

# LGFA Quarterly Report for period ended 31 March 2012

## 1. COMMENTARY ON OPERATIONS FOR THE QUARTER

Results of LGFA's inaugural bond tender held on 15 February 2012 were previously reported to shareholders in the LGFA Half Yearly Report to 31 December 2011.

On 21 March 2012 LGFA held its second bond tender. The same two maturities were offered to investors; \$85 million of the 15 April 2015 bond and \$180 million of the 15 December 2017 bond. As with the inaugural tender, volumes offered in each maturity reflected the preferences of the councils who participated (eight in total, including seven who were borrowing from LGFA for the first time). With \$265 million of bonds being issued in total, this brought bond issuance in the first two tenders to \$565 million, representing over 50% of expected issuance for the calendar year.

**Table 2: Results of LGFA Bond Tender Number 2 held on 21 March 2012.**

Tender Date: 21 Mar 2012  
Bids Close: 2.00pm  
Results: From 2.15pm  
Settlement Date: 26 Mar 2012

LGFA Bonds Offered:	15 Apr 2015	15 Dec 2017
Coupon Rate:	6.00%	6.00%
Amount Offered:	\$85 million	\$180 million
Total Bids Submitted:	\$194 million	\$765 million
Total Number of Bids Submitted:	16	47
Total Successful Bids:	\$85 million	\$180 million
Total Number of Successful Bids:	10	7
Successful Range:	3.96% - 4.05%	4.89% - 4.93%
Weighted Average Successful Yield:	4.01%	4.91%
Unsuccessful Range:	4.05% - 4.15%	4.93% - 5.05%
Weighted Average Unsuccessful Yield:	4.10%	4.98%

### Highlights of LGFA's second bond tender were:

- Over \$950 million of bids received for \$265 million of bonds offered, resulting in an overall bid cover ratio of 3.6 times. Although not quite as good as the first tender, this was still a strong result.
- Pricing at 107 bps over NZGBs for the December 2017 maturity and 78 bps over NZGBs for the April 2015 maturity. The improvement in pricing of the longer dated bond was an encouraging outcome.
- Pricing at an estimated 38 bps under Auckland Council for the December 2017 maturity was also very encouraging. As outstandings in our longer dated bond grow (currently \$430 million), trading activity in the secondary market is steadily improving the relative pricing of this maturity.
- A very tight successful bid range for the December 2017 maturity (4.89% - 4.93% ie just 4 bps). This was a marked improvement on the successful bid range of 33bps experienced in the inaugural tender of December 2017s.
- A total of 63 bids recorded for the tender, which continues to demonstrate widespread bidding activity in LGFA tenders.

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## 2. PERFORMANCE AGAINST OBJECTIVES AND PERFORMANCE TARGETS

### Primary Objective

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

- Providing debt to Participating Local Authorities at the lowest possible interest rates commensurate with the relevant maturity.

The primary objective has been achieved by:

- Holding two LGFA bond tenders in the past quarter. Tenders are the most efficient and transparent method of issuing debt.
- Undertaking an investor roadshow (Melbourne, Sydney, Auckland and Wellington) in late January 2012 to market the inaugural LGFA bond tender.
- Participating in conferences to further promote LGFA bonds to investors and intermediaries.

- Making longer-term borrowings available to Participating Local Authorities

From the inaugural tender held on 15 February 2012, borrowing terms in excess of five years (ie. the 15 December 2017 LGFA bond) have been made available to participating councils.

- Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice

On the one hand, access to debt markets has been enhanced by the success of the first two LGFA bond tenders. In particular, total bidding interest of around \$2.3 billion in these tenders indicates very strong investor demand for LGFA debt.

On the other hand, the uncertainty that a tender will be fully subscribed has prevented LGFA from making firm commitments to lend to participating councils. This issue is currently being addressed in the development of a guidance note on bond tenders for consideration by the LGFA Board. Further discussions are also planned with participating councils.

### Additional objectives

LGFA has a number of additional objectives which complement the primary objective. These objectives will be measurable and achievable and the performance of the company in achieving its objectives will be reported annually. These additional objectives are to:

- 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

By holding its first two bond tenders so soon after commencement of operations, LGFA is now forecasting a close to break-even result for the month of April 2012. A third bond tender in May 2012 is expected to generate a small profit for that month, and therefore contribute towards the first scheduled dividend payment.

- Become the primary source of debt funding for Participating Local Authorities

It is pleasing to note that 11 (out of 18) participating councils have borrowed from LGFA following the first two bond tenders.

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- Operate in a manner to ensure LGFA is successful and sustainable in the long-term

The key to LGFA's long-term sustainability is to ensure that it can always fund councils at lower rates than they can fund themselves. In this respect, it is critically important that LGFA improves its relative pricing to Auckland Council as a market benchmark for funding all participating councils.

At end March, ANZ Credit Focus showed LGFA December 2017s trading at 45 bps under Auckland's September 2017s. This represents a significant improvement on the 32 bps margin achieved at LGFA's inaugural bond tender.

- Educate and inform all Local Authorities (both participating and non-participating) on matters within the scope of LGFA's operations

During the quarter, LGFA:

- Presented at two Shareholders' Council meetings on various aspects of its operations;
- Released its own media statement and assisted in the preparation of a LGNZ media statement on the successful outcome of the inaugural LGFA bond tender (both documents were distributed to all councils); and
- Met with Selwyn District, Timaru District, Waimate District and Dunedin City councils as part of an initial LGFA roadshow in the South Island.

- Become a leading participant in the New Zealand capital markets

We have attached two articles from the March 2012 edition of KangaNews which provide evidence of the support and status that LGFA has already achieved in New Zealand capital markets.

- Provide excellent service to Participating Local Authorities

Aspects of the first settlement process between LGFA, NZDMO and participating councils (in relation to the issue of LG securities and Borrower Notes) required improvement. It is pleasing to report that, with significant assistance from Mike Timmer, the second settlement process was successfully completed. No issues at all have been reported from the 8 councils who participated in the second bond tender.

- Ensure excellent communication exists and be professional in its dealings with all its stakeholders

During the quarter, LGFA:

- Met on several occasions with NZDMO to work on streamlining settlement processes involving councils, NZDMO, Computershare and LGFA;
- Maintained regular communication with intermediaries and investors to review and revise its debt issuance strategies; and
- Conducted numerous media interviews and contributed to bank research articles to ensure that markets (and the public generally) are well informed about LGFA's activities and operations.

- Ensure its products and services are delivered in a cost-effective manner

During the quarter, LGFA:

- Charged a "base" margin to councils that averaged 0.30%, well below the maximum permitted of 0.40%; and
- Restricted operating costs to less than \$200,000 per month, well below the maximum permitted of \$250,000.

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- Consult with Shareholders regarding the potential requirement for LGFA Borrowers to obtain comprehensive insurance cover

LGFA is planning to hold an initial meeting on this issue with the Chair of the Shareholders' Council in May 2012.

- Review the appropriateness of LGFA's "broker" business model

The "broker" business model has operated efficiently for the first two LGFA bond tenders and associated on-lending activity.

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

This has been achieved to date.

- Achieve the Financial Forecasts set out in section 4

LGFA's updated financial forecasts for key items set out in Section 4 of the SOI, for the periods ended 31 March and 30 June 2012 are:

	\$m 31 Mar 2012 Estimated	\$m 30 Jun 2012 Estimated	\$m 30 Jun 2012 Budget
Total Net Income	0.3	1.1	1.5
Overheads			
- Operating Costs	(0.4)	(1.1)	(1.4)
- Establishment Costs	(0.1)	(0.3)	-
- Total	(0.5)	(1.4)	(1.4)
Pre-Establishment Costs	(4.0)	(4.0)	(4.6)
Borrower Notes Interest	-	(0.1)	(0.1)
Retained Deficit	(4.2)	(4.4)	(4.6)

Note that establishment costs cover credit rating agency fees and implementation fees payable to NZDMO that have been invoiced since incorporation. These costs were originally budgeted as pre-establishment costs.

Note also that LGFA's financial results to 31 March 2012 are estimates only. NZDMO is currently developing a general ledger for LGFA's treasury transactions, while LGFA is installing a general ledger for its overhead costs. The latter is expected to be operational within two weeks.

- Achieve the Dividend Policy set out in section 6

Refer to our earlier comments on this issue.

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## **Performance Targets**

Six performance targets are specified for LGFA in the SOI. Progress against each of these targets is discussed below, including an explanation of any material variances.

	<b>Performance Measure</b>	<b>Target</b>	<b>Result</b>
1	Average cost of funds relative to NZGS	<0.50%	1.03%
2	Average margin above LGFA's cost of funds	<0.40%	0.30%
3	Annualised operating overheads	<\$3.0 million	\$2.0 million
4	Lending to participating councils	>\$500 million	\$541 million
5	Number of council shareholders	>30	18
6	Number of eligible borrowers	>40	19

There are two key reasons for LGFA's relative cost of funds averaging just over twice the target level of 50bps:

- A very high proportion (76%) of longer dated bonds was issued in the first two bond tenders. While this reflected council demand for funding, longer dated bonds are relatively more expensive to issue.
- Higher costs are incurred when bonds are initially issued, due to market uncertainty about pricing and the relative illiquidity of new bond maturities.

A major push to sign up new council shareholders and borrowers is planned for the June quarter.

### **Key initiatives include:**

- A letter from LGFA to all 60 non-participating councils seeking information on their plans to join LGFA (as shareholder, guarantor or borrower), and the current status of those plans.
- Building a database (in spread sheet format) to track councils' progress against their plans, and opportunities for LGFA to assist in the process.
- Recruiting a fourth LGFA staff member with principal duties including relationship management of the local government sector, and undertaking initial credit analysis of the LGFA's current and prospective borrowers.

## **3. DETAILS OF EVENTS OF REVIEW**

There have been no events of review in respect of any Participating Local Authority.