From: Sharon Bodeker
To: [redacted]
Subject: [redacted]
Date: Friday, 8 March 2019 04:07:00 p.m.
Attachments: Covering report for Bancorp Review.pdf

Dear [redacted]

Further to you (g) below, please find attached a copy of the covering report that went to Council accompanying the Bancorp Review.

Kind regards
Sharon

From: [redacted]
Sent: Tuesday, 5 March 2019 12:28 p.m.
To: Sharon Bodeker <Sharon.Bodeker@dcc.govt.nz>
Cc: Sandy Graham <Sandy.Graham@dcc.govt.nz>
Subject: [redacted]

[redacted]

g. Report which went to Council accompanying the Bancorp Review requested 26/2/19

[redacted]

REVIEW OF BORROWING ARRANGEMENTS

Department: Finance

REASONS FOR CONFIDENTIALITY

Grounds:	S48(1)(a) - The public conduct of the part of the meeting would be likely to result in the disclosure of information for which good reason for withholding exists under section 7.
Reason:	S7(2)(b)(ii) - The withholding of the information is necessary to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information.
	S7(2)(h) - The withholding of the information is necessary to enable the local authority to carry out, without prejudice or disadvantage, commercial activities.

EXECUTIVE SUMMARY

1 Council currently obtains its debt finance via Dunedin City Treasury Limited ("DCTL"), which is a Council Controlled Trading Organisation ("CCTO"). DCTL also manages the debt requirements of the other group companies.

2 DCTL manages these debt requirements via commercial relationships with the private sector (eg institutional finance organisations).

3 In 2011, a 'collective borrowing vehicle for the local government sector in New Zealand' was incorporated, known as the Local Government Funding Agency ("LGFA"). LGFA began providing loan finance to local governments who became members and/or guarantors of LGFA. CCTOs were unable to directly borrow from LGFA.

4 In March 2018 Council began planning for an independent review to identify, amongst other things, the risks and benefits to Council of joining LGFA.

5 The independent review highlighted that the existing treasury structure is regarded as 'best practice'. The independent review also recommended that it would be beneficial to add LGFA as a new funding source for Council and the wider group.

6 In November 2018 LGFA voted to amend their LGFA Foundation Policy to enable LGFA to lend directly to a CCTO. The outcome of this vote has a significant impact on how Council's membership of LGFA could be structured and on the quantum of benefits arising from membership.

RECOMMENDATIONS

That the Council:

a) **Approves** DCC supporting DCHL/DCTL in their application to add LGFA to its potential funding sources.

b) **Requests** DCHL to work with DCC to review the necessary arrangements to allow LGFA to be a potential funding source for DCC and DCC CCOs.

c) **Notes** the independent report formally recognises the benefits that the current lending structures have provided DCC to date and highlights that "DCC, through the DCTL structure, operates its Treasury function via a market 'best practice' framework".

BACKGROUND

7 The DCC Long Term Plan 2018 to 2028 ("DCC LTP") "Financial Strategy" section notes that DCC plans "*to spend $878m on capital projects over the next ten years, compared with $636m in the last 10 year plan*" and "*To deliver the capital programme, the Council will need to borrow an additional $147m*."

8 The decision to increase DCC debt was a reversal of the trend included in the previous DCC LTP which included a reduction in DCC debt from $255m to $153m.

9 DCC officers determined that it was timely to commission an independent review of Council's borrowing strategies.

10 Shortly after commissioning this independent review, the major provider of debt-funding to local government in New Zealand (the Local Government Funding Agency – "LGFA") announced that it was seeking to expand its role in supplying debt finance to local government to include the provision of debt finance to Council Controlled Organisations.

11 LGFA announced in November 2018 that this expansion had been approved and that the necessary arrangements were being undertaken to enable CCOs to have access to the LGFA offering. This expansion provides potential opportunities for the DCC Group that were not previously available.

12 Operationally, this expansion means that the DCC Group debt can continue to be managed via Dunedin City Treasury Ltd and avoids having to demarcate this debt by DCC borrowing some of its debt finance direct from a lender.

Overview of LGFA (information as per LGFA website)

13 "The LGFA is a CCO operating under the Local Government Act 2002. LGFA specialises in financing the New Zealand local government sector, the primary purpose being to provide more efficient funding costs and diversified funding sources for New Zealand local authorities. LGFA was established to raise debt on behalf of local authorities on terms that are more favourable to them than if they raised the debt directly." (LGFA website "About LGFA" section).

14 LGFA was incorporated on 1 December 2011 following almost three years of development work by a steering group and other stakeholders.

15 At 30 June 2017 LGFA had 45 million ordinary shares on issue (valued at $1 each), 20 million of which remain uncalled. There were currently 31 shareholders, comprising the New Zealand Government (20%) and 30 local councils (combined 80%).

16 LGFA's debt obligations are guaranteed by its council shareholders and borrower and guarantor councils. Basically, each council that borrows in excess of $20million from LGFA guarantees a proportion of each other's debt to LGFA.

17 Up until November 2018, CCOs were unable to borrow from LGFA – the opportunity to borrow from LGFA only extended to local governments. As stated above, voting undertaken in November 2018 will enable this to change.

Summary of Independent Review

18 The independent review commissioned by DCC in relation to its borrowing strategies recommends that DCC becomes a guaranteeing member of the LGFA to supplement its existing funding arrangements but that it continues with using DCTL for its existing commercial paper programme.

19 Importantly, the independent review also notes that the existing model, of managing treasury activity via the group structure, is best practice and should be continued.

DISCUSSION

20 DCC has traditionally managed its debt requirements via a specialist CCO, DCTL. DCTL also manages the debt requirements of all other CCOs.

21 In March 2018 DCC management decided to commission an independent review of the borrowing strategies and framework of the DCC Group.

22 The terms of reference for the review included specific reference to LGFA as Officers were aware of LGFA's increased 'business maturity' and resulting market penetration.

23 Independent of the review, information provided by LGFA in May 2018 stated that "by the end of 2018 it is likely that DCC and one other council will be the only councils in New Zealand with debt levels greater than $10 million who are not members of LGFA". Included in this information were the following key points relating to LGFA membership:

- Each member of LGFA guarantees the debts of LGFA under an agreement where each obligation is in proportion to the rates revenue of each council guarantor;
- LGFA members can borrow on terms from 30 days to 15 years;
- Total loans outstanding by LGFA to councils is $7.8 billion as at May 2018;
- Borrowing is not compulsory;
- LGFA has approximately 85% market share of all council borrowing in New Zealand;
- The only councils who tend to borrow in their own name are Auckland, Dunedin and Invercargill. Auckland Council borrows through LGFA but is restricted in how much it can borrow through LGFA so issues bonds in its own name as well as LGFA borrowing;
- LGFA has the same credit rating (AA+) as the New Zealand Government and can therefore borrow more cheaply than any other borrower in New Zealand except for Central Government;

- If DCC (credit rating AA) were to join as a guarantor then the DCC pro rata share of the guarantee would be 2.66% (this means that if another council defaulted on a loan and, for example, a $100 million 'guarantee call' was made, DCC would be required to contribute $2.66 million);

- All guaranteeing councils value their respective contingent liability as zero in their financial statements.

24 The attached Independent Report ("the Bancorp Report") provides background and analysis of DCC and CCOs' current borrowing structures and the implications of borrowing from LGFA.

25 The Bancorp Report recommendations includes DCC becoming a guaranteeing member of LGFA and, ultimately, DCTL 'joining' LGFA so DCTL can borrow from LGFA.

26 The Bancorp Report recommendations, if supported, would require staff to conduct further investigation to identify the changes to legal and other governance-documents (eg debenture deeds, Policies etc) that would need to be amended to enable DCC and DCTL membership of, and borrowing from, LGFA.

27 DCC is unlikely to have any significant borrowing requirements in the period before DCHL/DCTL can join LGFA (the "interim period"). Accordingly it is recommended that DCC does not become a member of LGFA but rather supports DCHL/DCTL in becoming a member and then benefits from LGFA via DCHL/DCTL. DCC would then conduct the required public consultation in the interim period.

28 Importantly, this would result in LGFA being added to (not 'replacing') potential funding sources used by DCTL.

29 Becoming a member of LGFA would therefore increase the opportunities for DCTL to access more favourable (and flexible) finance products.

30 The DCC Treasury Risk Management Policy includes the following (Section 6, "Permitted Debt Instruments Policy"):

> "Borrowings via LGFA are subject to approval from Council in relation to participation in the LGFA structure and analysis from DCTL that this would be a cost effective funding source".

31 The major reservation about becoming a member of LGFA is generally regarded as being the 'guarantee risk' that is attached to membership. Appendix One of the Bancorp Report includes sections titled "The Joint and Several Guarantee" and "The Mechanics of a Council Default" which provide detailed commentary relating to the guarantee.

OPTIONS

32 Option One recommends that DCC supports DCHL/DCTL in their application to add LGFA to its potential funding sources on the proviso that, once the administrative details become clear, should DCHL/DCTL consider that adding LGFA to its potential funding sources is not advisable, officers will formally report back to Council.

33 In the interim period, before DCHL/DCTL are able to add LGFA to its borrowing sources, it is possible for DCC to become a member of, and borrow directly from, LGFA.

34 However, as:

- the interim period is expected to be 'months' and not 'years'; and

- DCC's expected requirement for additional loan finance during this period is expected to be less than $15m; and

- it is quite possible that this $15m debt requirement can be effectively satisfied via existing mechanisms;

such 'interim membership' does not appear warranted.

35 Further, in the interim period, it is possible for DCC to join LGFA, 'channel' all Group Debt refinancing requirements via DCC and borrow from LGFA. DCC would then lend these amount to the other CCOs, possibly via DCTL. This would have significant implications, risks and costs for the management of Group Debt and the role of DCTL and is accordingly not considered further in this Report.

36 Accordingly, the Options considered in this Report do not include DCC becoming a member of LGFA in the interim period.

Option One – Recommended Option

37 Council supports DCHL/DCTL in their application to add LGFA to its potential funding sources.

38 Due to the guarantee element that is associated with this Recommendation, this Recommendation requires approval from Council.

39 As the details of a CCO becoming a member of LGFA are currently being developed, officers will provide a further Council Paper should such membership subsequently appear unfavourable.

Advantages

- DCC (and CCOs) may ultimately access lower costs of debt;

- DCC (and CCOs) may ultimately access more flexible debt products;

- DCC retains its independently-recognised "best practice' treasury model;

Disadvantages

- DCC (and CCOs) may ultimately take on additional risk;

- Cost of changing existing arrangements (expected to be recouped via lower borrowing rates).

Option Two – Status Quo

40 Council maintains its status quo, does not become a member of LGFA and does not request DCHL/DCTL to 'join' LGFA.

Advantages

- DCC (and CCOs) continue borrowing without taking on additional risk;

- Avoids cost of looking at changing existing arrangements;

Disadvantages

- DCC (and CCOs) may not be accessing lowest possible costs of debt;

- DCC (and CCOs) may not be accessing most flexible debt products and, accordingly, may no longer be regarded as "best practice".

NEXT STEPS

41 Council liaises with DCHL to assist them (or DCTL) in becoming a member of LGFA.

Signatories

Author:	Dave Tombs - General Manager Finance and Commercial
Authoriser:	Sue Bidrose - Chief Executive Officer

Attachments

	Title	Page
A	Bancorp Report *(Under Separate Cover)*	

SUMMARY OF CONSIDERATIONS

Fit with purpose of Local Government

This proposal relates to commercial considerations relating to providing a public service and it is considered good-quality and cost-effective.

Fit with strategic framework

	Contributes	Detracts	Not applicable
Social Wellbeing Strategy	☐	☐	☒
Economic Development Strategy	☐	☐	☒
Environment Strategy	☐	☐	☒
Arts and Culture Strategy	☐	☐	☒
3 Waters Strategy	☐	☐	☒
Spatial Plan	☐	☐	☒
Integrated Transport Strategy	☐	☐	☒
Parks and Recreation Strategy	☐	☐	☒
Other strategic projects/policies/plans	☒	☐	☐

This report impacts upon Council's, and the Group's, commercial and risk profiles.

Māori Impact Statement

There are no known impacts for tangata whenua.

Sustainability

This report could impact on Council's, and the Group's, long term financial results and risk profile.

LTP/Annual Plan / Financial Strategy /Infrastructure Strategy

Future cost of borrowings are expected to reduce as a result of pursuing membership of LGFA. Becoming a member of LGFA would also attract additional risks to Council.

Financial considerations

Future cost of borrowings are expected to reduce as a result of pursuing membership of LGFA. Becoming a member of LGFA would also attract additional risks to Council.

Significance

This decision could result in lower finance costs for Council and CCOs and also exposes the Group to additional risk. Although the extra risk is unlikely to eventuate, its consequences could be significant. Accordingly this decision is considered of low to moderate significance in terms of Council's Significance and Engagement policy.

Engagement – external

Independent Review was conducted by Bancorp. The Review included interviews with senior executives and staff from DCTL.

Engagement - internal

The Review included interviews with senior executives and finance staff from DCC.

Risks: Legal / Health and Safety etc.

The risks of becoming a member of LGFA are detailed in the Bancorp Report.

Conflict of Interest

No conflict of interest has been identified. A director of DCTL who has an interest in LGFA was not involved in this Review.

Community Boards

There are no implications for Community Boards.