

Shareholders' Council

Quarterly Monitoring Report

Q4 Review
to
30 June 2014

SUMMARY
<p>Three successful bond tenders totalling \$470m were undertaken during the June quarter. Majority of the tenders were for the April 2023 maturity, approximately 76% of the tenders.</p> <p>Strong support has continued from offshore investors and now reaching 18% of total bonds outstanding.</p> <p>The average cost of funds remained stable relative to NZ Government Stock (NZGS) during the quarter. The April 2023 bonds margins ranged from 0.87% to 0.90%.</p> <p>Both March 2019 and May 2021 bonds have now reached the key liquidity target level of \$1b.</p>

ISSUES AND RISKS
<p>Treasury Policy limit breach occurred during May in relation to a NZDMO error in executing interest rate swap transactions. Additional operating procedures are now in place to ensure that this will not occur. Generally LGFA operates under a matched exposures basis and any interest rate swap transactions are undertaken based on requirements by borrowing Councils. The erroneous swaps have now been reversed and there is no further exposure for LGFA.</p> <p>The 'Request for Tender' for a treasury system was issued to a selected group of vendors in June and now the shortlisting process is underway.</p> <p>Mark Butcher was appointed as Chief Executive on 1 July 2014. The Board have decided not to seek a replacement Director i.e. there will be five Directors in future. The Shareholders' Council agrees with this position given the skill coverage of the remaining Board members, which is appropriate for the current operating model.</p> <p>There have been no events of review in respect of any participating Council.</p>

KEY PERFORMANCE INDICATORS						
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MEASURE		Full Year	Q1	Q2	Q3	Q4
		30 Jun 13	30 Sep 13	31 Dec 13	31 Mar 14	30 Jun 14
Average cost of funds relative to NZ Government Stock.	Target %	<0.50	<0.50	<0.50	<0.50	<0.50
	Actual %	0.84 ✗	0.97 ✗	0.71 ✗	0.74 ✗	0.85 ✗
Average margin over COF	Target %	≤0.40	≤0.25	≤0.25	≤0.25	≤0.25
	Actual %	0.23 ✓	0.18 ✓	0.15 ✓	0.15 ✓	0.15 ✓
*Estimated interest cost savings (%)	Target %	≥0.30	≥0.30	≥0.30	≥0.30	≥0.30
	Actual %	0.30 ✓	0.23 ✗	0.25 ✗	0.23 ✗	0.23 ✗
Annualised issuance and operating expenses	Target \$m	<3.2	<3.2	<3.2	<3.2	<3.2
	Actual \$m	3.0 ✓	2.8 ✓	3.0 ✓	3.2	3.3 ✗
Lending to participating councils	Target \$m	>900	2,695	2,945	3,195	3,400
	Actual \$m	2,481 ✓	2,791 ✓	3,055 ✓	3,227 ✓	3,697 ✓

*For AA rated borrowers based on March 2019 maturity. This provides the most reliable market information as a basis for calculations.

The KPI measures over which the LGFA has a high degree of control are average margin charged to Councils and operating expenses. The average margin charged to Councils has met the KPI and operating expenses were higher than forecast by \$80k mainly resulting from increased Approved Issuer Levy (AIL) payments. Increases in AIL are more than offset by pricing benefits achieved from attracting offshore investors.

The KPI measures which the LGFA has limited influence and were not achieved during the quarter.

- Margins over NZGS increased during the quarter, mainly resulting from the large portion of the issuance in the longest maturity (April 2023), which accounted for 76% of the total issuance in the quarter; and
- Increase in the offshore holdings improved the pricing performance and has allowed issuance of longer dated bonds.

The Shareholders' Council are comfortable with all the KPI levels above and expect the LGFA to increasingly comply with the targets over the SOI period to June 2016.

ACTIVITIES

Bond tenders (nos. 19 to 21) totalling \$470m was issued during the quarter. 76% of these tenders were for the April 2024 maturity. Bid to cover ratio averaged at 2.34 times for the quarter.

Margins against both NZGS and Swap bench mark rates increased for the March 2019 maturity during the quarter while margins for the May 2021 and April 2023 maturities remained relatively flat.

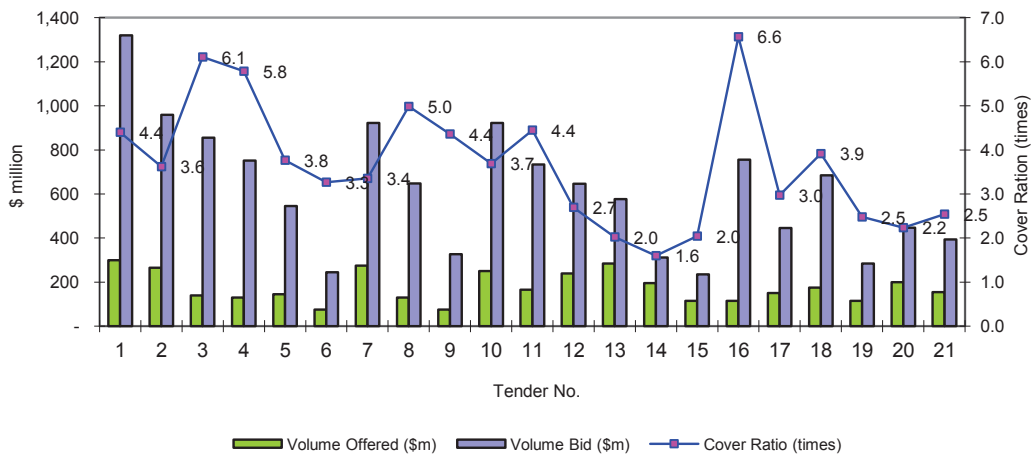
OUTLOOK

The LGFA expects further increases in the offshore investor base to improve pricing performance and allow issuing longer dated bonds.

As the offshore investor base grows there will be an increase in AIL payments and this is more than offset by improved pricing resulting from the increase in offshore investors.

KEY TRENDS

Weighted Average Tender Offer/Bid Summary



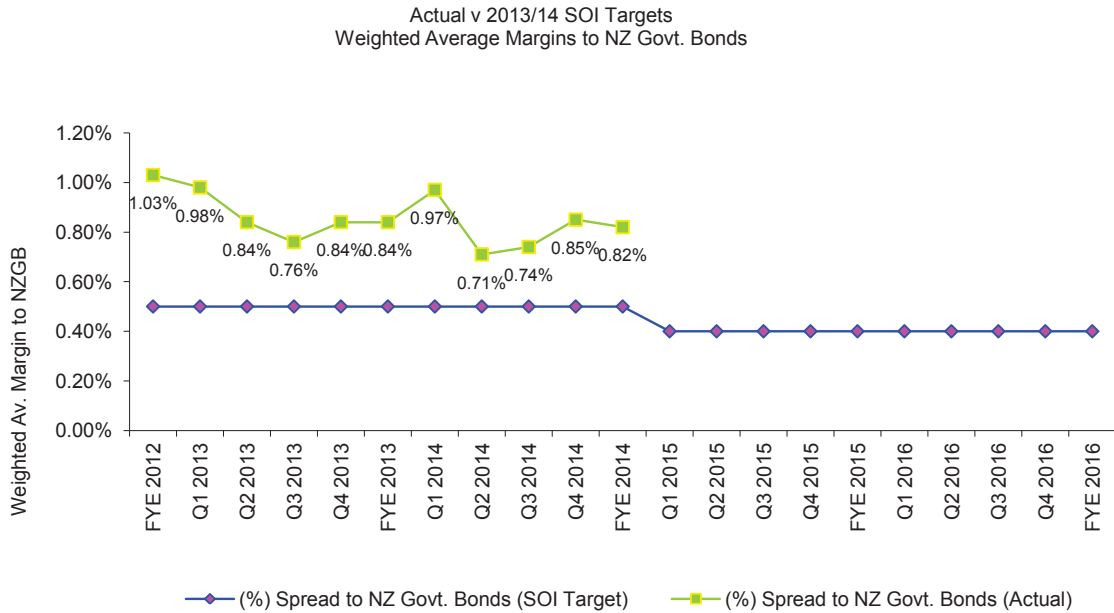
This is not a KPI.

Tender no. 20 was a large tender issuing \$200m and of which \$155m for April 2023 maturity. This tender was extremely successful and achieved a low margin of 0.45% against the swap bench mark.

Significant improvement in pricing have been achieved for the December 2017 and March 2019 bonds as they have now reached optimal liquidity and greatest frequency of issuance with over \$1b on issue for each.

To-date LGFA has received \$13b of tenders over the 21 tenders at an average cover ratio of 3.5 times.

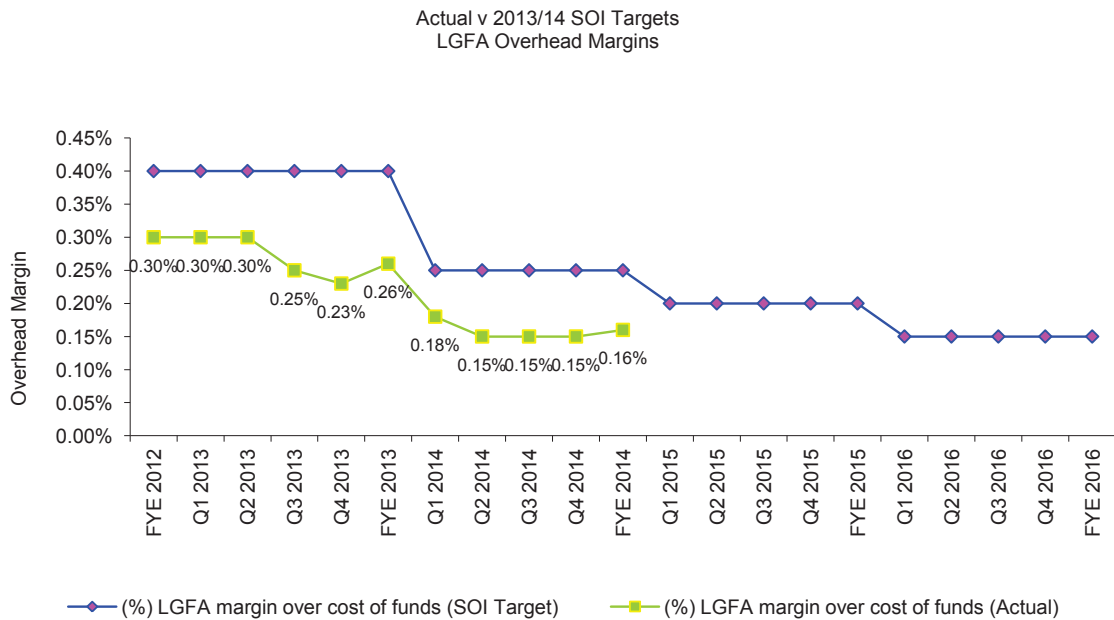
KEY TRENDS



KPI not achieved ❌

This is an aspirational and investor focussed KPI for the LGFA. Reducing the LGFA's weighted average margin to NZGS is challenging while most of the debt issuance has been for a term greater than 5 years. It is expected that the increasing offshore investor base, together with issuing shorter duration bonds will support the achievement of this KPI.

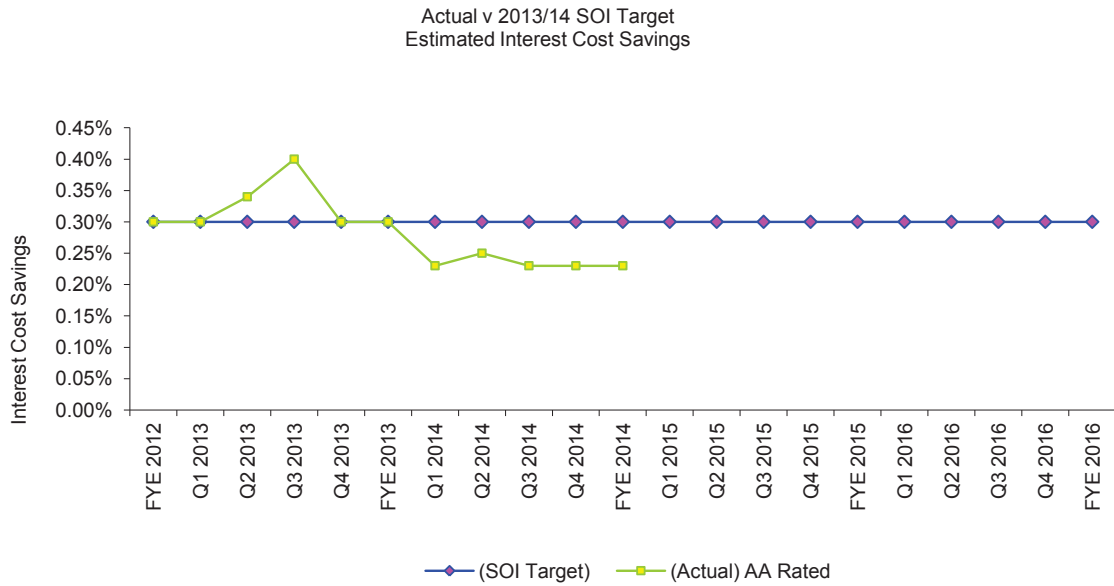
The Shareholders' Council note that LGFA has made limited progress with this challenging measure. It is expected that improvement will be made on this as borrowing Councils' debt requirements for short-term debt increase.



KPI achieved ✅

There has been no change in the overhead margin charged to borrowing Councils in this quarter and performance is well within the SOI target. This reduction in overhead margin is reflected in lower borrowing costs to Councils.

KEY TRENDS



KPI not achieved ✖

The estimated annual interest cost savings did not achieve the target of at least 0.30% during June quarter. This resulted mainly from improving swap margins for benchmark councils (Auckland and Dunedin) influenced by the LGFA's presence in the market. Based on trends, LGFA expects to meet its long-term interest cost savings target of at least 0.30%.

The Shareholders' Council expects improvement against this target and is monitoring progress closely.

SUMMARY COMMENTS

- Net operating profit for the year ending 30 June 2014 is forecast at \$6.9m (SOI target at \$6.6m).
- Dividend at the rate of 7% is expected to be declared and paid later this year.

Financial Statements for the year ending 30 June 2014 are expected to be published by 30 September.