NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY
TE PŪTEA KĀWANATANGA Ā-ROHE

Statement of Intent 2021/22

1. Introduction

This Statement of Intent (SOI) sets out the intentions and expectations of New Zealand Local Government Funding Agency Limited (LGFA).

The LGFA is enabled under the Local Government Borrowing Act 2011 and is a council-controlled organisation (CCO) for the purposes of the Local Government Act 2002.

The SOI is prepared in accordance with section 64(1) of the Local Government Act 2002.

2. Nature and scope of activities

LGFA will raise debt funding either domestically and/or offshore in either NZ dollars or foreign currency and provide debt funding to New Zealand local authorities and CCOs and may undertake any other activities considered by the Board of LGFA to be reasonably related or incidentally to, or in connection with, that business.

The LGFA will only lend to Councils and CCOs that enter into all the relevant arrangements with it (such Councils being "Participating Local Authorities" and such Councils and CCOs being "Participating Borrowers") and comply with the LGFA's lending policies.

In lending to Participating Borrowers, LGFA will:

- Operate in a manner to ensure LGFA is successful and sustainable in the long-term;
- Educate and inform Participating Local Authorities on matters within the scope of LGFA's operations;
- Provide excellent service to Participating Borrowers;
- Ensure excellent communication exists and be professional in its dealings with all its stakeholders; and
- Ensure its products and services are delivered in a cost-effective manner.

3. Objectives

Principal Objectives

In accordance with the Local Government Act 2002, in carrying on its business, the principal objectives of LGFA will be to:

- Achieve the shareholder-agreed objectives and performance targets specified in this Statement of Intent;
- Be a good employer;
- Demonstrate social, economic, environmental and cultural responsibility;
- Maintain strong and sound corporate governance;
- Set and model high standards of ethical behaviour; and
- Operate in accordance with sound business practice.

Primary Objectives

LGFA will optimise the debt funding terms and conditions for Participating Borrowers. Among other things, this includes:

- Providing interest cost savings relative to alternative sources of financing;
- Offering flexible short and long-term lending products that meet Participating Borrowers' borrowing requirements;
- Delivering operational best practice and efficiency for its lending services;
- Ensuring certainty of access to debt markets, subject always to operating in accordance with sound business practice.

LGFA will ensure its asset book remains at a high standard by ensuring it understands each Participating Borrower's financial position, as well as general issues confronting the Local Government sector. Amongst other things, LGFA will:

- Proactively monitor and review each Participating Borrower's financial position, including its financial headroom under LGFA policies;
- Analyse finances at the Council group level where appropriate and report to shareholders;
- Endeavour to meet each Participating Borrower annually, including meeting with elected officials as required, or if requested; and
- Take a proactive role to enhance the financial strength and depth of the local government debt market and work with key central government and local government stakeholders on sector and individual council issues.

Additional objectives

LGFA has the following eight measurable and achievable additional objectives which complement the primary objectives. Performance against these objectives is reported annually.

LGFA will:

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

2. Provide at least 80% of aggregate long-term debt funding to the Local Government sector[1].

3. Achieve the financial forecasts outlined in section 4 for net interest income and operating expenses, including provision for a shareholder dividend payment in accordance with the approved dividend policy.

4. Meet or exceed the Performance Targets outlined in section 5.

5. Comply with the Health and Safety at Work Act 2015.

6. Comply with the Shareholder Foundation Polices and the Board-approved Treasury Policy at all times.

7. Assist the local government sector with significant matters such as COVID -19 response and the proposed Three Waters Reform Programme.

8. Improve sustainability outcomes within LGFA and assist the local government sector in achieving their sustainability and climate change objectives.

[1] This includes Auckland Council borrowing both in its own name and through LGFA and recognising that the amount of borrowing by Auckland Council from LGFA is restricted by the Foundation Policy covenants.

4. Financial forecasts

LGFA's financial forecasts for the three years to 30 June 2024 are:

	SOI 2022		
Comprehensive income $m	**Jun-22**	**Jun-23**	**Jun-24**
Net Interest income	**18.1**	**17.0**	**18.2**
Other operating income	1.0	1.5	1.5
Total operating income	**19.1**	**18.5**	**19.7**
Approved Issuer Levy	0.6	0.6	0.3
Issuance & onlending costs	2.7	2.7	2.7
Operating overhead	4.4	4.6	4.7
Issuance and operating expenses	**7.8**	**7.9**	**7.7**
P&L	**11.3**	**10.6**	**11.9**

Financial position $m	**Jun-22**	**Jun-23**	**Jun-24**
Liquid assets portfolio	1,961	2,124	2,324
Loans to local government	13,294	14,515	15,623
Other assets	-	-	-
Total assets	**15,255**	**16,639**	**17,947**
Bonds on issue (ex Treasury stock)	13,975	15,190	16,362
Bills on issue	500	500	500
Borrower notes	256	302	340
Other liabilites	-	-	-
Total liabilities	**14,731**	**15,992**	**17,202**
Capital	25	25	25
Retained earnings	81	92	104
Shareholder equity	**106**	**117**	**129**

Ratios	**Jun-22**	**Jun-23**	**Jun-24**
Liquid assets/funding liabilities	13.8%	13.7%	13.9%
Liquid assets / total assets	12.9%	12.8%	12.9%
Net interest margin	0.14%	0.12%	0.12%
Cost to income ratio	40.7%	42.7%	39.4%
Return on average assets	0.07%	0.06%	0.07%
Shareholder equity/total assets	0.7%	0.7%	0.7%
Shareholder equity + BN/total assets	2.4%	2.5%	2.6%
Asset growth	10.2%	9.1%	7.9%
Loan growth	11.3%	9.2%	7.6%
Return on equity	12.0%	10.0%	10.2%
Capital ratio	11.9%	12.6%	13.1%

Note that there is some forecast uncertainty around the timing of Net Interest Income, Profit and Loss, Total Assets, LG Loans, Bonds and Borrower Notes depending upon council decisions regarding the amount and timing of refinancing of their April 2022, April 2023 and April 2024 loans. LGFA will work with council borrowers to reduce this uncertainty.

The above tables assume gross issuance of LGFA bonds per year of $2.90 billion (2021/22), $2.875 billion (2022/23) and $2.850 billion (2023/24), however the issuance volume will be determined by LGFA at the relevant time by reference to factors including refinancing of existing borrowing by councils and (if applicable) council-controlled organisations, new borrowing by councils and (if applicable) council-controlled organisations and LGFA's own borrowing requirements for liquidity purposes.

No decision has been made as to final issuance volume at this point and will depend upon market conditions.

There has been no allowance made in the forecasts for the impact on councils from the proposed Three Waters Reform Programme.

5. Performance targets

LGFA has the following performance targets:

- LGFA's total operating income for the period to:
    - 30 June 2022 will be greater than $19.1 million.
    - 30 June 2023 will be greater than $18.5 million.
    - 30 June 2024 will be greater than $19.7 million.
- LGFA's annual issuance and operating expenses (excluding AIL) for the period to:
    - 30 June 2022 will be less than $7.2 million.
    - 30 June 2023 will be less than $7.3 million.
    - 30 June 2024 will be less than $7.4 million.
- Total lending to Participating Borrowers[2] at:
    - 30 June 2022 will be at least $13,294 million.
    - 30 June 2023 will be at least $14,515 million.
    - 30 June 2023 will be at least $15,623 million.
- Conduct an annual survey of Participating Borrowers who borrow from LGFA and achieve at least an 85% satisfaction score as to the value added by LGFA to the borrowing activities
- Meet all lending requests from Participating Borrowers, where those requests meet LGFA operational

[2] Subject to the forecasting uncertainty noted previously

and covenant requirements.

- Achieve 80% market share of all council borrowing in New Zealand

- Review each Participating Borrower's financial position, its headroom under LGFA policies and arrange to meet each Participating Borrower at least annually.

- No breaches of Treasury Policy, any regulatory or legislative requirements including the Health and Safety at Work Act 2015.

- Successfully refinance existing loans to councils and LGFA bond maturities as they fall due.

- Maintain a credit rating equal to the New Zealand Government Sovereign rating where both entities are rated by the same credit rating agency.

6. Dividend policy

LGFA will seek to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders. Consequently, it is intended to pay a limited dividend to Shareholders.

The Board's policy is to pay a dividend that provides an annual rate of return to Shareholders equal to LGFA fixed rate bond cost of funds plus 2.00% over the medium term.

At all times payment of any dividend will be discretionary and subject to the Board's legal obligations and views on appropriate capital structure.

7. Governance

Board

The Board is responsible for the strategic direction and control of LGFA's activities. The Board guides and monitors the business and affairs of LGFA, in accordance with the Companies Act 1993, the Local Government Act 2002, the Local Government Borrowing Act 2011, the Company's Constitution, the Shareholders' Agreement for LGFA and this SOI.

The Board comprises six directors with five being independent directors and one being a non-independent director.

The Board's approach to governance is to adopt best practice[3] with respect to:

- The operation of the Board.

- The performance of the Board.

- Managing the relationship with the Company's Chief Executive.

- Being accountable to all Shareholders.

All directors are required to comply with a formal Charter.

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[3] Best practice as per NZX and Institute of Directors guidelines

The Board will meet on a regular basis and no fewer than 6 times each year.

Shareholders' Council

The Shareholders' Council is made up of between five and ten appointees of the Shareholders (including an appointee from the Crown). The role of the Shareholders' Council is to:

- Review the performance of LGFA and the Board, and report to Shareholders on that performance on a periodic basis.
- Make recommendations to Shareholders as to the appointment, removal, replacement and remuneration of directors.
- Make recommendations to Shareholders as to any changes to policies, or the SOI, requiring their approval.
- Ensure all Shareholders are fully informed on LGFA matters and to coordinate Shareholders on governance decisions.

8. Information to be provided to Shareholders

The Board aims to ensure that Shareholders are informed of all major developments affecting LGFA's state of affairs, while at the same time recognising both LGFA's obligations under NZX Listing Rules and that commercial sensitivity may preclude certain information from being made public.

Annual Report

The LGFA's balance date is 30 June.

By 30 September each year, the Company will produce an Annual Report complying with Sections 67, 68 and 69 of the Local Government Act 2002, the Companies Act 1993 and Financial Reporting Act 2013. The Annual Report will contain the information necessary to enable an informed assessment of the operations of the company, and will include the following information:

- Directors' Report.
- Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position, Statement of Cashflows, Statement of Accounting Policies and Notes to the Accounts.
- Comparison of the LGFA's performance regarding the objectives and performance targets set out in the SOI, with an explanation of any material variances.
- Auditor's Report on the financial statements and the performance targets.
- Any other information that the directors consider appropriate.

Half Yearly Report

By 28 February each year, the Company will produce a Half Yearly Report complying with Section 66 of the Local Government Act 2002. The Half Yearly Report will include the following information:

- Directors' commentary on operations for the relevant six-month period.
- Comparison of LGFA's performance regarding the objectives and performance targets set out in the SOI, with an explanation of any material variances.
- Un-audited half-yearly Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position and Statement of Cashflows.

Quarterly Report

By 31 January, 30 April, 31 July, and 31 October each year, the Company will produce a Quarterly Report. The Quarterly Report will include the following information:

- Commentary on operations for the relevant quarter, including a summary of borrowing margins charged to Participating Borrower's (in credit rating bands).
- Comparison of LGFA's performance regarding the objectives and performance targets set out in the SOI, with an explanation of any material variances.
- Analysis of the weighted average maturity of LGFA bonds outstanding.
- In the December Quarterly Report only, commentary on the Net Debt/Total Revenue percentage for each Participating Local Authority that has borrowed from LGFA (as at the end of the preceding financial year).
- To the extent known by LGFA, details of all events of review in respect of any Participating Borrower that occurred during the relevant quarter (including steps taken, or proposed to be taken, by LGFA in relation thereto).
- Details of any lending to CCOs during the quarter and the amount of CCO loans outstanding.
- Commentary on sustainability initiatives.

Statement of Intent

By 1 March in each year the Company will deliver to the Shareholders its draft SOI for the following year in the form required by Clause 9(1) of Schedule 8 and Section 64(1) of the Local Government Act 2002.

Having considered any comments from the Shareholders received by 30 April, the Board will deliver the completed SOI to the Shareholders on or before 30 June each year.

Shareholder Meetings

The Board will hold an Annual General Meeting between 30 September and 30 November each year to present the Annual Report to all Shareholders.

The Company will hold a meeting with the Shareholders' Council approximately every six months – prior to the Annual General Meeting and after the Half Yearly Report has been submitted. Other meetings may be held by agreement between the Board and the Shareholders' Council.

9. Acquisition/divestment policy

LGFA will invest in securities in the ordinary course of business. It is expected that these securities will be debt securities. These investments will be governed by LGFA's lending and/or investment policies as approved by the Board and/or Shareholders.

Any subscription, purchase or acquisition by LGFA of shares in a company or organisation will, if not within those investment policies, require Shareholder approval other than as concerns the formation of wholly-owned subsidiaries and the subscription of shares in such wholly-owned subsidiaries.

10. Activities for which compensation is sought from Shareholders

At the request of Shareholders, LGFA may (at its discretion) undertake activities that are not consistent with its normal commercial objectives. Specific financial arrangements will be entered into to meet the full cost of providing such activities.

Currently there are no activities for which compensation will be sought from Shareholders.

11. Commercial value of Shareholder's investment

LGFA will seek to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders.

Subject to the Board's views on the appropriate capital structure for LGFA, the Board's intention will be to pay a dividend that provides an annual rate of return to Principal Shareholders equal to LGFA fixed rate bond cost of funds plus 2.00% over the medium term.

As the Shareholders will have invested in the LGFA on the basis of this limited dividend, the Board considers that at establishment the commercial value of LGFA is equal to the face value of the Shareholders' paid up Principal Shares - $25 million.

In the absence of any subsequent share transfers to the observed share transfers on 30 November 2012, the Board considers the current commercial value of LGFA is at least equal to the face value of the Shareholders' paid up Principal Shares of $25 million. This equates to a value per share of $1.00.

12. Accounting policies

LGFA has adopted accounting policies that are in accordance with the New Zealand International Financial Reporting Standards and generally accepted accounting practice. A Statement of accounting policies is attached to this SOI.

The following statement is taken from the Financial Statements presented as part of LGFA's Annual Report 2020 (updated where necessary), accordingly, the statement does not contemplate LGFA lending to CCOs.

ATTACHMENT: Statement of accounting policies

a. Reporting entity

The New Zealand Local Government Funding Agency Limited (LGFA) is a company registered under the Companies Act 1993 and is subject to the requirements of the Local Government Act 2002.

LGFA is controlled by participating local authorities and is a council-controlled organisation as defined under section 6 of the Local Government Act 2002. LGFA is a limited liability company incorporated and domiciled in New Zealand.

The primary objective of LGFA is to optimise the debt funding terms and conditions for participating local authorities.

The registered address of LGFA is Level 8, City Chambers, 142 Featherston Street, Wellington Central, Wellington 6011.

The financial statements are as at and for the year ended 30 June 2020.

These financial statements were authorised for issue by the Directors on 28 August 2020.

b. Statement of compliance

LGFA is an FMC reporting entity under the Financial Markets Conduct Act 2013 (FMCA). These financial statements have been prepared in accordance with that Act and the Financial Reporting Act 2013. LGFA's bonds are quoted on the NZX Debt Market.

LGFA is a profit orientated entity as defined under the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP) and they comply with NZ IFRS and other applicable Financial Reporting Standard, as appropriate for Tier 1 for-profit entities. The financial statements also comply with International Financial Reporting Standards (IFRS).

c. Basis of preparation

Measurement base

The financial statements have been prepared on a historical cost basis modified by the revaluation of certain assets and liabilities.

The financial statements are prepared on an accrual basis.

Functional and presentation currency

The financial statements are presented in New Zealand dollars rounded to the nearest thousand, unless separately identified. The functional currency of LGFA is New Zealand dollars.

Foreign currency conversions

Transactions denominated in foreign currency are translated into New Zealand dollars using exchange rates applied on the trade date of the transaction.

Changes in accounting policies

NZ IFRS 16 Leases.

NZ IFRS 16 became effective from 1 July 2019 and did not have a material impact on the financial statements.

On adoption of NZ IFRS 16, LGFA recognised right-of-use assets and lease liabilities in relation to its property leases which had previously been classified as operating leases under NZ IAS 17 Leases.

In adopting NZ IFRS 16, LGFA elected to use the simplified retrospective approach which does not require restatement of comparative information. The lease liability is recognised at the present value of the remaining lease payments, discounted using LGFA's incremental borrowing rate, with the corresponding right-of-use asset recognised as an equal amount.

The following items in the balance sheet were impacted by the change of accounting on 1 July 2019: Other assets and Other liabilities both increased by $0.157 million.

Lease payments previously included in other operating expense are now classified to financing and depreciation costs under NZ IFRS 16.

There have been no other changes to accounting policies.

Early adoption standards and interpretations

LGFA has not early adopted any standards.

New standards adopted

NZ IFRS 16 Leases became effective from 1 July 2019.

Standards not yet adopted

LGFA does not consider any standards or interpretations in issue but not yet effective to have a significant impact on its financial statements.

d. Financial instruments

Financial assets

Financial assets, other than derivatives, are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method.

Cash and cash equivalents include cash on hand; cash in transit and bank accounts and deposits with an original maturity of no more than three months.

Purchases and sales of all financial assets are accounted for at trade date.

At each balance date, an expected credit loss assessment is performed for all financial assets and is calculated as either:

- Credit losses that may arise from default events that are possible within the next 12 months, where no significant increase in credit risk has arisen since acquisition of the asset, or
- Credit losses that may arise from default events that are possible over the expected life of the financial asset, where a significant increase in credit risk has arisen since acquisition of the asset.

Impairment losses on financial assets will ordinarily be recognised on initial recognition as a 12-month expected loss allowance and move to a lifetime expected loss allowance if there is a significant deterioration in credit risk since acquisition.

Financial liabilities

Financial liabilities, other than derivatives, are recognised initially at fair value less transaction costs and subsequently measured at amortised cost using the effective interest rate method.

Derivatives

Derivative financial instruments are recognised both initially and subsequently at fair value. They are reported as either assets or liabilities depending on whether the derivative is in a net gain or net loss position respectively.

Fair value hedge

Where a derivative qualifies as a hedge of the exposure to changes in fair value of an asset or liability (fair value hedge) any gain or loss on the derivative is recognised in profit and loss together with any changes in the fair value of the hedged asset or liability.

The carrying amount of the hedged item is adjusted by the fair value gain or loss on the hedged item in respect of the risk being hedged. Effective parts of the hedge are recognised in the same area of profit and loss as the hedged item.

e. Other assets

Property, plant and equipment (PPE)

Items of property, plant and equipment are initially recorded at cost.

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its remaining useful life.

Intangible Assets

Intangible assets comprise software and project costs incurred for the implementation of the treasury management system. Capitalised computer software costs are amortised on a straight-line basis over the estimated useful life of the software (three to seven years). Costs associated with maintaining computer software are recognised as expenses.

f. Other liabilities

Employee entitlements

Employee entitlements to salaries and wages, annual leave and other similar benefits are recognised in the profit and loss when they accrue to employees.

g. Revenue and expenses

Revenue

Interest income

Interest income is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest income each period.

Expenses

Expenses are recognised in the period to which they relate.

Interest expense

Interest expense is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash payments through the expected life of the financial liability to that liability's net carrying amount. The method applies this rate to the principal outstanding to determine interest expense each period.

Income tax

LGFA is exempt from income tax under Section 14 of the Local Government Borrowing Act 2011.

Goods and services tax

All items in the financial statements are presented exclusive of goods and service tax (GST), except for receivables and payables, which are presented on a GST-inclusive basis. Where GST is not recoverable as input tax, then it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the IRD is included as part of receivables or payables in the statement of financial position.

The net GST paid to, or received from the IRD, including the GST relating to investing and financing activities, is classified as a net operating cash flow in the statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

h. Segment reporting

LGFA operates in one segment being funding of participating local authorities in New Zealand.

i. Judgements and estimations

The preparation of these financial statements requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and income and expenses. For example, the present value of large cash flows that are predicted to occur a long time into the future depends critically on judgements regarding future cash flows, including inflation assumptions and the risk-free discount rate used to calculate present values. Refer note 2a for fair value determination for financial instruments.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Where these judgements significantly affect the amounts recognised in the financial statements they are described below and in the following notes.