LGFA
NEW ZEALAND
LOCAL GOVERNMENT
FUNDING AGENCY

24 February 2017

Dear Shareholder

Draft Statement of Intent 2017/18

Please find attached a copy of the Draft Statement of Intent ("SOI") for the 2017/18 year. We have also attached a tracked change version to highlight what we propose changing from the previous 2016/17 SOI.

LGFA continues to focus on delivering strong results for both our council borrowers and shareholders.

For our borrowing councils we seek to optimise funding terms and conditions by:

- Achieving savings in borrowing costs
- Provide longer dated funding and
- Provide certainty of access to markets

For our shareholders we are focused on:

- Delivering a strong financial performance
- Monitoring asset quality and
- Enhancing our approach to treasury and risk management and

The following points regarding the Draft 2017/18 SOI are worth noting:

- While profitability is forecast to remain strong it is expected to reduce in the 2019/20 financial year as we forecast a reduction in net interest income while total expenses are also forecast to track lower but at a lessor rate.

- Net interest income is expected to be lower in the outer years due to the forecast repayment by councils of the higher margin loans made during the 2012-14 period. Many of these loans mature between 2017 and 2019 and are being refinanced with loans at a reduced on lending margin. While this is positive for council borrowers, it does reduce our forecast profitability.

- We have increased our forecast for Local Government loans outstanding as at June 2018 to $7.864 billion and to $7.913 billion as at June 2019 (from $7.762 billion and $7.850 billion in the previous SOI). This reflects today's higher starting point for council loans offset by some uncertainty regarding the impact on LGFA lending if councils substitute LGFA borrowing for funding from the Housing Infrastructure Fund facility.

- We have made no changes to the on-lending margins given the base lending margin now averages 10 bps (0.10%). Any further reductions in the base margin is unlikely as we need to ensure we have sufficient capital to match the growth in the balance sheet. LGFA on-lending margins are the narrowest when compared with our international peers.

- Compared to the previous SOI, issuance and on-lending costs excluding Approved Issuer Levy (“AIL”) are forecast to be higher due to the additional NZX listing fees and a small increase in personnel costs. However, a forecast reduction in AIL payments offsets these increases and total expenses are lower than forecast in the previous SOI.

- The SOI performance targets are similar to the targets in the previous SOI except that we have removed the target for LGFA bonds to be issued at 0.50% above New Zealand Government Bonds. This target did not accurately reflect funding costs for our council borrowers who are focused on borrowing on a spread to swap i.e. a floating rate basis. We have also improved how we measure cost savings to council borrowers by comparing our funding costs to the funding costs of registered banks.

- There is some timing uncertainty within the SOI forecast relating to Local Government loans and LGFA bonds outstanding as we now have to project both the repayment amount and repayment timing of the Local Government loans that are due to mature in December 2017 and March 2019. Decisions made by our council members regarding early refinancing will have a phasing impact across all three years in the SOI forecast.

If you have any questions or wish to provide comments by 30 April 2017 then please feel free to contact myself or any member of the Shareholders Council.

Yours sincerely

Mark Butcher
Chief Executive

NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED
AUCKLAND Level 12, West Plaza Tower, Corner Albert and Customs Street
WELLINGTON Level 8, City Chambers, 142 Featherston Street
PO Box 5704, Lambton Quay, Wellington 6145 | PH +64 4 974 6530 | www.lgfa.co.nz