Quarterly Report
For period ended 30 June 2015

LGFA
NEW ZEALAND
LOCAL GOVERNMENT
FUNDING AGENCY

1. COMMENTARY ON OPERATIONS FOR THE QUARTER

Key points to note during the June quarter:

- The April 2015 LGFA bond matured and associated council borrowings were refinanced without any issues.
- LGFA margins to swap rates were unchanged to slightly wider during the quarter while LGFA margins to NZGB narrowed in line with other non-government issuers.
- Debt issuance of $370 million for the quarter was in line with the average quarterly issuance of $379 million since LGFA commenced tendering in February 2012. $1.5 billion of bonds were issued in the June 2015 financial year.
- Council borrowers continue to favour long dated terms from LGFA and bespoke lending has been very successful with $79 million of non-standard lending undertaken.
- Total outstandings across the six LGFA maturities now stand at $4.955 billion and LGFA is the largest issuer of NZD securities after the NZ Government.
- Offshore holdings continue to increase in nominal terms to $1.4 billion and as a percentage of LGFA bonds outstanding (28.5%). This helps for further spread contraction and reduces our reliance upon domestic investors for funding.
- Implementation of the SunGard Quantum Treasury system has been successfully completed and LGFA is ready to take over front, middle and back office services from the Debt Management Office (DMO) on 1 July 2015.

Two LGFA bond tenders were held during the quarter (April and June) with $370 million of bonds issued in the quarter.

Results of LGFA Bond Tender Number 28

Tender Date: 08 April 2015
Settlement Date: 15 April 2015

Tender 28 - 08 April 2015	15-Dec-17	15-Apr-20	15-Apr-23	15-Apr-27
Total Amount Offered ($million)	30	25	25	110
Total Amount Allocated ($million)	30	25	25	110
Total Number of Bids Received	8	12	13	39
Total Amount of Bids Received ($million)	98	104	102	243
Total Number of Successful Bids	2	3	3	21
Highest Yield Accepted (%)	3.565	3.675	3.840	4.070
Lowest Yield Accepted (%)	3.560	3.675	3.810	3.990
Highest Yield Rejected (%)	3.650	3.750	3.930	4.150
Lowest Yield Rejected (%)	3.565	3.675	3.840	4.070
Weighted Average Accepted Yield (%)	3.564	3.675	3.824	4.035
Weighted Average Rejected Yield (%)	3.604	3.698	3.881	4.100
Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield*	50	71.4	33.3	85
Coverage Ratio	3.27	4.16	4.08	2.21

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Margins over NZGBs and mid-swap levels at the tender were:

LGFA Spreads to NZGBs/Swap (bps)	Tender No. 28 – 08 April 2015	
	NZGB spread	Swap spread
Dec 2017	49.5	6.75
April 2020	56.5	11.25
April 2023	64.5	17.5
April 2027	74.5	29.75

Highlights of the tender were:

The tender highlights were the record low spreads to swap and record lows for outright issuance yields. Other highlights included the $190 million issued was the largest tender for six months and tight successful bid ranges were achieved for all maturities except the 2027s.

The coverage ratio (at 2.9 times) was identical to the March tender and reflected the reduced demand from domestic investors given the tightness of LGFA spreads to swap.

Total LGFA outstandings across the six maturities following the tender was $4.775 billion.

The tender was timed to coincide with the maturity of the LGFA April 2015 bond (and associated on-lending to councils). The bond maturity and on-lending all settled with no problems with most councils already prefunded their borrowings. Three councils borrowed on a bespoke basis in this tender.

Results of LGFA Bond Tender Number 29

Tender Date: 03 June 2015
Settlement Date: 08 June 2015

Tender 29 – 03 June 2015	15-Apr-20	15-Apr-23	15-Apr-27
Total Amount Offered ($million)	35	70	75
Total Amount Allocated ($million)	35	70	75
Total Number of Bids Received	12	23	28
Total Amount of Bids Received ($million)	53	182	227
Total Number of Successful Bids	79	16	11
Highest Yield Accepted (%)	3.80	4.12	4.37
Lowest Yield Accepted (%)	3.73	4.00	4.33
Highest Yield Rejected (%)	3.87	4.25	4.56
Lowest Yield Rejected (%)	3.80	4.125	4.40
Weighted Average Accepted Yield (%)	3.766	4.0816	4.3524
Weighted Average Rejected Yield (%)	3.82	4.1966	4.4974
Amount Allotted at Highest Accepted Yield as Percentage of Amount Bid at that Yield	50	100	100
Coverage Ratio	1.51	2.6	3.03

Margins over NZGBs and mid-swap levels at the June 2015 tender were:

LGFA Spreads to NZGBs/Swap (bps)	Tender No.29 – 03 June 2015	
	NZGB spread	Swap spread
April 2020	52	16.5
April 2023	61	22.5
April 2027	62	30.5

Highlights of the tender were:

The tender highlights were the successful issuance at good levels i.e. 2bps to 4 bps above prevailing secondary market levels at the time of high market volatility and uncertainty. German 10 year Bund yields had risen from 0.54% to 0.71% the night before the tender, US Bond yields had risen to recent highs and the two most recent NZ Government Bond (NZGB) tenders had struggled in the previous three weeks.

Weighted average successful yields on the 2027s rose 32bps from the previous tender while margins to NZGB narrowed but margins to swap widened. The bid coverage ratio of 2.6 was the lowest since August 2015 but understandable given the market conditions and the recent strong outperformance of the long dated LGFA bonds to NZGB.

An unusually high number of councils (14) borrowed though the tender possibly due to the eight week gap since the April tender and we had also completed a further four bespoke lending transactions during that period.

We have included a chart of the successful bid range for all of our bonds (for tenders over the past two years), which provides a good guide to the market conditions in which we are tendering. In general, the lower the successful bid range (difference between the highest and lowest successful bids), the better the tender

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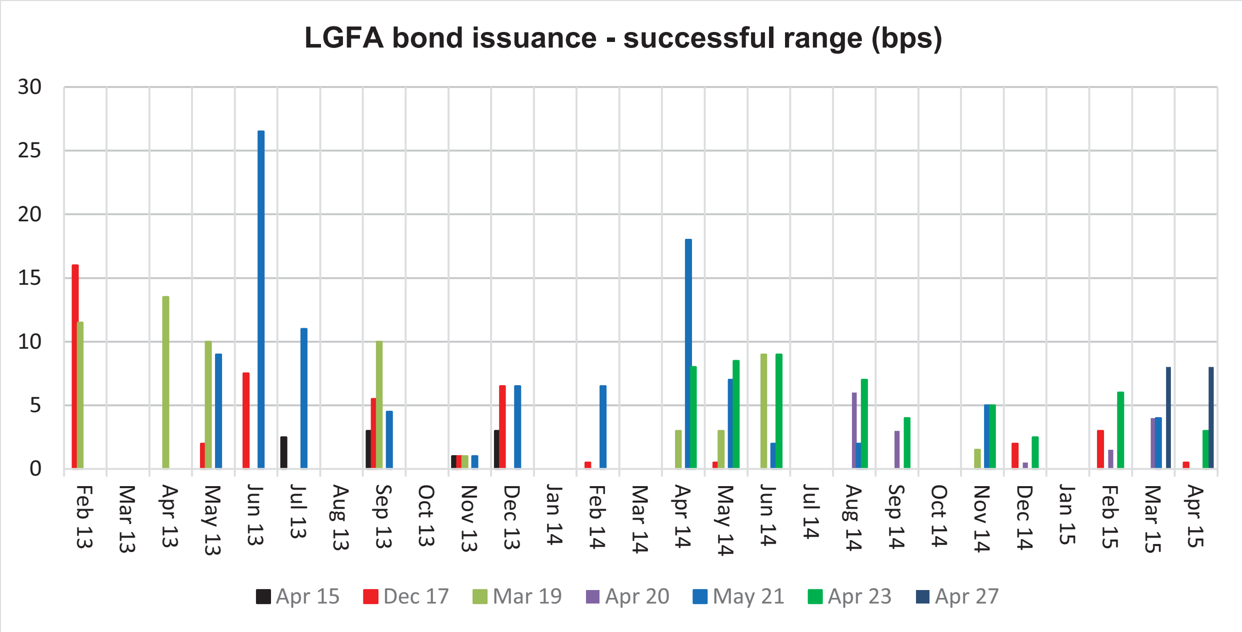

We are pleased to see tighter bidding ranges in the current financial year despite the large size of each tender and a greater composition of longer dated bonds than normal in the tenders held during the period.

Summary of council borrowing margins

The following table outlines the total borrowing margin applicable to councils borrowing on a floating rate basis (i.e. LGFA's margin over swap plus the base margin and credit margins) at the tenders held during the quarter.

Tender No.28 – 08 April 2015

Council Credit Rating Bands	Dec 2017	Apr 2020	Apr 2023	Apr 2027
AA	18.75	25.25	34.5	46.75
AA-	23.75	30.25	39.5	51.75
A+	28.75	35.25	44.5	56.75
Unrated	38.75	45.25	55.5	66.75

Tender No.29 – 03 June 2015

Council Credit Rating Bands	Apr 2020	Apr 2023	Apr 2027
AA	26.5	39.5	45.5
AA-	31.5	44.5	50.5
A+	36.5	49.5	55.5
Unrated	46.5	59.5	65.5

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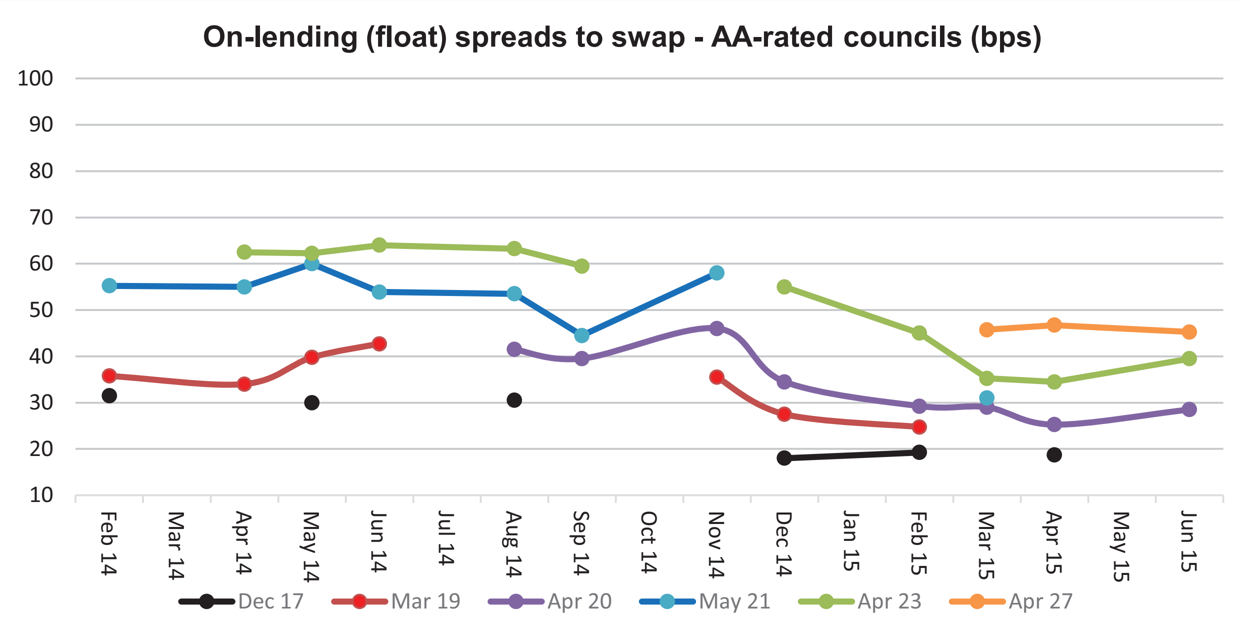
The chart below shows the total borrowing margin charged to AA rated councils (borrowing on a floating rate basis) at the twelve tenders since February 2014. Over the period, the total borrowing margin charged to councils have been steadily declining for all maturities (as a general trend).



PERFORMANCE AGAINST SOI OBJECTIVES AND PERFORMANCE TARGETS

Primary Objective

LGFA operates with the primary objective of optimising the debt funding terms and conditions for participating local authorities. Among other things this includes:

- Providing estimated savings in annual interest costs for all Participating Local Authorities of at least 30 basis points, based on the methodology set out in LGFA's Annual Report 2012-2013;
- Making longer-term borrowings available to Participating Local Authorities; and
- Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice.

  We have met our primary objective by achieving significant improvement in the pricing of our benchmark 15 December 2017, 15 March 2019, 15 May 2021 and April 2023 bonds since they were first issued. These bonds are regarded as our benchmark bonds because they have large volumes outstanding (approximately $1 billion), the most liquidity and greatest frequency of issuance.

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Over the course of the twelve months ended 30 June 2015:

- LGFA margins to NZGB improved by 25, 28, 22 and 20 bps respectively for the December 2017, March 2019s, May 2021s and April 2023 maturities.
- LGFA margins to swap improved by 8, 12, 18 and 24 bps respectively for our December 2017, March 2019, May 2021 and April 2023 bonds.

These secondary market pricing movements are summarised in the following tables:

Margins – 15 December 2017	30 June 2014 (bps)	31 Dec 2014 (bps)	30 June 2015 (bps)	Pricing movement over past year
LGFA margin to NZ Government Bonds	61	40	36	(25)
NZGB margin to swap	(46)	(33)	(29)	17
LGFA margin to swap	15	7	7	(8)

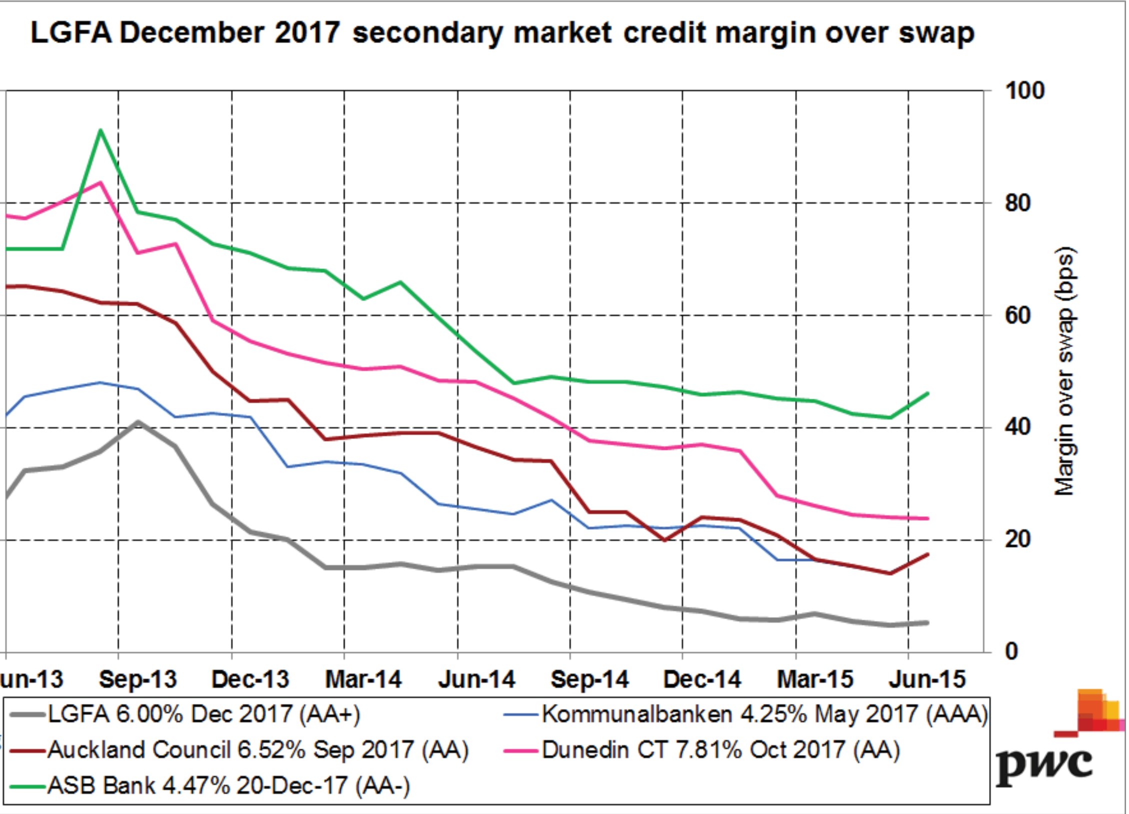
Margins – 15 March 2019	30 June 2014 (bps)	31 Dec 2014 (bps)	30 June 2015 (bps)	Pricing movement over past year
LGFA margin to NZ Government Bonds	72	55	44	(28)
NZGB margin to swap	(49)	(39)	(33)	16
LGFA margin to swap	23	16	11	(12)

Margins – 15 May 2021	30 June 2014 (bps)	31 Dec 2014 (bps)	30 June 2015 (bps)	Pricing movement over past year
LGFA margin to NZ Government Bonds	80	67	58	(22)
NZGB margin to swap	(46)	(42)	(42)	4
LGFA margin to swap	34	25	16	(18)

Margins – 15 April 2023	30 June 2014 (bps)	31 Dec 2014 (bps)	30 June 2015 (bps)	Pricing movement over past year
LGFA margin to NZ Government Bonds	87	75	67	(20)
NZGB margin to swap	(43)	(41)	(47)	4
LGFA margin to swap	44	34	20	(24)

The significant improvement in our margin to both NZGB swap over the past year is due to strong credit market conditions and growing offshore investor interest in LGFA bonds.

Over the past year, our estimate of annual interest cost savings has slipped below the 30 bps target. This is because issuance margins to swap for our benchmark councils (Auckland and Dunedin) also improved. These two councils have both been able to issue securities at favourable pricing following the success of LGFA and with LGFA covering most of the sector, there is now a general shortage of single name council debt.



Source: Bloomberg

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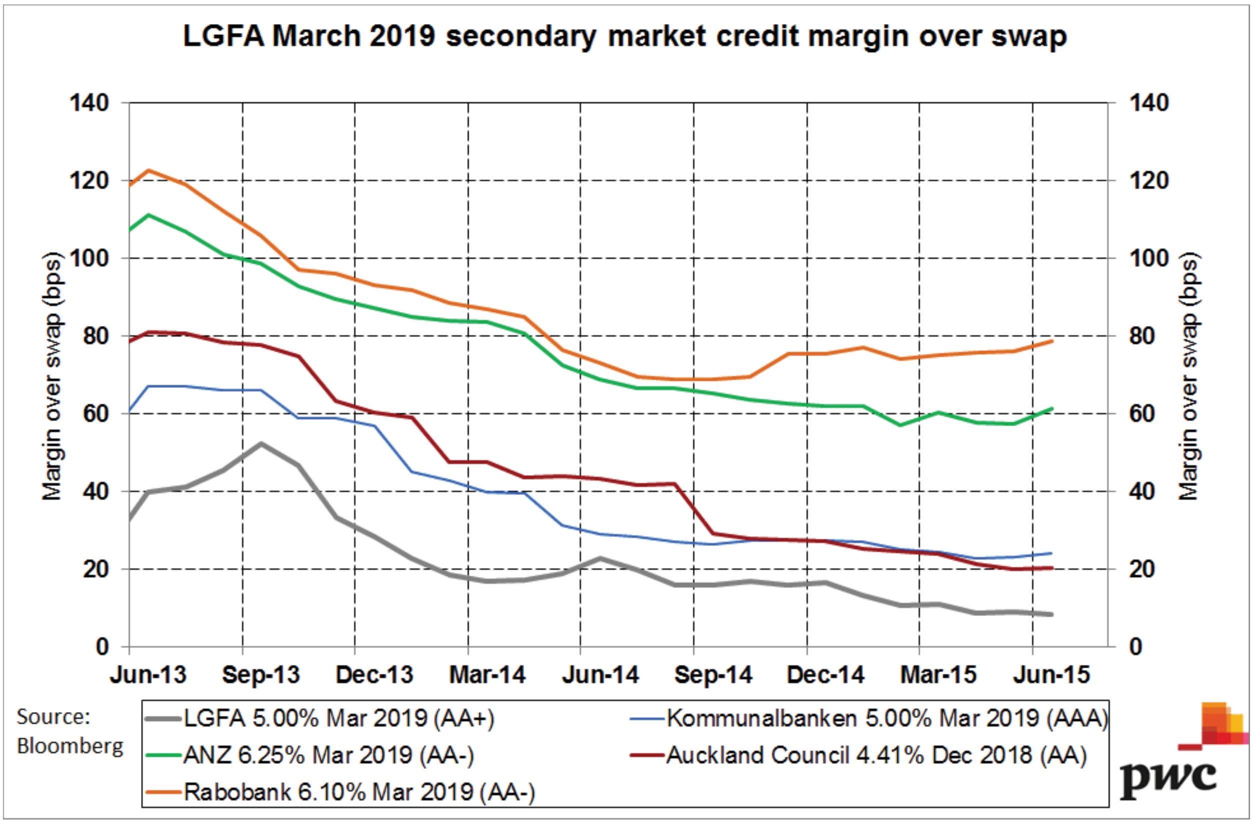


From the above charts and the following tables, we estimate that as at end June 2015, LGFA was saving AA rated councils approximately:

- 17 to 19 bps in annual interest costs on a December 2017 maturity, and
- 17 bps in annual interest costs on a March 2019 maturity.

The basis for these estimates is set out in the table below:

Margins as at 30 June 2015	**December 2017 maturity (bps)**	**March 2019 maturity (bps)**
AA rated councils margin to swap*	23 to 25	27
Less: LGFA margin to swap	(7)	(11)
LGFA Funding Advantage	16 to 18	16
Less: LGFA Base Margin	(9)	(9)
LGFA Net Funding Advantage	7 to 9	7
Add: 'LGFA Effect' **	10	10
Total saving for AA rated councils	**17 to 19**	**17**

* *For the 2017 bond, the benchmark councils are Auckland (23 bps) and Dunedin (25 bps). For the 2019 bond, the benchmark is Auckland. Dunedin does not have a 2019 bond on issue.*

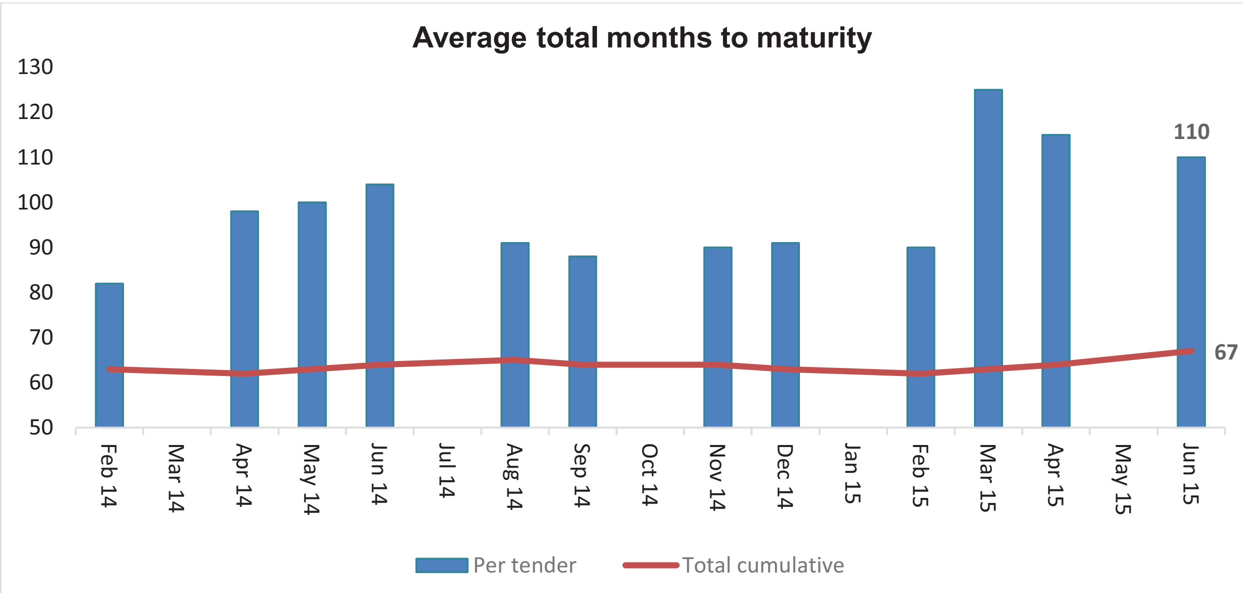
** *The 'LGFA effect' represents the estimated conservative reduction in AA rated council's margin to swap as a result of LGFA operations. From May to June 2012, the margin to swap for AA rated councils fell by 10 bps, with no corresponding move in swap spreads for other borrowers. This suggests that potential access to cost-effective LGFA funding has enabled these councils to reduce their borrowing margin by around 10 bps.*

- *Making longer-term borrowings available to Participating Local Authorities*

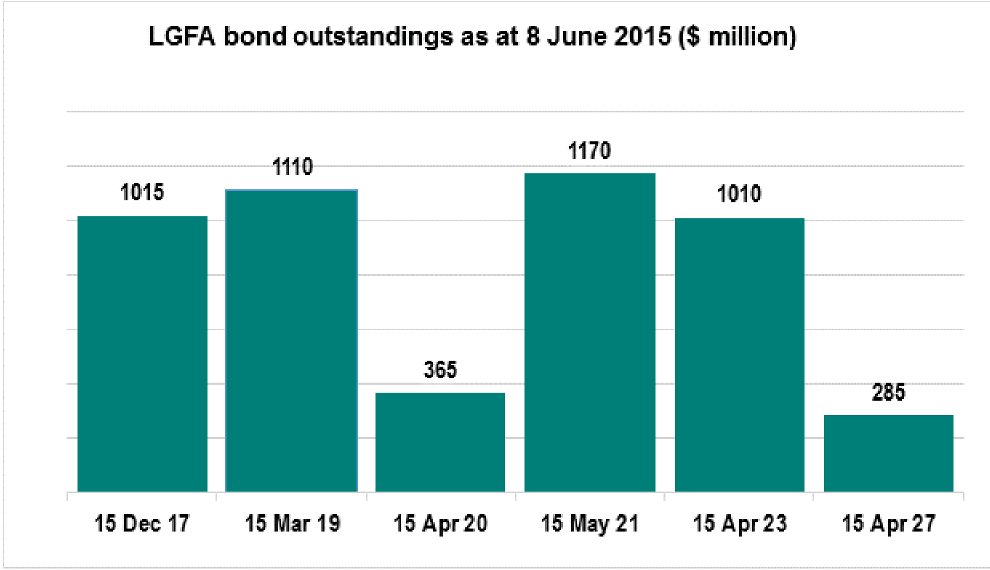
  Over the course of the June quarter, LGFA lent to Councils in maturities ranging from two and a half years to twelve years (2017 to 2027). The weighted average term of lending for the June 2015 quarter was 9.3 years.

  Over the past year a new twelve year maturity (April 2027) was first issued in the March 2015 tender. Total outstandings in this new maturity by the end of June 2015 was $285 million.

  The following graph shows the average months to maturity for LGFA bonds issued at tender, and the average months to maturity for all LGFA bonds outstanding at each tender:

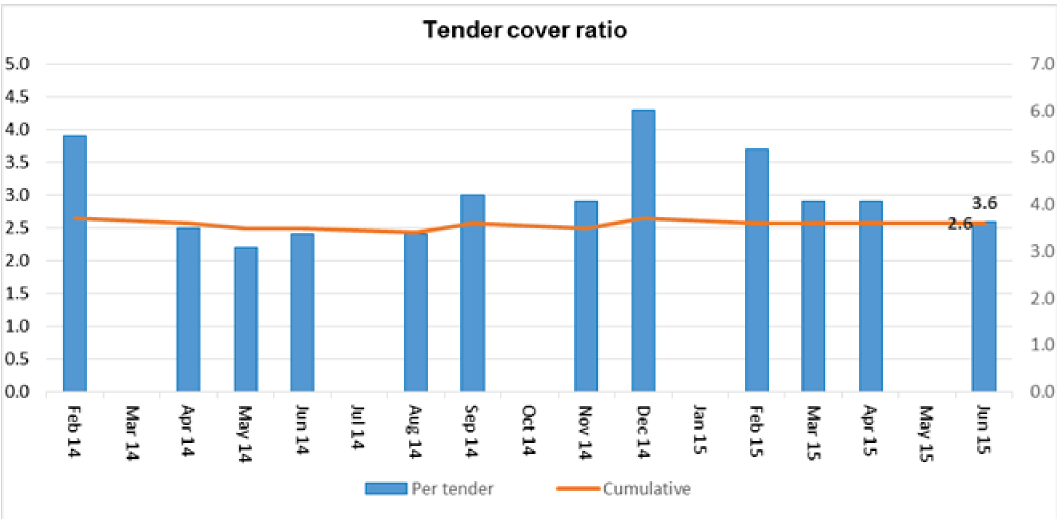


The average maturity issued for the two tenders in the quarter was 110 months (10 years and five months) while the average for all bonds outstanding is 67 month (5 years and seven months).



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

  Access to debt markets has been enhanced by the consistently strong cover ratios achieved at most LGFA bond tenders held to date. Our cover ratio (i.e. ratio of total amount bid to total amount offered) for each tender has been:



From the above chart, it is important to note that:

- Total bids received have amounted to $17.44 billion in the past twenty nine tenders;
- The average cover ratio has been 3.6 times; and

- Our cover ratio in the two tenders held during the June 2015 quarter averaged 2.75 times. The reduced coverage ratio is in line with that experienced by the NZ Government and reflects market volatility, relative expensiveness of LGFA bonds to other investments, low outright yields and a tendency to issue longer dated bonds that are less attractive to bank investors. However, price tension remains strong despite the lower volumes.

Additional objectives

LGFA has a number of additional objectives which complement the primary objective. These objectives will be measurable and achievable and the performance of the company in achieving its objectives will be reported annually. These additional objectives are to:

- Operate with a view to making a profit sufficient to pay a dividend in accordance with its stated Dividend Policy set out in section 6;

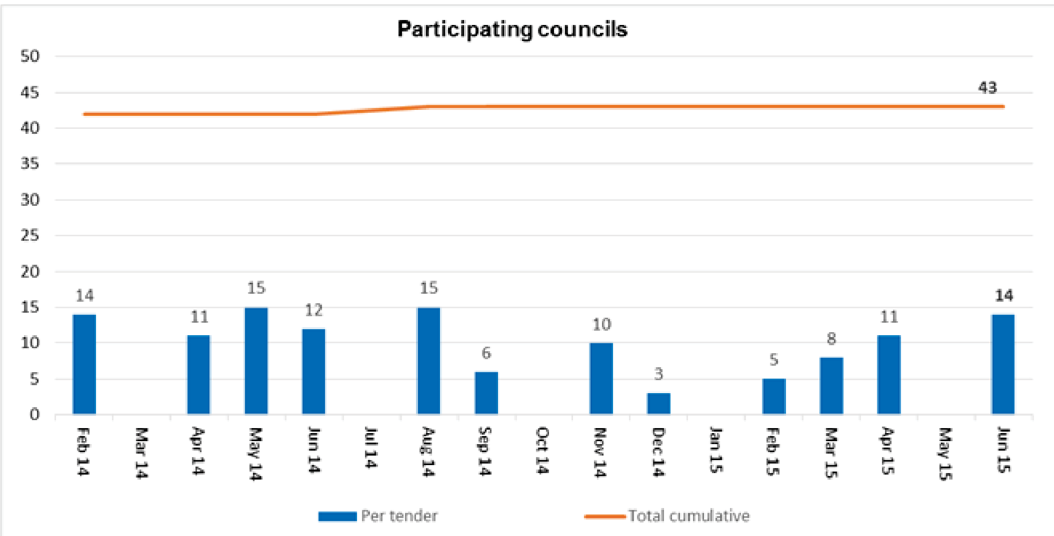
  LGFA's policy is to pay a dividend that provides an annual rate of return to shareholders equal to LGFA cost of funds plus 2%.

  Assuming a cost of funds of 4.4% during 2014/15, LGFA anticipates paying an annual rate of return to shareholders of 6.4%. This equates to an expected total dividend payment of $1.6 million on $25 million of paid-up ordinary shares.

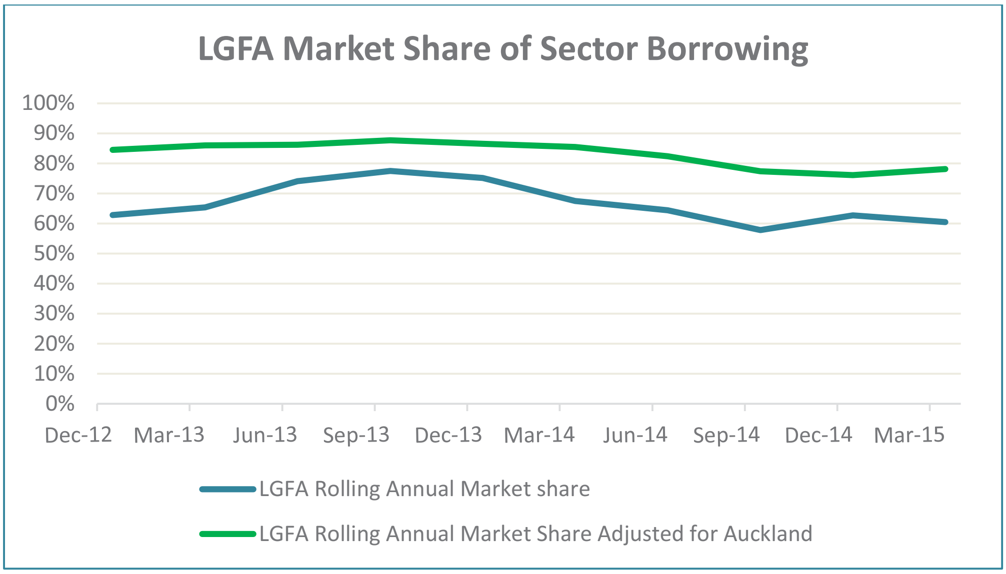
  While the final net operating profit for the year ended 30 June 2015 is yet to be audited, the unaudited financial performance gives rise to no concerns that would lead LGFA to alter its guidance around dividend payments.

- Provide at least 50% of aggregate long-term debt funding for Participating Local Authorities

  Strong council support for LGFA is demonstrated in the following graph which shows the progression of council participation over the past year:



The following chart sourced from PricewaterhouseCoopers and LGFA data shows LGFA share of lending to the sector on a rolling 12 month basis. In the year to March 2015 LGFA's market share was 60.5% compared to 67.5% in the year to March 2014. The reduced market share was due to additional issuance by Auckland Council in the domestic bond market over the past year and councils borrowing outside of LGFA in different maturities to those previously offered by LGFA. The LGFA market share after adjusting for Auckland Council borrowing was 78.1% for the year to March 2015 compared to 85.5% for the year to March 2014.



- *Ensure its products and services are delivered at a cost that does not exceed the forecast for issuance and operating expenses set out in section 4*

  Management estimate of LGFA's actual issuance and operating expenses for the twelve month period ended 30 June 2015 are compared with the SOI budget in the table below:

Twelve months ended	**Actual YTD 30 June 2015 $m**	**SOI Budget 30 June 2015 $m**
Issuance and on-lending expenses	2.507	1.4983
Operating expenses	2.102	3.177
Total expenses	**4.609**	**4.670**

  Total expenses (unaudited) are estimated to be $60,000 below budget for the twelve month period to June 2015. The primary reason for this is the Treasury System Project is being delivered under budget (Operating Expenses) but offset by higher Approved Issuer Levy (AIL) payments as offshore investor holdings of LGFA bonds are higher than forecast (Issuance and on-lending expenses).

- *Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency*

- On 18 November 2014, Fitch affirmed LGFA's local currency credit rating at AA+ and foreign currency credit rating at AA. The outlook on both ratings was revised from stable to positive.

- On 20 October 2014, Standard & Poor's affirmed LGFA's local currency credit rating at AA+ and foreign currency credit rating at AA. The outlook on both ratings is stable.

- LGFA's credit ratings from both Fitch and Standard & Poor's are the same as the New Zealand sovereign ratings.

Fitch has placed the LGFA rating on positive outlook and this is in line with the outlook for the NZ sovereign foreign currency credit rating. Fitch has defined LGFA as a dependant Public Sector Entity and our credit rating is explicitly linked to the NZ sovereign.

LGFA is scheduled to meet with both rating agencies in September 2015 as part of the annual review.

- *Achieve the Financial Forecasts set out in section 4*

  LGFA's actual financial results (for key items set out in Section 4 of the SOI), for the twelve month period ended 30 June 2015 are compared with forecast in the table below.

Twelve months ended June 2015	Actual $m	SOI Budget $m
Net interest income	13.874	11.97
Total expenses	4.609	4.67
Operating profit	**9.264**	**7.30**

  Net interest income is higher due to greater than forecast lending during the twelve month period while all expense categories except for AIL payments and legal fees have been contained as per the earlier comments.

- *Comply with its Treasury Policy, as approved by the Board*

  There were no breaches to the Treasury Policy or Foundation Policy during the three month period to 30 June 2015.

Performance Targets

Four performance targets are specified for LGFA in the SOI. Progress against each of these targets is discussed below, including an explanation of any material variances.

Performance Measure	Full Year Target	Result as at 30 June 2015	Expect to meet target?
Average cost of funds relative to NZGS	<0.50%	0.79%	No. Refer to (i) below
Average margin above LGFA's cost of funds	<0.15%	0.11%	Yes.

Annualised issuance and operating expenses	<$4.67 million	$4.609 million	Yes. Refer to (ii) below
Lending to participating councils	>$4,400 million	$4,975 million	Yes. Refer to (iii) below

(i) Average cost of funds

The LGFA weighted average cost of borrowing relative to NZGB as measured by the borrowing cost in each of the past twenty-nine tenders is 79 bps. This has improved by 5 bps over the quarter. This is a less relevant measure than a measure based upon current secondary market levels as current levels dictate where a council can borrow from LGFA, rather than a historical average.

The LGFA average cost of borrowing (on a simple weighted basis) relative to NZGB as measured by secondary market levels at 30 June 2015 was 54 bps i.e. 4 bps over the target level of 50 bps. This was 14 bps tighter compared to June 2014 and 1 bps tighter compared to March 2015.

	Dec 2012	June 2013	Dec 2013	June 2014	Sept 2014	Dec 2014	March 2015	June 2015
LGFA average margin to NZGS – secondary market	0.84%	0.84%	0.71%	0.68%	0.55%	0.53%	0.55%	0.54%

On a volume weighted basis the current average margin based upon secondary market levels as at the end of June 2015 is 52.3 bps compared to 58.3 bps as at March 2015 and 71 bps as at June 2014.

Finally, the issuance margin is positively correlated to the term of issuance and we would expect the spread to be wider given that 69% of issuance in the past year has been for terms of seven years and longer.

Maturity	July 2014 to June 2015 Issuance ($ million)
Apr 2015	nil
Dec 2017	55
Mar 2019	40
Apr 2020	365
May 2021	100
Apr 2023	655
Apr 2027	285
Total Issuance	1500

(ii) Issuance and operating expenses

See previous comments – we are expecting full year issuance and operating expenses to be in line with budget. The only variances to note are legal and AIL fees are above budget while operating costs are less than budget. Note these are management forecasts only and currently unaudited.

(iii) Lending to participating councils

Lending to councils for the June quarter was $377 million and for the 2014/15 year totalled $1,443 million. Outstanding loans as at June 2015 of $4.975 billion compared with a forecast of $4.4 billion.

2. DETAILS OF EVENTS OF REVIEW

There have been no events of review in respect of any Participating Local Authority.

3. UPDATE ON TREASURY SYSTEM AND MIGRATION OF OPERATIONAL SERVICES FROM DMO

As at 30 June 2015, LGFA had successfully completed the treasury system and NZDMO migration project in preparation for go-live on 1 July 2015.

Accordingly, from 1 July 2015, LGFA formally assumes responsibility for the following functions which had been outsourced to NZDMO:

- Debt issuance
- Local authority lending
- Investment
- Risk management reporting
- Settlements and accounting

Councils were formally advised of the migration on 18 June 2015. From an operational perspective, there will be little change to established processes other than a change of settlements contacts for loans and borrower notes.

The migration of outsourced services represents a significant step in building LGFA's internal capability. We would like to formally acknowledge the support of the NZDMO over the last three years, which provided LGFA with invaluable assistance for its operational functions during the start-up phase.

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ATTACHMENT 1. UNAUDITED FINANCIAL STATEMENTS – NOTE THAT THESE ARE MANAGEMENT ACCOUNTS ONLY

Schedule of revenue and expenses for the year to date 30 June 2015

Unaudited	Actual ($000s)
Interest income from	
Cash and cash equivalents	1,472
Loans to local government	201,352
Marketable securities	283
Deposits	3,467
Derivatives (if net revenue)*	16,208
Total interest income	**222,782**
Interest expense on	
Bills	
Bonds*	205,908
Borrower notes	3,000
Derivatives (if net expense)*	-
Total interest expense	**208,909**
Net interest income	**13,874**
Operating expenses	
Issuance & on lending costs	2,507
Operating overhead	2,102
Total Expenses	**4,609**
Net Operating Gain	**9,264**

Schedule of assets and liabilities for the year to 30 June 2015

Unaudited	Actual ($000s)
Assets	
Financial assets	
Cash and bank balances	31,708
Trade and other receivables	-
Loans to local government	5,031,942
Marketable securities	5,345
Deposits	70,896
Derivatives in gain	270,503
Non-financial assets	-
Prepayments	324
Property, plant and equipment	1,068
Total assets	**5,411,786**
Liabilities	
Financial liabilities	
Trade and other payables	(302)
Accrued Expenses	(375)
Bonds	(5,274,319)
Borrower notes	(85,120)
Derivatives in loss	(15,324)
Total liabilities	**(5,375,439)**
Net assets	**36,347**
Equity	
Share capital	25,000
Current earnings	9,264
Retained earnings	2,083
Total equity	**36,347**