Chairperson and Committee Members
OPERATIONS AND FINANCE COMMITTEE

15 NOVEMBER 2018

Meeting Status: **Public**

Purpose of Report: For Decision

CONFIRMATION OF THE COUNCIL'S VOTE AT THE LOCAL GOVERNMENT FUNDING AGENCY'S 2018 ANNUAL GENERAL MEETING

PURPOSE OF REPORT

1 The purpose of this report is to provide the Committee with the Agenda for the upcoming Annual General Meeting (AGM) of the Local Government Funding Agency (LGFA) and to confirm the Council's vote for each agenda item.

DELEGATION

2 The Operations and Finance Committee has the delegation to consider this matter. The current Governance Structure and Delegations for the 2016-19 triennium states that the Operations and Finance Committee has been delegated:

> *the responsibility to deal with monitoring and decision-making on all broader financial management*

BACKGROUND

3 On 30 November 2012, the Council became a Principal Shareholding Local Authority in the LGFA. The LGFA was incorporated on 1 December 2011 with the primary objective of optimising the debt funding terms and conditions for Participating Local Authorities. This includes providing savings in annual interest costs, making longer-term borrowings available and enhancing the certainty of access to debt markets.

4 The LGFA issues bonds to wholesale and retail investors and on-lends the funds raised to participating local authorities with borrowing needs. The quality of the LFGA's credit rating, and the liquidity created by issuing homogenous local authority paper, ensures that participating councils can raise funds on better terms than if they were issuing in their own name.

5 As at 30 June 2018, the LGFA had 45 million ordinary shares on issue, 20 million of which remain uncalled (that is, not paid in full). All ordinary shares rank equally with one vote attached to each ordinary share. Ordinary shares have a face value of $1 per share. The Council holds a total of 200,000 ordinary shares (with 100,000 shares uncalled), which equates to a 0.4% shareholding in the LGFA. Currently, the New Zealand Government is the largest shareholder with an 11.1% shareholding.

6 The LGFA meets the Local Government Act 2002 (the Act) definition of a Council Controlled Organisation (CCO) as one or more local authorities have the right, directly or indirectly, to appoint 50% or more of the directors.

7 The LGFA is holding its next AGM on 21 November 2018 in Wellington and the Agenda items include:

- election of directors to the LGFA Board;
- election of Nominating Local Authorities (NLA) to the Shareholders' Council; and
- proposed changes to the Foundation Policy that allows financial covenant compliance of councils to be tested at the group level (including CCOs) where appropriate and to allow lending directly to a CCO.

ISSUES AND OPTIONS

Election of directors

8 The LGFA Shareholders Agreement requires the Board to comprise five independent directors and one non-independent director. Currently, the five independent directors are John Avery, Philip Cory-Wright, Anthony Quirk, Linda Robertson and Craig Stobo and the non-independent director is Mike Timmer.

9 *Independent directors are defined in the Shareholders' Agreement as a director "who is not an employee of any shareholder, employee of a CCO owned (in whole or in part) by any shareholder or a councillor of any Local Authority which is a shareholder and was not such an employee or councillor at any time in the five years prior to the time that person's appointment as a director. For the avoidance of doubt, a director (or former director) of a CCO shall not by virtue of this reason alone be precluded from being an independent director."*

10 The Shareholders' Agreement sets out that one of the independent directors and the non-independent director must retire by rotation each year. If they wish, they can offer themselves for re-election.

11 Accordingly, this year John Avery retires by rotation and offers himself for re-election as an independent director and Mike Timmer retires by rotation and offers himself for re-election as a non-independent director.

12 Both John Avery and Mike Timmer have the support of the Shareholders' Council and the LGFA Board to continue as directors of LGFA.

13 Biographies for both candidates are provided in Appendix 1 to this report.

Officers' Recommendation

14 Officers find no reason to vote against the candidates standing for re-election as directors on the LGFA Board, for the following reasons:

- the successful performance to date of the LGFA; and
- the skills and experience of the nominated directors.

Election of Nominating Local Authorities to the Shareholders' Council

15 A Principal Shareholder may be appointed or removed as a nominator of membership to the Shareholders' Council. Each NLA may appoint or remove one member of the Shareholders' Council.

16 Each member appointed by a NLA must be an employee or councillor of that NLA. In addition, the New Zealand Government (for so long as it is a Shareholder) may appoint or remove one other member of the Shareholders' Council.

17 The Shareholders' Council comprises between five and 10 members with the current members being the Crown and nine Council members. The current NLAs are:

- Auckland Council;
- Bay of Plenty Regional Council;
- Christchurch City Council;
- Hamilton City Council;
- Tasman District Council;
- Tauranga City Council;
- Wellington City Council;
- Western Bay of Plenty District Council, and
- Whangarei District Council.

18 The Shareholders Agreement requires two NLA members to retire by rotation each year. If they wish, they can offer themselves for re-election.

19 Accordingly this year Hamilton City Council and Tauranga City Council will retire and seek re-election.

Discussion

20 Since the LGFA was established in 2011, the local authority membership of the Shareholders' Council has come almost entirely from the 'tight nine' group of councils that promoted and steered the establishment of the LGFA, plus the Bay of Plenty Regional Council, which was also a foundation member. These members also have the largest shareholdings in the LGFA.

21 Election of NLA members from outside of this group does not appear to be actively considered by the Shareholders' Council. All LGFA shareholders regularly transact with the LGFA; having a greater shareholding does not mean that a council is any better placed to assess the governance or operations of an organisation than other councils with smaller shareholdings.

22 It might be argued that the amount of business undertaken by shareholder councils with the LGFA could be taken into account when considering who should become a Shareholders' Council member. Using the value of loans held at 30 June 2018 as a proxy for the amount of business done with the LGFA, officer's analysis suggests that the Kāpiti Coast District Council, Hutt City Council and Hauraki District Council are well placed to be considered as NLA appointments.

23 Perhaps the most significant reason for refreshing the membership of the Shareholders' Council would be to facilitate greater representation from the regions. The majority of the current members of the Shareholders' Council are large metropolitan councils, whose views may not reflect those of their more provincial counterparts.

24 Furthermore, the continued uninterrupted membership of the Shareholders' Council might lead to 'staleness' of the existing membership. The introduction of a 'fresh pair of eyes' from outside can bring new ideas, greater inclusiveness and ultimately more assurance for all members.

Officers' Recommendation

25 Officers recommend voting for the candidates standing for re-election however officers also recommend that the matter of 'refreshing' the composition of the Shareholders' Council is raised with the LGFA and the Shareholders' Council.

Changes to the LGFA Foundation Policy

26 All shareholder councils must comply with the 'Foundation Policies' outlined in the Shareholders Agreement. Any changes to the Foundation Policies require shareholders' consent. There are two proposed changes to the Foundation Policy requiring shareholder approval by Ordinary Resolution:

i. measurement of council compliance with LGFA covenants at a group level; and

ii. direct lending to CCOs.

27 The LGFA are proposing these changes in response to feedback received from both member and non-member councils. This is a continuum of the LGFA's successful track record of continuously improving and evolving to meet councils' needs, for example short dated and bespoke lending.

Measurement of council compliance with LGFA covenants at a group level

28 Currently the LGFA tests each council borrower's compliance with either the Foundation Policy or Lending Policy covenants at the parent council level, that is, it excludes any debt, revenue or interest payments made by a subsidiary entity from the calculations.

29 This might not reflect the most accurate representation of a council's financial position if the parent council delivers some of its services or activities or holds assets through a subsidiary entity, for example, Auckland Council delivers a large amount of services through Watercare and Auckland Transport.

30 It is proposed that a council can apply to the LGFA Board to be tested at the group level rather than at the parent level for compliance with LGFA covenants.

31 The Foundation Policy Covenants (for councils that have an external credit rating) or Lending Policy Covenants (if no external credit rating) would still apply to those councils regardless of being measured on a parent or group basis.

32 The Senior Manager Credit and External Relationships (LGFA) would provide analysis and recommendation to the LGFA Board for consideration as to whether they should approve the request.

33 To provide certainty to the applicant council, the testing at the group level would apply for the life of the existing loans from the LGFA.

34 At this stage, the LGFA currently expects only Auckland Council would wish to have their covenants calculated at group level.

35 The Kāpiti Coast District Council only has one CCO – the LGFA - so whether measurement takes place at the parent or group level it makes little difference to the Council's compliance with the LGFA covenants.

Direct Lending to CCOs

36 Currently the LGFA only lends to the parent council and not to any other related entities. This is not ideal as:

- Several councils borrow funds directly and then on-lend to their CCOs, for example Auckland Council (on-lends to Watercare); Christchurch City Council (on-lends to Christchurch City Holdings Limited); New Plymouth District Council (on-lends to New Plymouth Airport); and Rotorua District Council (on-lends to Rotorua Regional Airport).
- The LGFA cannot currently lend to multiple owned CCOs. While there are currently very few of these entities which have borrowings, they may be established in the future.
- Dunedin City Council (DCC) borrows via its Council Controlled Trading Organisation subsidiary company, Dunedin City Treasury Limited. This is one reason why DCC cannot become a member of LGFA.

37 To ensure that the LGFA does not bear any additional risk than incurred with lending to a parent council, it is proposed that the LGFA could lend to a CCO provided that:

- The parent council (or group of shareholding councils) of the CCO must each be a guarantor of the loan in favour of the LGFA.
- The LGFA will only lend to a CCO if there is uncalled capital from the parent council that is at least equal to the financial obligations of the CCO or there is a guarantee from the parent council in respect of the CCO.
- The LGFA will undertake credit analysis on the CCO as well the parent council.
- The CCO would be subject to the LGFA Board approval before borrowing.
- The LGFA Board would apply bespoke financial covenants to each CCO taking into consideration factors such as the ownership structure, cash flow and balance sheet quality and what activity/services the CCO is delivering on behalf of the parent council shareholder(s).
- The LGFA would require bespoke covenants for CCOs because whilst councils are very similar to each other, there can be significant differences between CCOs. In addition, CCOs do not have rates revenue. Therefore, the LGFA Board, following advice from LGFA management and external legal advisors, would need to negotiate bespoke covenants with each CCO.

Officers' Recommendation

38 Officers support the proposed changes to the Foundation Policy for the following reasons:

- At this stage, the LGFA only expects Auckland Council to request that their covenants be calculated at the group level and this would be consistent with how they are analysed by their credit rating agencies.
- There are some council members who currently borrow and on-lend to their CCO subsidiaries, so this proposal will give them the option to streamline the borrowing process and provide more flexibility in how they restructure their borrowings.
- There is no increased risk to the LGFA. Regardless of being measured at the parent council or group level, all councils must remain compliant with the LGFA covenants and the LGFA has recourse over rates revenue as security. Additionally, where a CCO borrows from the LGFA, the LGFA has the benefit of a parent council uncalled capital or guarantee.
- The LGFA do not feel that credit rating agencies or investors would be concerned with these changes. Again, this is because all councils must remain compliant with the LGFA covenants and the underlying security remains unchanged. Lending to CCOs will also diversify the LGFA lending book and could bring in new council members to the LGFA.
- The proposed changes will not make it easier for councils to borrow more or to avoid a covenant breach. This is because the Board approves testing of a council at the group or parent level. The Board will consider whether a move to testing at the group level will weaken the credit profile of a given council before deciding on the change. Regardless of the basis for measurement, the LGFA Board expects all council borrowers to maintain sufficient headroom under the LGFA covenants.
- The Foundation Policy documents (a final version and a track changes version) are attached as Appendices 2 and 3 to this report.

CONSIDERATIONS

Policy considerations

39 There are no policy considerations.

Legal considerations

40 The Council may appoint a representative to attend and vote at the AGM on the Council's behalf. Alternatively, the Council may appoint a proxy to vote at the AGM on the Council's behalf.

41 The proxy does not need to be a shareholder and to be effective, the LGFA must receive notice from the Council, authorising the proxy to vote on its behalf not later than 48 hours before the start of the AGM, which is 2pm on Wednesday 21 November 2018.

Financial considerations

42 There are no financial considerations in addition to those already discussed within this report.

Tāngata whenua considerations

43 There are no issues requiring specific consideration by Tāngata whenua.

Strategic considerations

44 Borrowing from the LGFA makes a significant contribution to achieving an improved financial position against financial constraints. The matter in this report makes an indirect contribution to this outcome.

SIGNIFICANCE AND ENGAGEMENT

Significance policy

45 This matter has a low level of significance under the Council's Significance and Engagement Policy.

Consultation already undertaken

46 No consultation has been undertaken in the development of this report.

Engagement planning

47 An engagement plan is not needed for this report to be considered.

Publicity

48 There are no publicity considerations.

RECOMMENDATIONS

49 That the Operations and Finance Committee:

i. receives the report, including the proposed changes to the Local Government Funding Agency Foundation Policy, attached as Appendix 2 and 3 to the report; and

ii. recommends that the Operations and Finance Committee:

a) authorises Jacinta Straker (Chief Financial Officer) and/or Anelise Horn (Financial Accounting Manager) to vote on behalf of the Council, at the Local Government Funding Agency's 2018 Annual General Meeting to be held on 21 November 2018, in accordance with the Council's votes on recommendations (aa) to (ee) inclusive, noting Committee recommendations in bold;

or, if Council officers are unable to attend the Annual General Meeting:

b) authorises Mark Butcher (Chief Executive Officer, LGFA) as the Council's proxy to vote on behalf of the Council, at the Local Government Funding Agency's 2018 Annual General Meeting to be held on 21 November 2018, in accordance with the Council's votes on recommendations (aa) to (ee) inclusive, noting Committee recommendations in bold:

(aa) re-elect John Avery as an independent director of the LGFA - (**For**/Against); and

(bb) re-elect Michael Timmer as non-independent director of the LGFA - (**For**/Against); and

(cc) re-elect Hamilton City Council as a Nominating Local Authority - (**For**/Against); and

(dd) re-elect Tauranga City Council as a Nominating Local Authority - (**For**/Against); and

(ee) approve, the amendments to the Foundation Policy of the LGFA - (**For**/Against).

iii. authorises officers to raise the matter of refreshing the composition of the Shareholders' Council with the Local Government Funding Agency and the Shareholders' Council.

Report prepared by	Approved for submission	Approved for submission
Jacinta Straker **Chief Financial Officer**	**Kevin Black** **Acting Group Manager** **Strategy and Planning**	**Janice McDougall** **Acting Group Manager** **Corporate Services**

Appendix 1 Candidate Biographies for Re-election to the LGFA Board

Appendix 2 2018 LGFA Amended Foundation Policy (Final Version)

Appendix 3 2018 LGFA Amended Foundation Policy (Mark-Up Version)

LGFA Board Candidate Biographies

John Avery Biography

John is a professional director with extensive experience across a range of business and industry sectors. He is a very experienced director, chair and committee chair. He has particular experience with both Council Controlled Organisations and Co- Operative style companies. Currently along with LGFA he is a director of Strategic Pay Ltd and Fund Managers Auckland Ltd

Former directorships include; The Warehouse Group Ltd, Independent Timber Merchants Ltd (ITM), NSM Contracting Ltd (a North Shore City Council CCO), Regional Facilities Auckland, Aotea Centre Board (an Auckland City Council CCO), Office Products Depo Ltd, Americas Cup Village Ltd (an Auckland City Council CCO), The New Zealand Guardian Trust Company Ltd, The Lawlink Group Ltd and The Royal New Zealand Ballet. He is also involved with several charities including The New Zealand School of Dance. Prior to becoming a fulltime director nine years ago, John was a commercial lawyer and former Managing Partner and Chair of an Auckland based law firm.

He is a Chartered Fellow of the Institute of Directors in New Zealand, a Barrister and Solicitor of the High Court and remains an associate member of the New Zealand Law Society.

Michael Timmer Biography

Mike has over 10 years' experience in senior finance roles in Local Government having joined Wellington Regional Council as Treasurer in January 2007.

He holds a Bachelor of Agricultural Science and a Bachelor of Business Studies degree both from Massey University and is a certified Charted Accountant and an INFINZ (cert) professional.

As Treasurer, his responsibilities include Treasury activities involving commercial paper issuance, bond placement, standby facilities, interest rate risk management, balance sheet structure, security documentation, funding and optimising subsidiary company borrowings. Other responsibilities include risk management, insurance, business assurance (internal audit), and managing Council's WRC Holdings board.

He has also been acting Chief Financial Officer for the council for around two years in total. Previous roles have involved Treasury and Accounting activities and working in the dealing room at Citibank for 5 years.

He has been active with local and sector CFO groups, has served on the initial Local Government Risk Agency establishment group and the LGFA establishment committee. Mike has been involved with the establishment of the LGFA initiating the idea and was one of the tight nine representatives setting up the LGFA documentation. He has been on the Shareholders' Council since its inception where he was vice chairman prior to taking up the LGFA directorship role.

Mike is a member of the Institute of Directors. He is Chairman of the Finance Committee of Physiotherapy New Zealand Incorporated and has been a director of the LGFA since 2015.

SCHEDULE 1
FOUNDATION POLICIES
(Clause 5.1)

All foundation policies may be reviewed annually by Principal Shareholders at the annual meeting of Shareholders. Any alteration requires approval pursuant to clause 5.1.

Credit Risk

Lending Policy

All Local Authorities that borrow from the Company will:

- Provide debenture security in relation to their borrowing from the Company and related obligations, and (if relevant), equity commitment liabilities to the Company and (if relevant) guarantee liabilities to a security trustee approved for the Company's creditors.
- Issue securities (bonds / FRNs / CP) to the Company (i.e. not enter into facility arrangements).
- Comply with their own internal borrowing policies.
- Comply with the financial covenants outlined in the following table, provided that:
    - Unrated Local Authorities or Local Authorities with a long-term credit rating lower than 'A' equivalent can have bespoke financial covenants that exceed the:
        - Lending policy covenants outlined in the following table with the approval of the Board;
        - Foundation policy covenants outlined in the following table with the approval of an Ordinary Resolution.
    - Local Authorities with a long-term credit rating of 'A' equivalent or higher will not be required to comply with the lending policy covenants in the following table and can have bespoke financial covenants that exceed the foundation policy covenants outlined in the following table with the approval of an Ordinary Resolution.
    - Any Board or Ordinary Resolution approval of bespoke financial covenants will only be provided after a robust credit analysis and any approval must also include bespoke reporting and monitoring arrangements.
- If the principal amount of a Local Authority's borrowings is at any time equal to, or greater than, NZD 20 million, be a party to a deed of guarantee and an equity commitment deed (in each case in a form set by the Company).

Financial covenant	Lending policy covenants	Foundation policy covenants
Net Debt / Total Revenue	<175%	<250%
Net Interest / Total Revenue	<20%	<20%
Net Interest / Annual Rates Income	<25%	<30%
Liquidity	>110%	>110%

Total Revenue is defined as cash earnings from rates, grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non government capital contributions (e.g. developer contributions and vested assets).

Net debt is defined as total debt less liquid financial assets and investments.

Liquidity is defined as external debt plus committed loan facilities plus liquid investments divided by external debt.

Net Interest is defined as the amount equal to all interest and financing costs less interest income for the relevant period.

Annual Rates Income is defined as the amount equal to the total revenue from any funding mechanism authorised by the Local Government (Rating) Act 2002 together with any revenue received from other local authorities for services provided (and for which the other local authorities rate).

Financial covenants are measured on Council only basis and not consolidated group basis, unless requested by a Local Authority and approved by the Board.

During the initial three years of operation the Auckland Council will be limited to a maximum of 60% of the Company's total Local Authority (including Council-Controlled Organisation ("CCO")) assets. After three years Auckland Council will be limited to a maximum of 40% of the Company's total Local Authority (including CCO) assets.

No more than the greater of NZD 100 million or 33% of a Local Authority's or CCO's borrowings from the Company will mature in any 12 month period.

Subject to implementation of any amendments or other actions considered necessary, advisable or expedient by the Board and the approval of the Board in relation to the relevant CCO (which may be a Council-Controlled Trading Organisation ("CCTO")), an approved CCO may borrow from the Company provided that:

- The CCO is a "council-controlled organisation" as defined in section 6 of the Local Government Act 2002;
- Each Local Authority that holds voting rights or rights of appointment in the CCO is a "CCO Shareholder";
- Each CCO Shareholder provides a guarantee in respect of the CCO in favour of the Company and/or there is sufficient uncalled capital within the CCO to meet the financial obligations of the CCO;
- Each CCO Shareholder provides equity commitment liabilities to the Company, guarantees liabilities to a security trustee approved for the Company's creditors, and provides debenture security for its equity commitments to the Company and guarantee liabilities to the security trustee;
- Each CCO Shareholder complies with Lending policy financial covenants or Foundation policy financial covenants required by the Board;
- The CCO complies with any covenants required by the Board; and
- If required by the Board, the CCO will grant security in favour of the Company (which may be subject to any intercreditor arrangements acceptable to the Board).

Cash and Liquid Investment Policy

The Company will only invest in NZD senior debt securities, money market deposits and registered certificates of deposits within the counterparty limits outlined in the following table.

New Zealand Local Authority and CCO securities are excluded from the Company's cash and liquidity portfolio.

Counterparty[1]	S & P Credit Rating or equivalent (Short-term / long-term)	Maximum % Limit (Total Cash + Liquid Assets)	Maximum New Zealand Dollar counterparty Limit (millions)	Maximum term (years)
NZ Government or RBNZ[2]	N/A	100%	Unlimited	No longer than the longest dated LGFA maturity on issue
Category 2	A1+ / AAA	80%	200	3
Category 3	A1+; A1 / AA+	80%	150	3
	A1+;A1 / AA	80%	150	3
	A1+;A1 / AA-	80%	125	3
Category 4	A1+; A1 / A+,	60%		
	NZ Registered Bank		125	1
	Other Issuers		30	1

The maximum individual counterparty limit (excluding the NZ Government) cannot be greater than 100% of Accessible Capital. Accessible Capital is defined as issued and paid capital plus retained earnings plus issued and unpaid capital plus outstanding borrower notes.

Derivative Policy

The Company will only enter into derivative transactions with the New Zealand Debt Management Office as counterparty.

Market Risk

The Company's total 12 month forecast portfolio PDH (Partial Differential Hedge) Limit is $40,000[3].

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[1] Category 2, 3, and 4 counterparties do not include the RBNZ or the NZ Government.

[2] At least 20% of the portfolio must be held at the RBNZ or invested in NZ Government securities.

[3] PDH risk measures the sensitivity of a portfolio to a one basis point change in underlying interest rates. For example, a PDH of $40,000 means that the portfolio value will fall by $40,000 for a one basis point fall in interest rates. The PDH limit will be set at .0025% of the 12 month forecast portfolio amount until this forecast reaches $1 billion, following which this $40,000 limit applies.

The Company's total portfolio Value at Risk (VaR) daily limit is $400,000[4].

Foreign exchange risk policy

The Company will take no foreign exchange risk.

Operational Risk

The Company will outsource the following functions to the New Zealand Debt Management Office as follows:

- Hedging – New Zealand Debt Management Office is the LGFA interest rate swap counterparty.

Dividend policy

The policy is to pay a dividend that provides an annual rate of return to Shareholders equal to the Company's cost of funds plus 2.00% over the medium term, recognising that, to assist in the start-up period, the initial expectation is for no dividend for the part period to 30 June 2012, and for a dividend equal to 50% of the target dividend in the two periods to 30 June 2014 to be paid. Thereafter, the intention is to pay at least the full target dividend until the target dividend return is achieved as measured from commencement, including consideration of the time value of money at the target annual rate of return.

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

[4] VaR measures expected loss for a given period with a given confidence. For example, 95% confidence, daily VaR of $250,000 means that it is expected that the portfolio will lose $250,000 on 5% of days. i.e. 1 day in 20 the portfolio value will decrease by $250,000.

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Credit Risk

Lending Policy

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- Provide debenture security in relation to their borrowing from the Company and related obligations, and (if relevant), equity commitment liabilities to the Company and (if relevant) guarantee liabilities to a security trustee approved for the Company's creditors.
- Issue securities (bonds / FRNs / CP) to the Company (~~ie~~i.e. not enter into facility arrangements).
- Comply with their own internal borrowing policies.
- Comply with the financial covenants outlined in the following table, provided that:
  - Unrated Local Authorities or Local Authorities with a long-term credit rating lower than ‘A’ equivalent can have bespoke financial covenants that exceed the:
    - Lending policy covenants outlined in the following table with the approval of the Board;
    - Foundation policy covenants outlined in the following table with the approval of an Ordinary Resolution.
  - Local Authorities with a long-term credit rating of ‘A’ equivalent or higher will not be required to comply with the lending policy covenants in the following table~~,~~ and can have bespoke financial covenants that exceed the foundation policy covenants outlined in the following table with the approval of an Ordinary Resolution.
  - Any Board or Ordinary Resolution approval of bespoke financial covenants will only be provided after a robust credit analysis and any approval must also include bespoke reporting and monitoring arrangements.
- If the principal amount of a Local Authority's borrowings is at any time equal to, or greater than, NZD 20 million, be a party to a deed of guarantee and an equity commitment deed (in each case in a form set by the Company).

Financial covenant	Lending policy covenants	Foundation policy covenants
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Net debt is defined as total debt less liquid financial assets and investments.

Liquidity is defined as external debt plus committed loan facilities plus liquid investments divided by external debt.

Net Interest is defined as the amount equal to all interest and financing costs less interest income for the relevant period.

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Financial covenants are measured on Council only basis and not consolidated group~~.~~ basis, unless requested by a Local Authority and approved by the Board.

During the initial three years of operation the Auckland Council will be limited to a maximum of 60% of the Company's total Local Authority ~~assets.~~(including Council-Controlled Organisation ("CCO")) assets. After three years Auckland Council will be limited to a maximum of 40% of the Company's total Local Authority (including CCO) assets.

No more than the greater of NZD 100 million or 33% of a Local Authority's or CCO's borrowings from the Company will mature in any 12 month period.

Subject to implementation of any amendments or other actions considered necessary, advisable or expedient by the Board and the approval of the Board in relation to the relevant CCO (which may be a Council-Controlled Trading Organisation ("CCTO")), an approved CCO may borrow from the Company provided that:

- The CCO is a "council-controlled organisation" as defined in section 6 of the Local Government Act 2002;
- Each Local Authority that holds voting rights or rights of appointment in the CCO is a "CCO Shareholder";
- Each CCO Shareholder provides a guarantee in respect of the CCO in favour of the Company and/or there is sufficient uncalled capital within the CCO to meet the financial obligations of the CCO;
- Each CCO Shareholder provides equity commitment liabilities to the Company, guarantees liabilities to a security trustee approved for the Company's creditors, and provides debenture security for its equity commitments to the Company and guarantee liabilities to the security trustee;
- Each CCO Shareholder complies with Lending policy financial covenants or Foundation policy financial covenants required by the Board;
- The CCO complies with any covenants required by the Board; and
- If required by the Board, the CCO will grant security in favour of the Company (which may be subject to any intercreditor arrangements acceptable to the Board).

Cash and Liquid Investment Policy

The Company will only invest in NZD senior debt securities, money market deposits and registered certificates of deposits within the counterparty limits outlined in the following table.

New Zealand Local Authority and CCO securities are excluded from the Company's cash and liquidity portfolio.

Counterparty[1]	S & P Credit Rating or equivalent (Short-term / long-term)	Maximum % Limit (Total Cash + Liquid Assets)	Maximum New Zealand Dollar counterparty Limit (millions)	Maximum term (years)
NZ Government or RBNZ[2]	N/A	100%	Unlimited	No longer than the longest dated LGFA maturity on issue
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	A1+;A1 / AA	80%	150	3
	A1+;A1 / AA-	80%	125	3
Category 4	A1+; A1 / A+,	60%		
	NZ Registered Bank		125	1
	Other Issuers		30	1

The maximum individual counterparty limit (excluding the NZ Government) cannot be greater than 100% of Accessible Capital. Accessible Capital is defined as issued and paid capital plus retained earnings plus issued and unpaid capital plus outstanding borrower notes.

Derivative Policy

The Company will only enter into derivative transactions with the New Zealand Debt Management Office as counterparty.

Market Risk

The Company's total 12 month forecast portfolio PDH (Partial Differential Hedge) Limit is $40,000[3].

[1] Category 2, 3, and 4 counterparties do not include the RBNZ or the NZ Government.

[2] At least 20% of the portfolio must be held at the RBNZ or invested in NZ Government securities.

[3] PDH risk measures the sensitivity of a portfolio to a one basis point change in underlying interest rates. For example, a PDH of $40,000 means that the portfolio value will fall by $40,000 for a one basis point fall in interest rates. The PDH limit will be set at .0025% of the 12 month forecast portfolio amount until this forecast reaches $1 billion, following which this $40,000 limit applies.

The Company's total portfolio Value at Risk (VaR) daily limit is $400,000[4].

Foreign exchange risk policy

The Company will take no foreign exchange risk.

Operational Risk

The Company will outsource the following functions to the New Zealand Debt Management Office as follows:

- Hedging – New Zealand Debt Management Office is the LGFA interest rate swap counterparty.

Dividend policy

The policy is to pay a dividend that provides an annual rate of return to Shareholders equal to the Company's cost of funds plus 2.00% over the medium term, recognising that, to assist in the start-up period, the initial expectation is for no dividend for the part period to 30 June 2012, and for a dividend equal to 50% of the target dividend in the two periods to 30 June 2014 to be paid. Thereafter, the intention is to pay at least the full target dividend until the target dividend return is achieved as measured from commencement, including consideration of the time value of money at the target annual rate of return.

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

[4] VaR measures expected loss for a given period with a given confidence. For example, 95% confidence, daily VaR of $250,000 means that it is expected that the portfolio will lose $250,000 on 5% of days. i.e. 1 day in 20 the portfolio value will decrease by $250,000.