

2 May 2013

Craig Stobo
Chair
New Zealand Local Government Funding Agency Ltd
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WELLINGTON 6145

Dear Craig

Statement of Intent for 2013/14 – Comment by Shareholders’ Council

Thank you for the time you took recently to discuss matters concerning the 2013/14 draft Statement of Intent (SOI).

In writing to you, I would like to ensure that:

- issues raised in the Shareholders’ Council’s Letter of Expectations, sent to the Agency in December last year, are reflected in the 2013/14 SOI;
- the SOI complies with the content requirements of the Local Government Act;
- there is an alignment between the prospective performance information in the SOI and that reported to shareholders in the next year; and
- compliance costs for the LGFA are minimised.

As a matter of record, it is pleasing that you have agreed to the following changes being made:

- Operational and financial risk (as described in Section 4 of its Treasury Policy): the LGFA will maintain a high level of focus on the operational and financial risks of the business and this will be acknowledged as a “primary objective” in the SOI and reported thereon;
- Profitability: the LGFA will adopt a “reserving policy” to prudently manage the expected level of retained earnings;
- Reporting: the LGFA will include a year-end forecast profit and loss statement in each of its quarterly reports. It will also report borrowing margins by Councils (in rating bands) relative to BKBM, and swap rates (but not at an individual Council level). This intention needs to be reflected in the SOI at a high level;
- Savings for the sector (the \$25m amount estimated prior to the LGFA’s establishment): while you mentioned that this would be dealt with in the quarterly reports, the Council does not wish to lose sight of this ‘outcome’ and considers it needs to be reflected in the SOI;
- Work with the Shareholders’ Council to develop maturity targets: Phil Combes has undertaken to shortly expand on the reasons why he considers that these targets should not be included in the SOI. It is important for the Council, however, that there are appropriate ‘SMART’¹ targets which provide stakeholders with a level of assurance that the business is performing in ways which are agreed, clear and

¹ SMART: Specific, Measurable, Agreed, Realistic, Timeframed.

measurable. Any other suggestions Phil may have on other ways to achieve these broad objectives, would be helpful.

In order for shareholders to better understand the LGFA's work, the following additional information should be included in the 2013/14 SOI:

1. *Asset quality*: Shareholders must be kept well informed of any business risks associated with the quality of the LGFA's loan portfolio. That is; the headroom to covenants as set out within the LGFA's Lending, Foundation and Treasury Policies. Shareholders expect that the risk profile of Councils, reflecting their net debt to total revenue ratios, should be broadly described in the SOI. It is important that further details be provided in the LGFA's quarterly reports, not necessarily at individual Local Authority level, including how it proposes to manage any developing issues and risks;
2. *Organisational capability and risk assessment*: The Council considers that an enhanced section in the SOI would be helpful as it would provide a clear link to quarterly reporting. Such a section could be included in place of the SOI's "Information to be provided to Shareholders" and cover defined risks such as those detailed in the heading on "Asset quality" (point 1 above) and other areas where particular risks need to be clearly identified and reported;
3. *Credit rating*: it is proposed that in order to reflect its importance to shareholders, the "additional objective" to maintain the LGFA's credit rating be raised in status and included as a "primary objective";
4. *Financial forecasts*: the current level and extent of financial information in the SOI will be helpful and baseline forecasts to 30 June 2013, for comparative purposes, should also be included;
5. *Quarterly report*: the original wording and reporting timetable from the 2012/13 SOI is to be retained. This matter can be raised again in subsequent years, but for the meantime the timeliness of the quarterly reporting that is captured in the current wording is preferred.
6. *Performance measures*: attached as Annex One is a comparative table of performance measures taken from the 2012/13 SOI and the 2013/14 draft. The Council proposes that a number of the current (2012/13) measures should be included again, with changes, to ensure that they can be meaningfully reported against.

It would be helpful if we were able to continue working together in this manner Craig, to ensure that a direct and positive relationship between the LGFA and the Council is maintained. I would be pleased to continue participating in this process and that any matters of concern to either party are directed through us in this way.

I know that the Council appreciates, and is very positive about, the excellent work and results being achieved by the LGFA.

Please don't hesitate to give me a call should you wish to discuss any of the matters raised in this letter.

Yours sincerely

A handwritten signature in black ink, appearing to be 'BT', with a large loop at the top and a horizontal stroke across the middle.

Brian Trott

Chair

Shareholders' Council

cc Phil Combes, CEO (by e-mail)
All Shareholders (by e-mail)

Comparison and commentary on objectives and performance measures²

Additional Objectives 2012/13 SOI	Additional Objectives 2013/14	Comment
<ul style="list-style-type: none"> • Become the primary source of debt funding for Participating Local Authorities (PLAs) 	<ul style="list-style-type: none"> • Replaced by "Provide at least 50% of [the dollar value of] aggregate long-term debt funding for PLAs". 	<p>The 50% should be increased to provide stretch to ensure that the LGFA is, or will become, the "primary" source of funding. Suggest adding [the dollar value]. To be reported in out-years, following implementation of processes to collect this information.</p>
<ul style="list-style-type: none"> • Operate in a manner to ensure LGFA is successful and sustainable in the long-term • Educate and inform all Local Authorities (both participating and non-participating) on matters within the scope of LGFA's operations • Provide excellent service to PLAs • Ensure excellent communications exist and be professional in its dealings with all stakeholders • Ensure its products and services are delivered in a cost effective manner 	<ul style="list-style-type: none"> • Not included 	<p>These are important objectives and should be included in the front-end of the 2013-16 SOI. They can be included as general business objectives without introducing an obligation for the LGFA to specifically report against them in its quarter & annual reports.</p>
<ul style="list-style-type: none"> • Maintain LGFA's credit rating equal to the NZ Government's sovereign rating where both entities are rated by the same Rating Agency 	<ul style="list-style-type: none"> • Maintain LGFA's credit rating equal to the NZ Governments sovereign rating where both entities are rated by the same Rating Agency 	<p>It is our view that this objective should be raised to the status of a Primary Objective – referred to in the cover letter.</p>

² Those objectives with which the Council agrees should remain as they are, and have not been included in this list.

Comparison and commentary on Performance Targets

Performance Targets 2012/13	Performance Targets 2013/14	Comment
Sector savings of \$25m (not included).	Sector savings should be formally included in the SOI.	The Council does not wish to lose sight of this 'outcome' and would like to see it reflected at some point in the SOI. Referred to in letter.
LGFA's annualised operating overheads will be less than \$3.2m.	LGFA's annual issuance and operating expenses will be less than \$3.3m.	Previous financial forecasts record issuance and operating expenses in 2014 as being \$3.1m. It is suggested that the LGFA set a target more in line with this figure. It would be appropriate to provide some level of 'stretch'.
<p>The total number of Participating Local Authorities Shareholders in the LGFA at 30 November 2012 will be at least 30.</p> <p>The total number of Participating Local Authorities (i.e. shareholders and eligible borrowers) in the LGFA at 30 November 2012 will be at least 40.</p>	Not included in 2013/14.	<p>Given the latest progress being made on this, and the utility of having as many Local Authorities participating as possible, the Council considers it important that a date and reasonable targets be included in the SOI.</p> <p>As above.</p>