STATEMENT OF PROPOSAL

Participating in the New Zealand Local Government Funding Agency Limited

This document is the Statement of Proposal prepared for the Special Consultative Procedure on the 25 August 2017

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WESTLAND
DISTRICT COUNCIL

STATEMENT OF PROPOSAL

Participation in the New Zealand Local Government Funding Agency Limited (LGFA)

Westland District Council has adopted the Statement of Proposal to participate in the New Zealand Local Government Funding Agency Limited.

This means that Council will participate in the LGFA Scheme, but not as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority, but simply as a borrower.

Under Section 82A of the Local Government Act 2002, the proposal is available for inspection and there is an opportunity to make submissions. The proposal is available at the Council's Customer Service Centre, 36 Weld Street, Hokitika, and also on Council's Website www.westlanddc.govt.nz.

Submissions must be in writing and addressed to the Council. Submissions may be sent either:

- by post to *the Group Manager: Corporate Services, Westland District Council, 36 Weld Street, Private Bag 704, Hokitika 7842*; or
- by email to consult@westlanddc.govt.nz.or
- Delivery to the Customer Service Centre, 36 Weld Street, Hokitika.

Submissions must be received no later than **5.00 pm** on **29 September 2017.**

Report

WESTLAND DISTRICT COUNCIL

DATE: 24 August 2017

TO: Mayor and Councillors

FROM: Group Manager, Corporate Services

LIABILITY MANAGEMENT POLICY AND INVESTMENT POLICY

1.0 SUMMARY

1.1 The purpose of this report is to adopt the updated Liability Management policy and Investment policy.

1.2 This issue arises due to the proposal to participate in the Local Government Funding Agency (LGFA).

1.3 The policies have been updated to allow Investment and Borrowing from the LGFA.

1.4 Council seeks to meet its obligations under the Local Government Act 2002 and the achievement of the District Vision adopted by the Council in September 2014, which will be set out in the next Long Term Plan 2015-25. The matters raised in this report relate to those elements of the vision identified in the following table:

1.5 This report concludes by recommending that Council adopts the Liability Management Policy attached as Appendix 1 and the Investment Policy attached as Appendix 2.

2.0 BACKGROUND

2.1 Local Government Act (LGA) s102(1) Council must adopt funding and financial policies including the Liability Management Policy and the Investment Policy.

2.2 Liability Management Policy adopted under LGA s104 must state the local authority's policies in respect of the management of both borrowing and other liabilities, including-

(a) Interest rate exposure
(b) Liquidity; and
(c) Credit exposure; and
(d) Debt repayment.

2.3 Investment Policy adopted under LGA s106 must state the local authority's policies in respect of investments, including-
(a) The mix of investments; and
(b) The acquisition of new investments; and
(c) An outline of the procedures by which investments are assessed and managed.

2.4 Under LGA s102(5) no consultation is necessary for changes to the Liability Management Policy or Investment Policy.

3.0 CURRENT SITUATION

3.1 Council are proposing participation in the Local Government Funding Agency. In order to participate, changes are required to both the Liability Management Policy and Investment policy. A summary of the changes are below.

3.2 Liability Management Policy Changes
3.2.1 Give Council the ability to borrow from LGFA.
3.2.2 Borrowing limits align with LGFA and sector benchmark.
3.2.3 Security arrangement change to Debenture Deed Trust.
3.2.4 Interest rate management; updated control limits.

3.3 Investment Policy changes
3.3.1 Give Council the ability to invest in the LGFA.
3.3.2 Investment maturity management to align with expenditure.
3.3.3 Minimum counterparty credit rating for NZ registered banks changed from A+/A-1 to A/A-1 in order to utilise Kiwibank.
3.3.4 $1m per Counterparty limit.
3.3.5 Lower limit for investment in Corporates and local government.
3.3.6 Investments, interest rate swaps and foreign exchange calculated within the counterparty exposure amount.
3.3.7 Investments in unsecured bonds must be senior ranking.

4.0 OPTIONS

4.1 Option One: The Council can adopt the amended versions of the Liability Management Policy and Investment Policy that are attached to this report as Appendix 1 and 2.

4.2 Option Two: The Council can make additional amendments to the Liability Management Policy and Investment Policy that are attached to this report and adopt them.

4.3 Option Three: The Council can direct that the policies be rejected.

5.0 SIGNIFICANCE AND CONSULTATION

5.1 The adoption of the policies is in itself of low significance. The LGA allows a Council to adopt a Liability Management Policy and Investment Policy without consultation.

6.0 ASSESSMENT OF OPTIONS (INCLUDING FINANCIAL IMPLICATIONS)

6.1 If the Council adopts the updated policies attached to this report as Appendix 1 and 2, it will be able to proceed with the proposal to participate in the LGFA. Participation in the LGFA should provide positive benefits to Council through a funding vehicle that was formed to provide benefits to Local Government.

6.2 It is a mandatory requirement for the Council to have a Liability Management policy and Investment Policy. The updates to the policies have been reviewed by our Treasury advisors and meet the requirements of the LGA and LGFA.

6.3 Do nothing, Council will be unable to apply to participate in the LGFA and will lose the opportunity to receive positive benefits.

6.4 If Council make any changes to the policies, they may not meet the requirements of the LGA or LGFA.

7.0 PREFERRED OPTION AND REASONS

7.1 The preferred option is that Council adopts the amended Liability Management Policy and Investment Policy that are attached to this report as Appendix 1 and 2. In order to apply for participation in the LGFA.

8.0 RECOMMENDATIONS

A) **THAT** Council adopts the Liability Management Policy and Investment Policy attached as Appendix 1 and 2.

Lesley Crichton
Group Manager: Corporate Services

Appendix 1: Liability Management Policy.

Appendix 2: Investment Policy.

LIABILITY MANAGEMENT POLICY

INTRODUCTION

Council's liabilities comprise of borrowings and various other liabilities. Council maintains borrowings in order to:

- Raise specific debt associated with projects and capital expenditures.
- Raise finance leases for fixed asset purchases.
- Fund assets whose useful lives extend over several generations of ratepayers.
- Council will not raise external debt to fund operating expenses, except where this relates to projects that will deliver economic benefits in excess of the total finance costs.

BORROWING LIMITS

Debt will be managed within the following limits:

Measure	Limit
Net Debt / Total Revenue	108%
Net Interest / Total Revenue	10%
Net Interest / Annual Rates Income	15%
Liquidity: (Liquid Investments + Term Debt + Available Facilities) / Term Debt	>110%

- 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 (e.g. developer contributions and vested assets).
- Net debt is defined as total debt less available liquid financial assets and investments.
- Liquidity is defined as external debt plus committed loan facilities plus available liquid investments and cash divided by external debt. Liquid investments are defined as being:
    - Overnight bank cash deposits
    - Wholesale/retail bank term deposits no greater than 30 days
- 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 LGs for services provided and for which the other LGs rate.
- Financial covenants are measured on Council only not the consolidated group.
- Disaster recovery requirements are to be met through the liquidity ratio.

GUARANTEES/CONTINGENT LIABILITIES AND OTHER FINANCIAL ARRANGEMENTS

Council may act as guarantor to financial institutions on loans or enter into incidental arrangements for organisations, clubs, Trusts, or Business Units, when the purposes of the loan are in line with Council's strategic objectives.

Council is not allowed to guarantee loans to Council-controlled trading organisations under Section 62 of the Local Government Act.

Financial arrangements include:

- Rural housing loans
- Tenant contribution flats
- Rural water supply or waste water loans
- Advances to community organisations

Council will ensure that sufficient funds or lines of credit exist to meet amounts guaranteed. At any time aggregate guarantees will not exceed the Council's available liquidity capacity.

INTERNAL BORROWING OF SPECIAL AND GENERAL RESERVE FUNDS

Council maintains certain reserve funds for future asset replacements and other projects. Where funds are required for capital expenditure internal borrowing from these funds will be used for in preference to external borrowing. Accordingly Council maintains its funds in short term maturities emphasising counterparty credit worthiness and liquidity. The interest rate yield achieved on the funds therefore is a secondary objective. Notwithstanding, short term investments may be held in excess of those required by covenants should the interest yield exceed Council's cost of finance, and where maturity dates are synchronised.

Liquid assets will not be required to be held against special funds or reserve funds unless such funds are held within a trust requiring such. Instead, Council will manage these funds using internal borrowing facilities against general reserves.

Any internal borrowing of reserve funds used must be reimbursed for interest revenue lost. Interest on internally-funded loans is determined and charged annually, based on year-end loan balances at the agreed three-year fixed interest rate. Except where a specific rate has been approved for particular circumstances, the three-year rate is set annually at the start of the financial year, based on the three-year swap rate plus the funding margin. The funding margin is based on the margin charged by the LGFA for a 3-year term.

SECURITY

Council's external borrowings and interest-rate risk management instruments will generally be secured by way of a charge over rates and rates revenue offered through a Deed of Charge which is proposed to be changed to a Debenture Trust Deed. Under a Deed of Charge or Debenture Trust Deed, Council's borrowing is secured by a floating charge over all Council rates levied under the Local Government (Rating) Act 2002. The security offered by Council ranks equally or pari passu with other lenders.

From time to time, and with Council approval, security may be offered by providing a charge over one or more of Councils assets.

Physical assets will be charged only where:

- There is a direct relationship between the debt and the purchase or construction of the asset, which it funds (e.g. an operating lease, or project finance).
- Council considers a charge over physical assets to be appropriate.
- Any pledging of physical assets must comply with the terms and conditions contained within the security arrangement.

DEBT REPAYMENT

The funds from all asset sales and operating surpluses will be applied to the reduction of debt and/or a reduction in borrowing requirements, unless the Council specifically directs that the funds will be put to another use.

Debt will be repaid as it falls due in accordance with the applicable loan agreement. Subject to the debt limits, a loan may be rolled over or re-negotiated as and when appropriate. The maximum period for any single tranche of external debt will be twenty years.

Council will manage debt on a net portfolio basis and will only externally borrow when it is commercially prudent to do so.

ASSET MANAGEMENT PLANS

In approving new debt Council considers the impact on its borrowing limits as well as the economic life of the asset that is being funded and its overall consistency with Council's LTP.

BORROWING MECHANISMS

Council is able to borrow through a variety of market mechanisms including issuing stock/bonds, commercial paper (CP) and debentures, direct bank borrowing, LGFA, accessing the short and long-term wholesale/retail debt capital markets directly or indirectly, or internal borrowing of reserve and special funds. In evaluating strategies for new borrowing (in relation to source, term, size and pricing) the following is taken into account:-

- Available terms from banks, LGFA, debt capital markets and loan stock issuance.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and margins relative to term for loan stock issuance, LGFA, debt capital markets and bank borrowing.
- The market's outlook on future credit margins and interest rate movements as well as its own.
- Ensuring that the implied finance terms and conditions within the specific debt (e.g. project finance) are evaluated in terms such as cost/tax/risk limitation compared to the terms and conditions Council could achieve in its own right.
- Legal documentation and financial covenants considerations.
- For internally funded projects, to ensure that finance terms for those projects are at least as equitable with those terms from external borrowing.
- Alternative funding mechanisms such as leasing should be evaluated with financial analysis in conjunction with traditional on-balance sheet funding. The evaluation should take into consideration rights and obligations, redemption value and effective cost of funds.

Council's ability to readily attract cost effective borrowing is largely driven by its ability to rate, maintain a strong financial standing and manage its relationships with its investors, LGFA, and financial institutions/brokers.

INVESTMENT POLICY

INTRODUCTION

Council generally holds investments for strategic reasons where there is some community, social or economic benefit accruing from the investment activity, or because it is required to do so by covenant. Generating a commercial return on strategic investments is considered a secondary objective. Investments and associated risks are monitored and managed, and regularly reported to Council. Specific purposes for maintaining investments include:

- strategic purposes consistent with Council's Long Term Plan
- provide alternative funds to rates for future commitments
- retention of vested land
- holding short term investments for working capital requirements
- support inter-generational allocations
- provide liquid funds in the event of an emergency
- funding for Restricted Reserves and Council Created Reserves
- investing proceeds from the sale of assets

Council recognises that as a responsible public authority all investments held, should be low risk and that this generally mean lower returns.

OBJECTIVES

In its financial investment activity, Council's primary objective when investing is the protection of its investment capital and that a prudent approach to risk/ return is always applied within the confines of this policy. Accordingly, only approved credit-worthy counterparties are acceptable. The Council will act effectively and appropriately to:

- protect its investments
- ensure the investments benefit the community
- maintain a prudent level of liquidity and flexibility to meet both planned and unforeseen cash requirements

POLICY

The Council's general policy on investments is that:

- Council may hold financial, property, forestry, and equity investments if there are strategic or economic reasons
- Council will keep under review its approach to all major investments and the credit rating of approved financial institutions.
- Council will review its policies on holding investments at least once every three years.

ACQUISITION OF NEW INVESTMENTS

With the exception of financial investments, new investments are acquired if an opportunity arises and approval is given by the appropriate Council committee, based on advice and recommendations from Council officers. Before approving any new investments, Council gives due consideration to the contribution the investment will make in fulfilling Council's strategic objectives, and the financial risks of owning the investment.
The authority to acquire financial investments is contained within the delegation manual.
Performance of Council's investment portfolio is reported quarterly.

INVESTMENT MIX

Council may maintain the following mix of investments:

Equity investments

Council maintains equity investments in Council Controlled Organisations [CCOs] and other minor shareholdings. Council's equity investments fulfil various strategic, economic and financial objectives as outlined in the LTP.

Council seeks to achieve an acceptable rate of return on all its equity investments consistent with the nature and purpose of the investment. Dividends received from CCOs and unlisted companies not controlled by Council are recognised when they are received in the consolidated revenue and expense account.

Any purchase or disposition of equity investments requires Council approval and any gain or loss arising from the sale of these investments is to be recognised in the Statement of Financial Performance.

Council may also acquire shares that are gifted or are a result of restructuring.

Unless otherwise directed by Council, the proceeds from the disposition of equity investments will be used firstly to repay any debt relating to the investment and then included in the relevant consolidated capital account.

Council recognises that there are risks associated with holding equity investments and to minimise these risks Council, or nominated Committee, monitors the performance of its equity investments on a twice yearly basis to ensure that the stated objectives are being achieved. Council seeks professional advice regarding its equity investments when it considers this appropriate.

New Zealand Local Government Funding Agency Limited

Council may invest in shares and other financial instruments of the New Zealand Local Government Funding Agency Limited (LGFA), and may borrow to fund that investment.
The Council's objective in making any such investment will be to:

- Obtain a return on the investment.
- Ensure that the LGFA has sufficient capital to become and remain viable, meaning that it continues as a potential source of debt funding for the Council.

Due to these dual objectives, the Council may invest in LGFA shares in circumstances in which the return on that investment is potentially lower than the return it could achieve with alternative investments. If required in connection with the investment, the Council may also subscribe for uncalled capital in the LGFA and act as guarantor.
As a borrower, Council's investment is recognised through shares and borrower notes. As an investor in LGFA shares and as a Guarantor, Council subscribes for uncalled capital in the LGFA.

Property investments

Council's overall objective is to only own property that is necessary to achieve its strategic objectives.
As a general rule, Council will not maintain a property investment where it is not essential to the delivery of relevant services, and property is only retained where it relates to a primary output of Council. Council reviews property ownership through assessing the benefits of continued ownership in comparison to other arrangements which could deliver the same results. This assessment is based on the most financially viable method of achieving the delivery of Council services. Council generally follows similar assessment criteria in relation to new property investments.
Council reviews the performance of its property investments on a regular basis. All income, including rentals and ground rent from property investments is included in the consolidated revenue account.
All rented or leased properties will be at market rentals, except where Council has identified a level of subsidy that is appropriate.
Properties for sale are to be marketed in accordance with statutory requirements and in a manner that does not disrupt the market place, and in consultation with Community Boards and Committees where appropriate.
Any purchased properties must be supported by a current registered valuation, substantiated by management including a fully worked capital expenditure analysis.

Forestry investments

Forestry assets are held as long term investments on the basis of net positive discounted cash flows, factoring in projected market prices and annual maintenance and cutting costs.
All income from forestry is included in the consolidated revenue account.
Any disposition of these investments requires Council approval. The proceeds from forestry disposition are used firstly to repay related borrowings and then included in the relevant consolidated capital account.

Financial investments

Council's primary objectives when investing is the protection of its investment capital. Accordingly, Council may only invest in approved creditworthy counterparties. Credit ratings are monitored and reported quarterly to Council.
Council may invest in approved financial instruments as set out below:

Short Term (up to 90 days)

- Call and Short term bank deposits
- Bank registered certificates of deposit (RCDs)

Core investments

- LGFA borrower notes / CP / bills / bonds
- NZ Government, Local Authority stock or State Owned Enterprise (SOE) bonds
- Bank and corporate bonds (senior)
- Corporate promissory notes/Commercial paper (senior)

All investments must be senior in ranking. The following types of investments are expressly excluded;

- Structured debt where the issuing entities are not a primary borrower/issuer
- Sub-ordinated debt (other than Borrower Notes subscribed from the LGFA), junior debt, perpetual bonds and hybrid notes such as convertibles

These investments are aligned with Council's objective of investing in high credit quality and highly liquid assets.

Council's investment portfolio will be arranged to provide sufficient funds for planned expenditure and allow for the payment of obligations as they fall due. Council prudently manages liquid financial investments as follows:

- Any liquid investments must be restricted to a term that meets future cash flow and capital expenditure projections.
- Interest income from financial investments is credited to general funds, except for income from investments for special funds, reserve funds and other funds where interest may be credited to the particular fund.
- Internal borrowing will be used wherever possible to avoid external borrowing.

Special funds and reserve funds

Liquid assets are not required to be held against special funds and reserve funds. Instead Council will internally borrow or utilise these funds wherever possible.

Trust funds

Where Council hold funds as a trustee, or manages funds for a Trust then such funds must be invested on the terms provided within the Trust. If the Trust's investment policy is not specified then this policy should apply.

Loan Advances

Council may provide advances to CCOs, CCTOs, charitable trusts and community organisations for strategic purposes only. New loan advances are by Council resolution only. Council does not lend money, or provide any other financial accommodation, to a CCO or CCTO on terms and conditions that are more favourable to the CCO or CCTO than those that would apply if Council were borrowing the money or obtaining the financial accommodation.
Council reviews performance of its loan advances on a regular basis to ensure strategic and economic objectives are being achieved. The GMCS monitors loan advances and reports to Council quarterly.

RISK MANAGEMENT

Investment Maturity/Interest Rate Risk Control Limits

Council's primary objective when investing is the protection of its investment. Accordingly, only high quality creditworthy counterparties are acceptable. Creditworthy counterparties (other than Government) are selected on the basis of their current Standard and Poor's (S&P) or equivalent rating (i.e. Fitch, Moody's).

Within the above credit constraints Council also seeks to:

- Ensure investments are negotiable and liquid
- Optimise investment return within policy maturity limits; and
- Manage potential capital losses if investments need to be liquidated before maturity.

The following operating principles capture Council's investment objectives as stated above and form the basis for its investment activity:

- Credit risk is minimised by placing maximum issuer and portfolio limits for each broad class of non-Government issuer and by limiting investments to strongly rated registered banks, local authorities, SOE's and corporates, and issuers secured by rates within prescribed amounts.
- Liquidity risk is minimised by ensuring that all negotiable investments must be capable of being liquidated in a readily available secondary market. Furthermore, Council must maintain at least 50% of its investments with a maturity of less than one year. The maximum investment term is no greater than 2 years.

An important objective of the financial investment portfolio is to match the portfolio's maturity term to planned expenditure thereby ensuring that investments are available when required. Financial investments should be restricted to a term that meets future cash flow projections and be mindful of forecast debt associated with future capital expenditure programs as outlined within the LTP.

Foreign Exchange Risk

Council has foreign exchange exposure through the occasional purchase of foreign exchange dominated plant, equipment and services. The library may also purchase items in foreign currency amounts.

Generally, all significant commitments for foreign exchange are hedged using foreign exchange contracts, once expenditure is committed and approved. Routine small payments are converted at the spot exchange rate on the date of payment. Both spot and forward foreign exchange contracts can be used by Council.

Council shall not borrow or enter into incidental arrangements, within or outside New Zealand, in currency other than New Zealand currency.

Counterparty Credit Risk

Counterparty credit risk is the risk of losses (realised or unrealised) arising from a counterparty defaulting on a financial instrument where the Council is a party. The credit risk to the Council in a default event will be weighted differently depending on the type of instrument entered into.
Credit risk will be regularly reviewed by the Council. Treasury related transactions would only be entered into with organisations specifically approved by the Council.
Counterparties and limits can only be approved on the basis of long-term Standard & Poor's, (S&P) credit ratings (or equivalent Fitch or Moody's rating) being A and above and/or short term rating of A-1 or above.
Limits should be spread amongst a number of counterparties to avoid concentrations of credit exposure.
The following matrix guide will determine limits:

Counterparty/issuer	Minimum S&P long term/short term credit rating	Investments maximum per counterparty ($m)	Risk management instruments maximum per counterparty ($m)	Total maximum per counterparty ($m)
NZ Government	N/A	Unlimited	None	Unlimited
Local Government Funding Agency (LGFA)	AA-/A-1	30.0	None	30.0
NZ Registered Bank	A/A-1	2.0	8.0	10.0
Local Government/SOE/Stock/Bonds/FRN/CP*	A+/A-1	1.0	None	1.0
Corporate Bonds/CP**	A+/A-1	1.0	None	1.0

* Subject to a maximum exposure no greater than 10% of the portfolio being invested in Local Government/SOE debt at any one point in time. The maximum portfolio exposure limit does not apply to the LGFA.
**Subject to a maximum exposure no greater than 20% of the portfolio being invested in corporate debt securities at any one point in time.

In determining the usage of the above gross limits, the following product weightings will be used:

- Investments (e.g. Bank Deposits) – Transaction Principal x Weighting 100% (unless a legal right of setoff exists).

- Interest Rate Risk Management (e.g. swaps, FRAs) – Transaction Notional x Maturity (years) x 3%.
- Foreign Exchange – Transaction face value amount x square root of the Maturity (years) x 15%.

To avoid undue concentration of exposures, financial instruments should be used with as wide a range of approved counterparties as possible. Maturities should be well spread. The approval process must take into account the liquidity of the market and prevailing market conditions the instrument is traded in and re-priced from.

DEPARTURES FROM NORMAL POLICY

The Council may, in its discretion, depart from the Investment Policies where is considers that the departure would advance its broader social or other policy objectives. Any resolution authorising an investment under this provision shall note that it departs from the Council's ordinary policy and the reasons justifying that departure.

INVESTMENT MANAGEMENT AND REPORTING PROCEDURES

Council's investments are reviewed on a regular basis, with sufficient minimum immediate cash reserves and a cash buffer maintained. The daily cash position is monitored and managed. Long-term cash flow is managed through a rolling forecast. To maintain liquidity, Council's short and long-term investment maturities are matched with Council's known cash flow requirements.

The performance of Council investments is regularly reviewed to ensure Council's strategic objectives are being met. Both performance and policy compliance are reviewed. Internal investment reports are a vital management tool and are produced and reported to Council on a quarterly and annual basis.

Report

WESTLAND DISTRICT COUNCIL

DATE: 24 August 2017

TO: Mayor and Councillors

FROM: Group Manager: Corporate Services

PARTICIPATION IN LOCAL GOVERNMENT FUNDING AGENCY – STATEMENT OF PROPOSAL

1 SUMMARY

1.1 The purpose of this report is to present the Statement of Proposal to participate in the Local Government Funding Agency (LGFA) as a borrower, and not as a Principle Shareholding Authority or as a Guaranteeing Local Authority for adoption and public consultation.

1.2 This issue arises due to Local Authorities having to face a number of debt related issues.

1.3 Council seeks to meet its obligations under the Local Government Act 2002 [LGA] and the achievement of the District Vision adopted by Council as part of the Long Term Plan 2015-25 [LTP] . These are stated on Page 2 of this agenda.

1.4 This report concludes by recommending that Council adopts the statement of proposal for participation in the Local Government Funding Agency as a borrower.

2 BACKGROUND

2.1 Local Authorities have significant existing and forecast debt requirements.

2.2 Pricing, length of funding term and other terms and conditions vary considerably across the sector and are less than optimal. This is due to limited debt sources, a fragmented sector and regulatory restrictions.

2.3 The New Zealand local authorities and central government undertook a detailed review and analysis of the borrowing environment in which New Zealand local authorities borrow.

2.4 The LGFA was developed to create the opportunity for a centralised local authority debt vehicle to generate significant benefits, due to the similar nature of local authorities, the large sector borrowing requirements and strong security position of local authorities.

2.5 LGFA provides:
- 2.5.1 Cheaper borrowing costs.
- 2.5.2 Scale, and is less fragmented.
- 2.5.3 Reliable access to long term funding.
- 2.5.4 Access to international funding markets.
- 2.5.5 Less reliance restricted to NZ funding market.
- 2.5.6 Improved credit rating and liquidity.

3 CURRENT SITUATION

3.1 The Council currently holds debt of $16.8m and is proposing to participate in the LGFA scheme because it believes participation provides an opportunity to borrow at lower interest margins, and that the benefit outweighs any costs and risks associated with the LGFA scheme.

3.2 Analysis of the costs and benefits is included in Part C of the information Memorandum included in the Statement of Proposal attached as **Appendix 1**.

3.3 Council proposes to access long-term core intergenerational debt through the LGFA, and use committed bank facilities for short-term debt purposes.

4 OPTIONS

4.1 Do nothing

4.2 Adopt the statement of proposal attached as **Appendix 1**.

4.3 Adopt a modified statement of proposal.

5 SIGNIFICANCE AND ENGAGEMENT

5.1 The decision to adopt a statement of proposal is in itself administrative and of low significance. By reference to Council's policy on Significance and Engagement the matter considered in the Statement of Proposal attached as **Appendix 1** is deemed to be of moderate significance.

5.2 Section 56 of the Local Government Act 2002 (**LGA 2002**) provides that a proposal to establish a council-controlled organisation (**CCO**) (which includes a CCTO) must be adopted following consultation in accordance with section 82 before a local authority may establish or become a shareholder in the CCO.

5.3 At any level of participation (including as a borrower), the Council either will become a shareholder, or will enter into commitments that could result in it becoming a shareholder in LGFA.

5.4 Consultation is required to be undertaken via the Special Consultative Procedure in accordance with s82 LGA.

6 ASSESSMENT OF OPTIONS (INCLUDING FINANCIAL IMPLICATIONS)

6.1 Do nothing
Since the matter is considered sufficiently significant to require consultation the matter cannot proceed without a statement of proposal.

6.2 Adopt the Statement of Proposal attached as **Appendix 1**.
A formal consultation on this matter allows Council to fully examine the potential consequences of the matter and for the community to provide input to the process. Council can consult via its existing media, as expressed in the Statement of Proposal, at relatively low cost.

6.3 Adopt a modified statement of proposal.
Council may wish to amend the proposal.

7 PREFERRED OPTION AND REASONS

7.1 The preferred option is 2: Adopt the Statement of Proposal attached as **Appendix 1**. This represents the most viable and efficient option based on the analysis completed to date. It would allow consultation to proceed.

8 RECOMMENDATIONS

A) <u>**THAT**</u> Council adopts the Statement of Proposal attached as **Appendix 1**.

Lesley Crichton
<u>Group Manager: Corporate Services</u>

Appendix 1: Statement of Proposal to participate in the Local Government Funding Agency as a borrower.

STATEMENT OF PROPOSAL

Westland District Council
Participation in New Zealand Local Government Funding Agency Limited

Date: 24 August 2017

CONTENTS

Introduction

The Westland District Council is considering participating in the New Zealand Local Government Funding Agency Limited (**LGFA**), which is a council-controlled trading organisation (**CCTO**).

Council is proposing it will participate as a borrower but not as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority.

The LGFA is established by the local authority sector and the Crown to enable local authorities to borrow at lower interest margins than would otherwise be available. The LGFA is recognised in legislation.

All member local authorities are able to borrow from the LGFA, but different benefits apply depending on the level of participation. Most local authorities borrowing from LGFA will have some shareholding and/or enter into guarantees in favour of the LGFA and other local authorities. This is certainly the case for Principal Shareholding and Guaranteeing Local Authorities. Local authorities which borrow from the LGFA without entering into the guarantee will only be able to borrow a limited amount, and will be required to pay higher funding costs.

Principal Shareholding Local Authorities are required to invest capital in the LGFA, but expected to receive a return on that capital.

Any local authority that borrows from the LGFA will be required to provide LGFA with subordinated debt (borrower notes, to the value of a percentage of the amount borrowed). These borrower notes will be held by the local authority while the borrowing is outstanding and may be certain situations convert to redeemable preference shares in LGFA.

An Information Memorandum, describing the arrangements in detail, is attached as Appendix 1, and forms part of this proposal. A number of terms which are used in this proposal are defined in that Information Memorandum.

Summary of Proposal

Given the short nature of this entire Statement of Proposal, Council is not producing a separate summary.

Statutory Considerations

Section 56 of the Local Government Act 2002 (**LGA 2002**) provides that a proposal to establish a council-controlled organisation (**CCO**) (which includes a CCTO) must be adopted following consultation in accordance with section 82 before a local authority may establish or become a shareholder in the CCO. At any level of participation (including as a borrower), the Council either will become a shareholder, or will enter into commitments that could result in it becoming a shareholder, in LGFA. The purpose of this consultation is to enable the Council to enter into these commitments.

Reasons for Proposal

The Council is proposing participating in the LGFA Scheme because it believes it provides an opportunity that will enable it to borrow at lower interest margins, and that this benefit outweighs any costs and risks associated with the LGFA Scheme. A discussion of these costs and benefits is included as Part C of the Information Memorandum.

The Council is proposing to participate solely as a potential borrower and not as a Principal Shareholding Local Authority or a Guaranteeing Local Authority for two reasons:

(a) Council's view is that for the Westland District Council the risks associated with being a Principal Shareholding Local Authority or a Guaranteeing Local Authority outweighs the rewards.
(b) Westland District Council is not in a position to commit the required capital to be a Principal Shareholding Local Authority.

The Council is consulting on this proposal for the reasons set out above under "Statutory Considerations".

Analysis of Reasonably Practicable Options

The reasonably practicable options are as follows:

1. **Participate in the LGFA Scheme as a Principal Shareholding Local Authority.**

2. **Participate in the LGFA Scheme as a Guaranteeing Local Authority, but not a Principal Shareholding Local Authority.**

3. **Participate in the LGFA Scheme, but not as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority, but simply as a borrower.**

4. **Not participate in the LGFA Scheme.**

Part C of the Information Memorandum sets out an analysis of the costs and benefits of participating in the LGFA Scheme. That analysis is supplemented by some consideration of the Council's specific circumstances below.

Q. Should the Council participate in the LGFA Scheme as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority?

Investing in the LGFA Scheme as a Principal Shareholding Local Authority would provide the lowest cost option for borrowing by:

(a) As discussed in the Information Memorandum (in Part C), a return will be paid on the capital investment made by Principal Shareholding Local Authorities.

(b) If the Council participates as a Principal Shareholding Local Authority, that increases the chance that the LGFA Scheme will be viable, and that the Council will be able to gain the benefits of participating in it.

However, there is an associated shared risk through:

- Westland District Council is not in a position to commit the required capital to be a Principal Shareholding Local Authority

- Principle Shareholding Local Authorities will be required to subscribe for uncalled capital which is equal in amount to its paid up equity contribution. LGFA would only call uncalled capital if there is a risk of imminent default. However, such a call is likely to be made before the guarantee or additional equity commitments are utilized.

- Guaranteeing Local Authorities being required to guarantee the obligations of all other Guaranteeing Local Authorities and the obligations of the LGFA.

- Guaranteeing Local Authorities commit to contributing additional equity to the LGFA if there an imminent risk that the LGFA will default.

(Refer to the *Summary of transactions a Council will enter into if it joins the LGFA Scheme* in Appendix 1 (Information Memorandum) for detail on what commitments will be made if participating as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority.)

The risk is assessed as low. Nonetheless it is a risk that the Council is proposing not to take.

Consequently, the Council is proposing that option (1) and option (2) NOT be adopted.

Q. Should the Council participate in the LGFA Scheme as a borrower (and not as a Principal Shareholding Local Authority or a Guaranteeing Local Authority)?

It is assumed that membership would be as a non-guaranteeing borrower so current LGFA pricing has been used for maturity terms 2021, 2022 and 2023. An amount of $15m has been assumed to be refinanced through issuing LGFA bonds of $5m for each maturity date. Upon repaying the bank debt, the equivalent of $15m of bank facilities would be cancelled. The Council estimates that the annual borrowing cost saving based on prevailing LGFA pricing is around $80,000 per annum.

Consequently, the Council proposes that Option (3) is adopted.

Investment Policy

The Council's Investment Policy includes a statement to make clear that the Council's investment activity includes the LGFA.

The primary objective for Council's interest in LGFA is to lower the Council's cost of borrowing.

Liability Management Policy

The Council's Liability Management Policy makes it clear that the Council may participate in the LGFA Scheme, including borrowing from the LGFA and entering into the transactions relating to that borrowing described in paragraph 63 of the Information Memorandum.

The primary objective of these changes is to allow borrowing by the Council at lower interest margins than it currently faces.

Opportunity to Make Submissions

This proposal will be distributed, and available for inspection and copying, as required by section 82A of the Local Government Act 2002.

This statement of proposal is available for inspection at Council's main office (36 Weld Street, Hokitika and any other place the Council considers appropriate to ensure all interested persons have a reasonable opportunity to view the proposal eg on Council's website; www.westlanddc.govt.nz. Visitor information centre, Library.

Submissions on this proposal must be in writing and addressed to the Council. Submissions may be sent either:

- by post to *the Group Manager, Corporate Services, Westland District Council,36 Weld Street, Private bag 704, Hokitika 7842*; or
- by email to consult@westlanddc.govt.nz.or
- Delivery to the Customer Service Centre, 36 Weld Street, Hokitika.

Submissions must be received no later than **5.00 pm** on **29 September 2017.**

Any person or organisation who makes a submission has a right to be heard by the Council. Submitters who wish to be heard must request this in their submission.

Every submission will be:

- acknowledged by the Council in accordance with the LGA 2002,
- copied and made available to the public.

The LGA 2002 requires the Council to make all written submissions on this consultation available to the public. This requirement is subject to the provisions of the Local Government Official Information and Meetings Act 1987. If you consider there to be compelling reasons why your contact details and/or submission should be kept confidential, you should advise within your submission.

The consultation process dates are as follows:

24 August 2017	adopts statement of proposal and summary of proposal
28 August 2017	public notice of proposal and consultation process in Local newspapers, Council website, electronic newsletter and local radio stations.
29 September 2017	submissions close at 5.00 pm
October 2017	If a hearing is necessary

Appendix 1

LOCAL GOVERNMENT FUNDING AGENCY SCHEME

INFORMATION MEMORANDUM

PART A – INTRODUCTION AND PURPOSE

Purpose of Information Memorandum

1. This Information Memorandum provides a description of the structure for local authorities (**LGFA Scheme**), which is designed to enable participating local authorities (**Participating Local Authorities**) to borrow at lower interest margins than they would otherwise pay.

2. The purpose of this Information Memorandum is to provide information to supplement any consultation materials prepared by local authorities consulting on whether to participate in the LGFA Scheme.

3. This Information Memorandum is divided into three parts:

(a) This Part A (Introduction and Purpose), which sets out the purpose of the Information Memorandum and provides some background on the purpose of, and rationale for, the LGFA Scheme.

(b) Part B (How the LGFA Scheme Works), which sets out the characteristics of the LGFA Scheme, and the transactions that Participating Local Authorities enter into as part of their participation in the LGFA Scheme.

(c) Part C (Local Authority Costs and Benefits), which sets out the costs and benefits to individual local authorities of participating in the LGFA Scheme.

Origin of the LGFA Scheme

4. The LGFA Scheme was developed by a group of New Zealand local authorities and central government. That development involved:

(a) undertaking a detailed review and analysis of:

(i) the borrowing environment in which New Zealand local authorities borrow; and

(ii) centralised local authority debt vehicle structures that have been developed offshore to successfully lower the cost of local authority borrowing;

(b) using this review and analysis to develop a funding structure (the LGFA Scheme), which is anticipated to deliver significant benefits to New Zealand local authorities;

(c) confirming with rating agencies that the proposed LGFA Scheme can achieve a high enough credit rating to deliver the anticipated benefits;

(d) obtaining formal central government support to facilitate establishment of the LGFA Scheme.

Rationale for LGFA Scheme

New Zealand Local Authority debt market

5. New Zealand local authorities face a number of debt related issues.

6. First, local authorities have significant existing and forecast debt requirements. Current long-term council community plans indicate that local authority debt will reach $20,036 million over the next 5 years.

7. Secondly, pricing, length of funding term and other terms and conditions vary considerably across the sector and are less than optimal. This is due to:

(a) Limited debt sources – Local authorities' debt funding options are limited to the banks, private placements and wholesale bonds (issuance to wholesale investors), and, to a lesser extent, retail bonds. Increasing local authority sector funding requirements and domestic funding capacity constraints are likely to further negatively impact pricing, terms and conditions and flexibility of local authority sector debt.

(b) Fragmented sector – There are 78 local authorities. Individually, a significant proportion of these local authorities lack scale - the 10 largest account for ~70%

(c) Regulatory restrictions - Offshore (foreign currency) capital markets are closed to local authorities and the process for local authority retail bond issuance is burdensome.

Addressing the local authority debt issues

8. Each of these issues needs to be addressed to rectify this situation. The LGFA Scheme rectified the situation by the following reasons:

(a) Individually, local authorities were not able to attain significant scale (except organically in the long-term).

(b) At a sector level it may be possible to address the issue regarding regulation, but regulators are likely to remain reluctant to significantly ease restrictions on financial management across the sector without gaining significant comfort as to the sophistication of the financial management of all local authorities. Even if this issue were addressed by regulators, this change alone would be insufficient to provide a major step change.

9. The LGFA Scheme was developed because of the homogenous nature of local authorities; the large sector borrowing requirements and the high credit quality / strong security position (i.e. charge over rates) of local authorities, created the opportunity for a centralised local authority debt vehicle to generate significant benefits.

10. There are numerous precedents globally of successful vehicles which pool local authority debt and fund themselves through issuing their own financial instruments to investors. Such vehicles achieve success through:

(a) "Credit rating arbitrage" – Attaining a credit rating higher than that of the individual underlying assets (local authority borrowers) and therefore being able to borrow at lower margins.

(b) "Economies of scale" – By pooling debt the vehicles can access a wider range of debt sources and spread fixed operating costs, thereby reducing the $ cost per $ of debt raised.

(c) "Regulatory arbitrage" – The vehicles can receive different regulatory treatment than the underlying local authorities, improving their ability to efficiently raise debt eg through access to offshore foreign currency debt markets.

11. The offshore precedents are typically owned by the local authorities in the relevant jurisdiction (often with central government involvement), and that is similar to the LGFA Scheme.

PART B – HOW THE LGFA SCHEME WORKS

Basic structure of the LGFA Scheme

12. The basic structure of the LGFA Scheme is that a company is established which will borrow funds and lend them on to local authorities at lower interest margins than those local authorities would pay to other lenders.

New Zealand Local Government Funding Agency Limited

13. LGFA was incorporated as a limited liability company under the Companies Act 1993 on 1 December 2011, and is subject to the requirements of the Local Government Act 2002. Its shares are held entirely by central government and by local authorities.

14. There are currently 31 shareholders comprising New Zealand Government at 20% and 30 Councils at 80%. As a result the LGFA is a council-controlled organisation.

15. The LGFA was established solely for the purposes of the LGFA Scheme, and its activities will be limited to performing its function under the LGFA Scheme.

16. A number of local authorities (**Principal Shareholding Local Authorities**) hold all, of those shares that are not held by central government. The Principal Shareholding Local Authorities have contributed capital and, as compensation for their capital contribution, will receive a pre-determined return on this capital. However, the over-arching objective is that the benefits of the LGFA Scheme are passed to local authorities as lower borrowing margins, rather than being passed to shareholders as maximised profits.

Design to minimise default risk

17. One of the things which is critical to the LGFA Scheme delivering its anticipated benefits is the achievement of a high credit rating for the LGFA (to achieve the credit rating arbitrage referred to in paragraph 10(a)). Consequently there are a number of features of the LGFA Scheme which are included to provide the protections for creditors which rating agencies require before agreeing to a high credit rating. These features are described in paragraphs 19 to 54 below.

18. Before agreeing to a high credit rating, rating agencies will consider the risks of both short term and long term default. Short term default is where a payment obligation is not met on time. Long term default is where a payment obligation is never met. In many cases short term default will inevitably translate into long term default, but this is not always the case – a short term default may be caused by a temporary liquidity problem (ie a temporary shortage of readily available cash).

Features of the LGFA Scheme designed to reduce short term default risk

19. When a local authority borrows, the risk of short term default, although low, is probably significantly higher than its risk of long term default. In the long term it can assess and collect sufficient rates revenue to cover almost any shortfall, but such revenue cannot be collected quickly. Consequently, there is a risk that inadequate liability and revenue management could lead to temporary liquidity problems and short term default.

20. The principal asset of the LGFA will be local authority debt, so such temporary liquidity risks are effectively passed on to the LGFA. Consequently, the rating agencies will look for safeguards to ensure that liquidity problems of a Participating Local Authority will not lead to a default by the LGFA.

21. There are two principal safeguards that the LGFA has put in place to manage short term default (liquidity) risk:

(a) It holds a certain amount of cash and other liquid investments (investments which can be quickly turned into cash).

(b) It has a borrowing facility with central government which allows it to borrow funds from central government if required.

22. It is expected that these safeguards will sufficiently reduce any short term default risk.

Features of the LGFA Scheme designed to reduce long term default risk

23. There are a number of safeguards that the LGFA has put in place to manage long term default risk, the most important of which are set out below:

(a) The LGFA requires all local authorities that borrow from it to secure that borrowing with a charge over that local authority's rates revenue (**Rates Charge**).

(b) The LGFA maintains a minimum capital adequacy ratio (or have some equivalent capital adequacy safeguard).

(c) The Principal Shareholding Local Authorities are required to subscribe for uncalled capital in an equal amount to their paid up equity contribution.

(d) The LGFA require most, or possibly all, Participating Local Authorities (**Guaranteeing Local Authorities**) to guarantee the obligations of all other Guaranteeing Local Authorities and the obligations of the LGFA.

(e) The Guaranteeing Local Authorities will commit to contributing additional equity to the LGFA if there an imminent risk that the LGFA will default.

(f) The LGFA hedge any exposure to interest rate and foreign currency fluctuations to ensure that such fluctuations do not significantly affect its ability to meet its payment obligations.

(g) The LGFA put in place risk management policies in relation to its borrowing and lending designed to minimise its risk. For example, it will impose limits on the percentage of lending which is made to any one local authority to ensure that its credit risk is suitably diversified.

(h) The LGFA ensure that its operations are run in a way that minimises operational risk.

24. Additional detail in relation to the features referred to in paragraphs 24(a) to 24(e) is set out below.

Rates Charge

25. All local authorities borrowing from the LGFA arerequired to secure that borrowing with a Rates Charge. Many but not all, local authorities have a Rates Charge in place already.

26. This is a powerful form of security for the LGFA, because it means that, if the relevant local authority defaults, a receiver appointed by the LGFA can assess and collect sufficient rates in the relevant district or region to recover the defaulted payments. Consequently, it significantly reduces the risk of long term default by a local authority borrower.

27. From a local authority's point of view it is also advantageous, because, so long as the local authority does not default, it is entitled to conduct its affairs without any interference or restriction. This contrasts with most security arrangements, which involve restrictions being imposed on a borrower's use of its own assets by the relevant lender.

Minimum capital

28. One important safeguard against long-term default for the LGFA will be having a minimum capital adequacy ratio (a ratio which measures the relative amounts of equity and debt-based assets which an entity has). This ratio is important, because it provides an indication of the ability of the LGFA to ultimately repay all of its debts despite local authorities that have borrowed from it defaulting or some other loss occurring.

29. The minimum capital adequacy ratio requirement is likely to be that the equity of the LGFA is an amount equal to at least 1.6% of its total assets.

Sources of equity for capital adequacy purposes

30. The equity held by the LGFA to ensure that it meets its minimum capital adequacy ratio requirement comes from two sources. First, central government and the Principal Shareholding Local Authorities contribute initial equity as the issue price of their initial shareholdings. Secondly, it is anticipated that each Participating Local Authority will, at the time that it borrows from the LGFA, contribute some of that borrowing back as equity.

31. The way the second source of equity works is that, whenever a Participating Local Authority borrows, it will not receive the full amount of the borrowing in cash. Instead, a small percentage of the borrowed amount will remain with the LGFA as equity. That percentage is to be 1.6% of the amount borrowed.

32. The equity contributed in this way is to be repaid when the borrowing is repaid, so, in effect, the amount which must be repaid will equal the cash amount actually advanced.

33. The equity is contributed by subscribing for "Borrower Notes". The LGFA may convert borrower notes into redeemable shares

34. To illustrate with an example, if a local authority borrowed $1,000,000 for five years from the LGFA, it would receive $984,000 in cash and $16,000 of Borrower Notes. At the end of the five years, it would repay $1,000,000, but would simultaneously redeem its Borrower Notes for $16,000, meaning its net repayment was equal to the $984,000 it initially received in cash.

35. A return will be paid on the Borrower Notes, which will be in the form of a dividend if they are redeemable preference shares. The amount will be the LGFA cost of funds plus 2.00%.. While it is anticipated that this return will be paid, it will be paid at the discretion of the LGFA.

36. There is some additional risk to Participating Local Authorities from this arrangement, because redemption of the Borrower Notes will only occur if the LGFA is able to pay its other debts. For example, if at the end of five years, the LGFA was insolvent, the local authority would have to repay $1,000,000, but would not receive its $16,000 back for redeeming its Borrower Notes.

Uncalled capital

37. Each Principal Shareholding Local Authority will be required to subscribe for uncalled capital which is equal in amount to its paid up equity contribution (**Uncalled Capital**).

38. It is anticipated that the Uncalled Capital will only be able to be called by the LGFA if it determines that there is a risk of imminent default if the call is not made. However, such a call is likely to be made before the Guarantee or additional equity commitment described below are utilised.

Guarantee

39. Participating Local Authorities are required to enter into a guarantee when they join the LGFA Scheme (**Guarantee**). Under the Guarantee the Guaranteeing Local Authorities guarantee the payment obligations of other Guaranteeing Local Authoritiesto the LGFA (**Cross Guarantee**), and guarantee the payment obligations of the LGFA itself (**LGFA Guarantee**).

40. The purpose of the Guarantee is to provide additional comfort to lenders (and therefore credit rating agencies) that there will be no long term default, though it may also be used to cover a short term default if there is a default which cannot be covered using the protections described in paragraphs 20 to 23 above, but which will ultimately be fully covered using the rates charge described in paragraphs 26 to 28. The Guarantee allows the LGFA to draw upon the resource of all Guaranteeing Local Authorities to avoid defaults.

Risk from Cross Guarantee

41. There are five factors which mitigate the risk to Guaranteeing Local Authorities under the Cross Guarantee:

(a) The risk only materialises if another Participating Local Authority defaults on its debt obligations. It is believed that no such default has ever occurred, which suggests that the risk of a local authority default is very low.

(b) If a Participating Local Authority defaults, but it is because of temporary liquidity problems only, the safeguards in place to cover temporary liquidity shortages may be sufficient for the LGFA never to have to call upon the Cross Guarantee. The detail of when the LGFA will be able to call upon the Cross Guarantee is not yet finalised, but it is likely that it will be restricted to situations in which there is a risk of an imminent default by the LGFA.

(c) It is anticipated that the Guarantee will only be called if a call on the Uncalled Capital does not generate sufficient funds to eliminate the risk of an imminent default by the LGFA.

(d) If a Participating Local Authority defaults, the burden will be shared by all Guaranteeing Local Authorities.

(e) If a Participating Local Authority defaults, the LGFA will exercise its rights under the Rates Charge to recover the payments defaulted on. The funds recovered through that exercise of rights will be passed on to the local authorities who have made payment under the Cross Guarantee, so those local authorities should, in the long term, be reimbursed for a significant portion, if not all, of the amount they have paid under the Cross Guarantee. The statutory processes involved in exercising these rights suggest that funds will be able to be recovered within 18 months of default.

LGFA Guarantee

42. The LGFA Guarantee will only ever be called if the LGFA defaults. Consequently, a call on the LGFA Guarantee will only occur if the numerous safeguards put in place to prevent an LGFA default fail. This is highly unlikely to happen.

43. If any such default did occur, and the Guaranteeing Local Authorities were called on under the LGFA Guarantee they could potentially be called on to cover any payment obligation of the LGFA. Such payment obligations may (without limitation) include obligations under the following transactions:

(a) A failure by the LGFA to pay its principal lenders.

(b) A failure by the LGFA to repay drawings under the liquidity facility with central government.

(c) A failure by the LGFA to make payments under the hedging transactions referred to in paragraph 24(f).

Guarantee risk shared

44. There is a mechanism to ensure that payments made under the Guarantee are shared between all Guaranteeing Local Authorities. The proportion of any payments borne by a single Guaranteeing Local Authority is likely to be based on the number of ratepayers in its district or region, or on some other statistic which is a proxy for its relative ability to make payments.

Rates Charge

45. It is possible that Guaranteeing Local Authorities will be required to provide a Rates Charge to secure their obligations under the Guarantee.

Benefits of being a Guaranteeing Local Authority

46. Participating Local Authorities are permitted not to be Guaranteeing Local Authorities, it will be on the basis that their borrowings are only allowed to reach a limited level, less than $20,000,000. Such local authorities will also be required to pay higher interest margins.

47. Guaranteeing Local Authorities will, therefore, have the benefit of not having this low limit on borrowing, and will pay lower funding costs.

Additional equity commitment

48. In addition to the equity contributions made in conjunction with borrowing, all Guaranteeing Local Authorities are likely to be required to commit to contributing equity if required under certain circumstances. It is expected that calls on any such commitments will be limited to situations in which there is a risk of imminent default by the LGFA.

49. A call for additional equity contributions will only be made if calls on the uncalled Capital and on the Cross Guarantee will not be sufficient to eliminate the risk of imminent default by the LGFA. Consequently, the factors which limit the risk in relation to the Cross Guarantee also apply here.

50. If an additional equity contribution is required, the LGFA will lend the money required to make that contribution to the relevant local authority. For example, if $100,000 was required, the LGFA might issue $100,000 of shares to the local authority and, in return, the local authority would owe it a debt of $100,000. Consequently, there would be no requirement on the local authority to immediately make a cash payment. However, such a debt would ultimately have to be paid if the LGFA never regained a position in which it could buy back the shares.

51. It is possible that Guaranteeing Local Authorities will be required to provide a Rates Charge to secure their obligations to contribute additional equity.

Initial purchase of a single share

52. It is possible that Guaranteeing Local Authorities may be required to initially subscribe for 1 share in the LGFA. This is so that, if they have an ongoing commitment to subscribe for shares when required, they will already be a shareholder in the LGFA. The significance of this is that they will not be required, when subscribing for further shares, to go through the special consultative process associated with becoming a shareholder in a council-controlled organisation.

Characteristics designed to make the LGFA Scheme fair for all Participating Local Authorities

53. The principal risk involved with the LGFA Scheme is that Participating Local Authorities will default on their payment obligations. The greater this risk is, the less attractive participation in the LGFA Scheme is for all Participating Local Authorities.

54. The Participating Local Authorities do not create this risk in equal amounts. There are some that carry a greater default risk than others, and therefore contribute disproportionately to the overall risk in the LGFA Scheme. Those local authorities are also the local authorities that would be likely to pay the highest interest margins if they borrowed outside the LGFA Scheme, and so potentially benefit the most from the LGFA Scheme.

55. To avoid, or at least minimise, what is effectively cross subsidisation of the higher risk local authorities by the lower risk local authorities different interest margins will be paid by different local authorities when they borrow from the LGFA, with those carrying the higher default risk paying the higher interest margins.

Viability of the LGFA Scheme dependent on participation levels

56. The modelling and other analysis done by Cameron Partners and Asia Pacific Risk Management (**APRM**) suggests that the LGFA Scheme will be viable (in that it will deliver sufficient benefits to justify its establishment and continued existence) if:

    (a) the LGFA maintains a high enough credit rating; and

    (b) sufficient funds are borrowed through it to obtain the economies of scale benefits referred to in paragraph 10(b).

57. An AA+ credit rating with Standard and Poor and Fitch is maintained.

58. Consequently, the participation of sufficient local authorities, both initially as Principal Shareholding Local Authorities (to contribute initial capital) and in meeting their ongoing borrowing requirements through the LGFA Scheme is critical.

59. The Principal Shareholding Local Authorities has collectively contributed $20 million by way of initial capital contribution. What this amounts to on a per-local authority basis will depend on the number of Principal Shareholding Local Authorities.

60. The Principal Shareholding Local Authorities are required to meet a certain proportion of their borrowing needs through the LGFA Scheme for an initial period, to ensure that the critical amount of utilisation is achieved.

Summary of transactions a Council will enter into if it joins the LGFA Scheme

61. If a Council joins the LGFA Scheme as a Principal Shareholding Local Authority, it will:

(a) subscribe for shares in the LGFA to provide it with capital (see paragraphs 16 and 31);

(b) possibly commit to meeting a certain proportion of its borrowing needs from the LGFA (see paragraph 62);

(c) borrow from the LGFA;

(d) subscribe for Uncalled Capital in the LGFA (see discussion in paragraphs 38 to 39 above);

(e) subscribe for Borrower Notes (see discussion in paragraphs 32 to 37);

(f) enter into the Guarantee (see discussion in paragraphs 40 to 45 above);

(g) commit to providing additional equity to the LGFA under certain circumstances (see discussion in paragraphs 49 to 53 above);

(h) possibly purchase one share in the LGFA at the time of joining the LGFA Scheme (see discussion in paragraph 54 above); and

(i) provide a Rates Charge to secure some or all of its obligations under the LGFA Scheme (see discussion in paragraphs 26 to 28, 46 and 53 above).

62. If a Council joins the LGFA Scheme as a Guaranteeing Local Authority, but not as a Principal Shareholding Local Authority, it will enter into the transactions described in paragraph 63, other than those described in paragraphs 63(a), 63(b) and 63(d).

63. If a Council joins the LGFA Scheme, but not as a Guaranteeing Local Authority (and therefore also not as a Principal Shareholding Local Authority) it will only enter into the transactions described in paragraph 63(e) and 63(i).

PART C - LOCAL AUTHORITY COSTS AND BENEFITS

64. The costs and benefits to a Participating Local Authority will depend on whether it participates as a Principal Shareholding Local Authority, a Guaranteeing Local Authority, or as neither.

Benefits to local authorities that borrow through the LGFA Scheme

65. The LGFA is able to borrow at a low enough rate for the LGFA Scheme to be attractive because of the three key advantages the LGFA will have over a local authority borrower described in paragraph 10. That is – exploiting a credit rating arbitrage, economies of scale and a regulatory arbitrage.

66. In addition, the LGFA provides local authorities with increased certainty of access to funding and terms and conditions (including the potential access to longer funding terms eg ~ 10 yrs+).

67. The potential savings for a local authority in terms of funding costs will depend on the difference between the funding cost to that local authority when it borrows from the LGFA and the funding cost to the local authority when it borrows from alternative sources. This difference will vary between local authorities.

68. The funding costs each local authority pays when it borrows from the LGFA will be affected by the following factors, some of which are specific to the local authority:

(a) the borrowing margin of the LGFA;

(b) the operating costs of the LGFA;

(c) any price adjustment made by the LGFA for that specific local authority as a result of:

(i) the credit quality of the local authority;

(ii) the size of the borrowings of that local authority from the LGFA; and

(iii) the local authority being a Guaranteeing Local Authority or not.

69. A diagram which shows what will affect the amount of any funding cost savings is set out as Annex 1.

70. Cameron Partners and APRM have developed a detailed financial model of the LGFA Scheme and analysed the current debt markets. The table set out in Annex 2 summarises the potential savings for local authorities depending on their credit status. (The modelling is based on conditions prevailing at December 2010 and on a number of assumptions regarding the LGFA, including its credit rating and the amount of loans it makes to local authorities.)

Costs to local authorities that borrow through the LGFA Scheme

71. The costs to Participating Local Authorities as a result of their borrowing through the LGFA Scheme take two forms:

(a) First, there are some risks that they will have to assume to participate in the scheme, which create contingent liabilities (ie costs which will only materialise in certain circumstances).

(b) Secondly, there is some cost associated with the Borrower Notes.

Risks

72. The features of the LGFA Scheme described above which are included to obtain a high credit rating are essentially steps which remove risk from lenders to make their residual risk low enough to justify the high credit rating. These features remove risk, in part, by transferring it to Participating Local Authorities.

73. These risks are that:

(a) in the case of Guaranteeing Local Authorities, a call is made under the Guarantee (see discussion in paragraphs 40 to 45 above);

(b) in the case of Guaranteeing Local Authorities, a call is made for a contribution of additional equity to the LGFA (see discussion in paragraphs 49 to 53 above); and

(c) in the case of all Participating Local Authorities, the LGFA is not able to redeem their Borrower Notes (see discussion in paragraphs 32 to 37).

74. Each of these risks is discussed in some detail in the paragraphs indicated next to the relevant risk. For the reasons set out in those discussions, it is anticipated that each of the risks is low.

Cost of Borrower Notes

75. As discussed in paragraphs 32 to 37, all Participating Local Authorities will be required to invest in Borrower Notes when they borrow from the LGFA. This carries a cost in addition to the risk referred to in paragraph 75(c), because the investment in Borrower Notes will be funded by borrowing from the LGFA, and the cost of this funding will be higher than the return paid on the Borrower Notes.

76. It is anticipated that the Borrower Notes will pay a discretionary payment equal to the LGFA's own cost of funds. Any discretionary payment is likely to be capitalised until maturity.

77. As noted in paragraph 36, while it is the intention for the LGFA to always pay the proposed annual payment on the Borrower Notes, such payments are at the LGFA's discretion so, in some situations, those payments may not be made.

Cost/benefit analysis for the investment by Principal Shareholding Local Authorities

78. In addition to those costs and benefits that all Participating Local Authorities are expected to receive in relation to their borrowing from the LGFA, Principal Shareholding Local Authorities will also hold shares in the LGFA (**Establishment Shares**).

79. Establishment shares will pay a discretionary annual payment, which is an amount up to the LGFA's own cost of funds plus 200 bps[1].

80. While it is the intention for the LGFA to always pay the annual payment on the Establishment Shares, this payment will not be made, or will be reduced, if the performance of the LGFA means that the LGFA does not consider it appropriate to make the payment.

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[1] A "bp" is a "basis point", which is a term that means "0.01%". 200 bps therefore refers to 2% of the amount invested.

81. Any local authority investor in Establishment Shares will also be required to subscribe for the same amount of Uncalled Capital in the LGFA. This Uncalled Capital can be called at the discretion of the LGFA under certain circumstances to ensure the ongoing viability of the LGFA. Once called the Uncalled Capital is called, it will have the same characteristics as Establishment Shares. This is an additional risk (and therefore contingent cost) for Principal Shareholding Local Authorities. Uncalled Capital is discussed in more detail in paragraphs 38 to 39 above.

Annex 1

DIAGRAM SHOWING FACTORS AFFECTING POTENTIAL SAVINGS

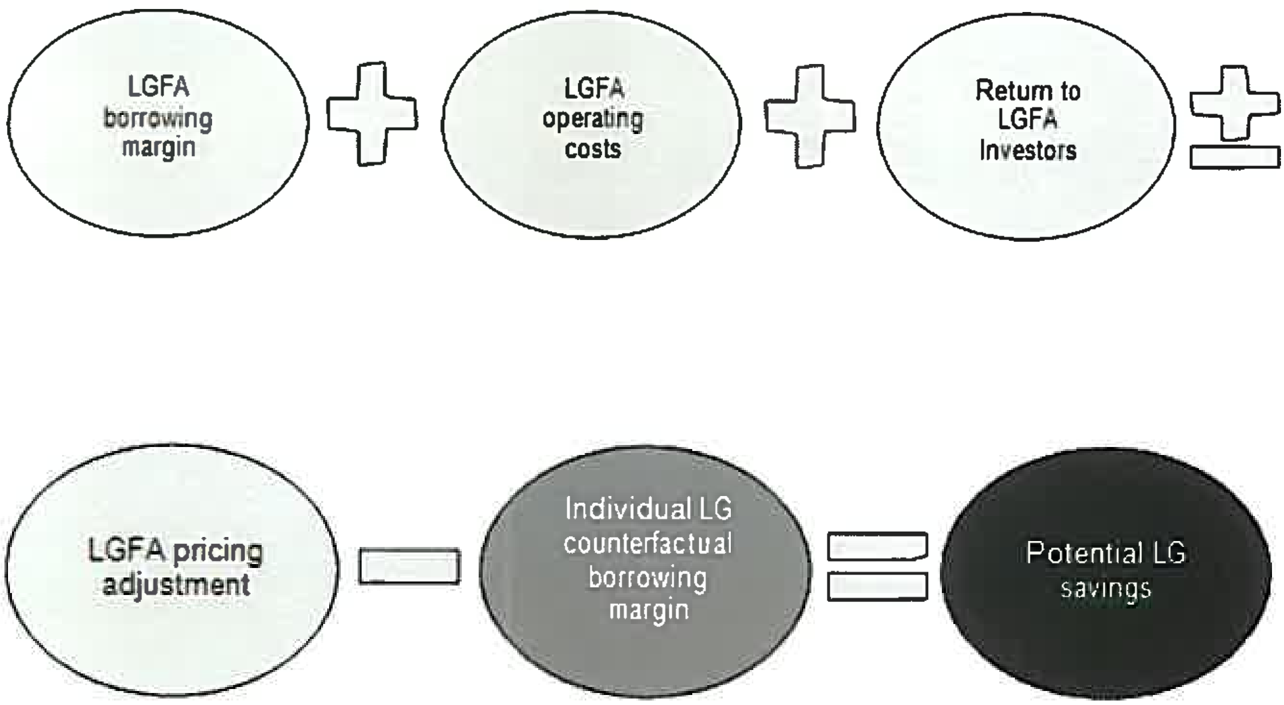

TABLE SHOWING ANTICIPATED PRICING BENEFITS

Cameron Partners and APRM have developed a detailed financial model of the LGFA Scheme and analysed the current debt markets. The following table summarises the potential savings for local authorities depending on their credit status and based on conditions prevailing at December 2010 and a number of assumptions regarding the LGFA (including its credit rating and the amount of loans it makes to local authorities).

Potential LGFA 5 Year Pricing Benefits (all bps*)						
LA Borrowers	LGFA Borrowing Margin	LGFA Operating Costs & Investor Returns	LGFA Pricing Adjustment	LGFA Pricing	Standalone LA Borrowing Rate	Potential LA Savings
AA+ rated	65	25	-10	80	120	40
AA rated	65	25	-5	85	125	40
AA- rated	65	25	0	90	130	40
A+ rated	65	25	5	95	135	40
A rated	65	25	10	100	140	40
Un-rated	65	25	15	105	155	50
As at December 2010						

* A "bp" is a "basis point" which is a term that means "0.01%"

Appendix 2

LIST OF ACTIONS FOR JOINING THE LGFA

1. LGFA notified of Westland's desire to join. This prompts LGFA to commence two processes:
    - The first is a credit analysis of Westland, and the
    - Second is an application for Westland to be accorded "Eligible Investor" status under the Securities Act.

Credit analysis takes about a week, but that a lot longer can be required if more than one Council is joining at the same time. For example, 3-4 weeks was not enough for one Council because a number of other Councils were joining at the same time.

The "Eligible Investor" application takes 2-3 weeks. Either way, the LGFA should be notified as soon as possible to get these processes under way.

2. Russell McVeagh (LGFA lawyers) are provided with Westland's Debenture Trust Deed and Registry Agreement, (refer to note 1) which they review and then provide a required list of amendments. Allow 2-3 weeks for this.

3. Then Council's lawyers prepare the required amendments (if any). This can be done within a few days.

4. Amendments are negotiated with the Registrar and Trustee. This can be done within a few days.

5. Russell McVeagh prepare accession documentation and Council lawyers review. This can be done within a few days.

6. Council lawyers prepare various ancillary documentation and Russell McVeagh reviews. This can be done within a few days.

7. Council lawyers send all documents out for signing. Elected members need to sign some documents, so this is sometimes held up a bit by constraints on their availability.

8. Council lawyers and Russell McVeagh check all documents as they come back. This is usually done within a day.

9. Council lawyers arrange for security stock to be issued and get registrar extracts. This can be done within a day.

10. Westland provides its Annual Rates Income number for the year ended 30 June. (This can be done any time in the process.)

11. Council lawyers prepare a legal opinion for the LGFA and the LGFA Security Trustee (Trustee Executors).

12. Council lawyers provide a conditions precedent sign-off to the LGFA Security Trustee.

WESTLAND DISTRICT COUNCIL

SUBMISSION ON THE PROPOSAL TO PARTICIPATION IN THE NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY LIMITED (LGFA)

This submission is a public document and the details provided will be available for viewing by members of the public.

Description of Proposal

Westland District Council has adopted the Statement of Proposal to participate in the New Zealand Local Government Funding Agency Limited. This means that Council will participate in the LGFA Scheme, but not as a Principal Shareholding Local Authority or as a Guaranteeing Local Authority, but simply as a borrower.

Under Section 82A of the Local Government Act 2002, the proposal is available for inspection and there is an opportunity to make submissions. The proposal is available at the Council's Customer Service Centre, 36 Weld Street, Hokitika, and also on Council's Website www.westlanddc.govt.nz.

The closing date for submissions is 29 September 2017 at 5pm

Send or Deliver to:	***Email to:***
Westland District Council	consult@westlanddc.govt.nz
Private Bag 704	
36 Weld Street	
Hokitika	

Name:	
Organisation (if applicable):	
Preferred contact details *(i.e. your postal address, or your email:*	
Phone No.	
Signature	
N.B. Your signature is not required if submitting by electronic means.	

1. **Please use one form for each submission.**
   Extra forms are available from the Council Office and online www.westlanddc.govt.nz.
2. **Indicate your attitude to the proposal.**
   i.e. I support/oppose/ are neutral to the application.
3. **Make your submission.**
   State clearly and in summary the nature of your submission. Give reasons.
4. **State any amendments you wish to have made.**
   Give details.
5. **State whether or not you wish to be heard by the Council at a hearing.**

I support /oppose / am neutral to the proposal *(circle one)*
My submission is:
Amendments I wish to have made:

(use separate paper if necessary)

1. Do you wish to be heard in support of your submission?	Yes	☐	No	☐
2. *If yes*, do you want to make a joint case with another party?	Yes	☐	No	☐
3. Do you require a language interpretor in order to present at the hearing? *If yes,* please specify your requirements.	Yes	☐	No	☐
4. Would you prefer to present via an audio or audio-visual link? *If yes, you will be contacted to discuss arrangements.*	Yes	☐	No	☐