


## 12. LOCAL GOVERNMENT FUNDING AGENCY



General Manager responsible:	General Manager Corporate Services, DDI 941-8528
Author:	Paul Anderson, General Manager Corporate Services

### PURPOSE OF REPORT

1. The purpose of this report is to approve for distribution and consultation a statement of proposal that the Council supports the establishment of a New Zealand Local Government Funding Agency (**Attachment 1**).

### EXECUTIVE SUMMARY

2. Over the past 18 months, Council staff have participated in a Steering Group chaired by Local Government New Zealand (LGNZ) to investigate the establishment of an entity that could provide lower-cost funding for local authorities. The Steering Group comprises staff representatives from Christchurch, Auckland, Wellington and Hamilton Councils, Treasury, Reserve Bank and the Minister of Finance's office. Staff have kept the Audit and Risk Management Subcommittee up to date on progress with these discussions.
3. Early analysis by the Steering Group suggested that borrowing costs to local government are higher than they could be and vary considerably across the sector. This is because local government consists of 78 separate entities and is generally unable to create large debt 'tranches' that could achieve lower rates. In addition, it has a heavy reliance on New Zealand banks for its funding requirements because there are regulatory restrictions in borrowing in foreign currency and councils face compliance costs if they wish to borrow by issuing bonds locally.
4. Combined Council LTCCPs show considerable borrowing requirements (over \$9 billion) over the next five years. Coupled with the issues in the preceding paragraph, this is likely to lead to higher interest rates in the coming years.
5. The Steering Group agreed to further work to investigate whether these issues could be addressed as a package. This work has resulted in a proposal for a Local Government Funding Agency (LGFA). Details of this proposal are contained in the Statement of Proposal and Information Memorandum attached to this report (**Attachment 2**). The key features of the proposed LGFA are:
  - The LGFA would lend to local government only.
  - The LGFA would be owned exclusively by local and central government. Central Government has budgeted for an investment of \$5 million in the LGFA and it is envisaged this would provide it with a 20% shareholding. Local government would hold the remaining 80%.
  - Along with central government, nine Councils have been actively involved in developing the LGFA proposal. These councils are Wellington, Hamilton, Auckland, Tauranga, Christchurch, Greater Wellington Regional Council, Whangarei, Tasman and Western Bay of Plenty. It is proposed these Councils will provide at least 50% of the capital and that the remainder of the sector will be invited to subscribe for up to 30% of the capital. Total capital requirements for establishment is \$25 million and it is proposed that Council approve an equity investment of \$2.5 million as its share. This investment should be rates neutral because the LGFA will pay a dividend of 2% above the LGFA's cost of funds which should more than offset CCC's funding costs.
  - The LGFA would be subject to its own legislation, which supports its operation by exempting it from certain regulatory and taxation criteria. This legislation enables the LGFA to be exempt from tax as if it is a local authority and also enables local authorities to provide a guarantee in respect of the LGFA. This legislation is supported by the government.
  - Based on the proposed structure, the Steering Group is confident that the LGFA would have a credit rating comparable to the New Zealand Government (AAA) enabling it to borrow at the very best rates available. Early assessment by rating agencies (Standard & Poors and Fitch) have ratified this view. A final rating process would be required once the LGFA is established.

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- The LGFA would have a range of conservative internal policies covering liquidity, pricing, lending, investing and borrowing. Further detail of these are contained in the Information Memorandum.
  - LGFA's treasury operations, capital raising, lending, liquidity and risk management would be outsourced to the New Zealand Debt Management Office (part of Treasury).
  - A guarantee would be required for all establishment shareholders and borrowers above \$20 million. The purpose of the guarantee is to provide additional comfort to rating agencies to ensure the LGFA receives as high a credit rating as is possible. The chances of the guarantee being called are extremely low, with multiple forms of funding available to the LGFA before the guarantee is used. The Information Memorandum provides further detail on this.
  - A Board would be established with central and local government representatives along with several independent appointments. The LGFA would be subject to the Local Government Act 2002 reporting and disclosure requirements (as a CCTO). It would be audited by Audit New Zealand.
6. The Steering Group has met with the Minister of Finance and the Minister of Local Government and has been heavily engaged with officials from Treasury and the Department of Internal Affairs. On 8 December 2010 a Cabinet Committee agreed to all recommendations proposed by Treasury and the Department of Internal Affairs, which covered government establishment funding (\$5 million), NZDMO outsourcing and standby line and legislation.
7. It is recommended that the Christchurch City Council becomes an establishment shareholder in the LGFA by making an investment of up to \$2.5 million and subscribing for uncalled capital of \$2.5 million. It is also recommended that Christchurch City Council enters into the guarantee as outlined in the Information Memorandum and makes changes to its Investment Management and Liability Management Policies to enable it to borrow from the LGFA.

### FINANCIAL IMPLICATIONS

8. Current modelling indicates that Christchurch City Council could achieve interest rate savings of 0.4% pa through the use of the LGFA once the LGFA is fully established (this would take several years). With existing gross debt of \$300 million, this would result in savings of \$1.2 million per annum if all Council debt was placed with LGFA. Based on Council's total gross debt forecast of \$853 million by 2019, this would result in savings of \$3.4 million per annum.

### LEGAL CONSIDERATIONS

8. Section 56 of the Local Government Act 2002 (LGA 2002) provides that a proposal to establish a council-controlled organisation (CCO) (which includes a CCTO) must be adopted in accordance with the special consultative procedure before a local authority may establish or become a shareholder in the CCO.
9. Christchurch City Council will be required to enter into a guarantee if it joins the LGFA scheme. The guarantee will be in respect of the payment obligations of other guaranteeing local authorities to the LGFA (cross guarantee) and of the LGFA itself (LGFA guarantee).
10. Section 62 of the LGA 2002 would prevent Council from giving such a guarantee. However, the government intends introducing amending legislation to support the operation of the LGFA by (amongst other things) exempting it from certain regulatory criteria that would otherwise apply to it. This would include compliance with section 62.
11. The Council has adopted policies in respect of investment and liability management. The Council's involvement in the LGFA as a Principal Shareholding Local Authority is not provided for in the Investment Policy, and specifics of the debt-raising arrangements with the LGFA go beyond what is currently provided in the Liability Management Policy (particularly the guarantee commitments). Proposed amendments to the policies to accommodate this proposal, should it be adopted by the Council, are attached as Appendices 1 and 2.

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12. Any amendment to the policies must be by way of an amendment to the Council's Long Term Plan.

### STAFF RECOMMENDATION

It is recommended that the Council resolves to:

- (a) Approve for distribution and consultation the statement of proposal for:
  - (i) The establishment of a New Zealand Local Government Funding Agency.
- (b) Adopt the following timetable for consultation:
  - (i) Public notification ("The Star", "The Press" and the Council's website) by Monday 11 April 2011.
  - (ii) Closing date for submissions is 5pm on Thursday 12 May 2011.
  - (iii) Hearing of submissions will be held on Monday 30 May 2011.
  - (iv) The Council meeting to formally adopt the proposal will be on Tuesday 21 June 2011.
- (c) Authorise the General Manager Corporate Services to make any necessary amendments to the documents referred to in this resolution.