greater WELLINGTON
REGIONAL COUNCIL
Te Pane Matua Taiao

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LGFA Final Statement of Intent and June 2016 Quarterly Report

1. Purpose

To present the final LGFA Statement of Intent for 2016/17 through to 2018/19 and the LGFA's Quarterly Report for the period ending 30 June 2016.

2. Background

The LGFA was established on 6 December 2011, and being a Council Controlled Trading Organisation (CCTO), it is required to prepare a Statement of Intent to its shareholders.

Greater Wellington Regional Council (GWRC) has been a promoter of this organisation and initially held $2 million of the $25 million share capital, being one of the initial 18 non-central government founding shareholders.

In December 2012, the Council sold down part of its shareholding, from $2m down to $1.866m, to allow 12 other councils to join the LGFA. This brought the total number of participating councils to 30.

Mike Timmer – Treasurer of GWRC – is a director of the LGFA since February 2016 after having been the Council's representative (Vice Chair) on the Shareholders' Council. The Shareholders' Council is a group consisting of the nine Councils which originally promoted the LGFA.

The principal role of the Shareholders' Council is to monitor the LGFA and to provide a focal point for LGFA communication. The Council has around five formal meetings a year.

The Shareholders' Council has developed its own charter, provided assistance with debt settlements, and developed a monitoring framework to monitor the LGFA and its performance. It provides a letter of expectation to the LGFA in relation to its SOI and business operation.

3. Statement of Intent

The Council received the Draft statement of Intent for comment on 29th February 2016. The final Statement of Intent (refer **Attachment 1)** was received on 30 June 2016.

Changes since the draft SOI have been reasonably meaningful in the financial forecast as interest rates moved significantly lower during these four months. The main changes are:

- The forecasted loans to Council's have been reduced by around $250 million per year, leading to a $750 million lower total of loans in June 2019. The new forecasted loan total is $7.85 billion, and better reflects updated Council demand.
- Net interest revenue reduces over time compared to the draft SOI reflecting lower interest rates both on retained funds and borrower notes and lower bond issuance volumes as note above.
- The forecasted net profit is unchanged for the 2016/17 year. However in 2018/19 the final SOI forecasts $11.02 million net profit, which is $2.5 million lower than in the draft SOI.
- The resulting impact of all changes is a forecasted equity of $73.64 million in June 2019, which is $8.96 million below the draft SOI forecast.
- The LGFA notes that there is a degree of uncertainty around the forecast with respect to the timing of the re-financing by Council's of their December 2017 Bonds LGFA bonds.

The key **primary objectives** set out in the final SOI are:

- Provide interest savings for all participating local authorities on a relative basis to other sources of financing.
- Make longer term borrowings available to participating local authorities.
- Enhance certainty of access to debt markets for local authorities.
- Offer more flexible lending terms.
- Ensuring that its assets remain of a high quality standard, by ensuring it understands the financial position and general issues of each Council as well as general issues of the sector. This includes an annual review of each Council's compliance with the LGFA's lending policies and an annual visit of each Council.

Key **additional objectives** are:

- Making a profit sufficient to pay a Dividend to its shareholders equal to the LGFA's cost of funds plus 2% over the medium term.
- Provide at least 50% of aggregate long term debt funding for Participating Local Authorities.

- Issue a new long dated Bond.
- Achieve its forecast for the next three years – see details below.
- Maintain the same credit rating as the New Zealand Government.
- Meet or exceed its performance targets.
- Comply with its Treasury Policy.

Looking at the three year plan / forecast, the following highlights are notable:

- A profit of $10.0 million is forecasted for the 2016/17 year, increasing to $10.8 million in 2017/18 and again to $11.02 million in 2018/19.
- A steady dividend is forecast of $1.50 million for the 3 years with equity growing from $54.8 million in 2016/17 to $73.6 million by June 2019.
- Total assets (mostly lending to Council) increase from $7,617 million in 2016/17 to $8,144 million in 2018/19.
- The performance targets have the LGFA's average cost of funds set at less than 0.50% above NZ Government Securities for all years.
- The forecasted margin charged by the LGFA to the highest rated participating local authority is set at no more than 0.10% for all years.
- The forecasted lending to Councils is forecasted to be at least $7.34 billion on 30 June 2017 increasing to $7.85 billion on 30 June 2019.

The LGFA forecasts to grow its shareholders funds from 0.72% of total assets at the end of the 2016/17 year to 0.90% of total assets per 30 June 2019. This provides greater financial resilience and align with anticipated requirements on new international banking regulations.

The LGFA's equity is forecasted to increase to $73.64 million in June 2019. Based on a review of its capital structure in the previous year, the LGFA has no need to seek further capital from shareholders or return capital to shareholder. While the capital has grown significantly it is matched by a large and growing balance sheet. Another capital review will be undertaken in 2018 again to assess the appropriate level of equity.

4. LGFA's Quarterly report – 30 June 2016

The LGFA Quarterly Report is appended as **Attachment 3.** The report from the shareholders councils is expected to be received in August 2016.

Highlights from the June quarter are noted below:

- Total bonds on issues were $6.22 billion as at 30 June 2016, which is an increase of $946 million over the previous year.

- While two of the five key performance indicators were not achieved during the quarter, the seriousness of this non-achievement is either beyond the control of the LGFA or minor in nature.

- The average margin relative to New Zealand Government Stock, being market determined has increased from 0.69% in June 2015 to 0.74% in June 2016, which is 0.24% above the target. The target could be considered to be very aspirational. Over time, with the NZ Government reducing its debt on issue, this margin will reduce. It will also reduce if the LGFA issues shorter dated bonds. It is important for the LGFA to measure itself against Government Bond rate, rather than against the swap rate which compares the LGFA to a bank.

- A key LGFA's performance indicator is to achieve interest savings for the participating councils. To measure savings, the LGFA compares the pricing of its bonds in the secondary market with bonds of Auckland and Dunedin City Council. For the quarter end June 2016, the LGFA calculated savings of 17BP for 2019 bonds, 27BP for 2021 bonds and 33BP for bonds maturing in 2025. This measure is not perfect, as the presence of the LGFA has reduced Local Government sector margins overall including those of Auckland and Dunedin. Therefore actual savings achieved could be potentially higher.

5. The decision-making process and significance

No decision is being sought in this report.

5.1 Engagement

Engagement on this matter is unnecessary

6. Recommendations

That the Council:

1. ***Notes** the contents of this report*

2. ***Notes** the Statement of Intent from the Local Government Funding Agency for 2016/17 and the next two years.*

3. ***Notes** the Quarterly Report per 30 June.16 from the LGFA*

Report prepared by: Report approved by

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Attachment 1: LGFA Final Statement of Intent
Attachment 2: Letter to shareholders to accompany 2016/17 Statement of Intent
Attachment 3: LGFA Quarterly Report 30 June 2016