LGFA
New Zealand Local Government Funding Agency
Te Pūtea Kāwanatanga ā-rohe

LGFA financing to local government for water services – December 2024 update

In late October 2024, LGFA wrote to the Mayors and CEOs of councils to outline our involvement in the Local Water Done Well ("LWDW") work programme and to suggest some considerations for councils when developing options for your Water Services Delivery Plans ("WSDP").

Over the past two months, LGFA has engaged with councils, their advisers, the Department of Internal Affairs ("DIA"), Crown Infrastructure Partners, and Water New Zealand to further develop our thinking as to how LGFA can support councils.

Following the introduction of the third piece of legislation, we thought that it was timely to provide further information for consideration by councils. We have provided the following table in this document to assist you and your finance team regarding our requirements (lending, financial covenants, reporting), loan pricing guidance, implementation considerations and views on best practice.

Further support and information

LGFA continues to work closely with council finance teams, DIA, and with Crown Infrastructure Partners to provide information and support for councils as you consider your future water services delivery arrangements through the development of your WSDP's.

We encourage you to contact us directly by emailing andrew.michl@lgfa.co.nz if you would like further information or to discuss how additional financing from LGFA can benefit your council and communities.

Importantly LGFA is not trying to tell councils what to do regarding LWDL but are wanting to help with your decision making process. We look forward to continuing to support you to enable the successful delivery of water services.

LGFA requirements (lending, financial covenants, reporting), loan pricing guidance, implementation considerations and views on best practice

Requirement – Water CCO Lending	**Comment/Explanation**[1]
All shareholders of a water CCO must be councils or Central Government and if a council they must be a guarantor of LGFA.	As required under the LGFA Foundation Policies.
Council financial support of a CCO.	Councils will be required to provide either a guarantee or uncalled capital to their water CCO (as required under the LGFA Foundation Policies). If a council opts to remove the guarantee in the future (like Auckland Council in respect of Watercare), the water CCO will no longer be able to borrow directly from LGFA. LGFA would expect the amount of uncalled capital in a water CCO to be always greater than the financial liabilities of the water CCO.
LGFA Board approval for membership.	Each water CCO will need to be approved by the LGFA Board (as is currently the case for all CCOs). The LGFA Board is not required to grant a water CCO membership.
Single owned or multiple owned water CCOs.	LGFA is indifferent as to the shareholding structure and the apportionment of the guarantee or uncalled capital as required under the LGFA Foundation Policies. The decision is for councils and their advisers to determine based on ownership, assets, debt, revenue, population etc. LGFA sees the potential financial and non-financial benefits from achieving scale via establishing multiple owned water CCOs.
LGFA will lend to a water CCO secured over its water revenue.	*Under the legislation, water organisations will be able to grant a security interest over revenue as security for a loan.* *If a receiver has been appointed in respect of a loan, the receiver may assess a special water charge to meet the water organisations commitments in respect of the loan.* *The receiver may not create any security over water services infrastructure.*

[1] Note that any comment in italics is referring to a requirement for water organisations under the proposed legislation rather than from LGFA.

Requirement – Financial Covenants	**Comment/Explanation**
Funds From Operation (FFO) to debt covenant.	To be negotiated on a bespoke basis with each water CCO. Factors to consider: 1. Size of water CCO (number of connections) 2. Forecast financial position. 3. Whether multiple owned or single owned – a multiple owned CCO should have greater scale and therefore expect a lower cost structure. Expectations are that most water CCOs will have a minimum FFO to debt ratio of between 8% and 12%. The limit will vary between water CCOs. LGFA will discuss the covenants for each individual water CCO with the Water Regulator and DIA to ensure there are no issues from their perspective. LGFA will have the final decision regarding the covenant level for each water CCO.
FFO cash interest coverage covenant.	This needs to be discussed with the Water Regulator and DIA to ensure there are no issues from their perspective. Expectations are that most water CCOs will have a minimum coverage ratio of between 1.5 times and 2 times. The limit will vary between water CCOs. LGFA will have the final decision regarding the covenant level for each water CCO.
A period of up to five years for the application of financial covenants (any request for a longer period would need to be considered by the LGFA Board).	LGFA recognises that not all water organisations will be able to comply with the financial covenants in the first year. A period will be agreed on a bespoke basis with each water CCO with interim targets in place to encourage an improving trend in ratios over time.
Water CCO debt, revenue, expenses not treated by LGFA for testing of financial covenants at the parent council level.	As set out in LGFA's Foundation Policies, financial covenants for councils are measured at the parent level, not consolidated group, unless otherwise agreed with LGFA.

Revenue and FFO definition.	A definition of the key financial terms will be provided to water CCOs and councils. It is intended to align the definitions as closely as possible to those of S&P global ratings. A decision will be required on what proportion of development contributions are included as revenue. Revenue and FFO definitions need to be discussed with the Water Regulator and DIA to ensure there are no issues from their perspective.
Harmonisation or differentiation of pricing or revenue within a multiple owned CCO will not be a requirement.	*A decision for the water CCO board and shareholders.*
Breach of a covenant.	If a water CCO breaches, then negotiations to commence between LGFA and the water CCO with the aim to agree a financial plan that will remedy the breach. LGFA would have the right to provide notice of [3] months to seek debt repayment if a breach is not expected to be remedied within a timeframe approved by the LGFA board.
Councils considered to be "high growth" who want to apply to LGFA Board for a bespoke Net Debt/Total Revenue covenant above 280% but below 350%.	The LGFA board will consider applications from high growth councils applying for a bespoke Net Debt/Total Revenue covenant above the current 280%. One of the considerations will be the financial sustainability for their water services delivery, preferably this includes having (or intending to have) their water assets in a water CCO, although each application will be considered on its merits.
Ministerial Powers.	*The Local Government Minister can appoint a Crown Facilitator. This can be down where they are asked to do so or where they believe a problem exists.* *The Minister has the power to appoint Crown Commissioners. This can be undertaken when requested or where the Minister believes that a significant problem exists.* LGFA supports these powers of appointment and would discuss the issues regarding the appointment with the Facilitator or Commissioner. Any appointment would not be regarded by LGFA as an event of repayment.

Requirement - Reporting	**Comment/Explanation**
Annual Compliance Certificates with standard reporting / covenant testing for water CCOs.	As per councils and existing CCO borrowers.
Audited financial statements.	*Required within 3 months of financial year end.*
Auditor.	*The Auditor General will be the auditor of water CCOs.* *Water CCO's will be required to produce both annual and half-yearly financial statements. LGFA would require copies of these documents.*
Performance Monitoring.	*Shareholders of a water CCO must provide a Statement of Expectations every three years and an annual review of the organisation's performance against the SOE.* LGFA would expect to receive copies of these documents.

Loan Pricing	**Comment/Explanation**
Current loan pricing to councils	Pricing of loans to councils are determined by the LGFA board and incorporated into the LGFA Lending Policy. The loan margin is based on whether the council has a credit rating and whether it is a guarantor or non-guarantor.
Loan pricing to single owned water CCO.	Loan pricing would be applied consistently across water CCOs. An additional water CCO loan margin would be determined closer to establishment of water CCOs but would be no more than 5 bps additional charge over the parent council borrowing margin for each loan to a single owned water CCO.
Loan pricing to multiple owned water CCO.	Loan pricing margin for a water CCO owned by more than one council would be calculated based upon the weighted average credit ratings of those councils providing the guarantee (or uncalled capital) of the borrowing water CCO.

Implementation Considerations	Comment/Explanation
Water CCOs to have access to full range of LGFA loan products to councils.	Short term borrowing, long term borrowing, standby facilities, and sustainable loans (at the same discount margin that councils and CCOs receive).
Councils to provide final WSDP to LGFA.	LGFA will need to ensure it is comfortable to lend to a water CCO and could be asked by DIA to comment on the Draft WSDP as part of the WSDP acceptance process by DIA. LGFA would be happy to review the draft financials of any proposed water CCO before the draft WSDP is provided to DIA.
Debt transfer from existing council to a water CCO.	LGFA cannot novate existing loans from a council to a water CCO. LGFA would consider new lending to a water CCO and allowing for a council on a case by case basis to repay its existing LGFA borrowings at market rates. The lending to a water CCO would be undertaken at market rates. Alternatively, LGFA could allow for the water CCO to repay water debt to councils over a five year period. The amount of debt to be transferred from each council to the water CCO would be a decision for each council(s) to agree with the water CCO. LGFA will require a financial model for the CCO which is sustainable and viable.
Interest Rate Swaps.	The novation of any interest rate swaps relating to water debt would be for individual councils and water CCOs to agree with banks. This is not for LGFA to determine.
If single owned water CCO subsequently merged with other water CCOs.	LGFA would be open to negotiate transition of debt in the event of a subsequent merger.
Lending only to an asset owning water CCO.	LGFA will not lend to a water CCO that is a management company only.
If a multiple owned water CCO is subsequently disestablished.	LGFA would be open to negotiate terms for repayment of debt or reassignment.

Best Practice	**Comment/Explanation**
Independent Boards.	*The draft legislation precludes elected members of councils or council employees from being appointed as a director of a water organisation.*
LGFA encourages water CCOs to obtain a credit rating but not required.	Obtaining a credit rating may assist the water CCO in borrowing from sources other than LGFA.
Expect a water CCO's projected financial position move to an equivalent standalone investment grade credit rating (BBB- minimum) within 10 years of establishment.	This is consistent with the financial covenants proposed by LGFA for water CCOs.
Water CCO to be a limited liability company, with ownership rights described in a constitution, and/or shareholder agreement.	*Water CCOs will be a company incorporated under the Companies Act 1993 and to be a water CCO, they must be owned by one or more local authorities. The legislation allows for a trust model where a water organisation can be owned by trustees.* LGFA can only lend to a water CCO if it is owned by councils and/or Central Government. All council shareholders of a water CCO who becomes a member of LGFA must be guarantors of LGFA. This precludes a trustee owned water organisation from joining LGFA.
Asset Management Plan.	*Shareholders can require that water CCO to provide an asset management plan.* LGFA would expect the asset management plan to be aligned to the financial strategy of the water CCO and be subject to third party scrutiny or audit. LGFA would expect this to be provided to LGFA.

Financial Management.	*Water organisations will be required to comply with section 211 of the Local Government (Water Services) Bill.* *LGFA supports the requirement for water organisations to manage their financials prudently including a requirement to set annual operating revenue at a level sufficient to meet annual operating expenses.* *S63 of the Local Government (Water Services) Bill states that after six years, a water organisation cannot rely upon property valuations as the basis for water charging.* While this is a decision for councils and water CCO boards, LGFA is supportive of this clause as it implies a preference for water CCOs to install metering and transition to volumetric pricing over time. LGFA would expect water CCOs to maintain an appropriate level of insurance coverage for assets.