council’s financial covenants are calculated.

2.2 LGFA Financial Covenants for councils that retain their water assets in-house.

The LGFA financial covenants will continue to be applied exactly as they have been historically.

As water debt and revenue will remain in-house, these will be part of the council's parent financial position and therefore be included in the LGFA financial covenant calculations.

LGFA will not require councils to separate out their water debt and water revenue for the purpose of calculating the financial covenants. But it is important to note under the water legislation there is a requirement to ring fence water revenue (this is a legislative requirement not an LGFA requirement).

Councils will need to continue to comply with the financial covenants in each financial year. Please note there is no phase in period for councils as there is for water CCOs.

2.3 LGFA Bespoke Net Debt to Revenue Covenant of 350% for Councils.

At the November 2024 AGM, LGFA shareholders approved changes to the Foundation Policy that provided the LGFA Board with the ability to approve a bespoke net debt to revenue covenant of up to 350%.

LGFA wishes to reiterate its previous guidance that the intention is to consider applications from councils who need additional headroom to support the investment in growth infrastructure.

The LGFA Board is unlikely to approve any application for a council who is seeking additional headroom for the renewal of water infrastructure.