LGFA
NEW ZEALAND
LOCAL GOVERNMENT
FUNDING AGENCY

27 February 2015

Dear Shareholder

Draft Statement of Intent 2015/16

Please find attached a copy of the Draft Statement of Intent (SOI) for the 2015/16 year.

LGFA continues to focus on delivering strong results for both our council borrowers and shareholders.

For our borrowing councils we seek to optimize funding terms and conditions by

- Achieving savings in borrowing costs
- Provide longer dated funding and
- Provide certainty of access to markets

For our shareholders we are focused on

- Delivering a strong financial performance
- Monitoring asset quality
- Enhancing our approach to treasury and risk management and
- Ensuring we have the correct governance framework and capital structure in place

Compared to the previous 2014/15 SOI, the following points are worth noting

- Profitability is forecast to be significantly higher as a result of higher net interest revenue, with expenses being held at a similar level to the previous year.

- Net Interest revenue is forecast to be higher due to an increase in the value of loans to Local Government. We have increased our forecast for Local Government loans outstanding in June 2017 to $6.970 billion (from $6.484 billion in the previous SOI).

- We have made no changes to the on-lending margins from the previous year's SOI with the base margin forecast to be reduce to 10bps by June 2016. A decision on any further reductions in base lending margins will be made following the completion of the review of the LGFA capital structure in 2015. Any changes will flow through into next year's SOI.

- Operational expenditure is forecast to be slightly lower due to the cost of the new Treasury Management System being less than originally forecast.

- Issuance and on-lending costs are forecast to be higher due to a significant increase in forecast Approved Issuer Levy (AIL) payments (2015/16 $1.5 million) as a result of growing offshore investor participation in LGFA bonds. The positive impact from the growth in offshore investors

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is the diversification of the LGFA investor base and tighter borrowing margins in a period of rising debt issuance.

- Performance targets – while we are comfortable with most of the previous SOI performance targets there are two modifications that we are proposing

  "LGFA's average cost of funds relative to the average cost of funds for New Zealand Government securities of 50 bps". Currently this is measured over the entire historical period since LGFA first issued bonds in February 2012. We believe that this measure is less relevant both for our council borrowers looking to borrow today and as a meaningful assessment of the success of LGFA. While we wish to retain the aspirational target of 50 bps, we propose measuring outcomes on a historical rolling one year simple weighted average basis and a prior quarter simple weighted average basis.

  The primary objective of "Providing estimated savings in annual interest costs for all Participating Local Authorities of at least 30 basis points, based on the methodology set out in LGFA's Annual Report 2012-2013". This measure does not take into account any additional "LGFA effect" than that first measured in 2012. The "LGFA effect" is the positive impact that LGFA has had on council borrowing costs (measured through council borrowing margins). Given recent pricing behavior by banks and investors, LGFA believes that this additional LGFA effect is significant. Furthermore, the savings should also be measured over entire interest rate and credit market cycles rather than over one part of the cycle. LGFA's preference is to amend the objective by removing the exact 30 basis point savings target but still retain a savings objective. LGFA would report on the savings achieved on a quarterly basis and provide historical analysis for comparative purposes.

If you have any questions or wish to provide comments then please feel free to contact Mark Butcher, myself or any member of the Shareholders Council.

Yours sincerely

Craig Stobo

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