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Committee Council
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Local Government Funding Agency (LGFA) Annual Report 2015/16

1. Purpose

To update the Council on the progress of the Local Government Funding Agency and to provide their annual report for the year ending 30 June 2016.

2. Background

The LGFA was established on 6 December 2011 and Greater Wellington Regional Council (GWRC) became a shareholder of the Local Government Funding Agency (LGFA), contributing \$2 million in paid up capital. In November 2012 GWRC reduced its shareholding to \$1.87 million by selling 134,021 \$1 shares to other councils that joined the LGFA. Since then the number of council shareholders remained unchanged at 30 councils plus the New Zealand Government. The latter holds 20% of the shares.

At the time the LGFA was set up, a body called the Shareholders' Council was also established. Its role is to monitor the LGFA and to provide a liaison between the LGFA and its shareholders. GWRC is no longer a member of the Shareholders' Council. Its previous representative, Mike Timmer – Treasurer GWRC, has been elected to the LGFA's board of directors.

The LGFA reports to shareholders via the Shareholders' Council. The LGFA, also being a Council Controlled Organisation, is obliged to produce a Statement of Intent (SOI) and report on it.

The SOI is monitored by the Shareholders' Council, which provides feedback to the LGFA on its performance and a collective liaison between the shareholders and the LGFA.

As at June 2016 GWRC has borrowed \$255 million from the LGFA in nine tranches of \$25 million and one tranche of \$30 million. The first two tranches (\$50 million) mature in December 2017. The remaining eight tranches mature relatively evenly spaced in periods of 12 – 24 months apart. The latest tranche is due for repayment in April 2027.

3. Comment

A cover letter from the LGFA's Chief Executive (**Attachment 1**) and the LGFA's Annual Report for the 2015/16 year (**Attachment 2**) are appended to this report.

The LGFA borrowing continues to grow with its book size at \$6.4 billion at 30 June 2016, an increase of \$1.4 billion from a year earlier. During the year the LGFA introduced short term borrowing - between 1 month and 1 year - to councils. This was an initiative lead by our Treasurer and it has seen savings in excess of 0.50% for the smaller councils. There has been no benefit for the bigger councils as they already access the wholesale investor market directly.

The LGFA reduced its on-lending margin to us from 0.15%, i.e. 15 points to 11 points, providing a small saving.

It also listed all its bonds on the NZX (Stock Exchange), which has increased the tradability as some foreign investors mandates only allow them to invest in securities that are listed.

In June 2016 the LGFA commenced the issuance of a 2025 bond, bringing the total maturities to seven.

For the 2015/16 year the LGFA achieved a net operating profit of \$9.5 million, of which \$1.3925 million will be paid out as dividend. GWRC has received a dividend of \$103,935 in October this year being a return of 5.55% on Council's \$1.87 million investment.

The debt issuance by the LGFA continues to be received well by the market as evidenced by the large amount of over subscription.

The performance targets as set out in the 2015/16 SOI have mostly been achieved or only narrowly missed and are discussed below under additional objectives. The Primary Objectives are listed below and commented on.

3.1 Primary Objectives

1. Optimising the debt funding terms and conditions for participating local authorities.

a) Providing savings in annual interest costs for all participating local authorities.

As part of this primary objective the LGFA aims to reduce its margins over New Zealand Government Bonds (NZGBs) and to minimise its margins over swap rates.

In the 2015/16 year the LGFA spreads to its benchmarks have widened from its historic lows. The spread increases ranged from 4 basis points (bps) higher margins for 2017 NZGBs to 35bps (0.35%) for 2027 NZGBs. This widening of spreads has affected all non-government borrowers and is mainly due to concerns from investors over the global economic outlook, raising volatility (BREXIT) and the need to manage

investments in a low rate environment. This led to a reduction in risk sentiment and lower demand for NZD bonds issued by non-government borrowers.

The LGFA has increased borrowing savings for councils over the financial year. This is evidenced by an improved 4bps pricing advantage when comparing secondary market pricing for LGFA 2021 bonds with Auckland Council and Dunedin City Treasury Bonds with similar maturities.

The LGFA estimates that as at 30 June 2016 it was saving AA rated councils between 17bps for a 2019 maturity and 33bps for a 2025 maturity.

b) Making longer term borrowings available to participating local authorities

Over the past year the LGFA has issued \$1.26 billion of debt with a weighted average debt maturity of eight years. It also commenced a bond maturing in April 2025. In total the LGFA issued bonds into three maturities dates in excess of 6 years.

c) Enhancing the certainty of access to debt markets for participating local authorities

During the year the LGFA held nine tenders and issued \$1.265 billion bonds. All tenders were successful and fully subscribed with an average cover ratio of 2.7 times.

d) Offering more flexible lending terms to participating local authorities

The LGFA introduced bespoke lending (February 2015) as well as short dated lending (November 2015). This now provides flexible lending terms for councils between 30 days and up to 11 years.

2. The 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.

The LGFA undertakes a detailed assessment of each of its borrowers and meets with all member councils on an annual basis while monitoring council performance during the year. The LGFA also reviews the Annual and Long Term Plans for each council and the annual financial statements. The LGFA assigns an internal credit rating to each of its council members as part of the review exercise. As per June 2015 all councils were compliant with the LGFA covenants.

LGFA staff met with the Office of the Auditor General and the Department of Internal Affairs as well as with Local Government New Zealand to work closely on sector issues.

3.2 Additional Objectives

Some of the additional targets have not been met. These are:

- 1) The target for the average cost of funds on debt issued relative to New Zealand Government Securities for the 12 month was set at to be at or below 0.50%. The actual achieved result is 0.74%, which is 0.12% higher than in the 2014/15 year. The widening in the margin is due to a softening in credit market sentiment for non-government bonds and the disproportionate amount of bonds issued (which have a higher margin) over the last six months. The result is very much determined by the market and although not achieved, it is still a very good result and provides great savings to councils.
- 2) The 2015/16 SOI sets the target for the average base on-lending margin at less than 0.10% above LGFA's cost of funds. The LGFA actually achieved a margin of 0.106%, which is only slightly higher. This is due to councils borrowing for longer tenors which attract a slightly higher on lending margin.
- 3) According to the SOI annualised issuance and operating expenses were meant to be below \$5.94 million. The actual expenses are fractionally (\$40,000) above budget. This is due to non-recurring legal expenses due to new lending products, new council members, NZX listing fees and transition to the Financial Markets Conduct Act (FMCA).

4. Communications

GWRC officers continue to monitor and report on the LGFA.

5. The decision-making process and significance

No decision is being sought in this report.

6. Engagement

No engagement is required in relation to this report.

7. Recommendations

That the Council:

1. *Receives the report.*
2. *Notes the content of the report.*

Report prepared by:

Report approved by:

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Attachment 1 – Cover letter to the LGFAs Annual Report 2015/16

Attachment 2 - LGFA Annual Report 2015/16