

***Preamble: This draft Statement of Intent has been prepared by the director designates of LGFA with the intention to negotiate and finalise it with proposed LGFA Shareholders prior to establishment. The finalised Statement of Intent will then be formally adopted by the LGFA Board once LGFA has been established.***

## **New Zealand Local Government Funding Agency Limited**

### **Draft Statement of Intent 2011/12**

#### **1. Introduction**

This Statement of Intent (SOI) sets out the intentions and expectations of New Zealand Local Government Funding Agency Limited (LGFA).

The LGFA is enabled under the Local Government Borrowing Act 2011 and is a council-controlled organisation (CCO) for the purposes of the Local Government Act 2002.

The SOI is prepared in accordance with section 64(1) of the Local Government Act 2002.

#### **2. Nature and scope of activities**

LGFA will raise debt funding either domestically and/or offshore in either NZ dollars or foreign currency and provide debt funding to New Zealand local authorities, and may undertake any other activities considered by the Board of LGFA to be reasonably related or incidentally to, or in connection with, that business.

The LGFA will only lend to local authorities that enter into all the relevant arrangements with it (Participating Local Authorities) and comply with the LGFA's lending policies.

#### **3. Objectives**

##### ***Principal Objectives***

In accordance with the Local Government Act 2002, in carrying on its business, the principal objectives of LGFA will be to:

- achieve the objectives of the shareholders (Shareholders) in LGFA (both commercial and non-commercial) as specified in this SOI;
- be a good employer;
- exhibit a sense of social and environmental responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so; and
- conduct its affairs in accordance with sound business practice.

### **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
- Making longer-term borrowings available to Participating Local Authorities commensurate with the relevant maturity
- Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice

### **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
- Become the primary source of debt funding for Participating Local Authorities
- Operate in a manner to ensure LGFA is successful and sustainable in the long-term
- Educate and inform all Local Authorities (both participating and non-participating) on matters within the scope of LGFA's operations
- Become a leading participant in the New Zealand capital markets
- Provide excellent service to Participating Local Authorities
- Ensure excellent communication exists and be professional in its dealings with all its stakeholders
- Ensure its products and services are delivered in a cost-effective manner
- Consult with Shareholders regarding the potential requirement for LGFA Borrowers to obtain comprehensive insurance cover
- Review the appropriateness of LGFA's "broker" business model
- Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency
- Achieve the Financial Forecasts set out in section 4
- Meet or exceed the Performance Targets outlined in section 5
- Achieve the Dividend Policy set out in section 6

## **4. Financial forecasts**

***[Clause 9(3) of Schedule 8 to the Local Government Act 2002 requires that financial information in the SOI, including forecasts, must be prepared in accordance with GAAP - NEED TO CONFIRM and reference section 12 Accounting Policies. To be reviewed and confirmed by PWC]***

A business case for LGFA has been developed. The Board has reviewed and ratified the assumptions that this business case is based on.

Based on the business case LGFA's financial forecasts for the three years to 30 June 2014 are:

Period to 30 June (\$m)	2012	2013	2014
Local Government Interest Income	9.9	31.2	52.1
LGFA Interest Expense	(8.4)	(27.2)	(46.4)
Net Liquidity Income	(0.0)	(0.1)	(0.1)
Total Net Income	1.5	3.9	5.6
Overheads	(1.7)	(3.2)	(3.3)
Net Profit	(0.2)	0.7	2.3
Borrower Notes Interest	(0.1)	(0.5)	(0.8)
Principal Shares Dividend	0	7	(0.7)
Retained Surplus / (Deficit)	(0.3)	(0.5)	0.8
Total Assets	621.5	1,099.5	1,605.8
Total Local Government Assets	565.0	999.5	1,459.8
Total Liabilities	592.4	1,063.9	1,562.0
Total Equity	29.2	35.6	43.8
Shareholder Funds / Total Assets	4.7%	3.2%	2.7%

Shareholder Funds means the aggregate of:

- Paid up Principal Share capital and Borrower Notes
- Retained earnings
- Asset revaluation reserves
- Other capital and revenue reserves

Total Assets shall mean the aggregate of:

- Current assets
- Investments
- Fixed assets
- Intangible assets

## 5. Performance targets

LGFA has the following performance targets:

- LGFA's average cost of funds relative to the average cost of funds for New Zealand Government Securities for the period to:
  - 30 June 2012 will be less than 0.50% higher
  - 30 June 2013 will be less than 0.50% higher
  - 30 June 2014 will be less than 0.40% higher

- The average margin above LGFA's cost of funds charged to the highest rated Participating Local Authorities will be no more than 0.40%
- LGFA's annualised operating overheads will be less than \$3.4 million
- Total lending to Participating Local Authorities at:
  - 30 June 2012 will be at least \$500 million
  - 30 June 2013 will be at least \$900 million
  - 30 June 2014 will be at least \$1,400 million
- The total number of Participating Local Authorities Shareholders in the LGFA at 30 September 2012 will be at least 30
- The total number of Participating Local Authorities (ie Shareholders and eligible Borrowers) in the LGFA at 30 September 2012 will be at least 40

## 6. Dividend policy

LGFA will seek to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders. Consequently it is intended to pay a limited dividend to Principal Shareholders.

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

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

## 7. Governance

### Board

The Board is responsible for the strategic direction and control of LGFA's activities. The Board guides and monitors the business and affairs of LGFA, in accordance with the Companies Act 1993, the Local Government Act 2002, the Local Government Borrowing Act 2011, the Company's Constitution, the Shareholders' Agreement for LGFA and this SOI.

The Board will comprise between four and seven directors with a majority of independent directors.

The Board's approach to governance is to adopt "best practice" with respect to:

- The operation of the Board
- The performance of the Board
- Managing the relationship with the Company's Chief Executive
- Being accountable to all Shareholders

All directors are required to comply with a formal Code of Conduct, to be developed and agreed with Shareholders. The Board will meet on a regular basis and no less than 11 times each year.

### **Shareholders' Council**

The Shareholders' Council is made up of ten appointees of the Shareholders (including an appointee from the Crown). The role of the Shareholders' Council is to:

- Review the performance of LGFA and the Board, and report to Shareholders on that performance on a periodic basis (no less frequently than quarterly)
- Make recommendations to Shareholders as to the appointment, removal, replacement and remuneration of directors
- Make recommendations to Shareholders as to any changes to policies, or the SOI, requiring their approval
- Ensure all Shareholders are fully informed on LGFA matters and to coordinate Shareholders on governance decisions

## **8. Information to be provided to Shareholders**

The Board aims to ensure that the Shareholders are informed of all major developments affecting LGFA's state of affairs, while at the same time recognising that commercial sensitivity may preclude certain information from being made public. The LGFA will adhere to a 'no surprises' approach in its dealings with its Shareholders.

### **Annual Report**

The LGFA's balance date is 30 June.

By 30 September each year, the Board will provide to the Shareholders an Annual Report complying with Sections 67, 68 and 69 of the Local Government Act 2002, the Companies Act and Financial Reporting Act. The Annual Report will contain the information necessary to enable an informed assessment of the operations of the company, and will include the following information:

- Directors' Report
- Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position, Statement of Cashflows, Statement of Accounting Policies and Notes to the Accounts
- Comparison of the LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances
- Auditor's Report on the financial statements and the performance targets
- Any other information that the directors consider appropriate

### **Half Yearly Report**

By 28 February each year, the Company will provide to the Shareholders a Half Yearly Report complying with Section 66 of the Local Government Act 2002. The Half Yearly Report will include the following information:

- Directors' commentary on operations for the relevant six month period

- Comparison of LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances
- Un-audited half-yearly Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position and Statement of Cashflows

#### **Quarterly Report**

By 30 April and 31 October each year, the Company will provide to the Shareholders Council a Quarterly Report. The Quarterly Report will include the following information:

- Directors' commentary on operations for the relevant quarter
- Comparison of LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances

#### **Statement of Intent**

By 1 March in each year the Company will deliver to the shareholder its draft SOI for the following year in the form required by Clause 9(1) of Schedule 8 and Section 64(1) of the Local Government Act 2002.

Having considered any comments from the Shareholders received by 30 April, the Board will deliver the completed SOI to the Shareholders on or before 30 June each year.

#### **Shareholder Meetings**

The Board will hold an Annual General Meeting between 30 September and 30 November each year to present the Annual Report to all Shareholders.

The Board will hold a meeting with the Shareholders' Council approximately every six months – prior to the Annual General Meeting and after the Half Yearly Report has been submitted. Other meetings may be held by agreement between the Board and the Shareholders' Council.

### **9. Acquisition / divestment policy**

LGFA will invest in securities in the ordinary course of business. It is expected that these securities will be debt securities. These investments will be governed by LGFA's lending and/or investment policies as approved by the Board and/or Shareholders.

Any subscription, purchase or acquisition by LGFA of shares in a company or organisation will, if not within those investment policies, require Shareholder approval other than as concerns the formation of wholly-owned subsidiaries and the subscription of shares in such wholly-owned subsidiaries.

### **10. Activities for which compensation is sought from Shareholders**

At the request of Shareholders, LGFA may (at its discretion) undertake activities that are not consistent with its normal commercial objectives. Specific financial arrangements will be entered into to meet the full cost of providing such as activities.

Currently there are no activities for which compensation will be sought from Shareholders.

## **11. Commercial value of Shareholder's investment**

LGFA will seek to maximise benefit to Participating Local Authorities as Borrowers rather than Shareholders.

Subject to the Board's views on the appropriate capital structure for LGFA, the Board's intention will be to pay a dividend that provides an annual rate of return to Principal Shareholders equal to LGFA cost of funds plus 2.00% over the medium term, including taking consideration of the time value of money at the target annual rate of return. Consequently LGFA will seek to operate so that it only generates sufficient free cash to enable this (ie no more and no less).

As the Shareholders will have invested in the LGFA on the basis of this limited dividend, the Board considers that at establishment the commercial value of LGFA is equal to the face value of the Shareholders' paid up Principal Shares - \$25 million.

## **12. Accounting policies**

LGFA has adopted accounting policies that are consistent with the New Zealand International Financial Reporting Standards, generally accepted accounting practice.



