**Chairperson and Committee Members**
OPERATIONS & FINANCE COMMITTEE

4 OCTOBER 2018

Meeting Status: **Public**

Purpose of Report: For Information

# LOCAL GOVERNMENT FUNDING AGENCY 2017/2018 ANNUAL REPORT

## PURPOSE OF REPORT

1 The purpose of this report is to update the Operations and Finance Committee on the Local Government Funding Agency (LGFA) 2017/18 Annual Report.

## DELEGATION

2 While noting that this report is for information, the Operations and Finance Committee, with its role of *monitoring and decision-making on all broader financial management matters* has the delegation to consider this report.

## 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 The LGFA meets the Local Government Act (LGA) 2002 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.

6 As a shareholder in a CCO, the Council must regularly undertake performance monitoring of that organisation to evaluate its contribution to the achievement of the Council's desired outcomes.

## ISSUES AND OPTIONS

### LGFA performance for the 2017/18 year

7 The LGFA recorded a strong financial performance for the year ended 30 June 2018. It's net operating profit was $11.80 million, which was 6.8% higher than the previous year result of $11.05. The increase was due to the early refinancing of loans by councils maturing in December 2017 and a higher level of liquid assets held than forecast.

8 The LGFA has a number of primary objectives including making longer-term borrowings available, offering flexible lending and enhancing the certainty of access to debt markets.

9 However, the primary objective that is arguably the most important for its borrowers is providing annual interest costs to Participating Local Authorities (PALs) on a competitive basis to other sources of financing. While the LGFA undoubtedly provides savings, it continues to struggle to meet its primary performance targets in relation to this objective, as shown in the table below:

| **Current performance targets** | **Target** | **Result for 12 months to 30 June 2018** | **Outcome** |
|---|---|---|---|
| Average margin above LGFA's cost of funds charged to the highest rated Participating Local Authorities for the period | Less than 0.10% | 0.105% | Not achieved |
| Savings on borrowing costs for council borrowers relative to other sources of financing and compared to previous years | Improvement since prior year end relative to borrowing by councils directly.<br>Council borrowing spreads as at June 2017:<br>2019s 12 bps,<br>2021s 20 bps<br>2025s 17 bps | Council borrowing spreads as at June 2018:<br>2019s 11bps<br>2021s 19 bps<br>2025s 10bps | Not achieved due to lack of single name issuance by councils. This reduced supply has tightened comparable spreads for Auckland Council and Dunedin City Treasury bonds |

10 The LGFA estimates that as at 30 June 2018, it was saving AA-rated councils between 10 basis points (bps) and 19 basis points (bps or 0.19%) depending upon the term of the maturity. The Kāpiti Coast District Council has a Standard and Poor's credit rating of A+, slightly lower than AA, suggesting a lower but comparable quantum of savings.

11 The LGFA continues to grow, both in terms of its balance sheet with total loans to councils reaching $7.98 billion at 30 June 2018 (2017: $7.78 billion) and total membership growing from 53 to 56 Councils during the year.

12 From the perspective of the Kāpiti Coast District Council, the LGFA has provided borrowing with interest rates and lending terms that have enabled the Council to meet its financial objectives and to stay within its financial targets.

13 Auckland Council is the LGFA's largest borrower ($2.1 billion), followed by Christchurch City Council ($1.7 billion). As at 30 June 2018, Kāpiti Coast District Council ranked as the 7th largest borrower with $205 million (205.8 million including accrued interest) in gross borrowings. Net borrowings, taking account of cash, borrower notes and prefunding is $148 million.

14 The full LGFA 2017/18 Annual Report is attached as Appendix 1.

## CONSIDERATIONS

### Policy considerations

15 In accordance with the LGA 2002, the Council must provide information on all of its CCOs in its Long Term Plan (LTP). Accordingly the Long term plan 2018-38 contains information on the LGFA, including key performance targets and other performance metrics.

### Legal considerations

16 There are no legal considerations arising from the matters in this report.

### Financial considerations

17 The Council is one of 31 Local Authority shareholders of the LGFA which has the objective of operating with a view to making sufficient profit to declare a dividend that provides an annual rate of return to its shareholders equal to LGFA cost of funds plus 2%.

18 On 30 August 2018 the directors declared a dividend for 2018 of $1.285 million ($0.0514 per share).The Council's share of the dividend was $5,140 and it was paid on 7 September 2018. The continuation of low interest rates has resulted in a lower cost of funds for the LGFA, and therefore lower borrowing costs for councils however this also means a lower dividend payment.

19 The Council also has an obligation in respect of uncalled share capital of $100,000. At 30 June 2018, the LGFA had bills and bonds totalling $8.6 billion and bills (2017: $8.2 billion).

20 Council officers consider the risk of the LGFA defaulting on repayment of interest or capital to be very low on the basis that:

a) The only circumstance where the LGFA would default on its debt is the event where a council defaulted on a loan obligation that exceeded the LGFA's available liquidity assets. As at 30 June 2018, this would need to be a single council default event that exceeded the sum of:

- cash and deposits of $251.4 million, and
- LGFA borrower notes of $131.6 million, and
- LGFA credit facility of $600 million, and
- uncalled share capital of $20 million from LGFA shareholders.

b) In the event of an LGFA default, the call on the guarantee is made on the council's proportion of their share of the underlying rate base.

c) In the event of a default exceeding the LGFA's available liquid assets, the council would be called for 1.2% of the overall call (less than the council's 2.6% of LGFA's loan assets).

### Tāngata whenua considerations

21 There are no tāngata whenua considerations.

## SIGNIFICANCE AND ENGAGEMENT

### Degree of significance

22 This matter has a low level degree of significance under the Council policy, and it is not significant.

### Consultation already undertaken

23 There is no need to consult on the matters discussed in this report.

### Engagement planning

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

### Publicity

25 There are no publicity considerations.

## RECOMMENDATIONS

26 That the Operations and Finance Committee notes the performance of the Local Government Funding Agency as set out in its 2017/18 Annual Report, attached as Appendix 1 to this report.

| **Report prepared by** | **Approved for submission by** |
|---|---|
| **Jacinta Straker**<br>**Chief Financial Officer** | **Janice McDougall**<br>**Acting Group Manager**<br>**Corporate Services** |

**Approved for submission by**

**Nicki Williams**
**Acting Group Manager**
**Strategy & Planning**

**ATTACHMENT**

Appendix 1 – LGFA 2017/18 Annual Report

# Partnering with Councils to finance infrastructure investment

## Mā te huruhuru ka rere te manu

Annual report

**30 June 2018**

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

*Mā te huruhuru ka rere te manu*
is a traditional saying literally meaning
‘birds need feathers to fly’.

Its wider meaning is that
‘investment is needed for success’.

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# About us
# Ko ngāi mātou

## Establishment

The New Zealand Local Government Funding Agency Ltd (LGFA) specialises in funding the New Zealand local government sector, the primary purpose being to provide more efficient funding costs and diversified funding sources for New Zealand local authorities. LGFA was established to raise debt on behalf of local authorities on terms that are more favourable to them than if they raised the debt directly.

**Incorporated** on 1 December 2011 under the Companies Act 1993.

**Enabled** by Local Government Borrowing Act 2011

**Council-controlled organisation** under the Local Government Act 2002.

## Ownership


**20** million of which remain **uncalled.**


**20%**
New Zealand Government

**80%**
30 councils

Share ownership is restricted to New Zealand Government or councils.

## Guarantee structure

LGFA's securities obligations are guaranteed by the councils that are Guarantors.

LGFA is not guaranteed by the New Zealand Government

All council shareholders must be a Guarantor as well as any council with aggregate borrowings over $20 million.

## Credit rating

as at 30 June 2018

**Domestic Currency AA+ / Foreign Currency AA (Stable Outlook)**
Standard & Poor's

**Domestic Currency AA+ / Foreign Currency AA (Stable Outlook)**
Fitch Ratings

These credit ratings are the same as the New Zealand Government ratings.

## Face value of bonds on issue

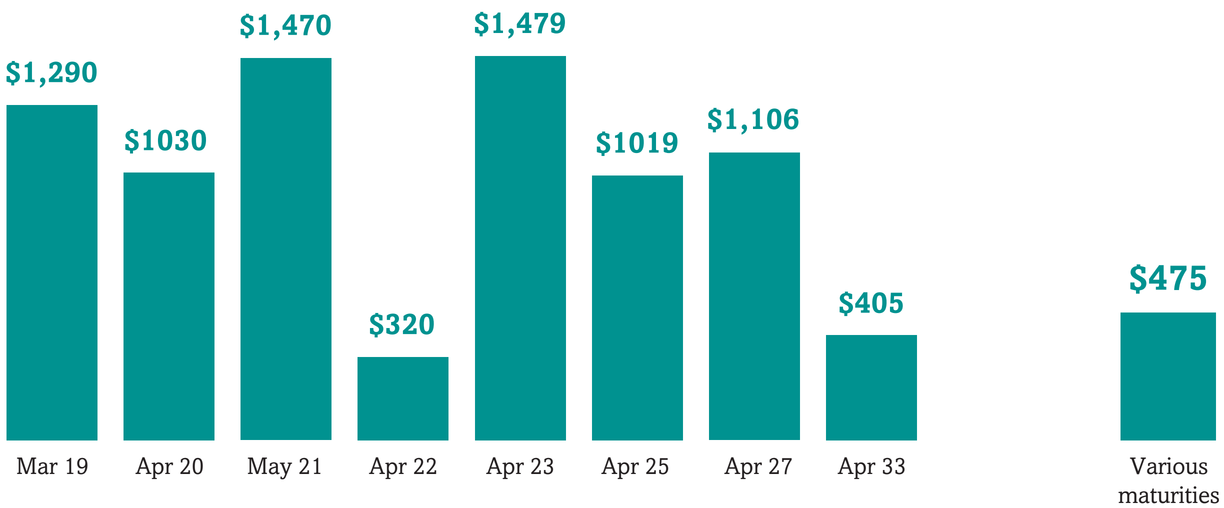
as at 30 June 2018 (NZ$ million)

**$8,119 million**

## Bills on issue

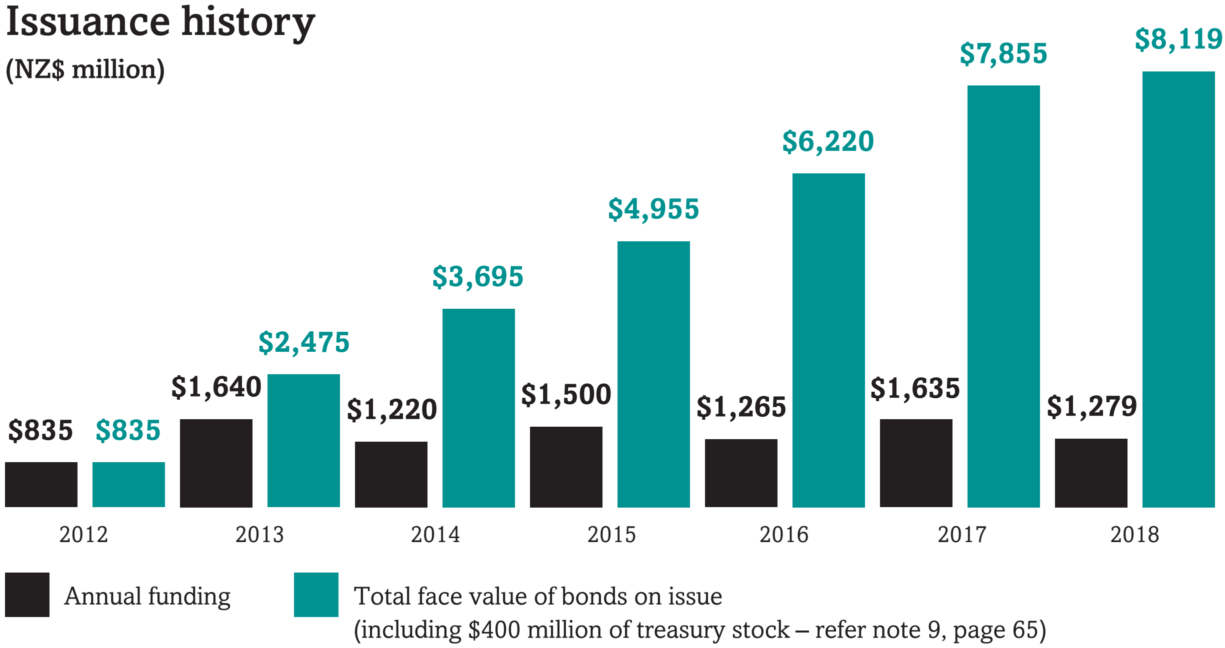
as at 30 June 2018 (NZ$ million)

**$475 million**




## Issuance history

(NZ$ million)



# Governance overview

**20%**
**Shareholding**
New Zealand Government

**80%**
**Shareholding**
30 councils

## 31 Shareholders

New Zealand Government shareholding reduces to 11.1% if a call is made on uncalled capital of the 30 council shareholders.

Shareholders' Council
**Page 27**

**LGFA Shareholders' Council,** comprising five to ten appointees from the Council Shareholders and the New Zealand Government. Role of the Shareholders' Council is to:

**Review and report** performance of LGFA and the Board;

**Recommendations** to Shareholders as to the **appointment, removal, replacement and remuneration of directors;**

**Recommendations** to Shareholders as to any **changes to policies**, or the SOI, requiring their approval;

**Update Shareholders** on LGFA matters and to coordinate Shareholders on governance decisions.

LGFA Board
**Page 17**

**LGFA 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:

- Local Government Act 2002;
- Local Government Borrowing Act 2011;
- Companies Act 1993;
- LGFA's Constitution;
- LGFA Shareholder Agreement;
- LGFA Annual Statement of Intent.

The Board comprises **five independent** and **one non-independent** directors appointed by shareholders.

Bonds listed on NZX Debt Market

Issue of securities to the public under the Financial Markets Conduct Act and regulated by Financial Markets Authority

Supervised by independent trustee

# Our history

**Dec 2011**

Incorporated
December 2011

Commenced bond issuance
February 2012

2015 and 2017 bonds issued

**June 2012**

KangaNews NZ Domestic Issuer of the Year – 2012

2019 bond issued

INFINZ award for Best Bond issue of 2012

Inaugural LGFA Borrowers Forum

**June 2013**

Inaugural dividend of $1.5m declared

2021 and 2023 bonds issued

**June 2014**

2020 and 2027 bonds issued

Bespoke lending introduced

Successful refinancing of April 2015 bond maturity and council loans

New Treasury Management System implemented

Transitioned front/middle/back office from NZDMO

**June 2015**

LGFA Bonds listed on NZX
November 2015

Commenced LGFA Bill issuance

Commenced short-term lending to councils

Transitioned to Financial Markets Conduct Act

**June 2016**

Bond lending facility established
October 2016

April 2033 bond issued

**June 2017**

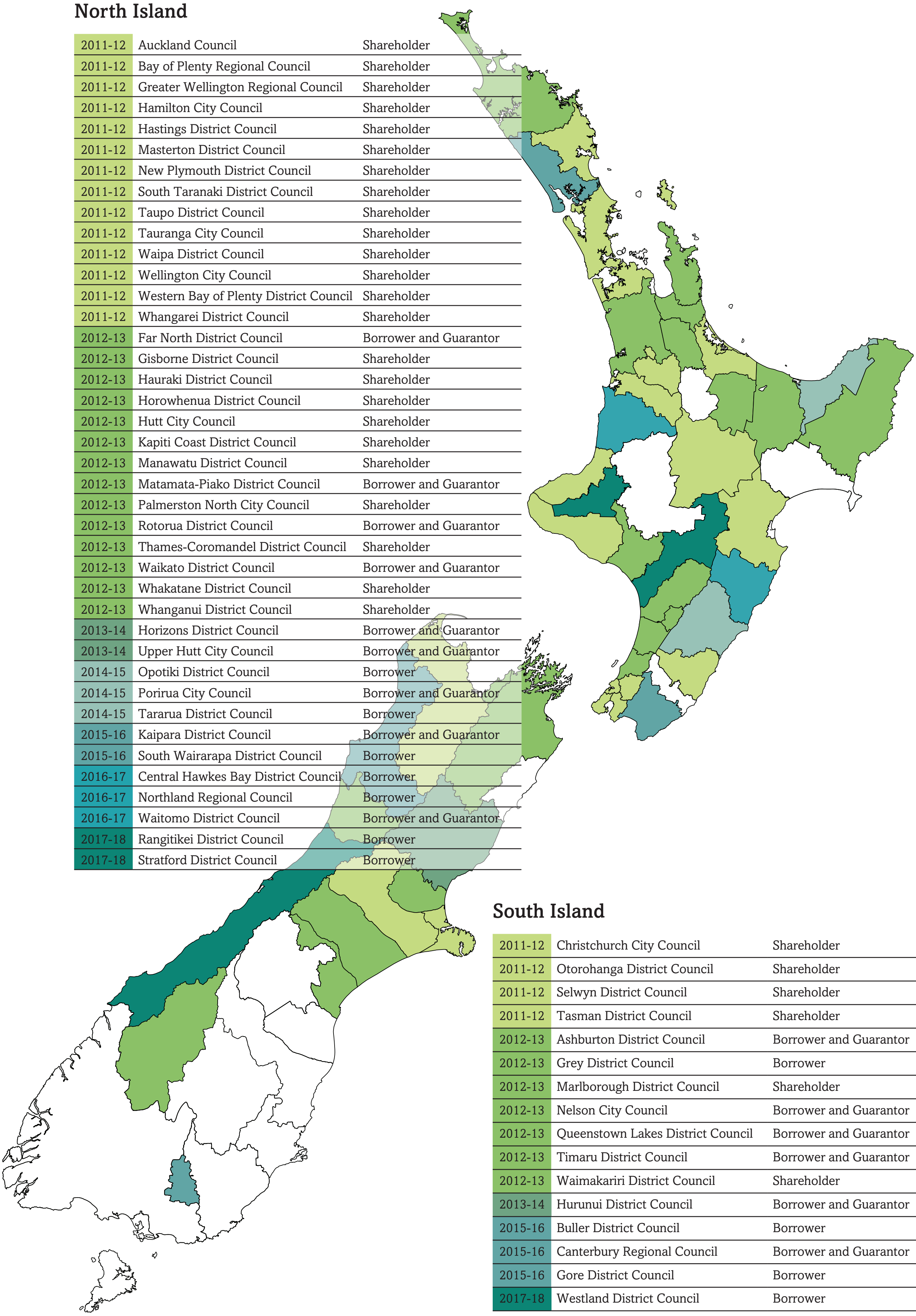
Successful refinancing of December 2017 bond maturity and council loans

April 2022 bond issued

First bond not matched to a New Zealand Government bond maturity

**June 2018**

# LGFA's 56 participating councils with year of joining



## North Island

| | | |
|---|---|---|
| 2011-12 | Auckland Council | Shareholder |
| 2011-12 | Bay of Plenty Regional Council | Shareholder |
| 2011-12 | Greater Wellington Regional Council | Shareholder |
| 2011-12 | Hamilton City Council | Shareholder |
| 2011-12 | Hastings District Council | Shareholder |
| 2011-12 | Masterton District Council | Shareholder |
| 2011-12 | New Plymouth District Council | Shareholder |
| 2011-12 | South Taranaki District Council | Shareholder |
| 2011-12 | Taupo District Council | Shareholder |
| 2011-12 | Tauranga City Council | Shareholder |
| 2011-12 | Waipa District Council | Shareholder |
| 2011-12 | Wellington City Council | Shareholder |
| 2011-12 | Western Bay of Plenty District Council | Shareholder |
| 2011-12 | Whangarei District Council | Shareholder |
| 2012-13 | Far North District Council | Borrower and Guarantor |
| 2012-13 | Gisborne District Council | Shareholder |
| 2012-13 | Hauraki District Council | Shareholder |
| 2012-13 | Horowhenua District Council | Shareholder |
| 2012-13 | Hutt City Council | Shareholder |
| 2012-13 | Kapiti Coast District Council | Shareholder |
| 2012-13 | Manawatu District Council | Shareholder |
| 2012-13 | Matamata-Piako District Council | Borrower and Guarantor |
| 2012-13 | Palmerston North City Council | Shareholder |
| 2012-13 | Rotorua District Council | Borrower and Guarantor |
| 2012-13 | Thames-Coromandel District Council | Shareholder |
| 2012-13 | Waikato District Council | Borrower and Guarantor |
| 2012-13 | Whakatane District Council | Shareholder |
| 2012-13 | Whanganui District Council | Shareholder |
| 2013-14 | Horizons District Council | Borrower and Guarantor |
| 2013-14 | Upper Hutt City Council | Borrower and Guarantor |
| 2014-15 | Opotiki District Council | Borrower |
| 2014-15 | Porirua City Council | Borrower and Guarantor |
| 2014-15 | Tararua District Council | Borrower |
| 2015-16 | Kaipara District Council | Borrower and Guarantor |
| 2015-16 | South Wairarapa District Council | Borrower |
| 2016-17 | Central Hawkes Bay District Council | Borrower |
| 2016-17 | Northland Regional Council | Borrower |
| 2016-17 | Waitomo District Council | Borrower and Guarantor |
| 2017-18 | Rangitikei District Council | Borrower |
| 2017-18 | Stratford District Council | Borrower |

## South Island

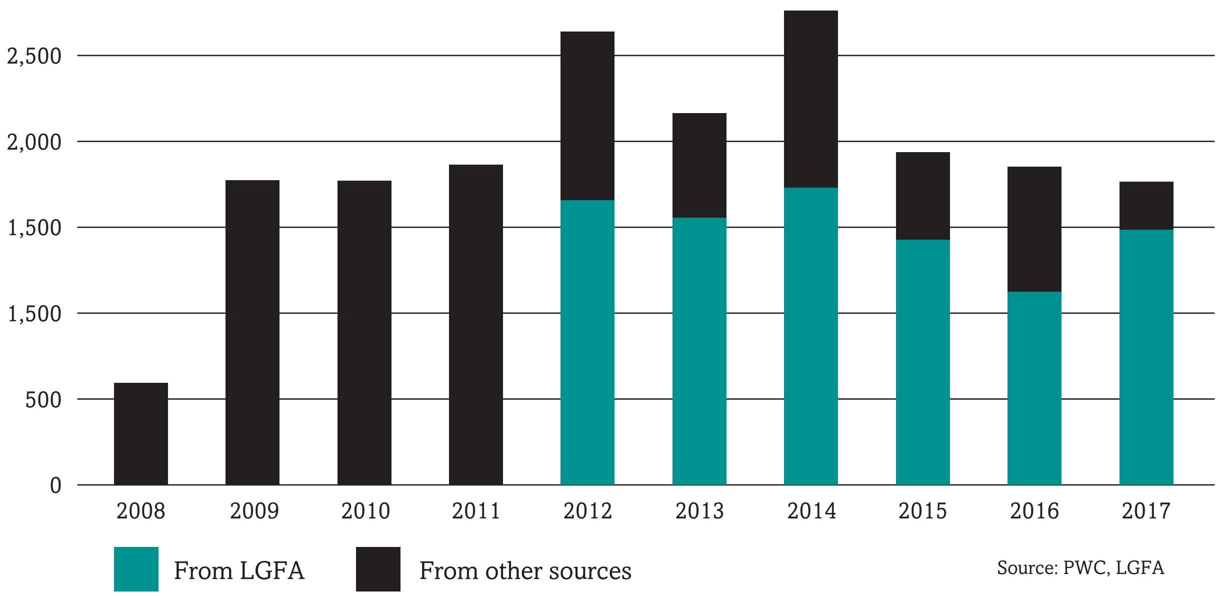
| | | |
|---|---|---|
| 2011-12 | Christchurch City Council | Shareholder |
| 2011-12 | Otorohanga District Council | Shareholder |
| 2011-12 | Selwyn District Council | Shareholder |
| 2011-12 | Tasman District Council | Shareholder |
| 2012-13 | Ashburton District Council | Borrower and Guarantor |
| 2012-13 | Grey District Council | Borrower |
| 2012-13 | Marlborough District Council | Shareholder |
| 2012-13 | Nelson City Council | Borrower and Guarantor |
| 2012-13 | Queenstown Lakes District Council | Borrower and Guarantor |
| 2012-13 | Timaru District Council | Borrower and Guarantor |
| 2012-13 | Waimakariri District Council | Shareholder |
| 2013-14 | Hurunui District Council | Borrower and Guarantor |
| 2015-16 | Buller District Council | Borrower |
| 2015-16 | Canterbury Regional Council | Borrower and Guarantor |
| 2015-16 | Gore District Council | Borrower |
| 2017-18 | Westland District Council | Borrower |

## Participating councils

| Borrower Type | Number of Councils | Amount Borrowed (NZ$ million) | Percentage of Total Borrowing |
|---|---|---|---|
| Guarantors | 45 | 7,846 | 98.6 |
| Non Guarantors | 11 | 130 | 1.4 |
| **Total** | **56** | **7,976** | **100** |

## Councils’ borrowing

**All councils (NZ$ million) calendar year**




## New member Councils

LGFA welcome the following three councils who joined as eligible borrowers in the year-ended 30 June 2018:

**Westland District Council**

**Stratford District Council**

**Rangitikei District Council**

# Message from the Chair

# He karere mai i te Toihau

**For the year ended 30 June 2018**

*"LGFA continues to be the leading provider of cost-effective funding to New Zealand councils while offering investors a highly rated, higher yielding alternative to New Zealand Government Bonds."*

Craig Stobo, Chair LGFA Board

Directors are pleased to record another period of strong financial and non-financial performance to 30 June 2018 and to highlight the following developments over the past year.

## Strong financial and operational performance

LGFA total interest income for the financial year of $342.8 million was a 6.9% increase over the 2016-17 financial year result of $320.7 million while net operating profit of $11.80 million for the financial year was a 6.8% increase on the 2016-17 financial year result of $11.05 million.

Net interest income and operating profit exceeded both the previous year's result and the Statement of Intent (SOI) forecast due to the early refinancing of loans by councils maturing in December 2017 and a higher level of liquid assets held than forecast.

Expenses have been managed under budget over the past year as lower personnel costs and lower fees from a reduced utilisation of the standby facility relative to forecast were offset by higher legal costs from the establishment of an Australian Medium Term Notes Programme and lending activities above budget.

While we achieved strong financial and operating performance and delivered value to stakeholders, we did not meet all SOI specific performance targets outlined on page 43 of this Annual Report. The average margin on loans to councils was higher than the SOI target due to many councils borrowing from LGFA for longer tenors at higher margins. For the coming year, we have adopted a flat margin structure for councils, irrespective of loan tenor. Our lending to councils was lower than expected due to the timing of the March 2019 loan refinancing. This led to LGFA not achieving our target for lending volumes for the first time in six years and we will work closer with councils in the coming year regarding the timing of their borrowing.

LGFA bonds continue to be an attractive investment for investors, while LGFA has also delivered savings in borrowing costs and extended the tenor of lending available to our council borrowers.

The financial strength of LGFA was reaffirmed in late 2017 by credit rating agencies Standard & Poor's and Fitch who both maintained our credit rating at 'AA+', which very importantly is the same as the New Zealand Government. In May 2018, S&P announced the introduction of a new ratings methodology for non-US public sector funding agencies such as LGFA and subsequently affirmed our local currency long term rating as 'AA+' on 13 July 2018.

## Borrowing activity

LGFA issued $1.279 billion of bonds over the financial year and outstandings now total $8.119 billion (including $400 million of treasury stock) across eight maturities from 2019 to 2033. A highlight was the debut issuance of an April 2022 bond which provides a new mid curve maturity for investors. The issuance of the April 2022 bond was a change from our previous strategy of issuing into New Zealand Government Bond (NZGB) maturities but, after careful consideration, it was decided to issue the new maturity to help reduce the mismatch between LGFA bond issuance and on-lending to councils.

LGFA is the largest issuer of NZD securities after the New Zealand Government and our bonds are amongst the largest and most liquid New Zealand dollar debt instruments available for investors. It was pleasing to see our estimated offshore investor holdings grow to 39% from 31% a year ago.

The performance of LGFA bonds over the past year was mixed with LGFA bond spreads to both swap and NZGB tighter on maturities out to 2021, but spreads wider on maturities beyond 2023. Outright yields declined between 28 bps (0.28%) on the 2033 maturity and 55 bps (0.58%) on the 2021 maturity over the year.

LGFA continues to issue short-dated LGFA Bills ranging in maturities from three months to 12 months through a combination of monthly tenders and private placements. Outstandings under the programme have reached $475 million. These instruments provide a source of funding for short-dated lending to our council borrowers and assist LGFA with liquidity management.

## Lending to the sector

LGFA was established in December 2011 to provide long-dated borrowing, certainty of access to markets and to reduce the borrowing costs for the local government sector. The original 31 shareholders including the New Zealand Government remain as shareholders. Over the past year, we added three new members with Stratford, Rangitikei and Westland District Councils joining as non-guarantors. Total membership is now 56 councils, and this is expected to rise in the coming year as several councils have included joining LGFA in their Long-Term Plans.

Long-dated lending over the 2017-18 year totalled $1.088 billion with much of the lending activity being the refinancing of council loans maturing on 15 December 2017. The tenor of borrowing by councils shortened slightly to an average term of borrowing of 6.9 years over the 12-month period.

Short-dated lending for terms less than 12 months has been well received by councils and as at 30 June 2018, LGFA had $236 million of short-term loans outstanding to 19 councils.

## The sector outlook and impact on LGFA

The success of LGFA over the past six years has been in part due to its ability to evolve and adapt to meet the needs of the local government sector. This has been apparent with the introduction of short-term lending, bespoke lending and the introduction of long-dated bond maturities allowing councils to undertake long-dated borrowing.

Following the change in central government in October 2017, there has been several policy announcements regarding the need to hasten delivery of housing infrastructure, the establishment of an inquiry by the Productivity Commission into local government funding and financing and the review of the management of drinking water, stormwater and waste water (the Three Waters review). The outcome of these initiatives may have a significant impact on the wider local government sector, so LGFA is assisting where possible both central and local government to work through the issues.

Our council members are also currently in the process of publishing their Long-Term Plans and we would expect both higher infrastructure investment and increased borrowing requirements from the sector over the next 10 years. We are confident that LGFA can meet the needs of our council members.

## Acknowledgments

The Agency's work cannot be implemented without the support of our staff, fellow directors, Shareholders' Council and the New Zealand Debt Management Office (NZDMO), whose efforts all should be acknowledged. I would like to also thank Mark Butcher, our Chief Executive, for his leadership of the organisation over the past year. Directors believe the Agency's future remains positive and look forward to working with all stakeholders in the year ahead.

**Craig Stobo**
**Chair, LGFA Board**


Award winning redeveloped Stratford District Library.
Stratford District Council

Stratford water treatment plant. The $7.0m project was undertaken to meet the new Drinking Water Standards.
Stratford District Council

# Performance highlights
# Putanga mahi matua

## Bonds issued over financial year

**$1.279 billion**

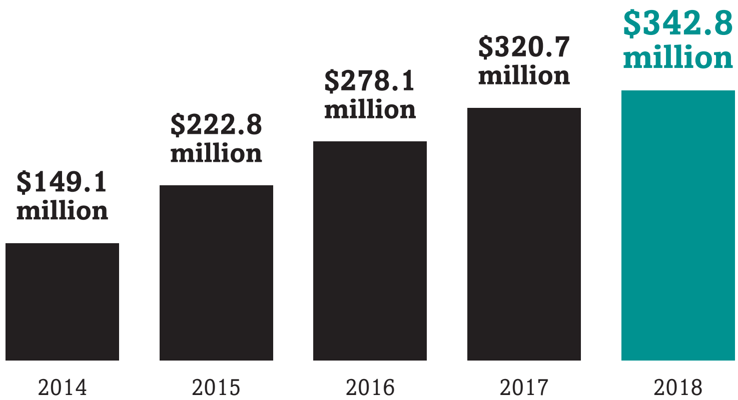
## Lending to councils over financial year

**$1.088 billion**

## Total interest income

**$342.8 million**

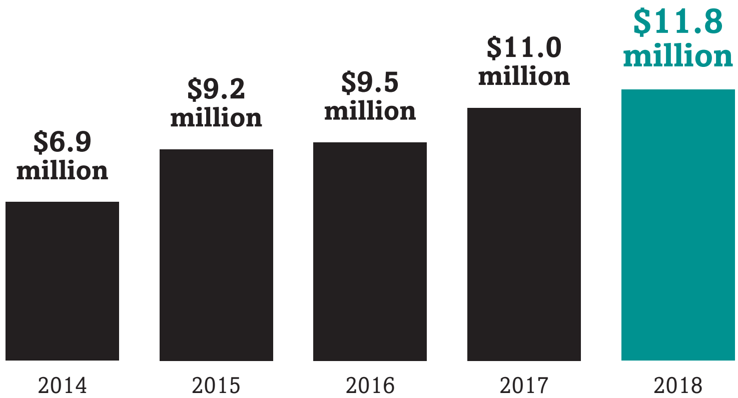
▲ **6.9%**
increase over the 2016-17 financial year



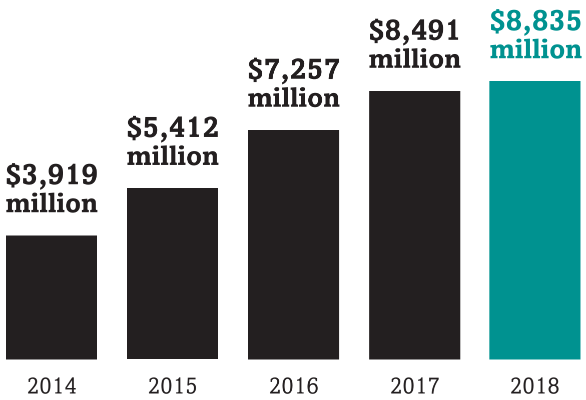

## Net operating profit

**$11.8 million**

▲ **6.8%**
increase over the 2016-17 financial year



## Total assets




## Liquidity as at 30 June 2018

Cash
**$50m**

Marketable securities
**$231m**

Deposits
**$201m**

Government committed liquidity facility
**$600m**

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## Shareholder funds 30 June 2018

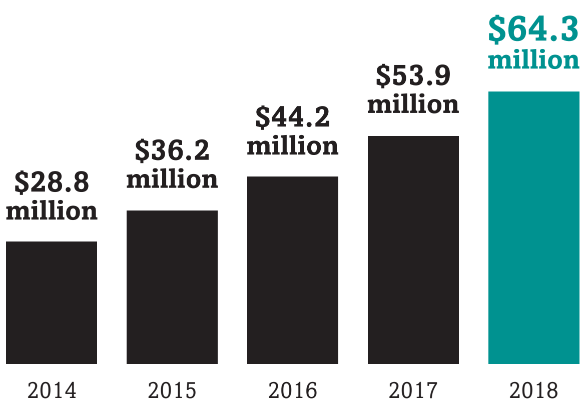
**Fully paid shares**

**$25m**

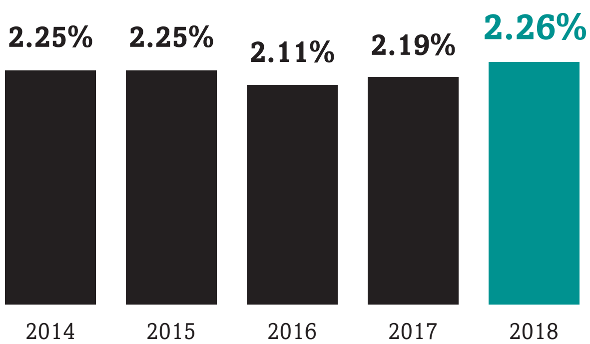
**Retained earnings**

**$39m**

## Shareholder equity




## Shareholder funds and borrower notes / total assets




Borrower Notes are subordinated convertible debt instruments subscribed for by borrowing councils.

# Corporate governance
# Ārahitanga ā-rangatōpū

## NZX Corporate Governance Best Practice Code

The LGFA Board is committed to ensuring the Company demonstrates ongoing commitment to strong and sound corporate governance.

LGFA is a listed issuer on the NZX Main Board and this section sets out the Company's compliance with the eight core principles underpinning the NZX Corporate Governance Best Practice Code 2017.

The Company considers that its governance practices have not materially differed from the NZX Code for the year ended 30 June 2018. Areas where the Company has implemented alternative measures to the Code are as follows:

| | |
|---|---|
| An Issuer should establish a nomination committee to recommend director appointments to the Board. | The process for the nomination and remuneration of directors is documented in the Constitution of New Zealand Local Government Funding Agency Limited and outlined below. |
| An Issuer should establish a remuneration committee to recommend remuneration packages for directors to shareholders. | |

The following governance documents referred to in this section are available on the LGFA website: lgfa.co.nz/about-lgfa/governance:

- LGFA Constitution
- Shareholders Agreement
- Code of Ethics
- Board Charter
- Audit and Risk Committee Charter
- Internal Audit Charter
- Diversity Policy

## Principle 1
### Code of ethical behaviour

Directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation.

### Code of Ethics

LGFA has adopted a formal Code of Ethics, incorporating both our Conflicts of Interest Policy and Code of Conduct Policy, which sets out the standards that both directors and employees of LGFA are expected to follow to reflect the values of LGFA.

The Company recognises impartiality and transparency in governance and administration are essential to maintaining the integrity of LGFA. Accordingly, the Conflicts of Interest Policy formally provides guidance to employees and directors of LGFA in relation to conflicts of interest and potential conflicts of interest, including specific guidance on the process for managing potential conflicts that may arise for non-independent directors. Directors and employees are expected to avoid all actions, relationships and other circumstances that may impact on their ability to exercise their professional duties.

The Code of Conduct Policy requires employees and directors to carry out their roles while maintaining high standards of integrity and conduct by clearly setting out our standards for expected behaviour. In addition, the policy sets out the Company's commitment to behave in a fair and reasonable manner to employees, while providing a fair and safe working environment.

### Protected Disclosures and Whistle Blowing

The Company has adopted a Protected Disclosures and Whistle Blowing Policy which provides procedure, support and protection to persons who disclose information which they reasonably believe to be about serious wrong-doing in or by LGFA.

### Financial Products Trading Policy

LGFA has formally adopted a Financial Products Trading Policy, which applies to all directors, employees and contractors, and details LGFA's policy on, and rules for dealing in, listed debt securities issued by LGFA and any other quoted financial products of LGFA.

To ensure an effective Board, there should be a balance of independence, skills, knowledge, experience and perspectives.

## Principle 2
### Board composition and performance

### LGFA Board Charter

The LGFA Board has adopted a Board Charter which describes the Board's role and responsibilities and regulates the Board's procedures. The Board Charter states that the role of the Board is to ensure the Company achieves the Company goals. Having regard to its role the Board will direct, and supervise the management of, the business and affairs of the Company, including:

- ensuring that the Company goals are clearly established, and that strategies are in place for achieving them (such strategies being expected to originate, in the first instance, from management);

- establishing policies for strengthening the performance of the Company;
- ensuring strategies are in place for meeting expectations set out in the current Statement of Intent and monitoring performance against those expectations, in particular the Company's primary objective of optimising the debt funding terms and conditions for participating local authorities;
- monitoring the performance of management;
- appointing the CEO, setting the terms of the CEO's employment contract and, where necessary, terminating the CEO's employment with the Company;
- deciding on whatever steps are necessary to protect the Company's financial position and the ability to meet its debts and other obligations when they fall due, and ensuring that such steps are taken;
- ensuring that the Company's financial statements are true and fair and otherwise conform with law;
- ensuring that the Company adheres to high standards of ethics and corporate behaviour; and
- ensuring that the Company has appropriate risk management/regulatory compliance policies in place. In the normal course of events, day-to-day management of the Company will be in the hands of management. The Board will satisfy itself that the Company is achieving the Company goals; and engaging and communicating with Shareholders' Council

## Board composition

The LGFA Board comprises five independent Directors and one non-independent Director. An independent director is a director who, within five years prior to appointment, was not an employee of any shareholder, employee of a Council Controlled Organisation owned by a shareholder, or a councillor of any local authority which is a shareholder.

**The directors of LGFA as at 30 June 2018:**

### Craig Stobo
**Independent Chair**

***BA (Hons) Economics. First Class, Otago***

Craig has worked as a diplomat, economist, investment banker and Chief Executive Officer of BT Funds Management (NZ) Limited. He has completed the Advanced Management Programme at Wharton Business School in Philadelphia, authored reports to the New Zealand Government on the Taxation of Investment Income (which led to the PIE regime), and the creation of New Zealand as a funds domicile. He currently chairs the listed companies Precinct Properties New Zealand Limited, and AIG Insurance (NZ Board). He has directorship and private equity interests in financial services and other businesses. He was chair of the Establishment Board and acting Chief Executive of LGFA. He is chair of the Establishment Board of the Local Government Risk Agency.

### John Avery
**Independent Director**

***LLB, C.F.Inst.D***

John was managing partner, then Chairman of Hesketh Henry. He was a director of The Warehouse Group Limited, several start-up businesses, a number of CCOs, an industry cooperative 'ITM', Regional Facilities Auckland Limited and Spider Tracks Limited. He is currently an independent director of Strategic Pay Limited, Fund Managers Auckland Limited and a trustee of the New Zealand School of Dance.

## Philip Cory-Wright
**Independent Director**

***LLB (Hons), BCA Business Management, INFINZ (Cert), C.F.Inst.D***

Philip is a solicitor of the High Court of New Zealand and Victoria. He has worked as a corporate finance adviser in New Zealand to the corporate sector on debt and equity matters for more than 25 years. He is currently a director of South Port New Zealand Limited, Papa Rererangi i Puketapu (New Plymouth Airport) and strategic adviser to clients in the energy and infrastructure sectors. He was a member of the Local Government Infrastructure Expert Advisory Group tasked with advising the Minister of Local Government on improvements in local government infrastructure efficiency.

## Linda Robertson
**Independent Director**

***B.Com, Dip Banking, INFINZ (Distinguished Fellow), C.F.Inst.D, GAICD***

Linda is a professional director with nearly 20 years governance experience and over 30 years experience in executive finance roles, having worked in the banking and energy sector in New Zealand. She is Chair of Pacific Radiology Group, a director of Auckland Council Investments Limited, Dunedin City Holdings Limited, Dunedin City Treasury Limited, NZPM Group Limited and Crown Irrigation Investments Limited. Linda is also a member of the Audit and Risk Committee for the Ministry of Social Development, a member of the Treasury Advisory Committee of the New Zealand Export Credit Office and Chair of the Audit and Risk Committee for Central Otago District Council.

## Mike Timmer
**Non-Independent Director**

***CA, BBS, BAgrSci, INFINZ (Cert), M.Inst.D***

Mike has worked for Citibank in its financial market section and held accountancy and treasury roles in the health sector and is presently Treasurer at the Greater Wellington Regional Council. He is Chairman of the Finance Committee of Physiotherapy New Zealand Incorporated and past Deputy Chair of the LGFA Shareholders' Council.

## Anthony Quirk
**Independent Director**

***BCA Hons (First Class), INFINZ (Fellow), M.Inst.D***

Anthony is an experienced financial services sector professional with over thirty years executive experience in the sector, including nine years as Managing Director of Milford Asset Management. He has a varied portfolio of governance interests with an emphasis on areas that improve or contribute to communities.

He is a Fellow of the Institute of Finance Professionals New Zealand (INFINZ) and is a former Chairman of that organisation. He was previously Chair of the Asset Management Advisory Board of the New Zealand Exchange, Deputy Chair and Board member of the New Zealand Society of Investment Analysts and a previous member of the Financial Reporting Standards Board of the New Zealand Society of Accountants.

| Name of Director | Nature and extent of interest | |
|---|---|---|
| Craig Stobo (Chair) | **Director**<br>Precinct Properties New Zealand Limited<br>Elevation Capital Management Limited<br>Saturn Portfolio Management Limited<br>Stobo Group Limited<br>AIG Insurance NZ Limited<br>Bureau Limited<br>SouthWest Trustees Limited<br>Appello Services Limited<br>Biomarine Group Limited<br>Legend Terrace Limited | **General disclosure**<br>Chair, Establishment Board, Local Government Risk Agency |
| John Avery | **Director**<br>Fund Managers Auckland Limited<br>Strategic Pay Limited<br>Strategic Pay Trustee Service Limited | **General disclosure**<br>The New Zealand School of Dance (Trustee)<br>New Zealand Dance Advancement Trust (Trustee)<br>Stinger Trust (Trustee) |
| Philip Cory-Wright | **Director**<br>South Port New Zealand Limited<br>Papa Rererangi i Puketapu (New Plymouth Airport) | |
| Anthony Quirk | **Director**<br>Evolve Education Group<br>Non-Executive Director and Shareholder, Milford Asset Management<br>Deputy Chair, Compass Housing NZ | **General disclosure**<br>Chairman, New Zealand Water Polo<br>Board member, Graeme Dingle Foundation, Wellington |
| Linda Robertson | **Director**<br>RML Consulting Limited<br>Dunedin City Holdings Limited<br>Dunedin City Treasury Limited<br>NZPM Group Limited<br>Auckland Council Investments Limited<br>Crown Irrigation Investments Limited<br>Pacific Radiology Group Limited (Chairman) | **General disclosure**<br>Central Lakes Trust<br>Audit and Risk Committee, Ministry of Social Development<br>Technical Advisory Committee, NZ Export Credit Office<br>Trustee, Central Otago District Council<br>Chair, Audit and Risk Committee |
| Mike Timmer | | **General disclosure**<br>Officer, Greater Wellington Regional Council<br>Chairman of Finance Committee, Physiotherapy New Zealand |

## Nomination of Directors

Director nominations can only be made by a shareholder by written notice to the Company and Shareholders' Council, with not more than three months, nor less than two months before a meeting of shareholders. All valid nominations are required to be sent by the Company to all persons entitled to attend the meeting.

## Retirement and re-election of Directors

Directors are appointed to the Board by an Ordinary Resolution of shareholders. At each Annual General Meeting, two directors must retire and, if desired, seek re-election. The directors who retire each year are one each of the independent and non-independent, who have been longest in office since their last appointment or, if there are more than one of equal term, those determined by lot, unless the Board resolves otherwise.

## Director tenure

As at 30 June 2018

| Director | Originally appointed | Last reappointed/ elected | Tenure |
|---|---|---|---|
| Craig Stobo (Chair) | 1 December 2011 | 19 November 2013 | 6 years, 7 months |
| John Avery | 1 December 2011 | 24 November 2015 | 6 years, 7 months |
| Philip Cory-Wright | 1 December 2011 | 24 November 2016 | 6 years, 7 months |
| Anthony Quirk | 21 November 2017 | 21 November 2017 | 7 months |
| Linda Robertson | 24 November 2015 | 24 November 2015 | 2 years, 7 months |
| Mike Timmer | 24 November 2015 | 24 November 2016 | 2 years, 7 months |

Abby Foote, Independent Director, retired from the Board on 21 November 2017. Abby was appointed to the LGFA Board on 1 December 2011 and served as a Director for 6 years.

## Meetings of the Board

The table below shows attendances at Board, committee and strategy meetings by directors during the year ended 30 June 2018. In addition to the scheduled meetings, additional meetings are convened as necessary to consider specific issues.

| Director | Board | Audit and Risk Committee |
|---|---|---|
| Craig Stobo (Chair) | 6/6 | -- |
| John Avery | 6/6 | -- |
| Philip Cory-Wright | 6/6 | 4/4 |
| Abby Foote [1] | 2/2 | 2/2 |
| Anthony Quirk [2] | 4/4 | 2/2 |
| Linda Robertson | 6/6 | 4/4 |
| Mike Timmer | 6/6 | 4/4 |

1. Abby Foote retired from the Board on 21 November 2017.
2. Anthony Quirk was elected to the Board on 21 November 2017.

## Board performance review

The Board has established an annual formal self-assessment procedure to assess director, board and committee performance. In addition, Board performance is reviewed by external consultants on a periodic basis.

## Director training

As part of LGFA's commitment to ongoing director education, LGFA regularly invites directors to attend relevant industry conferences and training events, as well as organising for industry experts to attend and present to directors at Board meetings.

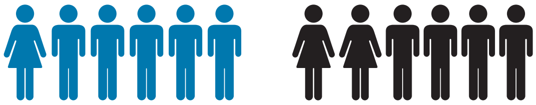
## Diversity

The LGFA is committed to promoting a culture that supports both workplace diversity and inclusion within the organisation.

The Company has formally adopted a Diversity Policy which applies to both LGFA employees and directors. Diversity and inclusiveness at LGFA involves recognising the value of individual differences and managing them in the workplace. Diversity in this context covers gender, age, ethnicity, cultural background, sexual orientation, religious belief, disability, education and family responsibilities.

Appointments to the LGFA Board are made in accordance with the Constitution of the Company and the Shareholders Agreement.

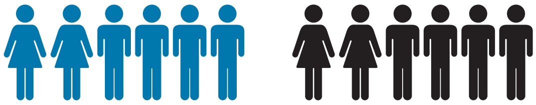
## Gender diversity of directors



**2018**
Female 1, Male 5

**2017**
Female 2, Male 4

## Gender diversity of employees



**2018**
Female 2, Male 4

**2017**
Female 2, Male 4

## Indemnities and insurance

Under the Company's constitution, LGFA has indemnified directors for potential liabilities and costs they may incur for acts of omission in their capacity as directors. LGFA has arranged directors' and officers' liability insurance covering directors and management acting on behalf of the Company. Cover is for damages, judgements, fines, penalties, legal costs awarded and defence costs arising from wrongful acts committed while acting for the Company. The types of acts that are not covered are dishonest, fraudulent, malicious acts, or omissions, wilful breach of statute or regulation, or duty to the Company, improper use of information to the detriment of the Company, or breach of professional duty.

## Principle 3
**Board committees**

The Board should use committees where this will enhance its effectiveness in key areas, while still retaining board responsibility.

### Audit and Risk Committee

The LGFA Audit and Risk Committee is a committee of the Board.

The Audit and Risk Committee is governed by an Audit and Risk Committee Charter, which states that the purpose of the Audit and Risk Committee is to provide advice, assurance and observations to the Board relating to the effectiveness and adequacy of internal control and risk management systems, processes and activities across LGFA. It assists the Board to fulfil its duties by considering, reviewing and monitoring:

- Risk management framework and processes;
- Internal control environment and mechanisms;
- Processes relating to the preparation and audit of financial statements of LGFA;
- The integrity of performance information, including financial reporting;
- The governance framework and process;
- Policies, processes and activities to ensure compliance with legislation, policies and procedures; and
- Statutory/regulatory disclosure and reporting and performance against Statement of Intent targets.

Audit and Risk Committee members are appointed by the Board. Membership comprises at least three directors, the majority of whom must be independent. The members of the Audit and Risk Committee as at the date of this Annual Report are:

- Linda Robertson (Chair)
- Philip Cory-Wright
- Anthony Quirk
- Mike Timmer

## Principle 4
**Reporting and disclosure**

The Board should demand integrity in financial and non-financial reporting, and in the timeliness and balance of corporate disclosures.

The Board is committed to ensuring the highest standards are maintained in financial reporting and disclosure of all relevant information.

The Audit and Risk Committee has responsibility to provide assurance to the Board that due process has been followed in the preparation and audit of the financial statements of LGFA and to ensure there are appropriate processes and activities to ensure compliance with relevant regulatory and statutory requirements.

The Company has adopted a formal Continuous Disclosure Policy, the requirements of which ensure that LGFA meets the continuous disclosure requirements of the NZX Listing Rules.

# Principle 5
## Remuneration

The remuneration of directors and the CEO should be transparent, fair and reasonable.

The remuneration of the Board reflects the size and complexity of the Company and the responsibilities, skills, performance and experience of the directors. A specialist independent adviser may be used to ensure the remuneration is appropriate.

Board remuneration is determined by an Ordinary Resolution of shareholders. The current board remuneration was approved by shareholder resolution at the Annual General Meeting on 21 November 2017.

### Approved Director annual fee breakdown

| Position. Fees per annum | 2018 | 2017 |
|---|---|---|
| Board Chair | $97,000 | $90,000 |
| Audit and Risk Committee Chair | $60,000 | $54,000 |
| Director | $55,000 | $51,000 |

### Director remuneration

| Director | 2018 |
|---|---|
| Craig Stobo | $97,000 |
| John Avery | $55,000 |
| Philip Cory-Wright | $55,000 |
| Abby Foote [1] | $23,500 |
| Anthony Quirk [2] | $33,611 |
| Linda Robertson [3] | $58,056 |
| Mike Timmer | $55,000 |
| **Total** | **377,167** |

1. Abby Foote retired from the Board on 21 November 2017.
2. Anthony Quirk was elected to the Board on 21 November 2017.
3. Linda Robertson was appointed Audit and Risk Committee Chair on 21 November 2017.

The remuneration of the CEO is determined by the Board and is reviewed on an annual basis taking into consideration the scope and complexity of the position with reference to the remuneration of CEOs of similar organisations. A specialist independent adviser may be used to ensure the remuneration is appropriate.

The CEO remuneration package comprises a fixed cash component of $504,000 per annum as at 30 June 2018 ($480,000, 2017) and an at-risk short-term incentive of up to 15% of the fixed cash component. The short-term incentive payment is made annually at the Board's discretion subject to the CEO and the Company meeting a range of specific performance objectives for the respective financial year.

### Chief Executive remuneration

| | 2018 | 2017 |
|---|---|---|
| Salary | 504,000 | 480,000 |
| Taxable benefits | - | - |
| Subtotal | 504,000 | 480,000 |
| Pay for Performance STI | 75,600 | 72,000 |
| **Total remuneration** | 579,600 | 552,000 |

### Staff remuneration

| Total remuneration | 2018 |
|---|---|
| $120,000 to $129,999 | 2 |
| $220,000 to $229,999 | 1 |
| $270,000 to $279,999 | 1 |
| $570,000 to $579,999 | 1 |
| **Total staff receiving $100,000 or more** | **5** |

Directors should have a sound understanding of the material risks faced by the issuer and how to manage them. The Board should regularly verify that the issuer has appropriate processes that identify and manage potential and material risks.

# Principle 6
# Risk management

LGFA recognises that an effective risk management framework is a critical part of its business structure. LGFA is exposed to both business and treasury related risks because of its normal business activities that relate to raising and on-lending funds to local councils.

LGFA adopts the three lines of defence model to ensure that essential risk management functions are completed using a systematic approach that reflects industry best practice:

- The first line of defence relates to the operational risk and control within the business. Managers within the business are responsible for identifying controls, maintaining effective controls, assessing the controls and mitigating risks. The first line of defence establishes risk ownership within the business.
- The second line of defence relates to establishing risk control within the organisation. The second line of defence involves reviewing risk reports, checking compliance against the risk management framework and ensuring that risks are actively and appropriately managed.
- The third line of defence establishes risk assurance using both internal and external audit functions to highlight control weaknesses and inefficiencies to management. The audit functions provide independent assurance on the risk governance framework.

The Audit and Risk Committee assists the Board by considering, reviewing and monitoring LGFA's risk management framework and processes, and the internal control environment and mechanisms.

LGFA continually reviews its core business risks. This review process includes the identification and assessment of core business risks which are ranked using predetermined criteria for both the likelihood and potential impact of each risk. LGFA maintains a company-wide risk register which records all identified risks, potential impacts and the controls and mitigation strategies used to manage the risks.

LGFA has treasury exposures arising from its normal business activities that principally relate to the raising and on-lending of funds. A detailed description of LGFA's risk management processes for treasury exposures is detailed in the Treasury Risk Management section of this report.

## Internal audit

LGFA has established an internal audit function to provide assurance that LGFA's risk management, governance and internal controls are operating effectively.

The Audit and Risk Committee has responsibility for oversight of the internal audit function, including:

- Reviewing the Internal Audit Charter, the operations of the internal audit and organisational structure of the internal audit function;
- Reviewing and approving the annual audit plan;
- Reviewing the effectiveness of the internal audit function; and
- Meeting separately with the internal auditor to discuss any matters that the Audit and Risk Committee or Internal Audit believes should be discussed privately.

## Health and safety

LGFA is committed to a safe and healthy work environment and has formally adopted a LGFA Health and Safety Policy that clearly sets out the duty of directors, LGFA and staff under the Health and Safety at Work Act 2015. A staff health and safety committee has been established with responsibility to continuously review health and safety issues and ongoing compliance with the Act, with reporting to the Board on health and safety issues at each Board meeting.

## Principle 7
**Auditors**

The Board should ensure the quality and independence of the external audit process.

### External audit

The external audit of LGFA is conducted in accordance with Section 14 of the Public Audit Act 2001, including the appointment of the external auditors of LGFA by the Auditor-General.

The Audit and Risk Committee has responsibility for all processes relating to the audit of financial statements, including the setting of audit fees and ensuring the independence and objectivity of the auditors.

The external audit of LGFA is conducted in accordance with a formal external audit plan which is reviewed and approved by the Audit and Risk Committee on an annual basis.

The external auditor attends the Company's Annual General Meeting.

## Principle 8
**Shareholder rights and relations**

The Board should respect the rights of shareholders and foster relationships with shareholders that encourage them to engage with the issuer.

LGFA has 31 Shareholders, comprising the New Zealand Government (20%) and 30 councils (80%).

New Zealand Government
Auckland Council
Bay of Plenty Regional Council
Christchurch City Council
Gisborne District Council
Greater Wellington Regional Council
Hamilton City Council
Hastings District Council
Hauraki District Council
Horowhenua District Council
Hutt City Council
Kapiti Coast District Council
Manawatu District Council
Marlborough District Council
Masterton District Council
New Plymouth District Council
Otorohanga District Council
Palmerston North City Council
Selwyn District Council
South Taranaki District Council
Tasman District Council
Taupo District Council
Tauranga City Council
Thames-Coromandel District Council
Waimakariri District Council
Waipa District Council
Wellington City Council
Western Bay of Plenty District Council
Whakatane District Council
Whanganui District Council
Whangarei District Council

## Foundation documents

The LGFA Constitution and the Shareholders' Agreement are foundation documents of the Company.

The **LGFA Constitution** defines the rights and the exercise of powers of shareholders, the acquisition and redemption of Company shares, proceedings of shareholder meetings, voting at meetings and the right to demand polls, shareholder proposals and review of management.

The **Shareholders' Agreement** is an agreement between the Company and its shareholders which clearly defines the Company's business, its objectives, the role of the Board, the establishment of the Shareholders' Council and the approval rights of the shareholders.

## LGFA Shareholders' Council

The LGFA Shareholders' Council comprises five to ten appointees from the Council Shareholders and the New Zealand Government. The role of the Shareholders' Council comprises the following:

- Review and report performance of LGFA and the Board;
- Recommendations to Shareholders as to the appointment, removal, replacement and remuneration of directors;
- Recommendations to Shareholders as to any changes to policies, or the Statement of Intent (SOI), requiring their approval;
- Update Shareholders on LGFA matters and to coordinate Shareholders on governance decisions.

## Members of the Shareholders' Council as at 30 June 2018

- Alan Adcock, Whangarei District Council, Chair
- John Bishop, Auckland Council, Deputy Chair
- David Jensen, Tauranga City Council
- David Bryant, Hamilton City Council
- Kumaren Perumal, Western Bay of Plenty District Council
- Mat Taylor, Bay of Plenty Regional Council
- Martin Read, Wellington City Council
- Mike Drummond, Tasman District Council
- Carol Bellette, Christchurch City Council
- Richard Hardie/David Stanley, New Zealand Government

# Treasury risk Management

# Whakahaeretanga ā-mōrearea

The Local Government Funding Agency (LGFA) funds itself through domestic and international wholesale and retail debt capital markets, with the funds raised on-lent to participating New Zealand Local Authority borrowers. LGFA activities are governed by the Local Government Borrowing Act 2011, the Local Government Act 2002, and the Companies Act 1993. In addition, the company is required to comply with 'Foundation Policies' outlined in the Shareholders Agreement. Any change to the Foundation Policies require shareholders' consent.

LGFA has treasury exposures arising from its normal business activities that principally relate to the raising and on-lending of funds. LGFA manages treasury exposures under a Board-approved Treasury Policy. The objectives for the Treasury Policy are to:

- Effectively manage balance sheet and interest rate risk within the interest rate risk control limits to protect LGFA's capital position and Net Interest Margin over time.
- Fund participating local authorities in the most cost-effective manner and in accordance with the operating principles, values and objectives of the LGFA.
- Protect LGFA's assets and prevent unauthorised transactions.
- Promote professional expertise of financial and management control to all external parties.
- Minimise operational risk by maintaining adequate internal controls, systems and staffing competencies.
- Provide timely reporting to the LGFA Board with meaningful and accurate reporting of interest rate exposures, liquidity, asset and liability maturity, funding, counterparty credit, performance and Policy compliance.

Specific treasury exposures relate to liquidity, interest rate/market risk, foreign exchange, counterparty credit, operational and lending risks.

## Liquidity risk

Liquidity risk refers to the potential inability of LGFA to meet its financial obligations when they become due, under normal or abnormal/stressed operating conditions.

Liquidity risk is managed using a forecasted cashflow approach measured over 30 day, 90 day and one year periods. LGFA is required to maintain sufficient liquidity (comprising a government standby facility and holdings of cash and liquid investments) to support 12 months operating and funding commitments.

## Interest rate risk / market risk

Interest rate risk is the risk that financial assets may re-price/mature at a different time and/or by a different amount than financial liabilities.

Market risk is managed using Value at Risk (VaR) and Partial Differential Hedge (PDH) limits to mitigate the potential change in value of the balance sheet due to changes in interest rates.

- PDH risk measures the sensitivity of a portfolio to a one basis point change in underlying interest rates. For example, a PDH of

NZD$40,000 means that the portfolio value will increase by NZD $40,000 for a one basis point fall in interest rates.

- Value at Risk is used to measure market risk. The VaR model calculates the amount LGFA's portfolio could be expected to lose 5% of the time over a given time period. It is calculated using historical changes in underlying risk variables and applying those changes to the current portfolio.

LGFA measures VaR over a daily time horizon with a 95% confidence interval. A daily 95% VaR exposure of $100,000 means that there is a 5% chance that the portfolio will lose more than $100,000 over the next business day.

## Counterparty credit risk

Counterparty credit risk is the risk of financial loss to LGFA (realised or unrealised) arising from a counterparty defaulting on an investment, security and/or financial instrument where LGFA is a holder or party.

Counterparty credit risk is managed through:

- Counterparty limits for investments. These are determined as a function of the term of investment, liquidity and credit quality of the counterparty (as measured by credit rating).
- Counterparty risk on derivative contracts is mitigated by utilising the NZDMO as the counterparty to derivative contracts.

Investment is restricted to approved financial investments listed in the Treasury Policy.

## Foreign currency risk

Exposure to foreign exchange could exist if LGFA accesses foreign capital markets for funding purposes.

Foreign exchange risk is managed through a requirement for LGFA to fully hedge back to floating rate NZD the full amount and term of all foreign currency funding and cash flows.

## Operational risk

Operational risk, with respect to treasury management, is the risk of financial and/or reputation loss because of human error (or fraud), negligent behaviour, system failures and inadequate procedures and controls.

Operational risk is managed using internal controls and procedures across LGFA's operational functions. Segregation of duties between staff members who have the authority to enter transactions with external counterparties and the staff who control, check and confirm such transactions is a cornerstone internal control principle, that is always complied with.

Financial instruments are not entered into if the systems, operations and internal controls do not satisfactorily support the measurement, management and reporting of the risks.

## Lending risk

The LGFA provides debt funding solely to New Zealand Local Government ie. the Local Government borrowing counterparty will be the Council itself and will not be any Council Controlled Organisation, Council Controlled Trading Organisation, Council joint venture or partially owned entity.

The LGFA Board will have ultimate discretion on approving term funding to councils.

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.
- If the principal amount of a Local Authority's borrowings is at any time equal to, or greater than, NZD 20 million, then it is required to become a party to a deed of guarantee and an equity commitment deed.
- Issue securities (bonds/floating rate notes/ commercial paper) to the Company (ie. 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 only with the approval of the Board;
    - Foundation policy covenants outlined in the following table only with the approval of an Ordinary Resolution of shareholders.
  - 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 only with the approval of an Ordinary Resolution of shareholders.

- 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.

| 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% |

- Non-compliance with the financial covenants will either preclude a council from borrowing from the LGFA or in the case of existing council borrowers trigger an event of review. An event of default will occur if (among other things) a council fails to meet an interest or principal payment (subject to grace periods). An event of default will enable the LGFA to accelerate all loans to the defaulting council.
- Total revenue is defined as cash earnings from rates, government grants and subsidies, user charges, interest, dividends, financial and other revenue and excludes non-government capital contributions, eg. developer contributions and vested assets.
- Net debt is defined as total consolidated 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 governments for services provided and for which the other local governments rate.

Financial covenants are measured on Council only, not consolidated group.

To minimise concentration risk the LGFA will require that no more than the greater of NZD 100 million or 33% of a Council's borrowings from the LGFA will mature in any 12-month period.

Auckland Council will be limited to a maximum of 40% of the LGFA's total Local Government assets.

**A bridge being helicoptered and laid onto the West Coast Wilderness Trail.**
**Westland District Council**

**Staff oversee work being carried out on the Rangitāiki Floodway Project.**
**Bay of Plenty Regional Council**

# Performance against objectives
# Tutukinga mahi ki ōna whāinga

The statement of service performance details LGFA's performance against the objectives and targets set out in the LGFA Statement of Intent 2017-18 (SOI)

## Performance against primary objectives

This section sets out LGFA's performance for the year ended 30 June 2018 against the two primary objectives set out in the 2017-18 SOI.

1. **LGFA will operate with the primary objective of optimising the debt funding terms and conditions for Participating Local Authorities. Among other things this includes:**

i. **Providing savings in annual interest costs for all Participating Local Authorities on a relative basis to other sources of financing;**

LGFA aims to minimise its issuance margin over swap rates to provide cost-effective funding to councils. The LGFA margin to swap will depend upon several factors including the relative demand and supply of high grade bonds, general credit market conditions, performance of New Zealand Government bonds and swap rates, investor perceptions of LGFA and the issuance volume and tenor of LGFA bonds.

## 2017-18 performance objectives

The SOI set out two primary performance objectives and eight additional objectives for LGFA for the year ended 30 June 2018:

### Primary objectives

1. LGFA will operate with the primary objective of optimising the debt funding terms and conditions for Participating Local Authorities. Among other things this includes:
   - i. Providing savings in annual interest costs for all Participating Local Authorities on a relative basis to other sources of financing;
   - ii. Making longer-term borrowings available to Participating Local Authorities;
   - iii. Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice; and
   - iv. Offering more flexible lending terms to Participating Local Authorities.
2. LGFA will monitor the quality of the asset book so that it remains of a high standard by ensuring it understands each Participating Local Authority's financial position and the general issues confronting the Local Government sector. This includes:
   - i. LGFA will review each Participating Local Authority's financial position, its financial headroom under LGFA policies and visit each Participating Local Authority on an annual basis;
   - ii. LGFA will analyse finances at the Council group level where appropriate;
   - iii. LGFA will work closely with the Department of Internal Affairs (DIA), Office of the Auditor General (OAG) and Local Government New Zealand (LGNZ) on sector and individual council issues; and
   - iv. LGFA will take a proactive role to enhance the financial strength and depth of the local government debt market

### Additional objectives

1. 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;
2. Provide at least 50% of aggregate long-term debt funding to the Local Government sector;
3. 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;
4. Take appropriate steps to ensure compliance with the Health and Safety at Work Act 2015;
5. Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency;
6. Achieve the Financial Forecasts (excluding the impact of AIL) set out in section 4;
7. Meet or exceed the Performance Targets outlined in section 5; and
8. Comply with its Treasury Policy, as approved by the Board.

Given that LGFA tends to match fund its on-lending to councils, ie. tends to issue bonds in the same tenor and volume as its on-lending, then LGFA only has influence over investor perception amongst the above factors that determine LGFA spreads to swap.

There will be periods within the interest rate and credit market cycles when LGFA bonds will outperform its benchmarks (spread narrowing) and there will be periods of time when LGFA bonds underperform (spread widening).

LGFA spreads to swap have consistently narrowed since it first began issuing bonds in February 2012 and over the past year, spreads to swap as measured by secondary market levels have narrowed on the shorter LGFA bond maturities and widened on the long-dated maturities.

| LGFA bond margin to swap | As at 30 June 2018 (bps) | As at 30 June 2017 (bps) | Spread movement (bps) |
|---|---|---|---|
| 15 March 2019 | 4 | 12 | (8) |
| 15 April 2020 | 5 | 15 | (10) |
| 15 May 2021 | 11 | 20 | (9) |
| 14 April 2022* | 20 | N/A | N/A |
| 15 April 2023 | 34 | 27 | 7 |
| 15 April 2025 | 53 | 38 | 15 |
| 15 April 2027 | 54 | 43 | 11 |
| 14 April 2033 | 79 | 72 | 7 |

*The first tranche of the 2022 bond was issued in April 2018.

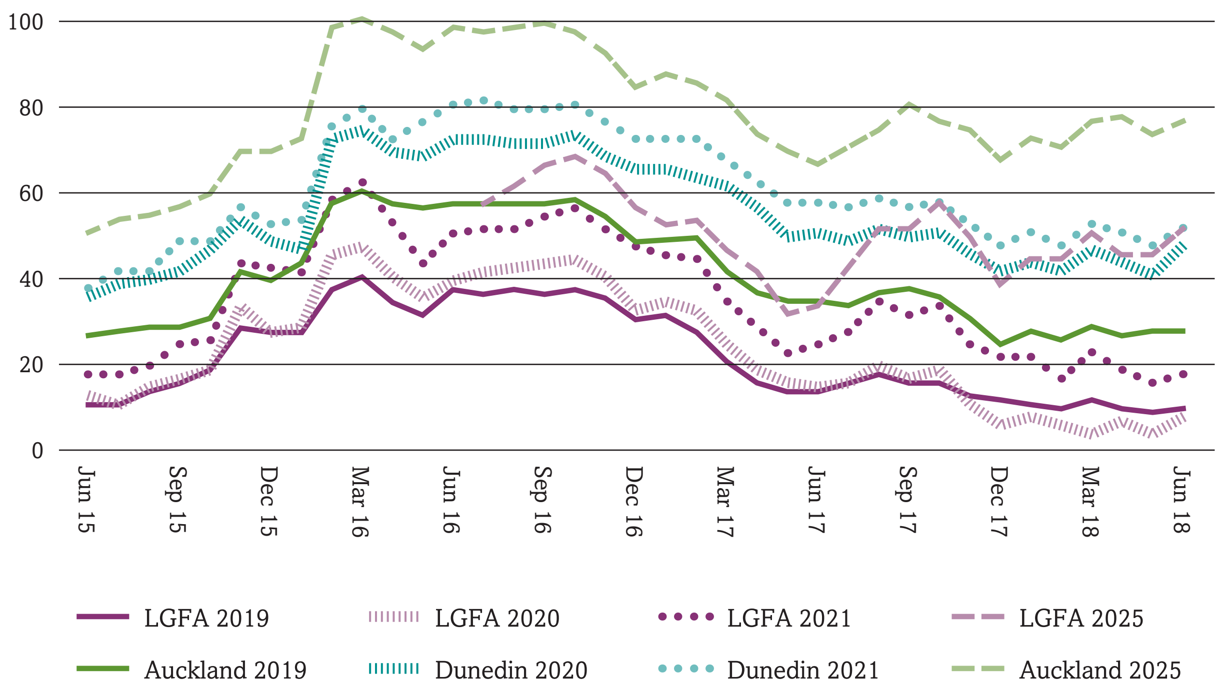
Some of the movement is due to the changes in the spread between swap rates and NZ Government Bond (NZGB) yields as over the same period LGFA spreads to NZGB have narrowed for some maturities.

| LGFA bond margin to NZGB | As at 30 June 2018 (bps) | As at 30 June 2017 (bps) | Spread movement (bps) |
|---|---|---|---|
| 15 March 2019 | 30 | 31 | (1) |
| 15 April 2020 | 37 | 39 | (2) |
| 15 May 2021 | 44 | 51 | (7) |
| 14 April 2022* | 53 | N/A | N/A |
| 15 April 2023 | 69 | 58 | 11 |
| 15 April 2025 | 83 | 71 | 12 |
| 15 April 2027 | 83 | 78 | 5 |
| 14 April 2033 | 104 | 103 | 1 |

*The first tranche of the April 2022 bond was issued in April 2018.

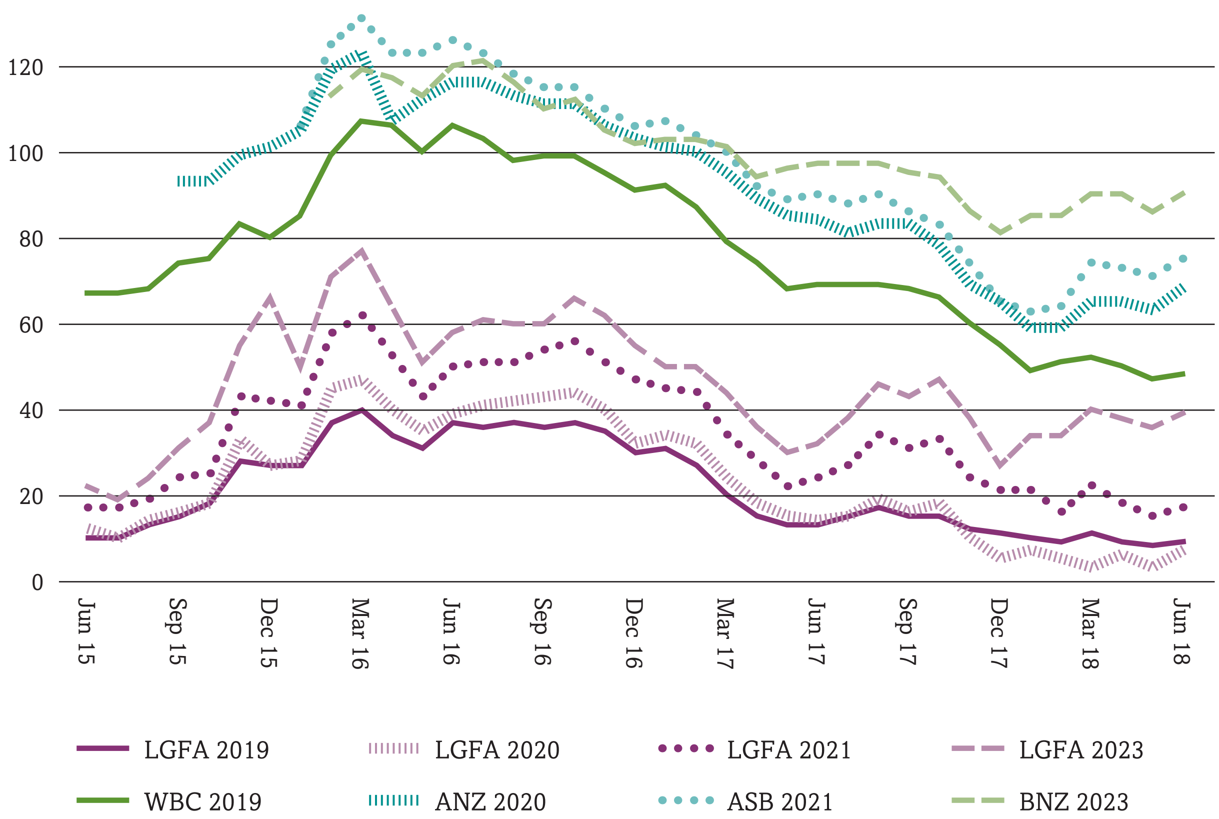
LGFA continues to provide savings in borrowing cost for councils relative to other sources of borrowing. We compare our secondary market spreads on LGFA bonds to those of Auckland Council and Dunedin City Treasury (as a proxy for councils borrowing in their own name) and a mix of banks (as a proxy for general market conditions).

## Secondary market credit spread to swap for LGFA and council bonds
**(basis points)**




Source: Bloomberg, LGFA

## Secondary market credit spread to swap for LGFA and bank bonds
**(basis points)**




Source: Bloomberg, LGFA

From the table below, we estimate that based upon secondary market spread data as at 30 June 2018, LGFA was saving AA rated councils between 10 bps and 21 bps depending upon the term of maturity. This compares to savings of between 12 bps and 22 bps a year ago.

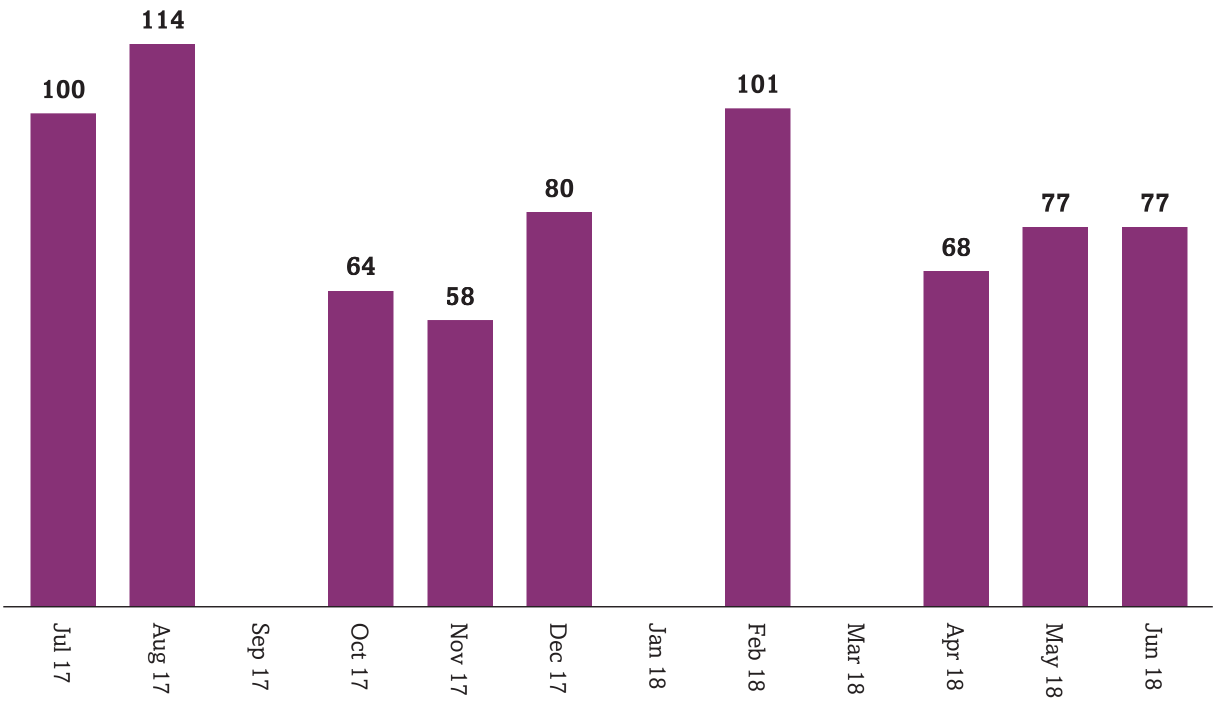
| 30 June 2018 | Auckland 2019 | Dunedin 2020 | Dunedin 2021 | Auckland 2022 | Auckland 2025 |
|---|---|---|---|---|---|
| AA rated councils margin to swap (bps) | 25 | 36 | 40 | 45 | 73 |
| Less LGFA margin to swap (bps) | (4) | (5) | (11) | (20) | (53) |
| LGFA gross funding advantage (bps) | 21 | 31 | 29 | 25 | 20 |
| Less LGFA base margin (bps) | (10) | (10) | (10) | (10) | (10) |
| Total saving (bps) * | 11 | 21 | 19 | 15 | 10 |

* Note that from June 2017 we have excluded from the estimated savings any positive impact from the 'LGFA effect' that was equivalent to 10 bps of savings evident when LGFA first commenced lending in February 2012.

**ii. Making longer-term borrowings available to Participating Local Authorities;**

The average borrowing term (excluding short-dated borrowing) for the 12-month period to June 2018 by council members was 6.9 years and this was significantly shorter than the average borrowing term of 8.1 years for the prior year. The shortening in term was due to councils reacting to the recent widening of borrowing margins in the longer-dated maturities. Also, many councils had taken advantage of the tighter margins and lower yields in early 2017, using the opportunity to extend longer when the 2033 maturities were first made available in April 2017.

## Average total months to maturity – on-lending to councils



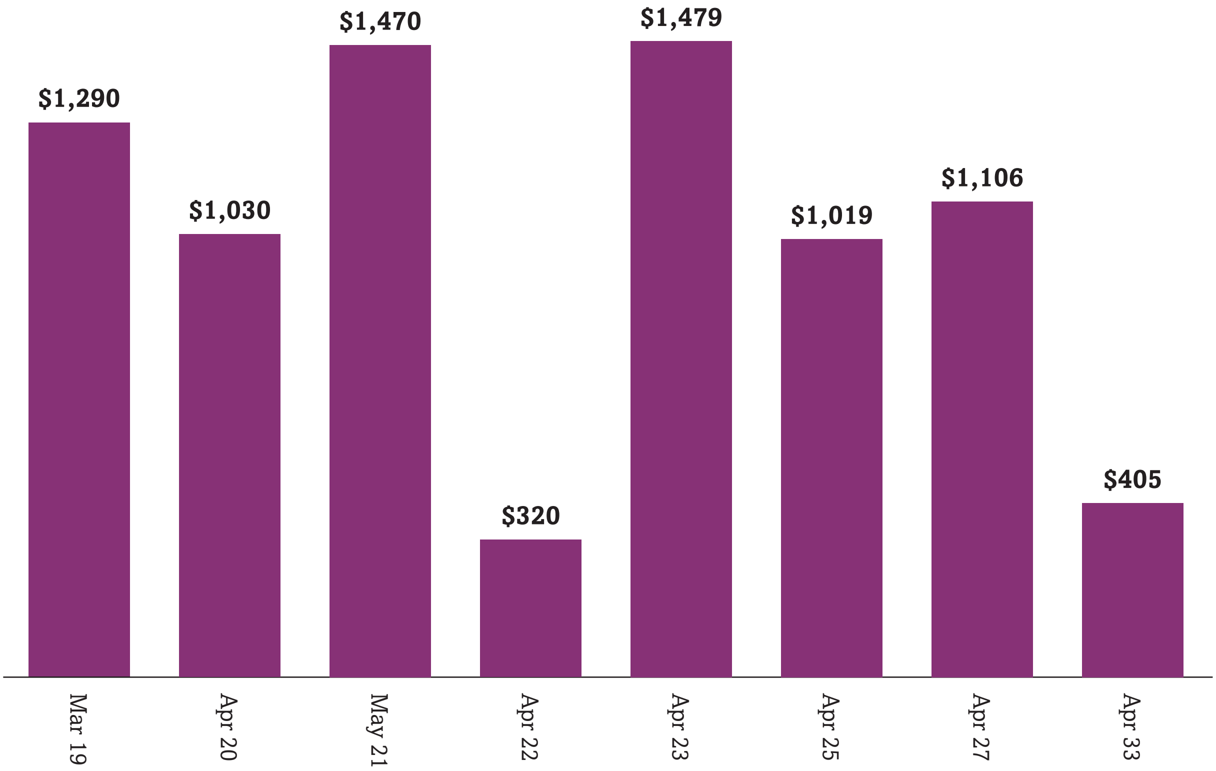
While LGFA can provide councils with the ability to currently borrow from LGFA for terms from one month to 15 years, it is up to the councils to determine their preferred term of borrowing.

In April 2018, LGFA commenced the issuance of a 4-year bond (April 2022) and this shorter maturity went against the recent trend of introducing a newer longer-dated bond each financial year. The decision to issue a new shorter bond maturity was made to reduce some of the mismatch between our bond issuance and council on-lending. However, with the issuance of the April 2033 LGFA bond, councils can borrow on a bespoke basis out to 15 years.

The following chart shows the total LGFA bond outstandings, including treasury stock, by maturity as at 30 June 2018.

## LGFA bonds on issue (NZ$ million)

**As 30 June 2018 : NZ$8,119 million**
Includes NZ$400 million treasury stock




**iii. Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practices;**

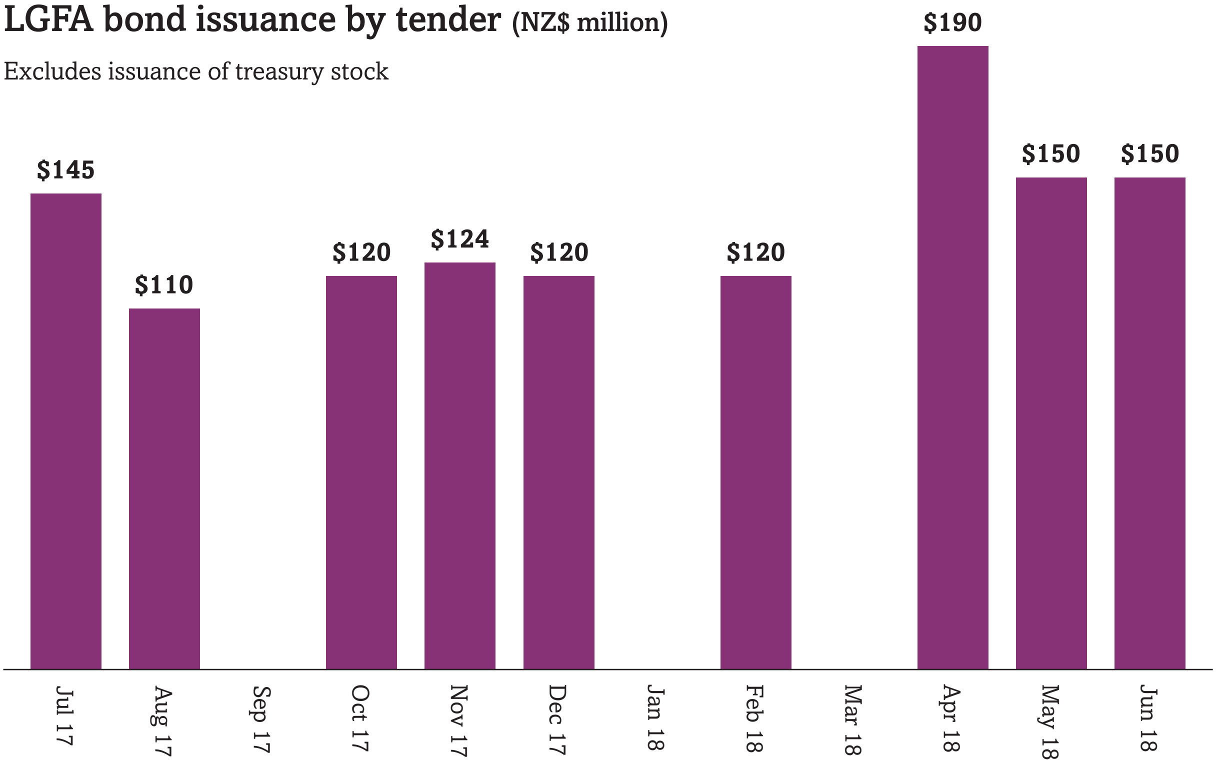
LGFA listed its bonds on the NZX Debt Market in November 2015 and this has led to greater awareness and participation in LGFA bonds by domestic retail and offshore investors. Average turnover on the NZX Debt Market since listing has been $13 million per month or 9% of the total turnover of the NZX Debt Market. Turnover has reduced over the past twelve months as retail investors are more attracted to higher term deposit rates.

LGFA commenced the issuance of LGFA Bills for terms of three months and six months in late 2015. Because of this issuance, LGFA has offered short-term loans of less than one year to councils since 2015. As at 30 June 2018, LGFA has short-term loans outstanding to 20 councils of $236 million.

LGFA held nine bond tenders during the 12-month period to 30 June 2018, with an average tender volume of $136.5 million and a range of $110 million to $190 million in size.

## LGFA bond issuance by tender (NZ$ million)

Excludes issuance of treasury stock




All tenders were successful. The average bid-coverage ratio across the nine bond tenders was 2.81 times and this compared to the average of 3.2 times for the 56 bond tenders held since LGFA first commenced issuance in February 2012.

| LGFA bond tender results by maturity | 2017-18 annual issuance amount (NZ$ million) | LGFA tender average bid coverage ratio | LGFA tender average successful bid range |
|---|---|---|---|
| 15 December 2017 | Nil | n/a | n/a |
| 15 March 2019 | 40 | 2.5 x | 0 bps |
| 15 April 2020 | 225 | 3.0 x | 1 bps |
| 15 May 2021 | 70 | 2.6 x | 3 bps |
| 14 April 2022 | 270 | 2.8 x | 3 bps |
| 15 April 2023 | 79 | 1.7 x | 2 bps |
| 15 April 2025 | 309 | 3.1 x | 2 bps |
| 15 April 2027 | 96 | 2.6 x | 2 bps |
| 14 April 2033 | 140 | 2.7 x | 3 bps |
| Across all LGFA maturities | 1,229 | 2.8 x | n/a |

The successful bid range (difference between the highest and lowest successful bid yield) for each maturity at each tender averaged between 0 bps and 3 bps with an average successful bid range of 2 bps across all maturities and all tenders over the year.

LGFA established an Australian Medium Term Notes Programme in November 2017 to provide the ability to issue in currencies other than NZD. It is not our intention to use this programme but instead to provide some flexibility in case of the unlikely scenario of a significant market disrupting event in the future.

### iv. Offering more flexible lending terms to Participating Local Authorities.

Councils can currently access flexible lending conditions by using the short-term lending and bespoke lending products. Short-term lending is for loans between 30 days and 364 days while bespoke lending is where councils can borrow for any term between one year and the longest dated LGFA bond maturity (currently 14 April 2033) on any drawdown date. Therefore, council members can borrow for terms ranging from 30 days to 15 years at any time they wish to drawdown.

Bespoke lending for council members has continued to grow in popularity over the past year. During the 12-month period to 30 June 2018 we lent $842.6 million on a bespoke basis to 35 councils. This was 77% of total term lending to our council members over that period.

Short-term borrowing by councils as at 30 June 2018 was $244 million comprising borrowing from 20 councils for terms between one and 12 months.

## 2. LGFA will monitor the quality of the asset book so that it remains of a high standard by ensuring it understands each Participating Local Authority's financial position and the general issues confronting the Local Government sector. This includes:

### i. LGFA will review each Participating Local Authority's financial position, its financial headroom under LGFA policies and visit each Participating Local Authority on an annual basis;

LGFA undertakes a detailed financial assessment on each of its borrowers, and meets with all member councils on an annual basis while monitoring council performance throughout the year. LGFA reviews the annual and long-term plans for each council and the annual financial statements. All councils were compliant with LGFA financial covenants as at 30 June 2017 and a copy of each council's borrowing position and compliance with LGFA covenants was provided to LGFA shareholders and non-shareholder guarantors in December 2017. LGFA assigns an internal credit rating to each of its council members as part of the review exercise.

LGFA management met with 47 councils over the 12-month period to 30 June 2018.

### ii. LGFA will analyse finances at the Council group level where appropriate;

LGFA reviews the financial position of each council on a parent basis except for Auckland Council where LGFA analyses the financial statements at both parent and group level. This is because Auckland Council is the only council to deliver a wide range of its essential services on a group basis.

### iii. LGFA will work closely with the Department of Internal Affairs (DIA), Office of the Auditor General (OAG) and Local Government New Zealand (LGNZ) on sector and individual council issues.

LGFA staff and directors have met with DIA, OAG, LGNZ, Ministry of Business Innovation and Employment (MBIE), Treasury, Crown Infrastructure Partners, Infrastructure New Zealand and the Local Government Commission during the 2017-18 year to discuss sector issues. LGFA attended the Local and Central Government Forum and participated in three sector-wide risk and audit forums. LGFA presented at each of the quarterly media briefings organised by LGNZ.

### iv. LGFA will take a proactive role to enhance the financial strength and depth of the local government debt market

LGFA management aim to meet with the management team of each council at least once a year. We also presented to elected officials at councils prior to them joining LGFA to remind them of their obligations.

We have been involved in discussions between Central Government agencies and the Housing Infrastructure Fund (HIF) councils regarding the structuring of the HIF loans to ensure the interests of councils, ratepayers and LGFA are protected.

We presented at various capital market conferences and regularly met with banks and investors on a regular basis. We present each quarter on sector finances at the LGNZ media briefing.

## Performance against additional objectives

In addition to the two primary performance objectives, LGFA has eight performance objectives which complement the primary objectives. This section sets out LGFA's performance for the year ended 30 June 2018 against the additional objectives set out in the 2017-18 Statement of Intent.

### 2.1 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 of the SOI.

The LGFA Board has the sole discretion to set the dividend and the policy is to pay a dividend that provides an annual rate of return to shareholders equal to LGFAs cost of funds plus 2%.

On 28 August 2018, the directors of LGFA declared a dividend for the year to 30 June 2018 of $1,285,000 ($0.0514 per share). This is calculated on LGFA's cost of funds for the 2017-18 year of 3.14% plus a 2% margin. This is similar to the previous year dividend of $0.0556 per share.

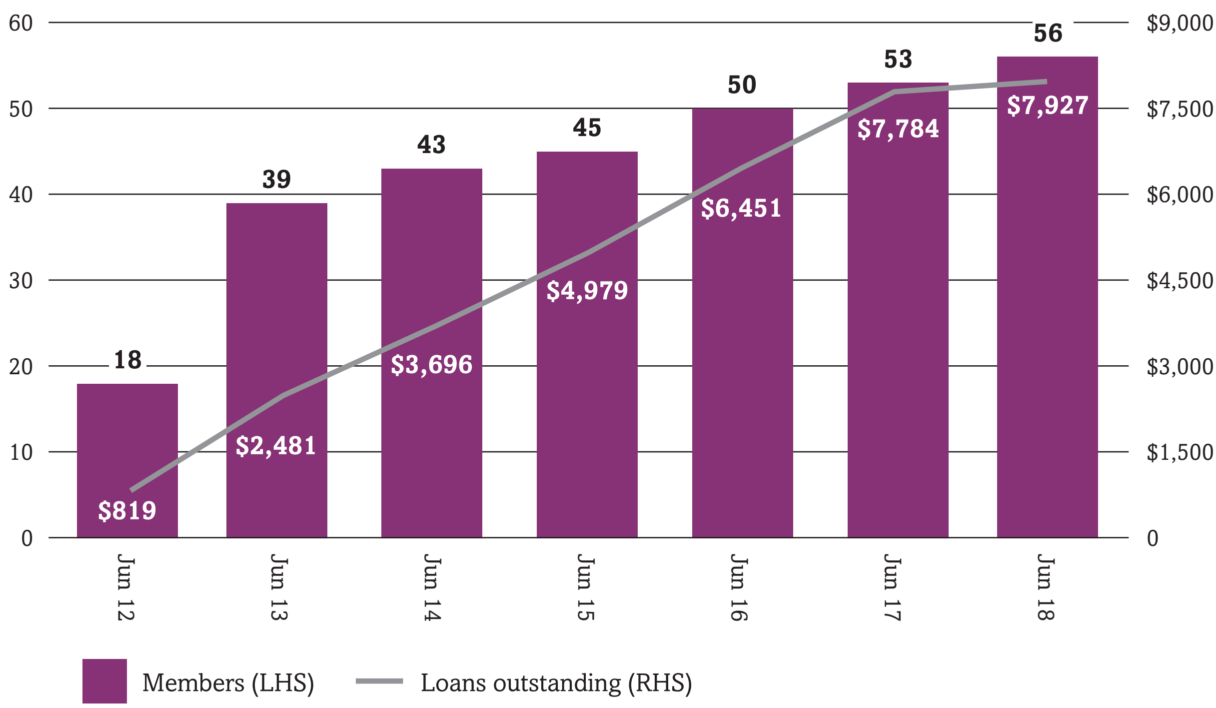
The impact from the current low interest rate environment is that LGFA has a lower cost of funds. While council borrowers benefit from lower borrowing costs, the dividend payment calculated on the above guidance is lower than it would otherwise be in an environment of higher interest rates.

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

Three councils joined LGFA in the 12-month period to June 2018, bringing the total number of council members to 56. Stratford, Rangitikei and Westland District Councils all joined as non-guarantor borrowers.

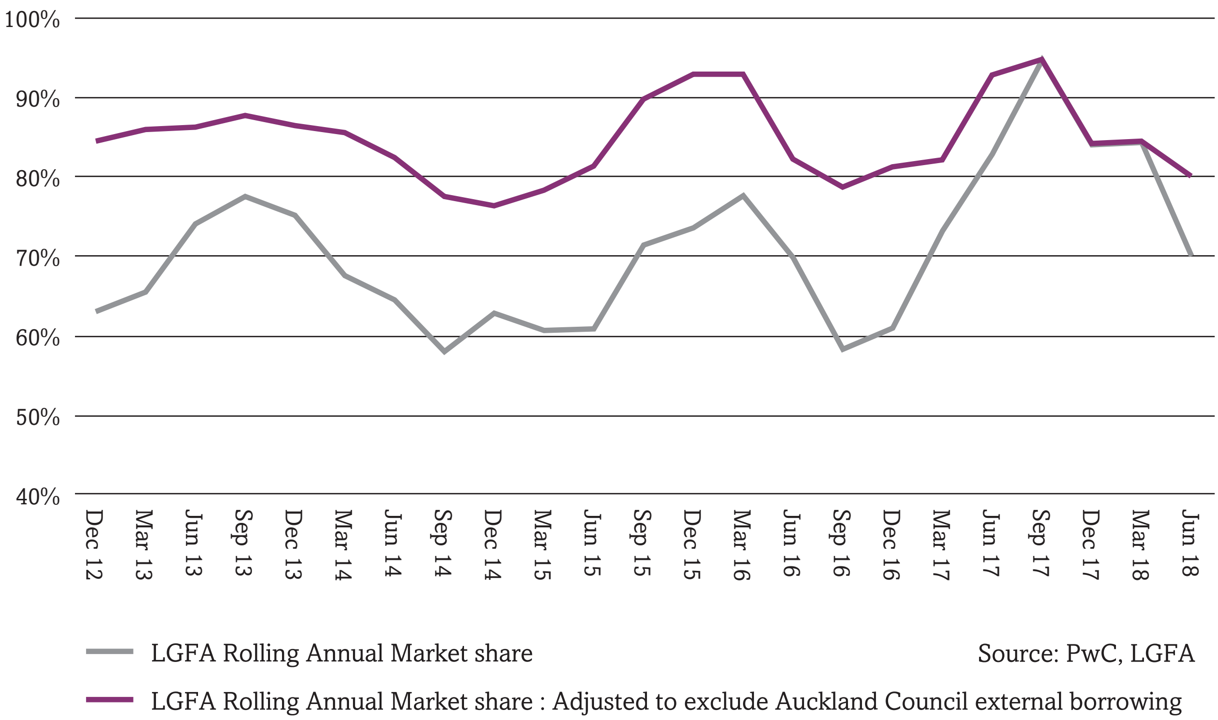
Councils have strongly supported LGFA by joining as members and borrowing from LGFA. As at 30 June 2018, 54 participating councils have so far borrowed from LGFA.

## LGFA council members and nominal loans outstanding (NZ$ million)



The following chart shows LGFA's share of new local government long-term debt issuance and is derived from survey data provided by PwC. Our share of long-term borrowing by the sector including non-members of LGFA was 69.9% for the 12-month period to 30 June 2018. The market share is influenced by the amount of debt issued by the sector's largest borrower, Auckland Council in its own name in the domestic market. Auckland Council is required to issue debt under their own name as LGFA is restricted by its foundation policies to a maximum of 40% of total loans outstanding to Auckland. If Auckland Council's external borrowing is excluded from the data, then LGFA estimated market share for the 12-month period to 30 June 2018 was 79.9%.

## LGFA council members and LGFA loans outstanding




### 2.3 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 of the SOI.

Issuance and operating expenses for the 12-month period to 30 June 2018 were $7.163 million which is $174k below SOI forecast. This variance is the consequence of:

- Issuance and on-lending costs (excluding Approved Issuer Levy payments) at $2.207 million were $118k below budget due to lower fees relating to the NZDMO facility, offset by higher legal costs from the establishment of the Australian Notes Programme and increased registry fees;
- Operating costs at $2.981 million were $143k below budget and reflected lower overhead, personnel and travel costs than forecast, offset by higher non-issuance legal fees; and
- Approved Issuer Levy payments of $1.975 million were $88k above forecast due to higher than expected holdings of LGFA bonds by offshore investors.

### 2.4 Take appropriate steps to ensure compliance with the Health and Safety at Work Act 2015.

LGFA has a Health and Safety Staff Committee and reporting on health and safety issues are made to the LGFA board on a regular basis by the Risk and Compliance Manager. There were no health and safety incidents during the 2017-18 year.

The Kaikoura earthquake in November 2016 impacted on Wellington CBD buildings. From November 2016 to November 2017, staff worked from the Local Government New Zealand offices and have subsequently relocated back into the office once the building was accessible.

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

LGFA has credit ratings from Standard and Poor's (S&P) and Fitch Ratings (Fitch) and meets with both agencies in September and October each year. Meetings were held in 2017 with both agencies and S&P affirmed the long-term rating of LGFA at AA+ (stable outlook) on 25 September 2017 and Fitch affirmed the rating at AA+ (stable outlook) on 10 November 2017.

On 22 May 2018, S&P announced a new methodology for rating the ten entities who comprise their Public-Sector Funding Agency (PSFA) group. LGFA is a member of that group and our rating as at 30 June 2018 remained at AA+ under the old methodology but LGFA was placed on Under Criteria Observation (or UCO) pending the outcome of the new methodology. [1]

Both the S&P and Fitch ratings reports are available on our website (www.lgfa.co.nz/for-investors/ratings).

Both the S&P and Fitch ratings are the same as, and are capped by, New Zealand Government's credit ratings. Fitch has defined LGFA as a credit linked Public Sector Entity and our credit rating is explicitly linked to the New Zealand Government's credit rating.

### 2.6 Achieve the Financial Forecasts (excluding the impact of AIL) set out in section 4 of the SOI.

For the 12-month period to 30 June 2018, LGFA's net operating gain exceeded forecast as net interest revenue was greater than forecast and expenses below forecast.

| In $ million | 30 June 2018 Actual | 30 June 2018 SOI Forecast |
|---|---|---|
| Net interest revenue | 18.97 | 18.22 |
| Issuance and operating expenses excluding Approved Issuer Levy (AIL) | 5.19 | 5.45 |
| Approved Issuer Levy (AIL) | 1.98 | 1.89 |
| Net Operating Gain | 11.80 | 10.88 |

1 After the 30 June 2018 balance date, S&P reaffirmed our AA+ credit rating under the new methodology and removed LGFA from UCO on 13 July 2018.

### 2.7 Meet or exceed the Performance Targets outlined in section 5 of the SOI.

LGFA achieved one of its four performance targets in the 12-month period to 30 June 2018

## Performance targets

| 2017-18 performance targets | Target | Result for 12-month period to 30 June 2018 | Outcome |
|---|---|---|---|
| Average margin above LGFA's cost of funds charged to the highest rated Participating Local Authorities for the period | <= 0.10% | 0.105% | ✗[1] |
| Annualised annual issuance and operating expenses (excluding AIL) | <= $5.45 million | $5.18 million | ✓ |
| Lending to Participating Local Authorities | >= $8.128 billion | $7.976 billion | ✗ Auckland Council did not borrow through LGFA during the 2017-18 year and councils looked to delay pre-funding of the March 2019 loans until the new 2018-19 financial year. |
| Savings on borrowing costs for council borrowers relative to other sources of financing and compared to previous years | Improvement since prior year end relative to borrowing by councils directly. Council borrowing spreads as at June 2017: 2019s 12 bps, 2021s 20 bps and 2025s 17 bps | Council borrowing spreads as at June 2018: 2019s 11 bps, 2021s 19 bps and 2025s 10 bps | ✗ Due to lack of single name issuance by councils. This reduced supply has tightened comparable spreads for Auckland Council and Dunedin City Treasury bonds |

1. The outcome is dependent upon the term of borrowing by councils as LGFA on-lending margin reflects a term structure premium for longer borrowing.

### 2.8 Comply with its Treasury Policy, as approved by the Board.

LGFA was compliant at all times with the Treasury Policy for the 12-month period ending 30 June 2018.

# Financial statements

# Taukī pūtea

In the opinion of the directors of the New Zealand Local Government Funding Agency Limited, the financial statements and notes on pages 45 to 68:

- Comply with New Zealand generally accepted accounting practice and give a true and fair view of the financial position of the Company as at 30 June 2018, and
- Have been prepared using appropriate accounting policies, which have been consistently applied and supported by reasonable judgements and estimates.
- The directors believe that proper accounting records have been kept which enables, with reasonable accuracy, the determination of the financial position of the Company and facilitates the compliance of the financial statements with the Financial Reporting Act 1993.

The directors consider that they have taken adequate steps to safeguard the assets of the Company, and to prevent and detect fraud and other irregularities. Internal control procedures are also considered to be sufficient to provide a reasonable assurance as to the integrity and reliability of the financial statements.

For and on behalf of the Board of Directors

Craig Stobo, Director
28 August 2018

Linda Robertson, Director
28 August 2018

# Statement of comprehensive income

**For the year ended 30 June 2018 in $000s**

| | Note | Year ended 2018 | Year ended 2017 |
|---|---|---|---|
| Interest income | | | |
| Cash and cash equivalents | | 627 | 598 |
| Loans to local government | | 228,381 | 219,852 |
| Marketable securities | | 3,116 | 2,518 |
| Deposits | | 5,475 | 3,782 |
| Derivatives | | 105,229 | 93,950 |
| Fair value hedge ineffectiveness | 2c | - | - |
| **Total interest income** | | **342,828** | **320,700** |
| Interest expense | | | |
| Bills | | 8,401 | 6,029 |
| Bonds | | 311,944 | 293,749 |
| Borrower notes | | 3,278 | 3,159 |
| Bond repurchase transactions | | 240 | 249 |
| **Total interest expense** | | **323,863** | **303,186** |
| **Net interest income** | | **18,965** | **17,514** |
| Operating expenses | | | |
| Issuance and on-lending expenses | 3 | 4,182 | 3,640 |
| Operating expenses | 4 | 2,981 | 2,828 |
| **Total expenses** | | **7,163** | **6,468** |
| **Net operating profit** | | **11,802** | **11,046** |
| **Total comprehensive income for the year** | | **11,802** | **11,046** |

# Statement of changes in equity

**For the year ended 30 June 2018 in $000s**

| | Note | Share capital | Retained earnings | Total equity |
|---|---|---|---|---|
| Equity as at 30 June 2016 | | 25,000 | 19,224 | 44,224 |
| Total comprehensive income for the year | | | 11,046 | 11,046 |
| Transactions with owners | | | | |
| Dividend paid on 14 October 2016 | | | (1,392) | (1,392) |
| **Equity as at 30 June 2017** | | **25,000** | **28,878** | **53,878** |
| Total comprehensive income for the year | | | 11,802 | 11,802 |
| Transactions with owners | | | | |
| Dividend paid on 20 September 2017 | | | (1,390) | (1,390) |
| **Equity as at 30 June 2018** | 12 | **25,000** | **39,290** | **64,290** |

# Statement of financial position

**As at 30 June 2018 in $000s**

| | Note | 2018 | 2017 |
|---|---|---|---|
| **Assets** | | | |
| Financial assets | | | |
| Cash and bank balances | | 50,281 | 49,919 |
| Receivable unsettled bond repurchases | | - | 13,723 |
| Loans to local government | 5 | 7,975,728 | 7,783,932 |
| Marketable securities | | 231,420 | 127,641 |
| Deposits | | 201,114 | 149,949 |
| Derivatives in gain | 2d | 375,371 | 364,953 |
| Non-financial assets | | | |
| Prepayments | | 561 | 544 |
| Other assets | 14 | 609 | 760 |
| **Total assets** | | **8,835,084** | **8,491,421** |
| Equity | | | |
| Share capital | | 25,000 | 25,000 |
| Retained earnings | | 39,290 | 28,878 |
| **Total equity** | | **64,290** | **53,878** |
| **Liabilities** | | | |
| Financial liabilities | | | |
| Trade and other payables | | 444 | 453 |
| Accrued expenses | | 348 | 554 |
| Bills | 6 | 473,421 | 348,179 |
| Bonds | 7 | 8,101,004 | 7,865,401 |
| Borrower notes | 8 | 135,108 | 131,614 |
| Bond repurchases | | 6,183 | 25,682 |
| Derivatives in loss | 2d | 54,286 | 65,660 |
| **Total liabilities** | | **8,770,794** | **8,437,543** |
| **Total equity and liabilities** | | **8,835,084** | **8,491,421** |

# Statement of cash flows

**For the year ended 30 June 2018 in $000s**

| | Note | Year Ended 2018 | Year Ended 2017 |
|---|---|---|---|
| Cash flow from operating activities | | | |
| Cash applied to loans to local government | 11 | (191,878) | (1,385,002) |
| Interest paid on bonds issued | | (356,416) | (341,100) |
| Interest paid on bills issued | | (8,400) | (6,029) |
| Interest paid on bond repurchases | | (239) | (247) |
| Interest paid on borrower notes | | (2,648) | - |
| Interest received from loans to local government | | 228,463 | 222,121 |
| Interest received from cash and cash equivalents | | 627 | 597 |
| Interest received from marketable securities | | 3,453 | 2,688 |
| Interest received from deposits | | 5,310 | 2,661 |
| Net interest on derivatives | | 149,898 | 137,262 |
| Payments to suppliers and employees | | (7,066) | (6,051) |
| **Net cash flow from operating activities** | 10 | **(178,896)** | **(1,373,100)** |
| Cashflow from investing activities | | | |
| Change in marketable securities | | (104,115) | 11,661 |
| Change in deposits | | (51,000) | (59,000) |
| **Net cashflow from investing activities** | | **(155,115)** | **(47,339)** |
| Cashflow from financing activities | | | |
| Cash proceeds from bonds issued | 11 | 221,120 | 1,267,666 |
| Cash proceeds from bills issued | | 125,241 | 124,263 |
| Cash proceeds from bond repurchases | | (5,778) | 11,957 |
| Cash proceeds from borrower notes | 11 | 2,863 | 20,840 |
| Diviends paid | | (1,390) | (1,392) |
| Cash applied to derivatives | | (7,683) | 9,940 |
| **Net cashflow from financing activities** | | **334,373** | **1,433,274** |
| **Net (decrease) / increase in cash** | | **362** | **12,835** |
| Cash, cash equivalents and bank overdraft at beginning of year | | 49,919 | 37,084 |
| **Cash, cash equivalents and bank overdraft at end of year** | | **50,281** | **49,919** |

# 1 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 2018.

These financial statements were authorised for issue by the Directors on 28 August 2018.

## 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

There have been no changes in accounting policies.

### Early adoption standards and interpretations

NZ IFRS 9: Financial Instruments. The first two phases of this new standard were approved by the Accounting Standards Review Board in November 2009 and November 2010. These phases address the issues of classification and measurement of financial assets and financial liabilities.

### 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. Those which may be relevant to LGFA are as follows:

NZ IFRS 9: Financial Instruments (2014). Effective for LGFA for the financial year commencing 1 July 2018. This standard aligns hedge accounting more closely with the risk management activities of the entity and introduces a new expected credit loss model for calculating impairment. The current estimated impact of transitioning to NZ IFRS 9 at 1 July 2018 on the financial statements is a reduction in net assets not exceeding $100,000, primarily due to the introduction of impairment allowances.

## 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, 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 assessment is made whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

### 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. Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

### i. Segment reporting

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

### j. 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 2b 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.

## 2 Analysis of financial assets and financial liabilities

### a. Categories of financial instruments

Derivative financial instruments are the only instrument recognised in the statement of financial position at fair value.

Derivative financial instruments are valued under level 2 of the following hierarchy.

- *Level 1* – Quoted market prices: Fair value based on quoted prices in active markets for identical assets or liabilities.
- *Level 2* – Valuation techniques using observable market inputs: Fair value based on a valuation technique using other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).
- *Level 3* – Valuation techniques using significant non-observable market inputs: Fair value based on a valuation technique using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value of derivative financial instruments is determined using a discounted cash flow analysis. Interest rates represent the most significant assumption used in valuing derivative financial instruments. The interest rates used to discount estimated cash flows are based on the New Zealand dollar swap curves at the reporting date.

#### Financial instruments recognised in the statement of financial position at amortised cost

Fair values of financial instruments not recognised in the statement of financial position at fair value are determined for note disclosure as follows:

#### Cash and bank, trade and other receivables, trade and other payables

The carrying value of cash and bank, trade and other receivables, trade and other payables approximate their fair value as they are short-term instruments.

#### Marketable securities and bonds

The fair value of bonds and marketable securities are determined using the quoted price for the instrument (Fair value hierarchy level 1).

#### Deposits

The fair value for deposits is determined using a discounted cash flow analysis. The interest rates used to discount the estimated cash flows are based on current market interest rates (Fair value hierarchy level 2).

#### Loans to local government

The fair value of loans to local government authorities is determined using a discounted cash flow analysis. The interest rates used to discount the estimated cash flows are based on LGFA bond yields at the reporting date plus an appropriate credit spread to reflect the counterparty's credit risk (Fair value hierarchy level 2).

### Borrower notes

The fair value of borrower notes is determined using a discounted cash flow analysis. The interest rates used to discount the estimated cash flows are based on LGFA bond yields at the reporting date (Fair value hierarchy level 2).

### Fair value of financial assets and financial liabilities

The fair value of financial assets and financial liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

| As at 30 June 2018 in $000s | Financial liabilities at amortised cost | Financial assets at amortised cost | Financial assets measured at fair value in accordance with NZ IFRS 9 | Fair value |
|---|---|---|---|---|
| Financial assets | | | | |
| Cash and bank balances | - | 50,281 | - | 50,281 |
| Trade and other receivables | - | - | - | - |
| Loans to local government | - | 7,975,728 | - | 8,224,666 |
| Marketable securities | - | 231,420 | - | 225,570 |
| Deposits | - | 201,114 | - | 202,061 |
| Derivatives | - | - | 375,371 | 375,371 |
| | **-** | **8,458,543** | **375,371** | **9,077,949** |
| Financial liabilities | | | | |
| Trade and other payables | 444 | - | - | 444 |
| Bills | 473,421 | - | - | 473,467 |
| Bonds | 8,101,004 | - | - | 8,172,546 |
| Borrower notes | 135,108 | - | - | 134,956 |
| Bond repurchases | 6,183 | - | - | 6,183 |
| Derivatives | - | - | 54 ,286 | 54,286 |
| | **8,716,160** | **-** | **54 ,286** | **8,841,882** |

| As at 30 June 2017 in $000s | Financial liabilities at amortised cost | Financial assets at amortised cost | Financial assets measured at fair value in accordance with NZ IFRS 9 | Fair value |
|---|---|---|---|---|
| Financial assets | | | | |
| Cash and bank balances | - | 49,919 | - | 49,919 |
| Trade and other receivables | - | - | - | - |
| Receivable unsettled bond repurchases | - | 13,723 | - | 13,726 |
| Loans to local government | - | 7,783,932 | - | 8,031,625 |
| Marketable securities | - | 127,641 | - | 127,818 |
| Deposits | - | 149,949 | - | 150,559 |
| Derivatives | - | - | 364,953 | 364,953 |
| | **-** | **8,125,164** | **364,953** | **8,738,600** |
| Financial liabilities | | | | |
| Trade and other payables | 453 | - | - | 453 |
| Bills | 348,179 | - | - | 348,296 |
| Bonds | 7,865,708 | - | - | 7,958,723 |
| Borrower notes | 131,614 | - | - | 131,109 |
| Bond repurchases | 25,682 | - | - | 25,682 |
| Derivatives | - | - | 65,660 | 65,660 |
| | **8,371,636** | **-** | **65,660** | **8,529,923** |

## b. Financial risk management

The Board of Directors has overall responsibility for carrying out the business of LGFA in accordance with risk management policies, including those relating to investing, lending, borrowing and treasury activities. The use of financial instruments exposes LGFA to financial risks, the most significant being market risk, credit risk, and liquidity risk. The exposure and management of these risks is outlined below.

### Market risk

Market risk is the risk that changes in market prices will affect LGFA's income or value of financial instruments. The most significant market risk which LGFA is exposed to is interest rate risk. LGFA has no significant exposure to foreign exchange risk.

### Interest rate risk

Interest rate risk is the risk that future cash flows or the fair value of financial instruments will decrease because of a change in market interest rates. LGFA is exposed to interest rate risk through its interest-bearing financial assets and liabilities.

Interest rate risk is managed using Value at Risk (VaR) and Partial Differential Hedge (PDH) limits to mitigate the potential change in value of the balance sheet due to changes in interest rates. PDH risk measures the sensitivity of a portfolio to a one basis point change in underlying interest rates, whereas VaR measures the expected loss for a given period with a given confidence.

The table below indicates the earliest period in which interest-bearing financial instruments reprice.

| As at 30 June 2018 in $000s | Face value | Less than 6 Months | 6 months – 1 Year | 1-2 Years | 2-5 Years | Over 5 Years |
|---|---|---|---|---|---|---|
| Financial assets | | | | | | |
| Cash and bank balances | 50,281 | 50,281 | - | - | - | - |
| Loans to local government | 7,927,441 | 6,709,699 | 300,500 | 12,500 | 568,000 | 336,742 |
| Marketable securities | 226,593 | 152,196 | 26,897 | 27,500 | 20,000 | - |
| Deposits | 199,000 | 130,000 | 69,000 | - | - | - |
| Financial liabilities | | | | | | |
| Bills | (475,000) | (475,000) | - | - | - | - |
| Bonds | (7,719,000) | - | (1,240,000) | (980,000) | (3,119,000) | (2,380,000) |
| Borrower notes | (123,062) | (103,690) | (4,696) | (200) | (9,088) | (5,388) |
| Bond repurchases | | | | | | |
| Derivatives | - | (6,454,200) | 936,200 | 938,750 | 2,516,250 | 2,063,000 |
| **Total** | **86,253** | **9,286** | **87,901** | **(1,450)** | **(23,838)** | **14,354** |

| As at 30 June 2017 in $000s | Face value | Less than 6 Months | 6 months – 1 Year | 1-2 Years | 2-5 Years | Over 5 Years |
|---|---|---|---|---|---|---|
| Financial assets | | | | | | |
| Cash and bank balances | 49,919 | 49,919 | - | - | - | - |
| Loans to local government | 13,723 | 13,723 | - | - | - | - |
| Receivable unsettled bond repurchases | 7,735,564 | 6,670,326 | 6,538 | 290,500 | 426,200 | 342,000 |
| Marketable securities | 126,302 | 103,747 | 7,555 | 15,000 | - | - |
| Deposits | 148,000 | 138,000 | 10,000 | - | - | - |
| Financial liabilities | | | | | | |
| Bills | (350,000) | (325,000) | (25,000) | - | - | - |
| Bonds | (7,505,000) | (1,015,000) | - | (1,200,000) | (2,105,000) | (3,185,000) |
| Borrower notes | (120,198) | (103,179) | (80) | (4,648) | (6,819) | (5,472) |
| Bond repurchases | (25,682) | (25,682) | - | - | - | - |
| Derivatives | - | (5,418,200) | - | 909,200 | 1,666,250 | 2,842,750 |
| **Total** | **72,628** | **88,654** | **(987)** | **10,052** | **(19,369)** | **(5,722)** |

### Interest rate sensitivity

Changes in interest rates impact the fair value of fixed rate assets and liabilities, cash flows on floating rate assets and liabilities, and the fair value and cash flows of interest rate swaps. A change of 100 basis points in interest rates at the reporting date would have increased/(decreased) profit or loss and equity by the amounts shown in the following table. This analysis assumes that all other variables remain constant.

| For the year ended 30 June in $000s | 2018 100 bps increase $000s | 2018 100 bps decrease $000s | 2017 100 bps increase $000s | 2017 100 bps decrease $000s |
|---|---|---|---|---|
| **Fair value sensitivity analysis** | | | | |
| Fixed rate assets | - | - | - | - |
| Fixed rate liabilities | 276,613 | (281,357) | 272,084 | (277,500) |
| Derivative financial instruments | (276,613) | 281,357 | (272,084) | 277,500 |
| | **-** | **-** | **-** | **-** |
| **Cash flow sensitivity analysis** | | | | |
| Variable rate assets | 64,806 | (64,806) | 62,982 | (62,982) |
| Variable rate liabilities | (1,037) | 1,037 | (1,008) | 1,008 |
| Derivative financial instruments | (66,432) | 66,432 | (63,867) | 63,867 |
| | **(2,663)** | **2,663** | **(1,893)** | **1,893** |

### Credit risk

Credit risk is the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations. LGFA is exposed to credit risk through its lending and investing activities.

Credit risk associated with lending activities is managed by requiring local authorities that borrow from LGFA to meet specific credit lending criteria and to provide security against the borrowing. The LGFA's credit risk framework restricts credit exposures to specific counterparties.

Credit risk associated with investing activities, excluding on-lending, is managed by only investing with New Zealand Government Agencies or counterparties that meet a minimum credit rating of A (Standard & Poor's equivalent). The LGFA's credit risk framework limits concentrations of credit risk for any single counterparty.

### Exposure to credit risk

LGFA monitors the concentration of credit risk by the type of counterparty. The carrying value and maximum exposure to credit risk at the reporting date, before taking account of collateral or other credit enhancements, for significant counterparty types are shown in the table below.

| As at 30 June 2018 in $000s | NZ government agencies | NZ local authorities | NZ registered banks | Other counter-parties | Total carrying value |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and bank balances | 49,773 | - | 508 | - | 50,281 |
| Trade and other receivables | - | - | - | - | - |
| Loans to local government | - | 7,975,728 | - | - | 7,975,728 |
| Marketable securities | 60,988 | 43,807 | 109,544 | 17,081 | 231,420 |
| Deposits | - | - | 201,114 | - | 201,114 |
| Derivatives | 321,085 | - | - | - | 321,085 |
| | **431,846** | **8,019,535** | **311,166** | **17,081** | **8,779,628** |

| As at 30 June 2017 in $000s | NZ government agencies | NZ local authorities | NZ registered banks | Other counter-parties | Total carrying value |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and bank balances | 49,385 | - | 534 | - | 49,919 |
| Trade and other receivables | - | - | - | - | - |
| Receivable unsettled bond repurchases | - | - | 13,723 | - | - |
| Loans to local government | - | 7,783,932 | - | - | 7,783,932 |
| Marketable securities | 31,180 | 16,937 | 34,845 | 44,679 | 127,641 |
| Deposits | - | - | 149,949 | - | 149,949 |
| Derivatives | 364,953 | - | - | - | 364,953 |
| | **445,518** | **7,800,869** | **199,051** | **44,679** | **8,476,394** |

### Collateral and credit enhancements

LGFA holds collateral against borrowings from local authorities in the form of debenture securities and guarantees.

### Credit quality of financial assets

All financial assets are neither past due or impaired. The carrying value of the financial assets is expected to be recoverable.

### Liquidity risk

Liquidity risk is the risk that LGFA will encounter difficulty in meeting the obligations of its financial liabilities. LGFA manages liquidity risk by holding cash and a portfolio of liquid assets to meet obligations when they fall due. LGFA is required by policy to maintain sufficient liquidity (comprising a committed liquidity facility and holdings of cash and liquid investments) to meet all operating and funding commitments over a rolling 12-month period.

The New Zealand Debt Management Office (NZDMO) provides a committed liquidity facility that LGFA can draw upon to meet any exceptional and temporary liquidity shortfall. As at 30 June 2018, the undrawn committed liquidity facility was $600 million (2017: $500 million).

### Contractual cash flows of financial instruments

The contractual cash flows associated with financial assets and liabilities are shown in the table below.

| As at 30 June 2018 in $000s | On demand | Up to 3 months | 3 months to 1 year | 1 year to 5 years | More than 5 years | Total contractual cash flows | Total carrying value |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and bank balances | 50,281 | - | - | - | - | 50,281 | 50,281 |
| Trade and other receivables | - | - | - | - | - | - | - |
| Loans to local government | - | 236,487 | 1,460,213 | 4,447,506 | 2,859,147 | 9,003,353 | 7,975,728 |
| Marketable securities | - | 114,836 | 59,305 | 61,268 | - | 235,409 | 231,420 |
| Deposits | - | 50,880 | 152,905 | - | - | 203,786 | 201,114 |
| **Financial liabilities** | | | | | | | |
| Trade and other payables | (444) | - | - | - | - | (444) | (444) |
| Bills | - | (375,000) | (100,000) | - | - | (475,000) | (473,421) |
| Bonds | - | (31,000) | (1,558,213) | (4,981,825) | (2,747,625) | (9,318,663) | (7,878,765) |
| Bond repurchases | - | (6,184) | - | - | - | (6,184) | (6,184) |
| Borrower notes | - | - | (23,639) | (74,147) | (52,889) | (150,675) | (135,108) |
| **Derivatives** | - | (15,961) | 152,202 | 333,394 | 106,640 | 576,275 | 321,085 |
| | **49,837** | **(25,942)** | **142,774** | **(213,803)** | **165,273** | **118,138** | **285,707** |

| As at 30 June 2017 in $000s | On demand | Up to 3 months | 3 months to 1 year | 1 year to 5 years | More than 5 years | Total contractual cash flows | Total carrying value |
|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | |
| Cash and bank balances | 49,919 | - | - | - | - | 49,919 | 49,919 |
| Trade and other receivables | | | | | | | |
| Receivable unsettled bond repurchases | | 13,723 | - | - | - | 13,723 | 13,723 |
| Loans to local government | - | 211,716 | 1,135,725 | 4,077,315 | 3,388,036 | 8,812,791 | 7,783,932 |
| Marketable securities | - | 58,808 | 54,569 | 15,750 | - | 129,126 | 127,641 |
| Deposits | - | 34,762 | 116,848 | - | - | 151,611 | 149,949 |
| Financial liabilities | | | | | | | |
| Trade and other payables | (453) | - | - | - | - | (453) | (453) |
| Bills | - | (200,000) | (150,000) | - | - | (350,000) | (348,179) |
| Bonds | - | (30,000) | (1,322,225) | (4,225,800) | (3,612,475) | (9,190,500) | (7,865,708) |
| Bond repurchases | | (25,684) | - | - | - | (25,684) | (25,684) |
| Borrower notes | - | - | (17,192) | (66,814) | (62,910) | (146,916) | (131,614) |
| Derivatives | - | (14,673) | 149,931 | 368,393 | 151,532 | 655,184 | 299,600 |
| | **49,466** | **48,652** | **(32,343)** | **168,844** | **(135,817)** | **98,802** | **53,126** |

## c. Hedge accounting

LGFA is exposed to interest rate risk from fixed rate borrowing and variable rate lending to councils. LGFA uses interest rate swaps to manage this interest rate risk. For hedge accounting purposes, LGFA has designated these swaps in fair value relationships to its fixed rate borrowing.

The gain or loss on the hedging instrument and the hedged item attributable to the hedged risk for fair value hedge relationships is shown in the table below.

| As at 30 June in $000s | 2018 Gain/(loss) | 2017 Gain/(loss) |
|---|---|---|
| Hedging instruments – interest rate swaps | 58,487 | (174,572) |
| Hedged items attributable to the hedged risk – fixed rate bonds | (58,487) | 174,572 |
| Hedged items attributable to the hedged risk – fixed rate bonds | - | - |

The gains or losses on the hedging instrument (interest rate swaps) and the hedged item (bonds) are mapped to the same fair value account. For this reason, the statement of comprehensive income will only report any ineffectiveness arising from the fair value hedge.

## d. Offsetting

NZ IAS 32: Financial Instruments Presentation allows financial assets and liabilities to be offset only when there is a current legally enforceable right to set off the amounts and there is an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously. LGFA does not offset any amounts. The following table shows amounts subject to an enforceable master netting arrangement or similar agreement that are not offset in the statement of financial position:

| As at 30 June 2018<br>in $000s | Derivative assets | Derivative liabilities |
|---|---|---|
| Gross amounts | 375,371 | 54,286 |
| Amounts offset | - | - |
| Carrying amounts | 375,371 | 54,286 |
| Amounts that don’t qualify for offsetting | - | - |
| Financial assets and liabilities | (54,286) | (54,286) |
| Collateral | - | - |
| **Net Amount** | **321,085** | **-** |

| As at 30 June 2017<br>in $000s | Derivative assets | Derivative liabilities |
|---|---|---|
| Gross amounts | 364,953 | 65,660 |
| Amounts offset | - | - |
| Carrying amounts | 364,953 | 65,660 |
| Amounts that don’t qualify for offsetting | - | - |
| Financial assets and liabilities | (65,660) | (65,660) |
| Collateral | - | - |
| **Net Amount** | **299,293** | **-** |

## 3 Issuance and on-lending expenses

Issuance and on-lending expenses are those costs that are incurred as a necessary expense to facilitate the ongoing issuance of LGFA debt securities.

| For the year ended 30 June<br>in $000s | 2018 | 2017 |
|---|---|---|
| NZDMO facility fee | 706 | 442 |
| NZX | 333 | 412 |
| Rating agency fees | 577 | 547 |
| Legal fees for issuance | 233 | 169 |
| Regulatory, registry, other fees | 106 | 37 |
| Trustee fees | 100 | 100 |
| Approved issuer levy[1] | 1,975 | 1,795 |
| Information Services | 154 | 138 |
| | **4,182** | **3,640** |

1. The amount of Approved Issuer Levy is a function of the number of the offshore holders of LGFA bonds.

## 4 Operating expenses

Operating expenses are all other expenses that are not classified as 'Issuance and on-lending expenses.'

| For the year ended 30 June<br>in $000s | 2018 | 2017 |
|---|---|---|
| Consultants[1] | 188 | 51 |
| Directors fees | 377 | 348 |
| Insurance | 60 | 60 |
| Legal fees | 88 | 37 |
| Other expenses | 743 | 875 |
| Auditors' remuneration | | |
| Statutory audit | 87 | 81 |
| Advisory services | - | 4 |
| Personnel | 1,418 | 1,372 |
| Recruitment | 20 | - |
| | **2,981** | **2,828** |

1. Consultants includes $119 for Treasury Systems Consultant (2017: $132). Previously, this cost was reported within Other expenses (with associated treasury systems costs).

## 5 Loans to local government

| As at 30 June in $000s | 2018 Short-term loans | 2018 Loans | 2017 Short-term loans | 2017 Loans |
|---|---|---|---|---|
| Ashburton District Council | 5,015 | 25,603 | 10,018 | 25,707 |
| Auckland Council | - | 2,101,357 | - | 2,429,887 |
| Buller District Council | - | 20,014 | - | 20,001 |
| Canterbury Regional Council | - | 30,103 | - | 25,083 |
| Central Hawkes Bay District Council | - | 2,027 | - | - |
| Christchurch City Council | 85,273 | 1,573,566 | 96,280 | 1,485,304 |
| Far North District Council | - | 40,130 | - | 30,121 |
| Gisborne District Council | - | 37,275 | - | 27,085 |
| Gore District Council | 6,014 | 11,064 | 6,023 | 11,034 |
| Greater Wellington Regional Council | - | 306,302 | - | 280,702 |
| Grey District Council | - | 20,446 | - | 20,551 |
| Hamilton City Council | - | 366,483 | - | 351,028 |
| Hastings District Council | 1,957 | 75,280 | - | 60,211 |
| Hauraki District Council | - | 38,156 | - | 41,139 |
| Horizons Regional Council | - | 20,035 | - | 10,013 |
| Horowhenua District Council | 6,008 | 72,868 | 12,013 | 63,923 |
| Hurunui District Council | - | 23,098 | - | 23,085 |
| Hutt City Council | 4,996 | 152,802 | - | 97,727 |
| Kaipara District Council | 4,925 | 40,174 | 8,925 | 43,172 |
| Kapiti Coast District Council | - | 205,754 | - | 210,623 |
| Manawatu District Council | - | 61,180 | - | 58,094 |
| Marlborough District Council | 17,297 | 63,237 | 19,851 | 63,207 |
| Masterton District Council | - | 52,234 | 2,006 | 52,209 |
| Matamata -Piako District Council | - | 27,599 | - | 29,581 |
| Nelson City Council | - | 60,239 | - | 55,201 |
| New Plymouth District Council | - | 74,324 | - | 61,167 |
| Northland Regional Council | - | 8,634 | - | - |
| Opotiki District Council | - | 5,163 | - | 5,180 |
| Otorohanga District Council | - | 6,120 | - | 9,178 |
| Palmerston North City Council | 10,028 | 82,317 | 10,025 | 77,255 |
| Porirua City Council | - | 61,754 | - | 28,608 |
| Queenstown Lakes District Council | 10,096 | 75,954 | 7,070 | 86,177 |
| Rotorua District Council | - | 150,266 | 1,001 | 114,976 |
| Selwyn District Council | - | 15,021 | - | 35,050 |

## 5 Loans to local government (cont)

| As at 30 June<br>in $000s | 2018<br>Short-term loans | Loans | 2017<br>Short-term loans | Loans |
|---|---|---|---|---|
| South Taranaki District Council | - | 62,278 | - | 62,267 |
| South Wairarapa District Council | - | 17,629 | 4,034 | 13,586 |
| Stratford District Council | - | 4,513 | - | - |
| Tararua District Council | 2,011 | 15,064 | 1,004 | 10,033 |
| Tasman District Council | 10,007 | 109,006 | - | 90,273 |
| Taupo District Council | - | 125,430 | - | 125,417 |
| Tauranga City Council | - | 362,308 | - | 347,207 |
| Thames-Coromandel District Council | - | 45,175 | - | 35,061 |
| Timaru District Council | 12,524 | 67,331 | 10,047 | 67,347 |
| Upper Hutt City Council | 4,976 | 31,638 | 2,997 | 31,628 |
| Waikato District Council | - | 80,382 | - | 80,265 |
| Waimakariri District Council | 20,024 | 105,818 | 10,010 | 85,797 |
| Waipa District Council | - | 13,016 | - | 13,015 |
| Waitomo District Council | 10,066 | 25,086 | 5,022 | 25,027 |
| Wellington City Council | - | 395,384 | - | 294,047 |
| Western Bay Of Plenty District Council | - | 105,426 | - | 105,386 |
| Westland District Council | 2,998 | 14,361 | - | - |
| Whakatane District Council | 6,011 | 48,220 | 6,021 | 34,129 |
| Whanganui District Council | 5,005 | 73,367 | - | 66,327 |
| Whangarei District Council | 9,971 | 132,516 | 9,972 | 142,522 |
| | **235,202** | **7,740,526** | **222,318** | **7,561,614** |

## 6 Bills on issue

As at 30 June 2018 in $000s

| Maturity date | Face value | Unamortised premium | Accrued interest | Total |
|---|---|---|---|---|
| 11 July 2018 | 50,000 | - | (27) | 49,973 |
| 27 July 2018 | 25,000 | - | (36) | 24,964 |
| 2 August 2018 | 125,000 | - | (210) | 124,790 |
| 6 August 2018 | 25,000 | - | (47) | 24,953 |
| 15 August 2018 | 50,000 | - | (121) | 49,879 |
| 23 August 2018 | 25,000 | - | (72) | 24,928 |
| 12 September 2018 | 50,000 | - | (199) | 49,801 |
| 26 September 2018 | 25,000 | - | (121) | 24,879 |
| 10 October 2018 | 25,000 | - | (146) | 24,854 |
| 31 October 2018 | 25,000 | - | (177) | 24,823 |
| 14 November 2018 | 25,000 | - | (192) | 24,808 |
| 12 December 2018 | 25,000 | - | (232) | 24,768 |
| | **475,000** | **-** | **(1,579)** | **473,421** |

As at 30 June 2017 in $000s

| Maturity date | Face value | Unamortised premium | Accrued interest | Total |
|---|---|---|---|---|
| 12-Jul-17 | 50,000 | (30) | - | 49,970 |
| 4-Aug-17 | 25,000 | (46) | - | 24,954 |
| 16-Aug-17 | 50,000 | (129) | - | 49,871 |
| 13-Sep-17 | 50,000 | (204) | - | 49,796 |
| 26-Sep-17 | 25,000 | (126) | - | 24,874 |
| 11-Oct-17 | 25,000 | (143) | - | 24,857 |
| 26-Oct-17 | 25,000 | (172) | - | 24,828 |
| 15-Nov-17 | 25,000 | (194) | - | 24,806 |
| 27-Nov-17 | 25,000 | (223) | - | 24,777 |
| 13-Dec-17 | 25,000 | (232) | - | 24,768 |
| 26-Jan-18 | 25,000 | (322) | - | 24,678 |
| | **350,000** | **(1,821)** | **-** | **348,179** |

## 7 Bonds on issue

Bonds on issue do not include $400 million face value of issued LGFA bonds subscribed by LGFA and held as treasury stock. Refer Note 9: Treasury stock and bond repurchase transactions.

As at 30 June 2018 in $000s

| Maturity date | | Face value | Unamortised premium | Accrued interest | Fair value hedge adjustment | Total |
|---|---|---|---|---|---|---|
| 15 March 2019 | 5% coupon | 1,240,000 | 8,990 | 18,196 | | |
| 15 April 2020 | 3% coupon | 980,000 | (5,904) | 6,185 | | |
| 15 May 2021 | 6% coupon | 1,420,000 | 57,960 | 10,882 | | |
| 14 April 2022 | 2.75% coupon | 270,000 | (223) | 1,582 | | |
| 15 April 2023 | 5.5% coupon | 1,429,000 | 67,183 | 16,535 | | |
| 15 April 2025 | 2.75% coupon | 969,000 | (44,090) | 5,606 | | |
| 15 April 2027 | 4.5% coupon | 1,056,000 | 35,890 | 9,997 | | |
| 14 April 2033 | 3.5% coupon | 355,000 | (31,672) | 2,648 | | |
| | | **7,719,000** | **88,134** | **71,631** | **222,239** | **8,101,004** |

As at 30 June 2017 in $000s

| Maturity date | | Face value | Unamortised premium | Accrued interest | Fair value hedge adjustment | Total |
|---|---|---|---|---|---|---|
| 15 December 2017 | 6% coupon | 1,015,000 | 7,762 | 2,662 | | |
| 15 March 2019 | 5% coupon | 1,200,000 | 19,488 | 17,609 | | |
| 15 April 2020 | 3% coupon | 755,000 | (12,471) | 4,765 | | |
| 15 May 2021 | 6% coupon | 1,350,000 | 68,236 | 10,345 | | |
| 15 April 2023 | 5.5% coupon | 1,350,000 | 69,813 | 15,621 | | |
| 15 April 2025 | 2.75% coupon | 660,000 | (34,201) | 3,818 | | |
| 15 April 2027 | 4.5% coupon | 960,000 | 33,450 | 9,089 | | |
| 14 April 2033 | 3.5% coupon | 215,000 | (20,650) | 1,604 | | |
| **Total** | | **7,505,000** | **131,427** | **65,513** | **163,460** | **7,865,401** |

## 8 Borrower notes

Borrower notes are subordinated debt instruments which are required to be held by each local authority that borrows from LGFA in an amount equal to 1.6% of the aggregate borrowings by that local authority.

LGFA may convert borrower notes into redeemable shares if it has made calls for all unpaid capital to be paid in full and the LGFA Board determines it is still at risk of imminent default.

## 9 Treasury stock and bond repurchase transactions

Periodically, LGFA subscribes for LGFA bonds as part of its tender process and holds these bonds as treasury stock. LGFA bonds held by LGFA as treasury stock are derecognised at the time of issue and no liability is recognised in the statement of financial position.

As at 30 June 2018, treasury stock had been issued in the following maturities (in $000s):

| | 2018 | 2017 |
|---|---|---|
| 15 March 2019 | 50,000 | 50,000 |
| 15 April 2020 | 50,000 | 50,000 |
| 15 May 2021 | 50,000 | 50,000 |
| 15 April 2022 | 50,000 | - |
| 15 April 2023 | 50,000 | 50,000 |
| 15 April 2025 | 50,000 | 50,000 |
| 15 April 2027 | 50,000 | 50,000 |
| 14 April 2033 | 50,000 | 50,000 |
| **Total** | **400,000** | **350,000** |

LGFA makes these treasury stock bonds available to banks authorised as its tender counterparties to borrow under short-term repurchase transactions. The objective of the bond lending facility is to assist with improving secondary market liquidity in LGFA bonds. Bonds lent to counterparties are disclosed as a separate stock lending liability on the face of the statement of financial position.

Each month, LGFA notifies the market the amount of outstanding repurchase transactions and LGFA bonds held as treasury stock.

As at 30 June 2018, bond repurchase transactions comprised:

| Maturity date | | 30 June 2018 Repurchase transactions | 30 June 2017 Repurchase transactions |
|---|---|---|---|
| 15 March 2019 | 5% coupon | 1,035 | - |
| 15 April 2020 | 3% coupon | 4,076 | - |
| 15 May 2021 | 6% coupon | - | - |
| 14 April 2022 | 2.75% coupon | - | - |
| 15 April 2023 | 5.5% coupon | - | - |
| 15 April 2025 | 2.75% coupon | - | 9,981 |
| 15 April 2027 | 4.5% coupon | 1,072 | 15,701 |
| 14 April 2033 | 3.5% coupon | - | - |
| | | **6,183** | **25,682** |

## 10 Reconciliation of net profit / (loss) to net cash flow from operating activities

| For the year ended 30 June in $000s | | 2018 | 2017 |
|---|---|---|---|
| Net profit/(loss) for the period | | 11,802 | 11,046 |
| Cash applied to loans to local government | 11 | (191,878) | (1,385,002) |
| Non-cash adjustments | | | |
| Amortisation and depreciation | | 1,083 | 438 |
| Working capital movements | | | |
| Net change in trade debtors and receivables | | (9) | 271 |
| Net change in prepayments | | (17) | (9) |
| Net change in accruals | | (28) | (39) |
| **Net Cash From operating activities** | | **(179,047)** | **(1,373,295)** |

## 11 LGFA December 2017 bond maturity

The nominal value of the 15 December 2017 6% coupon bond maturity was $1,015 million. Loans to councils with nominal values totalling $879 million, and associated nominal borrower notes totalling $14 million, also matured on 15 December 2017.

## 12 Share Capital

As at 30 June 2018, LGFA had 45 million ordinary shares on issue, 20 million of which remain uncalled. All ordinary shares rank equally with one vote attached to each ordinary share. Ordinary shares have a face value of $1 per share.

### Shareholder Information

| Registered holders of equity securities as at 30 June | 2018 | | 2017 | |
|---|---|---|---|---|
| New Zealand Government | 5,000,000 | 11.1% | 5,000,000 | 11.1% |
| Auckland Council | 3,731,960 | 8.3% | 3,731,960 | 8.3% |
| Christchurch City Council | 3,731,960 | 8.3% | 3,731,960 | 8.3% |
| Hamilton City Council | 3,731,960 | 8.3% | 3,731,960 | 8.3% |
| Bay of Plenty Regional Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Greater Wellington Regional Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Tasman District Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Tauranga City Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Wellington City Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Western Bay of Plenty District Council | 3,731,958 | 8.3% | 3,731,958 | 8.3% |
| Whangarei District Council | 1,492,784 | 3.3% | 1,492,784 | 3.3% |
| Hastings District Council | 746,392 | 1.7% | 746,392 | 1.7% |
| Marlborough District Council | 400,000 | 0.9% | 400,000 | 0.9% |
| Selwyn District Council | 373,196 | 0.8% | 373,196 | 0.8% |
| Gisborne District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Hauraki District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Horowhenua District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Hutt City Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Kapiti Coast District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Manawatu District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Masterton District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| New Plymouth District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Otorohanga District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Palmerston North District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| South Taranaki District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Taupo District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Thames-Coromandel District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Waimakariri District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Waipa District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Whakatane District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| Whanganui District Council | 200,000 | 0.4% | 200,000 | 0.4% |
| | **45,000,000** | **100%** | **45,000,000** | **100%** |

### Capital management

LGFA's capital is equity, which comprises share capital and retained earnings. The objective of managing LGFA's equity is to ensure LGFA achieves its goals and objectives for which it has been established, whilst remaining a going concern.

### Dividend

LGFA paid a dividend of $1,390,000 on 20 September 2017, being $0.0556 per paid up share (2017: $1,392,500 on 14 October 2016, being $ 0.0557 per paid up share).

## 13 Operating Leases

| As at 30 June in $000s | 2018 | 2017[1] |
|---|---|---|
| Less than one year | 122 | - |
| Between one and five years | 263 | - |
| **Total non-cancellable operating leases** | **385** | **-** |

1. Not disclosed in 2017 as lease obligations were suspended following 2016 Kaikoura earthquake.

## 14 Other Assets

| As at 30 June in $000s | 2018 | 2017 |
|---|---|---|
| Property, plant and equipment | - | - |
| Intangible assets[2] | 609 | 760 |
| **Total other assets** | **609** | **760** |

2. Intangible assets comprise acquired and internally developed software costs incurred on the implementation of LGFA's treasury management system.

## 15 Capital commitments

As at 30 June 2018, there are no capital commitments.

## 16 Contingencies

There are no contingent liabilities at balance date.

## 17 Related parties

### Identity of related parties

The Company is related to the local authorities set out in the Shareholder Information in Note 12.

The Company operates under an annual Statement of Intent with the respective local authorities that sets out the intentions and expectations for LGFA's operations and lending to participating local authorities.

Shareholding local authorities, and non-shareholder local authorities who borrow more than $20 million, are required to enter into a guarantee when they join or participate in LGFA. The guarantee is in respect of the payment obligations of other guaranteeing local authorities to the LGFA (cross guarantee) and of the LGFA itself.

### Related party transactions

LGFA was established for the purpose of raising funds from the market to lend to participating councils. The lending to individual councils is disclosed in Note 5, and interest income recognised on this lending is shown in the statement of comprehensive income.

The purchase of LGFA borrower notes by participating councils. Refer Note 8.

NZDMO provides LGFA with a committed credit facility and is LGFA's derivatives counterparty.

Transactions with key management personnel: Salaries $849,969 (2017: $802,434)

Fees paid to directors are disclosed in operating expenses in Note 4.

## 18 Subsequent events

Subsequent to balance date, LGFA has issued $285 million in bonds through two tenders.

Subsequent to balance date, on 28 August 2018, the Directors of LGFA declared a dividend of $1,285,000 ($ 0.0514) per paid up share.

Subsequent to balance date, on 13 July 2018, Standard and Poors' affirmed the local currency issuer rating of LGFA at 'AA+/A-1+' and removed LGFA from Under Criteria Observation.

A natural play area installed at the Octopus's Garden Playground, Ngawhatu Reserve. Nelson City Council

Site inspection at the Neale Park Sewer Pump Station Upgrade. Nelson City Council

## INDEPENDENT AUDITOR'S REPORT

## TO THE SHAREHOLDERS OF NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED

The Auditor-General is the auditor of New Zealand Local Government Funding Agency Limited (the company). The Auditor-General has appointed me, Brent Manning, using the staff and resources of KPMG, to carry out the audit of the financial statements and performance information of the company on his behalf.

### Opinion

We have audited:

- the financial statements of the company on pages 45 to 68, that comprise the statement of financial position as at 30 June 2018, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information; and
- the performance information of the company on pages 32 to 43.

In our opinion:

- the financial statements of the company on pages 45 to 68:
  - present fairly, in all material respects:
    - its financial position as at 30 June 2018; and
    - its financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP) and they comply with New Zealand equivalents to International Finacnial Reporting Standards and International Financial Reporting Standards (IFRS); and
- the performance information of the company on pages 32 to 43 presents fairly, in all material respects, the company's actual performance compared against the performance targets and other measures by which performance was judged in relation to the company's objectives for the year ended 30 June 2018.

Our audit was completed on 28 August 2018. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Board of Directors and our responsibilities relating to the financial statements and the performance information, we comment on other information, and we explain our independence.

### Basis for our opinion

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole. The materiality for the financial statements as a whole was set at $61 million determined with reference to a benchmark of company Total Assets. We chose the benchmark because, in our view, this is a key measure of the company's performance. In addition, we also assess whether other matters that come to our attention during the audit would in our judgement change or influence the decisions of a reasonably knowledgeable person ('qualitative' materiality).

**Key Audit Matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the shareholders as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and we do not express discrete opinions on separate elements of the financial statements.

| The key audit matter | How the matter was addressed in our audit |
|---|---|
| ***Existence and impairment of loans*** | |
| Refer to Note 5 to the Financial Statements.<br><br>The loans LGFA has provided to local government make up over 90% of total assets. The loans are recognised at amortised cost and the nature of the counterparties is such that we do not consider these loans to be at high risk of significant misstatement. However, based on their materiality, and the judgement involved in assessing the credit worthiness of counterparties they are considered to be the area which had the greatest effect on our overall audit strategy and allocation of resources in planning and completing our audit. | Our audit procedures included:<br>- understanding the processes in place to assess borrowers and to record loan transactions. This included evaluating the control environment in place at LGFA.<br>- agreeing the 30 June 2018 loan balances to external confirmations received from NZ Clear.<br>- assessing the borrowers' compliance with financial covenants.<br><br>We did not identify any material differences in relation to the existence or impairment of loans. |
| ***Application of hedge accounting*** | |
| Refer to Note 2 of the Financial Statements.<br><br>LGFA enters into derivatives (interest rate swaps) to manage interest rate risk related to issuing fixed rate bonds. Fair value hedge accounting is applied where specific requirements are met around documentation of the hedge relationship and the relationship is demonstrated as being an effective hedge. Hedge accounting is complex, particularly in the area of whether the requirements (both initial and ongoing) for its application are met. Should the requirements for hedge accounting not be met, LGFA could experience significant volatility in the Statement of Comprehensive Income from changes in the fair value of the derivatives.<br><br>Due to the size of the derivative positions and the complexity of hedge accounting we consider this to be a key audit matter. | Our audit procedures included:<br>- agreeing the terms of the derivatives to the confirmation provided by the derivative counterparty.<br>- using our treasury valuation specialists we independently recalculated the fair value of all of the derivatives recorded by LGFA.<br>- ensuring the hedge documentation supporting the application of hedge accounting was in accordance with relevant accounting standards.<br>- determining that management's hedge effectiveness calculations were correctly performed using appropriate source information.<br><br>We did not identify any material differences in relation to the application of hedge accounting. |

KPMG

**Responsibilities of the Board of Directors for the financial statements and the performance information**

The Board of Directors is responsible on behalf of the company for preparing financial statements that are fairly presented and that comply with generally accepted accounting practice in New Zealand. The Board of Directors is also responsible for preparing the performance information for the company.

The Board of Directors is responsible for such internal control as it determines is necessary to enable it to prepare financial statements and performance information that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements and the performance information, the Board of Directors is responsible on behalf of the company for assessing the company's ability to continue as a going concern. The Board of Directors is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless the Board of Directors intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors' responsibilities arise from the Local Government Act 2002.

**Responsibilities of the auditor for the audit of the financial statements and the performance information**

Our objectives are to obtain reasonable assurance about whether the financial statements and the performance information, as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of shareholders, taken on the basis of these financial statements and the performance information.

We did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the financial statements and the performance information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- We evaluate the appropriateness of the reported performance information within the company's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board of Directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability

to continue as a going concern. If we conclude that a material uncertainty exists we are required to draw attention in our auditor's report to the related disclosures in the financial statements and the performance information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.

- We evaluate the overall presentation, structure and content of the financial statements and the performance information, including the disclosures, and whether the financial statements and the performance information represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibilities arise from the Public Audit Act 2001.

**Other Information**

The Board of Directors is responsible for the other information. The other information comprises the information included on pages 4 to 31, but does not include the financial statements and the performance information, and our auditor's report thereon.

Our opinion on the financial statements and the performance information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements and the performance information, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements and the performance information or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independence

We are independent of the company in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1(Revised): Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board.

Other than the audit, we have no relationship with, or interests in, the company.

Brent Manning
KPMG
On behalf of the Auditor-General
Wellington, New Zealand

# Other disclosures
# Whākitanga

### Waivers from NZX Limited (NZX)

LGFA's fixed rate bonds are quoted on the NZX Debt Market (LGFA Bonds). NZX has granted LGFA a number of waivers from the NZX Listing Rules.

**Waiver from Rule 3.2.1**

NZX has granted LGFA a waiver from NZX Listing Rule 3.2.1(a) to the extent that this requires the trust deed under which the LGFA Bonds are issued (Trust Deed) to provide that the appointment of a new trustee is to be approved by an extraordinary resolution of the holders of the Securities to which the Trust Deed relates. Effective from 10 May 2016, LGFA ceased to rely on this waiver as the Trust Deed was amended to comply with NZX Listing Rule 3.2.1(a).

**Waiver from Rule 5.2.3**

NZX has granted LGFA a waiver from NZX Listing Rule 5.2.3 to the extent that this requires the LGFA Bonds to be held by at least 100 members of the public holding at least 25% of the number of securities of that class issued.

The waiver from NZX Listing Rule 5.2.3 was provided on the conditions that:

a. LGFA clearly and prominently disclose the waiver, its conditions and its implications in its annual reports and in each profile or Offering Document for the LGFA Bonds;

b. LGFA will disclose market liquidity as a risk in each offering document (excluding any offering document referred to in paragraph (f) of the definition of "Offering Document" under NZX Listing Rule 1.6.1) for the LGFA Bonds; and

c. the nature of LGFA's business and operations do not materially change from its business and operations as at the date of the waiver decision.

The effect of the waiver is that the LGFA Bonds may not be widely held and there may be reduced market liquidity in the LGFA Bonds.

**Waiver from Rule 6.3.2**

NZX has granted LGFA a waiver from NZX Listing Rule 6.3.2 so that the deemed date of receipt of notices for a holder of LGFA Bonds who has supplied LGFA with an address outside of New Zealand, will be five working days after that notice is posted to that physical address.

### Donations

No donations were made by LGFA during the year ended 30 June 2018.

### Net Tangible Assets

Net tangible assets per $1,000 of listed bonds as at 30 June 2018 is $7.92 (2017: $6.86).

### Earnings per security

Earnings per security as at 30 June 2018 is $1.45 (2017: $1.41).

### Amount per security of final dividends

Not applicable

### Spread of Quoted Security holders

Spread of bondholders (LGF020, LGF030, LGF040, LGF050, LGF060, LGF070, LGF080 and LGF090) as at 30 June 2018.

| Holding range | Holder count | Holding quantity | Holding quantity % |
|---|---:|---:|---:|
| 10,000 to 49,999 | 397 | $10,194,000 | 0.13 |
| 50,000 to 99,999 | 149 | $10,519,000 | 0.13 |
| 100,000 to 499,999 | 200 | $43,272,000 | 0.53 |
| 500,000 to 999,999 | 35 | $24,897,000 | 0.31 |
| 1,000,000 and above | 70 | $8,030,118,000 | 98.90 |
| **Total** | **851** | **$8,119,000,000** | **100.00** |

# Directory
## Rārangi tauwaea

Postal address

PO Box 5704
Lambton Quay
Wellington 6145

Office hours

Monday through Friday,
09.00-17.30 hrs

Except Public Holidays

Phone

+64 4 974 6530

Personnel e-mail addresses

firstname.lastname@lgfa.co.nz

Website

**www.lgfa.co.nz**

General enquiries

lgfa@lgfa.co.nz

Street address


**WELLINGTON**

Level 8
City Chambers
142 Featherston Street
Wellington 6011


**AUCKLAND**

Level 5
Walker Wayland Centre
53 Fort Street
Auckland 1010

LGFA

NEW ZEALAND LOCAL
GOVERNMENT FUNDING AGENCY

TE PŪTEA KĀWANATANGA Ā-ROHE

www.lgfa.co.nz