

How a local authority participates in the LGFA borrowing structure.

Purpose:

This paper describes how a local authority participates in the New Zealand Local Government Funding Agency ("LGFA") borrowing structure.

Local authority's decision to borrow:

Every three years a local authority must publish a Long-Term Plan ("LTP").¹ Among other things, the LTP's purpose is to describe the activities of the local authority, provide integrated decision-making and co-ordination of the resources of the local authority, and provide a basis for accountability of the local authority to the community.²

All local authorities must undertake public consultation as part of the LTP process.³ Local authorities must produce a consultation document to provide an effective basis for public participation relating to the content of the local authority's LTP.⁴ This requires the consultation document to, among other things, provide a fair representation of the matters that are proposed for inclusion in the LTP and an explanation how the objectives of those proposals may affect rates, debt, and levels of service.⁵

Local Authorities must outline their approach to providing security for borrowing in the financial strategy part of its LTP.⁶ Among other things, the financial strategy must include the local authority's policy on granting security for its financial obligations.⁷

Statutory requirements on local authorities:

There are statutory requirements imposed on local authorities which are designed to ensure local authorities are run in a financially prudent manner.

The Local Government Act 2002 requires that a local authority:

- Maintain a balanced budget, "... a local authority must ensure that each year's projected operating revenues are set at a level sufficient to meet that year's projected operating expenses."⁸
- Act prudently, "... a local authority must manage its revenues, expenses, assets, liabilities, investments, and general financial dealings prudently and in a manner that promotes the current and future interests of the community."⁹
- Must adopt a financial strategy.¹⁰

¹ Local Government Act 2002, s 93(1).

² At s 93(6).

³ At s 93(2).

⁴ At s 93B

⁵ At s 93B(a)(i).

⁶ At s 101A(1).

⁷ At s 101A(3)(c).

⁸ At s 100.

⁹ At s 101.

¹⁰ At s 101A.

- Must adopt a set of funding and financial strategies.¹¹
- Must prepare an annual plan each financial year.¹²
- Must prepare an audited annual report.¹³
- Must prepare pre-election report.¹⁴

Local authorities granting security:

A borrower can raise money on a secured or unsecured basis. Benefits of borrowing on a secured basis may include a lower cost of borrowing and increasing the pool of potential lenders. Unlike other borrowers, local authorities have a statutory ability to set rates across properties in their district¹⁵, which ratepayers within the district are liable to pay.¹⁶ The Local Government (Rating) Act 2002 sets out the process that a local authority must follow to recover unpaid rates.¹⁷ This process can include the sale or lease of the property.¹⁸

It is common for local authorities that borrow on a secured basis to grant a charge over a specific rate or a charge over rates revenue in general. The granting of a charge over rates by a local authority is contemplated by the Local Government Act 2002.¹⁹

A charge over rates revenue is typically created by a local authority entering into a Debenture Trust Deed (“DTD”). The DTD creates a security interest in favour of a specified Debenture Trustee who holds the security for the benefit of the secured creditors of the local authority. The DTD provides the mechanism for the security to operate and requires the Debenture Trustee to oversee and enforce the DTD.

If a local authority does not meet its financial obligations (as principal or as guarantor), the secured creditor may make demand on the DTD by requesting the relevant Debenture Trustee to enforce the security interest created by the DTD. If the security interest is enforced, one of the options available to the Debenture Trustee is to appoint a receiver. If a receiver is appointed, and the local authority has given security over its rates revenue, then section 115(2) of the Local Government Act 2002 applies.

Section 115(2) states that the receiver can assess and collect in each financial year a rate under this section to recover sufficient funds to meet the payment of the local authority’s commitments in respect of the loan or financial obligation during that year, and the reasonable costs of administering, assessing, and collecting the rate.

The LGFA:

LGFA was established to raise money on behalf of local authorities on terms that are more favourable to them than if they raised it directly. The statutory provisions described above apply when a local authority decides to participate in the LGFA borrowing structure.

LGFA requires local authorities that wish to participate in the LGFA borrowing structure to meet certain financial covenants. These financial covenants are designed to be indicators of a local

¹¹ At s 102.

¹² At s 95.

¹³ At s 98.

¹⁴ At s 99A.

¹⁵ Local Government (Rating) Act 2002, s 3(a).

¹⁶ At s 12.

¹⁷ At ss 63-75.

¹⁸ At s 68.

¹⁹ At s 115.

authority's ability to meet its financial obligations as they fall due. LGFA is not obliged to lend to a local authority and a local authority is not obliged to borrow through LGFA.

When LGFA borrows money, its obligations are guaranteed by most of the local authorities who participate in the LGFA borrowing structure. LGFA requires the following local authorities to be guarantors:

- Each local authority shareholder of LGFA;
- Any local authority that borrows in aggregate NZ\$20 million or more from LGFA; and
- Any local authority shareholder of a council-controlled organisation who enters into a borrowing arrangement with LGFA.

The guarantee is made in favour of the Security Trustee who holds the guarantee for the benefit of LGFA's lenders. The New Zealand Government does not guarantee LGFA.

LGFA's lenders can request the Security Trustee to make demand under the Guarantee if LGFA defaults on its obligations. Any demand the Security Trustee makes under the Guarantee must be made on a pro-rata basis according to guarantor's prior year's annual rates revenues. If a guarantor fails to pay its pro-rata share of a demand under the Guarantee, the Security Trustee will make further demands on the other guarantors for payment of the unpaid amount on a pro-rata basis until the outstanding amounts are paid in full.

Local authority's obligations under the Guarantee are secured by the security provided by local authorities under their respective DTDs.

Additional statutory oversight:

The Minister of Local Government has certain powers under Part 10 of the Local Government Act 2002 to:

- Require information from a local authority.²⁰
- Appoint a crown review team.²¹
- Appoint a crown observer.²²
- Appoint a crown manager.²³
- Appoint a commission.²⁴
- Call a general election of a local authority.²⁵

Under the Local Government (Financial Reporting and Prudence) Regulations 2014, a local authority must report progress against the following on an annual basis:

- Rates affordability benchmark.²⁶
- Debt affordability benchmark.²⁷
- Balanced budget benchmark.²⁸
- Essential services benchmark.²⁹

²⁰ Local Government Act 2002, s 257.

²¹ At s 258.

²² At s 258B.

²³ At s 258D.

²⁴ At s 258F.

²⁵ At s 258M.

²⁶ Local Government (Financial Reporting and Prudence) Regulations 2014, s 17.

²⁷ At s 18.

²⁸ At s 19.

²⁹ At s 20.

- Debt servicing benchmark.³⁰
- Debt control benchmark.³¹
- Operations control benchmark.³²

There is additional oversight of a local authority's financial position by the Officer of the Auditor General, the local authority's auditor and Department of Internal Affairs.

³⁰ At s 21.

³¹ At s 22.

³² At s 23.