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In reply please quote            LGFA  
Or ask for                            Alan Adcock

29 January 2016

Craig Stobo  
Chairman  
New Zealand Local Government Funding Agency Ltd  
PO Box 5704  
Lambton Quay  
WELLINGTON 6145

Dear Craig

## Statement of Intent 2016/17 and Shareholder Expectations

This letter sets out, on behalf of shareholders, the Shareholders' Council's expectations of the New Zealand Local Government Funding Agency Ltd (LGFA) for consideration in the LGFA's business planning and the development of its 2016/17 Statement of Intent (SOI).

It is the expectation of shareholders that the company's intentions set out in its current (2015/16) SOI will continue in the 2016/17 SOI.

As you are aware the Shareholders' Council, on behalf of all shareholders, undertakes a review and analysis of all LGFA reports and accountability documents. In order to carry out an effective review, and keep shareholders engaged and informed, we request that your draft 2016/17 SOI be provided as early as possible, and preferably in time for the Shareholders Council meeting on 16 February 2016.

This annual letter offers an appropriate opportunity to remind the LGFA about reiterating the Board's plans for lowering the cost of borrowing, how new risks are being managed (such as the commercial paper) and notifying the Shareholders' Council in a timely way to ensure appropriate lead-in times to consult with shareholders.

Annex One contains additional expectations of shareholders that the Shareholders' Council asks are acknowledged by the LGFA in its 2016/17 SOI. The Shareholders' Council would like to see a renewed focus on a clear methodology for the key performance indicators (KPIs) and provide the Shareholders' Council with key organisational risks and strategies to mitigate risk.

The Shareholders' Council welcomes discussion on the content of this letter and the LGFA's views on its priorities in drafting the 2016/17 SOI. As mentioned earlier we look forward to receiving the company's draft SOI before the statutory deadline of 1 March 2016, and will respond with feedback prior to 1 May 2016, in order that the company is in a position to deliver its final SOI by 30 June 2016.

It was a pleasure to attend the 2015 Annual General Meeting, and recognise the significant achievements of the LGFA over the last year, such as the New Zealand Debt Market (NZDX) listing and the continued provision of attractive debt funding options for New Zealand councils.

If you have any queries or comments, please don't hesitate to contact me.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Alan Adcock'.

Alan Adcock  
Chairman  
LGFA Shareholders' Council

cc. Mark Butcher, CEO LGFA

## ANNEX ONE

### 2016/17 Expectations

[Note this list is structured to follow the headings in the 2015/16 SOI]

#### OBJECTIVES

**Primary objective - asset quality:** It is shareholders' enduring expectation that the LGFA will continue to take appropriate steps to ensure that it understands each borrower's headroom and the overall sector headroom within its Lending Policies and Foundation Policies as detailed in the company's Treasury Policy.

Shareholders believe that maintaining high quality assets is fundamental to the LGFA's business and is critical to shareholders.

**Primary objective - availability of longer-term bonds:** The Shareholders' Council asks that the LGFA includes more specific information about its intentions in this area in the 2016/17 SOI.

The LGFA should also indicate the steps it will undertake to ensure it understands the maturity profile of councils, potentially through a mechanism like an annual survey.

**Measurement of progress towards objectives:** Shareholders support the Company's objectives stated in its current SOI. It is appropriate to include in the next SOI specific measures, against which progress on these objectives in the 2016/17 year can be assessed. The Shareholders have identified key performance indicators that could benefit from further clarity on the methodology.

#### FINANCIAL FORECASTS

**Alignment of forecast financial information and financial reporting:** The current SOI contains brief financial forecast information. The Shareholders' Council has appreciated the willingness of the company to provide additional financial information and comment to inform the Shareholders' Council's own reporting to shareholders. It is important that this information is provided again for the 2016/17 year, either in the 2016/17 SOI (which is our preference), or separately.

These quarterly financial forecasts should ideally be in a format that matches the level of financial detail provided by the Shareholders' Council in its recent reports to shareholders. Shareholders also ask that the company aligns its quarterly financial reporting with this new level of detail. We note that the NZX listing has introduced strict reporting requirements (and in some cases, constraints), but hope that information that is relevant to shareholders can be provided without compromising NZX reporting.

#### PERFORMANCE TARGETS

The Shareholders' Council asks that the performance indicators and targets used to measure the performance of the LGFA continue to provide a clear methodology, are robust and meaningful measures for all stakeholders.

1. LGFA's average cost of funds on debt issued relative to the average cost of funds for New Zealand Government Securities for the 12 month period to:
  - 30 June 2017 will be less than 0.50% higher
  - 30 June 2018 will be less than 0.50% higher
  - 30 June 2019 will be less than 0.50% higher

LGFA to include issuing bills in the calculation and to provide methodology to the Shareholders' Council.

2. The average base margin above LGFA's cost of funds charged to the highest rated Participating Local Authorities for the period to:
  - 30 June 2017 will be no more than 0.10%.
  - 30 June 2018 will be no more than 0.10%.
  - 30 June 2019 will be no more than 0.10%.

LGFA to only include bonds issued in the current year in the calculation of this target.

3. LGFA's annual issuance and operating expenses for the period to:
  - 30 June 2017 will be less than \$6.88 million.
  - LGFA to link general cost increases to CPI from a target perspective (excluding issuing costs such as Issuer Levy/NZX listing).
4. Total lending to Participating Local Authorities at:
  - 30 June 2017 will be at least \$7,095 million.
 LGFA to clarify whether short-term lending (30 to 364 days) forms part of this target.
5. Savings on borrowing costs for council borrowers:
  - LGFA will demonstrate the savings to council borrowers achieved in the relevant financial year compared to previous financial years and to document the methodology for calculating the savings.

#### **DIVIDEND POLICY**

LGFA to continue the policy to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders, however the Shareholders' Council would like to see a dividend return on the average rate plus 2.0% based on all outstanding debt since inception, not just the current financial year.

#### **GOVERNANCE**

**Annual General Meeting:** To maintain the capability of the LGFA Board and Shareholders' Council over time, it is important that the best possible talent is available. The Shareholders' Agreement sets out the procedures and timeframes for the election of Board members and Nominating Local Authorities.

It is important that the LGFA builds on the successful recruitment process in 2015 and continues to work closely with the Shareholders' Council in 2016 to ensure that the right skills mix is on the board.

The notice of the AGM and its agenda should be issued at least 1 month prior to the meeting.

#### **INFORMATION TO BE PROVIDED TO SHAREHOLDERS**

The Shareholders' Council values the positive and open working relationship with the LGFA. The provision of timely and responsive information when request are made is essential to this.

**Risk reporting:** Shareholders value the quarterly, half year and annual reporting provided by the LGFA. A worthwhile addition to this can be achieved by regularly reporting on risks and we ask that a risk section be included in future reports.

**NZDX:** The Shareholders' Council would value an update on any new risks, reporting or disclosure requirements for the LGFA bond listing on the NZDX.

#### **Treasury project:**

The Shareholders' Council considers that a post implementation review of the new treasury system should be undertaken, and reported to shareholders. A post implementation review would be appropriate to signal in your SOI.

**Events of review:** The current SOI notes that details of events of review will be included in quarterly reports.

Shareholders would like to take this opportunity to reinforce the importance of them receiving full and early disclosure from the LGFA of company policy breaches by Participating Local Authorities. It is crucial that all Shareholders are informed as soon as possible once an event has occurred given their potential liability.