



# Is local government debt constrained?

A review of local government financing tools

# New Zealand Infrastructure Commission / Te Waihanga

Te Waihanga seeks to transform infrastructure for all New Zealanders. By doing so our goal is to lift the economic performance of Aotearoa and improve the wellbeing of all New Zealanders.

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## Research Insights series contact

### Graham Campbell

Principal Economist

Email: [graham.campbell@tewaihanga.govt.nz](mailto:graham.campbell@tewaihanga.govt.nz)

Website: [tewaihanga.govt.nz](http://tewaihanga.govt.nz)

LinkedIn: [tewaihanga](https://www.linkedin.com/company/tewaihanga)

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# Cut to the chase

## Local government is integral to our infrastructure networks

Local government plays a significant role in providing infrastructure networks. It builds and provides local roads, water supplies and wastewater, and public transport networks. It also provides a wide array of social infrastructure like parks, libraries, and leisure centres. It owns and operates about 26% of all our infrastructure, worth a total of \$76 billion.<sup>1</sup>

The costs of building, renewing, and maintaining this infrastructure are significant. Since 2002, for every \$100 invested in infrastructure, about \$24 comes from local government, an average of \$3.8 billion per year.

However, paying for public infrastructure is increasingly straining council finances.<sup>2</sup>

## Do current financing tools constrain infrastructure investment?

While local government funding tools haven't changed much over the past 120 years, the way councils use debt to *finance* infrastructure has changed significantly.

In the early part of the 20th century, local government financing was based upon ad hoc borrowing from private individuals, with local referenda used to decide whether to take on debt for new projects. Today, local government financing is much more structured. Councils have three main tools to debt finance infrastructure<sup>3</sup>:

- borrowing from the **Local Government Funding Agency (LGFA)**, which accesses capital on domestic and international debt markets and lends money to councils that are members of the LGFA
- **issuing debt directly** to domestic and international investors and banks
- **special-purpose vehicles (SPVs)** enabled by the Infrastructure Funding and Financing Act 2020 or other finance vehicles.

### **Funding versus financing**

*Funding* represents all the money needed to pay for infrastructure. It comes from the community through users, taxpayers, and ratepayers.

*Financing* is about when we pay for our infrastructure. It could mean using cash surpluses now or borrowing and repaying later. Financing is about how we align the timing of revenues for an infrastructure asset with the money needed to build it.

Because of its low borrowing and administrative costs, the LGFA is the primary financing tool for local government. It is likely to continue to be so. Member councils in LGFA must comply with certain financial rules, the most pressing of which is the debt-to-revenue limit, which prevents member councils from carrying debts greater than 280% or 175%<sup>4</sup> of their revenues depending on their credit rating.

Given their growing debt burdens in the face of infrastructure capital needs, councils are increasingly approaching their debt limits and may be deferring capital investment or raising rates to remain under

<sup>1</sup> *Build or maintain? New Zealand's infrastructure asset value, investment, and depreciation, 1990–2022.* Te Waihanga. February 2024.

<sup>2</sup> 'Council rates hikes "mature approach" to help pay for billions needed for infrastructure – LGNZ' RNZ. 18 December 2023, <https://www.rnz.co.nz/news/national/505040/council-rates-hikes-mature-approach-to-help-pay-for-billions-needed-for-infrastructure-lgnz>

<sup>3</sup> Other financing tools not covered in depth include public private partnerships (see SPV section for a brief discussion) and local government borrowing from central government. These methods represent a minimal share of total current borrowing.

<sup>4</sup> These are temporarily higher through 2025 to account for financial pressures resulting from the COVID-19 pandemic.

them.<sup>5</sup> This has led some to conclude that councils are debt constrained. If an LGFA member council is close to its debt limit, its ability to finance capital investment is indeed limited: every dollar of new revenue can only raise about \$3 of debt, where other forms of finance like SPVs have raised almost \$10 per dollar of revenue, albeit with higher borrowing costs. This low leverage ratio may be fine for social infrastructure that does not directly generate revenue, but it might make it harder to finance revenue-generating infrastructure that could support higher debt loads.

We examined the financing tools available to councils to identify whether councils are debt constrained and whether there are limitations to the current tools.

### While there may be capacity for councils to take on more debt, LGFA covenants force fiscal discipline and low risk

At the end of 2022, most councils were not close to approaching their LGFA debt limits. At this point, only five out of the 72 councils in LGFA had a debt ratio over 150%. However, a handful of fast-growing urban councils are forecast to approach LGFA debt to revenue caps over the next decade (See Box 1).

LGFA limits do constrain these growth councils. In theory, these councils could support more debt because they are growing faster, but they face the same debt limits as slow-growing councils.

Councils are likely to have debt capacity in excess of LGFA limits because the fundamentals of council debt are strong. All councils currently have low debt servicing costs. Even if it were downgraded, council debt would still be considered of high quality to domestic and international markets, especially relative to other private infrastructure providers.

Councils are not legislatively prevented from leaving LGFA and taking on higher debt ratios. However, leaving would require them to refinance their entire stock of existing LGFA debt, which could be administratively costly. There is also the fear of a credit downgrade and higher borrowing costs. However, the financial cost of a modest credit downgrade is unlikely to prevent councils from servicing their debt (see right).

Rather, the main cost appears to be reputational. Leaving the LGFA may be judged as fiscally reckless.

Further, while council debt burdens have been growing of late, history also tells us that they've been significantly more indebted in the past, as measured by their debt-to-revenue ratios. In the 40 years prior to the Second World War, local government sustained debt burdens that were four to five times greater than they are today (Figure 1).

#### **The cost of a credit rating downgrade**

How much would a credit downgrade cost a council? While it is likely to vary between councils, it appears to be modest in the case of Auckland.

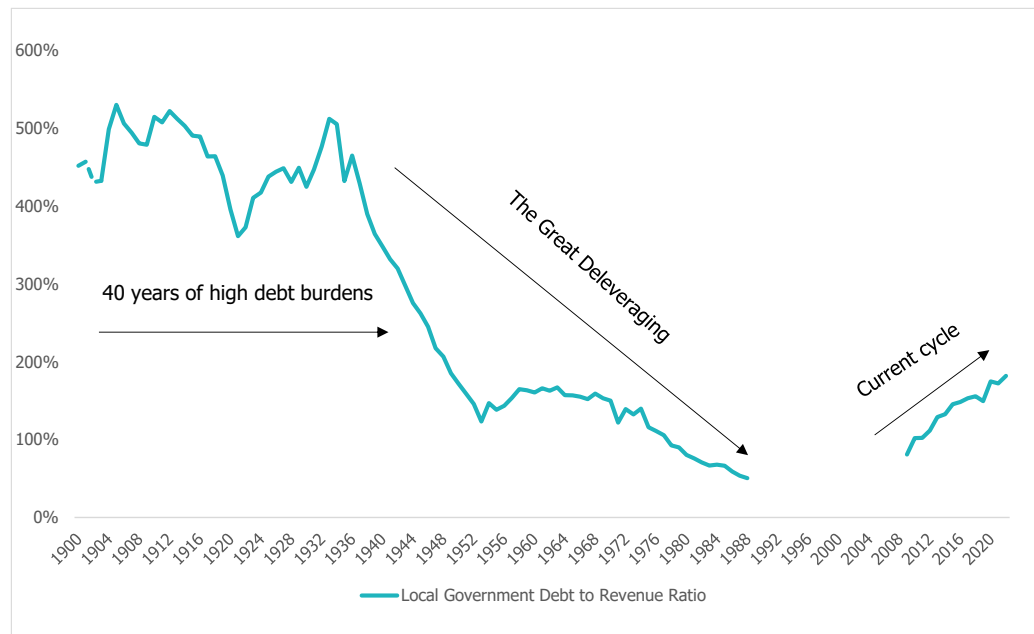
Credit ratings reflect the perceived risk that an organisation will default on its debt. S&P, one of the major credit rating agencies, rates debt on a scale from 'AAA' (indicating the safest debt) to 'D' (indicating a borrower that is in default).

Auckland Council is rated AA, S&P's third-highest rating. It estimates that a one-notch downgrade (from AA to AA-) would increase interest rates on its debt by 0.05 to 0.1 percentage points. However, borrowing costs would rise more if a council was downgraded from investment grade (BBB- or higher) to speculative grade (BB+ or lower).

Auckland estimates that every 1.0 percentage point increase in interest rates translates to roughly \$20 million in higher debt servicing costs. If a rating downgrade increased rates by 0.1 percentage points, this would translate to an impact of less than 0.03% on the city's operating budget, at least in the short term.

<sup>5</sup> 'Council debt: QLDC edges \$186 million closer to debt limit'. *Crux News*. <https://crux.org.nz/crux-news/council-debt-qldc-edges-186-million-closer-to-debt-limit>. 'Big rises in water charges and council credit downgrades'. *Newsroom*. <https://newsroom.co.nz/2023/11/20/big-rises-in-water-charges-and-council-credit-downgrades/>

Figure 1: Local government debt as a share of revenue, 1900–2022



Sources: Pre-1989 data for local government debt is sourced from New Zealand Official Yearbooks. Data from 2009 onward are from Stats NZ Local Authority Statistics. Note: No data are available for the 1989–2008 period.

## Options to circumvent the debt limit are expensive and carry risk

In the end, debt limits are designed to constrain debt. For councils approaching them, there are limited options, and they carry costs and risks. See Table 1.

Table 1: Options for councils nearing their LGFA debt limits

Option	Advantages	Drawbacks and risks
<b>Increased use of SPVs</b>	<ul style="list-style-type: none"> <li>• Debt is off-balance sheet</li> <li>• Debt is linked with revenues</li> </ul>	<ul style="list-style-type: none"> <li>• Higher borrowing costs (between 70 and 100bp above headline LGFA rates)</li> <li>• Best for certain projects with wide benefit areas</li> </ul>
<b>Exit LGFA</b>	<ul style="list-style-type: none"> <li>• Allows faster growing councils to trade-off borrowing costs, risk, and more debt finance</li> </ul>	<ul style="list-style-type: none"> <li>• Higher borrowing and administrative costs</li> <li>• Requires refinancing all LGFA debt</li> <li>• Potentially judged as fiscally imprudent</li> </ul>
<b>LGFA increases debt limits for certain councils</b>	<ul style="list-style-type: none"> <li>• Allows for councils that can support more debt to do so</li> </ul>	<ul style="list-style-type: none"> <li>• Higher borrowing costs</li> <li>• Potentially judged as fiscally imprudent</li> <li>• Requires majority of councils in LGFA to agree</li> </ul>
<b>Increase revenues, stay in LGFA</b>	<ul style="list-style-type: none"> <li>• Creates debt headroom</li> <li>• Maintains system integrity which means low borrowing costs for members</li> <li>• Could incentivise better project selection since raising revenues requires ratepayer support</li> </ul>	<ul style="list-style-type: none"> <li>• Politically challenging</li> <li>• Debt headroom for every dollar of revenue is small (2.8x for every dollar raised)</li> <li>• Creates generational inequities</li> </ul>

Crown Infrastructure Partners (CIP) has fielded interest in additional SPVs, but their current use is limited. CIP estimates that even with significant take-up, available financing through SPVs would only represent up to one-fifth of the current LGFA level. We are not aware of any councils considering exiting LGFA to increase their debt capacity, or any attempts to increase LGFA's debt limits.

Rather than focusing on LGFA limits or identifying ways to increase debt, however, we might reconsider *how* we use debt finance for infrastructure.

### Do we need to modify our local government financing tools?

Our analysis does not conclusively demonstrate whether or not current financing tools are appropriate. Rather, it highlights that there are two distinct, and opposed, views that could be taken on this question.

The first view is that current debt limits are too low, and that there is therefore a need for policy changes to increase local government’s ability to spread the cost of infrastructure investments over time. Key evidence for this view includes:

- All councils in LGFA face uniform debt to revenue limits, regardless of the speed at which they are growing.
- Councils appear to have the ability to service more debt, as evidenced by higher debt to revenue ratios in the past.
- There would likely still be demand for council debt beyond LGFA limits.

The second view is that current debt limits are appropriate and there is no need for significant policy change. Key evidence for this view includes:

- There are multiple ways for councils to access finance beyond LGFA’s debt caps. They could:
  - opt out of LGFA and issue directly
  - use SPV finance for investments that generate new revenue
  - create debt headroom by shifting revenue-producing assets to independent council-controlled organisations (CCOs) that can set their own charges, as Auckland does with Watercare.
- Many councils set internal debt to revenue limits that are significantly lower than LGFA covenants and/or caps on revenues or their growth.

Our conclusion is that, to assess the case for changing (or not changing) current local government financing tools, we need to ask a different question: what is the debt being used for?

Consideration should be given to the types of infrastructure we are seeking to debt-finance and how we will ultimately repay that debt using existing or new revenues. To paraphrase Jeff Goldblum’s character in *Jurassic Park*, just because you can take on more debt, it doesn’t mean you should.

### Sustainable infrastructure investment requires debt to be matched with revenues

Using debt involves trade-offs. For local government, increased debt means trading off infrastructure provision today with future investments. Infrastructure providers can take three basic approaches: they can pay for infrastructure with current revenues (pay-as-you-go); they can debt-finance investment and make payments with existing revenue streams; or they can debt-finance investment and make payments by growing revenues.

As Table 2 shows, each approach has consequences for who pays, when we pay, and how much is built. In particular, debt-financing investment without finding ways to grow revenues to repay the debt will mean that any additional investment today will come at the cost of reduced future investment.

Table 2: Who pays, when, and how much gets built for various financing methods for infrastructure

Financing method	Who pays for investment?	When is it paid for?	How much gets built?
<b>Using current revenues (pay-as-you-go)</b>	Current residents	Now	Less now, but more later
<b>Debt-financed investment</b>	Some current but mostly future residents	Future periods	More now, but less later
<b>Debt-financed investment with matching revenues</b>	Current and future residents	Future periods	More now and more later

### Our ancestors paid for periods of sustained investment by lifting debt *and* revenue

Local government undertook sustained periods of infrastructure investment from 1920 to 1936 and 1950 to 1970. During these periods, their revenues grew in line with debt, which prevented debt ratios from exploding and preserved their ability to make future investments (Table 3).

Our current investment cycle which began in the mid-1990s appears to be the first where local government has significantly increased debt to fund added investment without increasing revenues at a similar rate. From 2009 to 2022, inflation-adjusted local government debt grew 226%, but inflation-adjusted rate revenues increased only 42%. This caused average debt to revenue ratios to more than double.

Table 3: Changes in inflation adjusted local government gross debt and revenue across investment cycles

Investment cycle	Debt stock growth	Rate revenue growth	Debt-to-revenue ratio at start	Debt-to-revenue ratio at end	Percentage change in ratio
1920–1936	196%	144%	396%	465%	Relatively stable (+18%)
1950–1970	135%	106%	172%	150%	Decrease (-13%)
2009–2022 (see note)	226%	42%	81%	182%	More than doubled (+125%)

Sources: Te Waihangā analysis of New Zealand Official Yearbooks. Data from 2009 onward are from Stats NZ Local Authority Statistics Debt stock is from the Local Authority Financial Statistics and is measured as net debt (Current and Term Debt minus cash and equivalents). Note: The most recent local government investment cycle begins around 1995 and continues through the present day. However, local government debt figures are only available from 2009 onward so we report statistics for a shorter time period.

This might be due to a change in our mix of investment over time. Between the 1920s and 1970s, local government was building new infrastructure networks from scratch to serve rapidly growing urban populations. Today, a much larger share of investment is directed towards renewal of existing infrastructure than to growth infrastructure (Table 4). It could also be our infrastructure networks are more mature today compared to previous cycles, meaning our investments are more incremental and unlikely to drive the same level of economic uplift.

Table 4: Estimated local government capital expenditure by type of expense

Capital Expenditure spending area	2013	2018	2023	2026
Capex for renewals	43%	48%	44%	52%
Capex for growth infrastructure	21%	20%	23%	19%
Capex to improve service levels	37%	31%	33%	29%

Sources: Department of Internal Affairs, 2012, 2015 and 2018 Long-Term Plans (LTPs). 2013 figures are from 2012 LTPs, 2018 are from 2015 LTPs and, 2023 and 2026 figures are from 2018 LTPs.

While investing in renewals is important, this investment is less likely to generate new direct revenue streams for councils, such as user charges or higher per-capita incomes that sustain higher rates. Debt-financing renewal investment is therefore likely to lead to persistently higher debt-to-revenue ratios.

Even if LGFA debt limits were relaxed and councils could shoulder a greater debt burden, if revenues do not grow, infrastructure investment will be lumpy and cyclical: we build now with debt and then we spend a generation paying for it at the expense of that period’s infrastructure investment.

### Getting back to fundamentals

Recommendation 51 in *Rautaki Hanganga o Aotearoa*, the New Zealand Infrastructure Strategy, highlights the need to better use debt for infrastructure. What our analysis has shown is that we don’t necessarily need new financing or revenue tools to address pressure points in local government funding and financing. There are actions we can take right now around what we build and how we build it. These include the following.

**Making good choices about financing options:** Financing options for new infrastructure investment should be chosen based on project characteristics. Debt financing is most likely to be appropriate for large, lumpy, or once-in-a-generation investments that will generate benefits over a long period of time. In these cases, debt can allow councils to spread large up-front costs of investment over a longer period of time.

However, debt financing is not necessarily appropriate for all types of infrastructure investment. In particular, there is a need for caution when using debt for routine renewal investment, or to catch up on renewal deficits. These investments do not generate significant direct revenues or per-capita income growth. Paying this debt off will likely come at the expense of future investment. Moreover, using debt to finance renewal deficits effectively pushes the payments on future generations twice: first when we underinvested and again when we use debt to finance the deficit.

In such cases, pay-as-you-go financing or funding depreciation may be a better approach.

**Strong asset management and project selection:** To prevent renewal deficits from arising in the first place, we need to put in place strong asset management plans that identify the timing and required money for future maintenance and asset renewals.

Once we have these in place, for future growth infrastructure, we should prioritise projects that maximise value for money that we achieve from our investment dollars. As the New Zealand Infrastructure Strategy points out, this could be using non-built solutions that don’t use debt at all. Maximising value for money for our investments will require more robust planning and prioritisation processes that prioritise use of cost-benefit analysis to select options. The Strategy includes a list of recommendations (39, 40, and 43) which highlight the need for better planning and analysis of projects before they are built.

**Use of more targeted revenue streams** that match our debt-financed infrastructure and its long run costs. This isn’t a new idea. Local government in the past frequently relied upon targeted levies, project

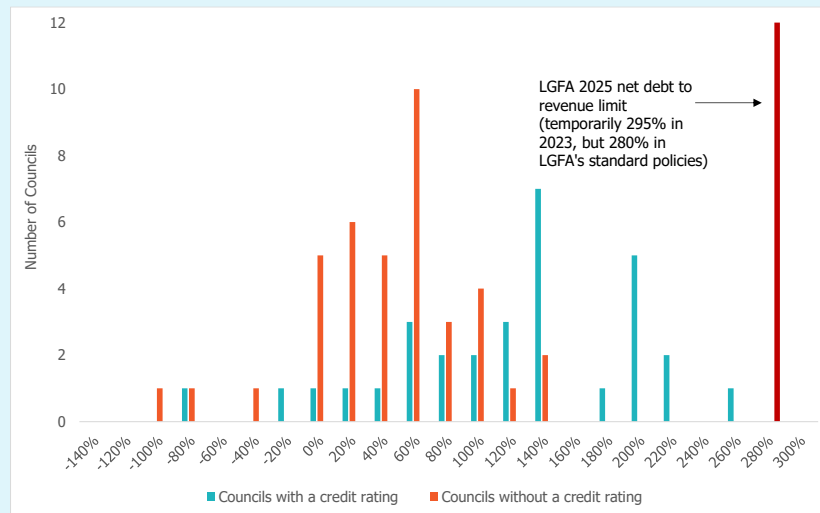


financing, and revenue bonds supported by referenda to fund and finance infrastructure improvements. Consistent with Recommendations 52 and 53 in the Strategy, today, this could mean greater use of user charges, targeted rates, levies, development contributions, and value capture. In this way, we can better match how future infrastructure is funded across current and future generations.

### Box 1: Councils and LGFA debt limits

Councils that borrow from LGFA must adhere to financial covenants that minimise the risk of default. The most pressing of these is the net-debt-to-total revenue covenant, which is less than 280% for councils with a credit rating and less than 175% for councils without. There is concern that councils, in the face of significant infrastructure needs, will be debt constrained by these covenants (Figure 2). As of end-2023, the median council with a credit rating had a net debt to revenue ratio of 120% while councils without a credit rating had a median ratio of 41%.

Figure 2: Distribution of council net debt to revenue ratios as of June 2023



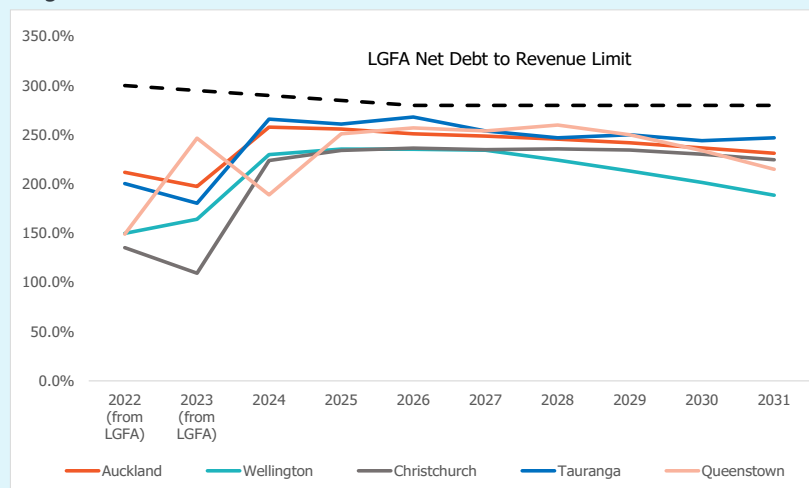
Sources: LGFA and Te Waihanga analysis

Councils' 2021 LTPs, which are the best current indication of their debt paths, show that some councils are forecast to approach debt-to-revenue limits in the next few years. However, these are almost certainly understatements since construction costs have grown since 2021 and councils have identified additional needs (Figure 3).

In addition, many councils set their own limits that force trade-offs involving capital spending. Some councils adopt stricter debt limits than LGFA to give them space to cover unexpected expenses. For instance, New Plymouth's internal debt limit is 135%. Almost all councils cap either the level of rates or growth in their rate revenues.

These debt and revenue limits have a meaningful impact on councils' ability to debt finance infrastructure. For instance, we estimate that if Wellington allowed its rates revenue to be 10% higher than its 2021 LTP, it would create over \$100 million in additional debt headroom.

Figure 3: Estimated select council net debt to revenue ratios in 2021 LTPs



Sources: LGFA, Council 2021 LTPs, and Te Waihanga analysis

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# 1. Introduction

## Local government faces significant future infrastructure demands

Local government is responsible for about one-third of all government infrastructure investment in New Zealand. It plays a lead role in building our local roads, water infrastructure, public transport and other social infrastructure like parks and leisure centres. The future costs of maintaining this responsibility are significant. For water infrastructure alone, the need could be more than \$100 billion over the next 30 years.<sup>6</sup>

## We need to figure out how to pay for it

Recommendation 51 in *Rautaki Hanganga o Aotearoa*, the New Zealand Infrastructure Strategy, highlights the need for improving our ability to debt finance infrastructure. Many infrastructure assets have long life spans. Their benefits spread across generations but need money to be built in the short term. This makes them good candidates for debt financing. Given the significant infrastructure pressures on local government, we need to know whether our financing system is up to scratch.

## The difference between funding and financing

Funding and financing are critical to building and renewing our infrastructure networks.

It is common for funding and financing to be used interchangeably, but they have different meanings. **Funding** represents all the money needed to pay for infrastructure. It comes from the community through users, taxpayers and ratepayers. This infrastructure is *funded* by a combination of rates, user charges, grants from the central government, and other contributions like development charges.

**Financing** is about when we pay for our infrastructure. It could mean using cash surpluses now or borrowing and repaying later. Regardless of how we pay for it, we always need to pay for what we build. Financing tools align the funding for infrastructure with the up-front capital needed to build it.

Funding and financing are often discussed together because the amount of capital expenditure a government can sustain at any given time is a direct function of how it is funded and financed.

Infrastructure investment financed entirely with debt will enable higher levels of spending now, but it needs to be paid for later. While not conventionally thought of as financing, investment built with today's revenues (i.e. pay-as-you-go) means less spending now but the ability to do more in future periods. Further, infrastructure that is *financed* with debt but *funded* with increases in revenue means more infrastructure across all time periods.

The relationship between debt and revenues is also important for considering how sustainable our debt is. If we increase our debt levels but our revenues grow faster, then our debt becomes more manageable. Consequently, debt burdens are measured against our ability to pay it (our revenues), rather than just the overall level of debt.

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<sup>6</sup> [https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/\\$file/briefing-three-waters-review-release-of-second-stage-evidence-base-released-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/briefing-three-waters-review-release-of-second-stage-evidence-base-released-june-2021.pdf)

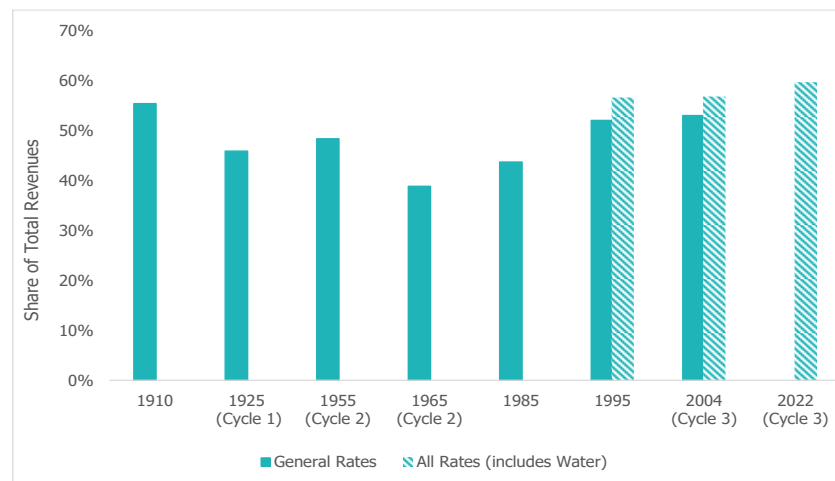
## Councils' revenue tools are the same as in the past

Local government infrastructure investment could be thought of as occurring in cycles. Historical data on local government public works and gross fixed capital formation suggests that there could be at least three periods of elevated spending: 1920 through 1936 (Cycle 1), 1950 through 1970 (Cycle 2) and 1995 to today (Cycle 3).<sup>7</sup>

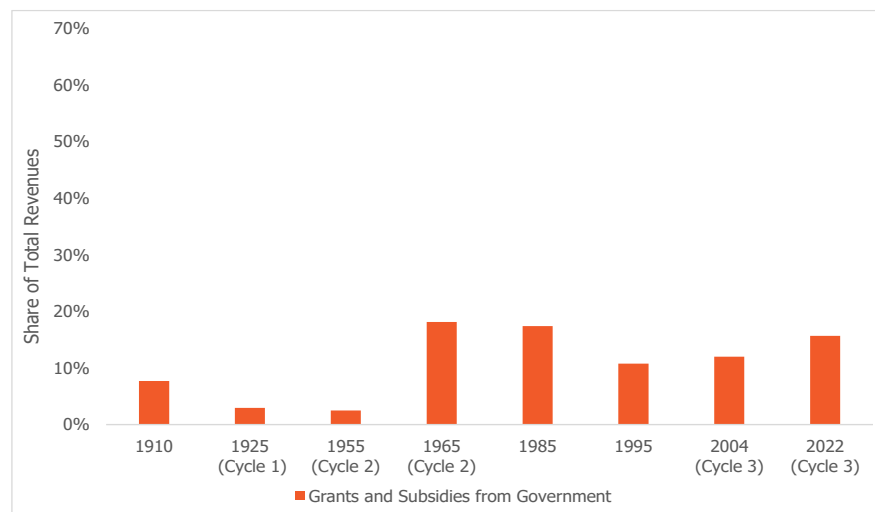
Across these three different investment cycles, rates have remained the main source of revenue for councils to varying degrees. What we don't see is a pattern of increased transfers from central government when local government ramped up investment (Figure 4). Some new revenue tools have been added over time, such as development contributions and new revenue streams associated with administering regulations. Regardless of the cycle, councils have remained largely reliant on rates.

Figure 4: Local government share of total revenue from rates and government transfers

Panel A: Rates as a share of local government revenue



Panel B: Central government grants and subsidies as a share of local government revenue



Sources: Te Waihanga analysis of New Zealand Yearbooks and Stats NZ Local Authority Statistics. Note: 1985 general rates figure includes 'rates, levies and fines'. For years prior to 1995, data for both sources are summed for four types of entities: counties, boroughs, town boards and road boards. This is similar to the approach taken by the 1958 Royal Commission on Local Authority Finance.

<sup>7</sup> See Appendix A for more detail and analysis.

Councils also completed these investments without necessarily increasing rate burdens. Rates as a share of income have ranged from 1.5% to 3.5% of national income since 1940 (Table 5).

Table 5: Local government rates revenue as a share of national income, 1940–2023

Rate revenue as a share of national income	
1940	3.45%
1945	2.38%
1955	2.38%
1965	2.56%
1993	1.56%
2000	1.56%
2010	2.22%
2023	2.82%

Sources: 1958 Royal Commission on Local Authority Finance, Table D, Appendix 12. 1975 Statistical Yearbook, Stats NZ Infoshare.

This is not to say the issue of revenue sources for local government hasn't been explored. Local government funding has been an issue of concern for the better part of the last 60 years. At least four major government reports have been commissioned on the subject, including:

- 2023 Future for Local Government report<sup>8</sup>
- 2020 Productivity Commission inquiry on local government funding and financing<sup>9</sup>
- 2007 Local Government Rates Inquiry<sup>10</sup>
- 1958 Royal Commission on Local Authority Finance<sup>11</sup>.

While these reports make various recommendations to enhance the funding available to local government, in general, none recommended wholesale changes to the system, significant new revenue tools, or new system-altering central government transfers. One reason for this is that the current system with its reliance on property taxes is simple and efficient to administer and hard to evade.<sup>12</sup>

## Are current financing tools constraining infrastructure investment?

Instead of examining funding tools, this paper investigates the financing tools available to local government.

Councils have three main sources of financing if they want to debt finance infrastructure:

- borrowing from the **Local Government Funding Agency (LGFA)**
- **issuing debt directly** to domestic and international investors and banks<sup>13</sup>
- **special-purpose vehicles (SPVs)** enabled by the Infrastructure Funding and Financing Act 2020.

LGFA is the primary financing tool for local government except Auckland Council. Member councils in LGFA must comply with certain financial rules, the most pressing of which is the debt-to-revenue limit,

<sup>8</sup> [https://www.dia.govt.nz/diawebsite.nsf/Files/Future-for-Local-Government/\\$file/Te-Arotake\\_Final-report.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/Future-for-Local-Government/$file/Te-Arotake_Final-report.pdf)

<sup>9</sup> <https://www.productivity.govt.nz/inquiries/local-government-funding-and-financing/>

<sup>10</sup> <https://ndhadeliver.natlib.govt.nz/ArcAggregator/arcView/frameView/IE12126512/http://www.dia.govt.nz/Agency-Independent-Inquiry-into-Local-Government-Rates-Index>

<sup>11</sup> <https://gg.govt.nz/sites/default/files/2023-04/Local%20Authority%20Finance%201958.pdf>

<sup>12</sup> See page 6 of the 2015 Productivity Report's recommendations for local government funding and financing above, footnote 9.

<sup>13</sup> At present, only Auckland Council is permitted to issue debt in foreign currencies. The Local Government Act of 2002 prohibits other councils from doing so.

which prevents member councils from carrying debts greater than 280% or 175% of their revenues depending on their credit rating.

With growing debt burdens in the face of infrastructure needs, some councils are increasingly approaching their debt limits and may be deferring capital expense. Councils are also currently significantly raising rates to stay under these debt limits and fund infrastructure.<sup>14,15</sup> This has led some to ask whether council's ability to debt finance infrastructure is constrained.

This paper sets out to analyse whether this is the case. We examine the existing financing tools and review the system as a whole, drawing out general observations and potential limitations.

For much of this analysis, funding streams are taken as given. However, in our conclusion, we will return to link between financing and funding and its importance for delivering infrastructure.

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<sup>14</sup> 'Council debt: QLDC edges \$186 million closer to debt limit'. *Crux News*. <https://crux.org.nz/crux-news/council-debt-qldc-edges-186-million-closer-to-debt-limit>

<sup>15</sup> 'Big rises in water charges and council credit downgrades'. *Newsroom*. <https://newsroom.co.nz/2023/11/20/big-rises-in-water-charges-and-council-credit-downgrades/>

## 2. Local Government Funding Agency

This section covers financing available to councils via the Local Government Funding Agency (LGFA). The LGFA was created under the Local Government Borrowing Act 2011. Its primary purpose is to lower the borrowing costs for councils.

### 2.1. Key structural features

In brief, LGFA works by accessing capital on domestic and international debt markets. It then lends to councils that are members of LGFA for capital needs. The loans it provides carry favourable rates and come with minimal transaction and administrative costs.

LGFA's governance structure influences how it lends. One-fifth (20%) of LGFA is owned by the Crown and 80% is owned by 30 councils. There are 72 councils that guarantee the payment of LGFA. LGFA can only lend to councils and council-controlled organisations (CCOs).<sup>16</sup> Auckland Council is LGFA's largest guarantor.

LGFA performs risk assessments of councils before lending to them. However, a key tenet of LGFA lending is that borrowers must maintain fiscal discipline through the adherence of covenants.<sup>17</sup> (See Table 6.)

These covenants are split into two categories:

- unrated councils or councils with a long-term credit rating lower than 'A' are required to adhere to financial rules set by LGFA's Lending policy covenants
- councils with a long-term credit rating of 'A' or higher only have to adhere to LGFA's Foundation policy covenants.

Table 6: LGFA financial covenants

Financial covenant	Lending policy covenants	Foundation policy covenants
Net debt/total revenue	<175%	<280%
Net interest/total revenue	<20%	<20%
Net interest/annual rates income	<25%	<30%
Liquidity	<100%	<110%

Source: LGFA.

For the years 2020 through 2025, the net debt to total revenue foundation policy covenants were increased (Table 7) due to the COVID-19 pandemic. Councils can be subject to bespoke covenants, but in most cases, it requires the approval of an ordinary resolution of LGFA's shareholders. Any change to the Lending policy or Foundation policy covenants requires the agreement of all LGFA member councils.

<sup>16</sup> LGFA can lend directly to CCOs, but a number of councils will borrow on behalf of their CCOs and lend at cost to their CCOs.

<sup>17</sup> These covenants are set in LGFA's Shareholder Agreement, rather than written into the terms of each loan  
<https://www.lgfa.co.nz/sites/default/files/2021-09/LGFA%20Foundation%20Policies%20-%20November%202020.pdf>



Table 7: Alternative debt covenants for 2020 through 2025

Financial year ending	Net debt/total revenue
30 June 2020	<250%
30 June 2021	<300%
30 June 2022	<300%
30 June 2023	<300%
30 June 2024	<290%
30 June 2025	<285%

These covenants for councils are similar to the benchmarks that credit rating agencies use to assess debt sustainability. In turn, the adherence to the covenants improves risk management for LGFA and underpins its strong credit rating.

LGFA’s high credit rating is also due, at least in part, to the assumption that the Crown will provide some form of financial assistance in times of stress.<sup>18</sup> This is despite the Local Government Borrowing Act 2011 explicitly stating that LGFA’s debt is not guaranteed by the Crown.<sup>19</sup> At present, the only explicit Crown support for LGFA is through a \$1.5 billion liquidity facility.

## 2.2. Current and future borrowing

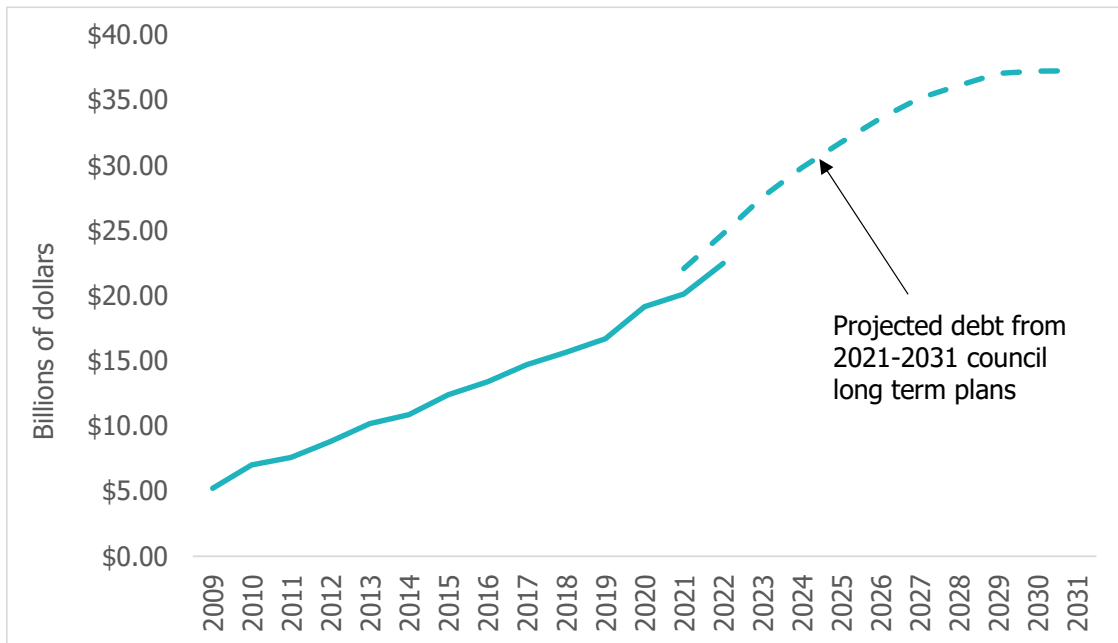
The majority of council borrowing occurs through LGFA. As of August 2023, LGFA’s loan portfolio stood at \$17.2 billion. For reference, at the end of 2022, total council and CCO debt stood at \$22.5 billion.

Demand for LGFA borrowing is likely to grow. According to 2021 council long-term plans (LTPs), over the 2021 to 2031 period, council debt is expected to rise from \$20.12 billion in 2021 to around \$37 billion by 2031, an increase of 69% (Figure 5).

<sup>18</sup> [https://www.lgfa.co.nz/sites/default/files/2023-03/RatingsDirect\\_NewZealandLocalGovernmentFundingAgency\\_54196807\\_Mar-02-2023\\_0.PDF](https://www.lgfa.co.nz/sites/default/files/2023-03/RatingsDirect_NewZealandLocalGovernmentFundingAgency_54196807_Mar-02-2023_0.PDF)

<sup>19</sup> Section 16: <https://www.legislation.govt.nz/act/public/2011/0077/latest/DLM3620704.html>

Figure 5: Historical and projected council debt



Sources: Stats NZ, 2021–2031 council LTPs, LGFA.

To meet this demand, LGFA will likely need to access borrowings from abroad, as domestic banks and institutional investors already hold significant LGFA debt and may want to limit risk to further exposure.<sup>20</sup> While LGFA does not foresee any issues meeting this demand, the importance of council credit-worthiness could become more important to satisfy foreign investor risk appetite.

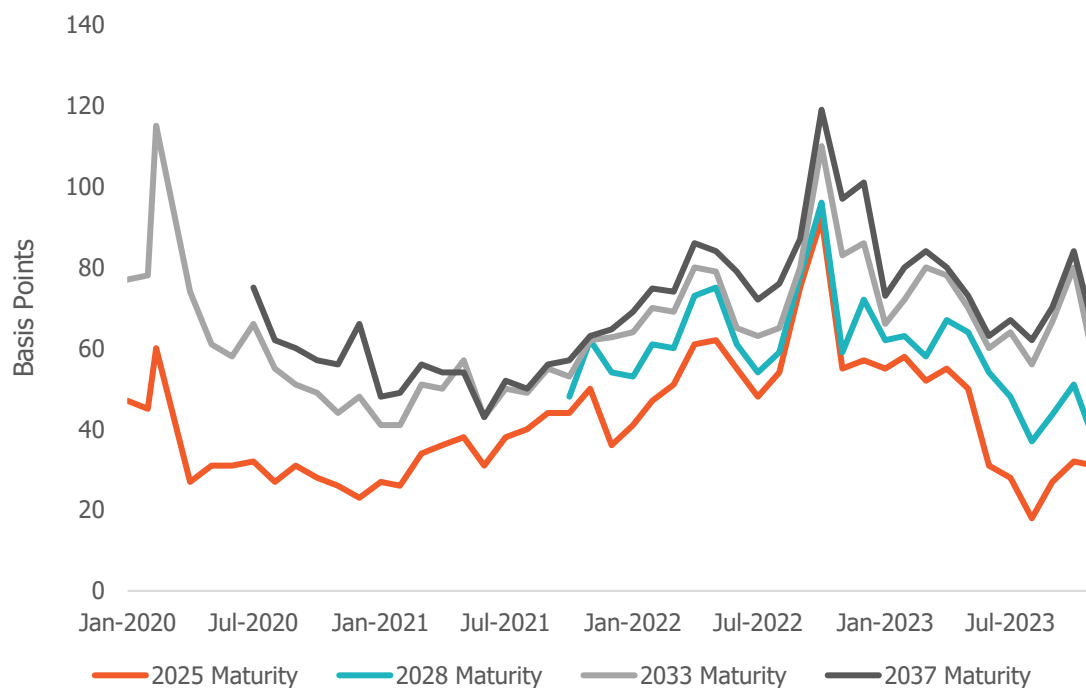
### 2.3. Key lending features

As of November 2023, LGFA lending currently carries an interest rate in the 6% range. Depending upon the maturity of the loan, this is 30 to 70 basis points<sup>21</sup> higher than the interest rates the Crown pays on its debt, which is considered to be the highest quality New Zealand dollar-denominated debt (Figure 6).

<sup>20</sup> Based upon conversations with both LGFA and Auckland Council.

<sup>21</sup> A basis point is defined as one .01%. 0.1% is equal to 10 basis points. 100 basis points is equal to 1%.

Figure 6: Interest rate spreads between LGFA and New Zealand government bonds



Source: LGFA.

LGFA recovers its administrative costs by charging a lending margin, ie the difference in interest rates it offers to councils compared to what it pays to borrow from the financial markets. This standard margin is 20 basis points, but it charges an additional 5 to 10 basis points depending upon the rating of the council. For unrated councils, an additional 20 basis points of margin are added.

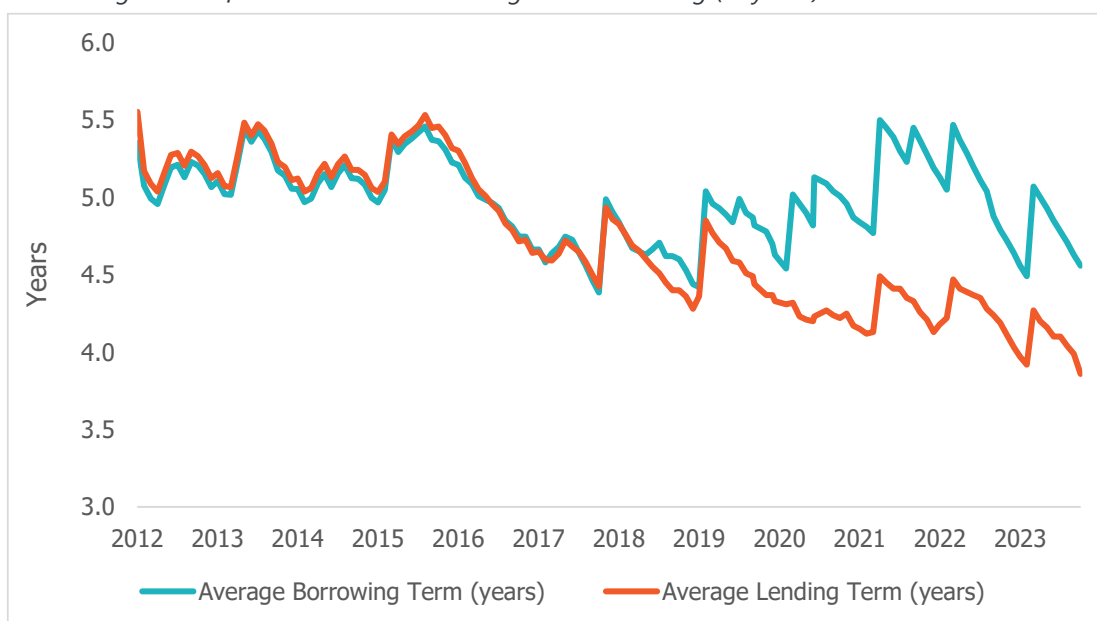
The average borrowing term is about four years and has been steadily decreasing over time. Councils can borrow for any term up to the longest dated LGFA bond on issue.<sup>22</sup> They can also refinance their LGFA borrowings to lengthen repayment periods.

At present, short borrowing terms are preferred by councils to avoid locking in a specific interest rate for the long term in a changing rate environment. LGFA has indicated that it is willing to lend for longer terms. LGFA also believes part of the reason for shorter-dated council borrowing despite long-dated council assets is councils planned for water-related debts to be repaid or transferred to water service entities in 2024 under previous three waters legislation, which has since been repealed<sup>23</sup> (Figure 7).

<sup>22</sup> As of November 2023, the longest term on issue was April 2037.

<sup>23</sup> Water Services Acts Repeal Bill of 2024

Figure 7: Average term of LGFA bonds outstanding and on-lending (in years)



Source: LGFA.

## 2.4. Issues and considerations

### What are the borrowing cost savings for councils from being in LGFA?

The main advantage of LGFA lending is that it allows councils to borrow at lower rates than they would on their own. By having the same credit rating as the Crown, LGFA is able to access offshore financing at low rates. Consolidating council debt in one place also means foreign investors do not need to perform due diligence and risk analysis on every council, also leading to lower costs for councils.

The savings that each council achieves through LGFA vary. Savings depend in part on whether councils have a credit rating, and, if they do, what they are rated.

Most rated councils carry an AA rating from Standard & Poor's (S&P), with some higher and some lower than this mark. (See Appendix C for complete listing.) To give a rough indication of potential savings from participating in LGFA, we note that domestic banks, which carry AA- ratings, issue debt at about 20 to 40 basis points higher than LGFA.<sup>24</sup> Though there are many factors that influence borrowing costs, it seems reasonable to assume that higher credit-rated councils achieve some modest savings by borrowing from LGFA versus directly from the market.

There are exceptions to this. Auckland Council believes that their borrowing costs are generally on par with LGFA, and as a result, issues debt directly to the market for the majority of its needs. Christchurch City Holdings, a CCO that operates major council assets, also borrows directly from the market. This suggests that it believes that it can achieve similar costs to LGFA.

Savings from participating in LGFA are likely to be higher for smaller councils without a credit rating or the administrative capacity to borrow on debt markets. It is difficult to estimate what their savings are from being in LGFA. If their alternative was borrowing directly from a domestic bank, they would certainly pay higher costs than the bank does for its lending, which is about 20 to 40 basis points higher than LGFA. According to LGFA, some small unrated councils saved 100 basis points by joining LGFA.

<sup>24</sup> LGFA 2023 Annual Report, page 13: [https://www.lgfa.co.nz/sites/default/files/2023-09/LGFA\\_AnnualReport\\_2023-FINAL.pdf](https://www.lgfa.co.nz/sites/default/files/2023-09/LGFA_AnnualReport_2023-FINAL.pdf)

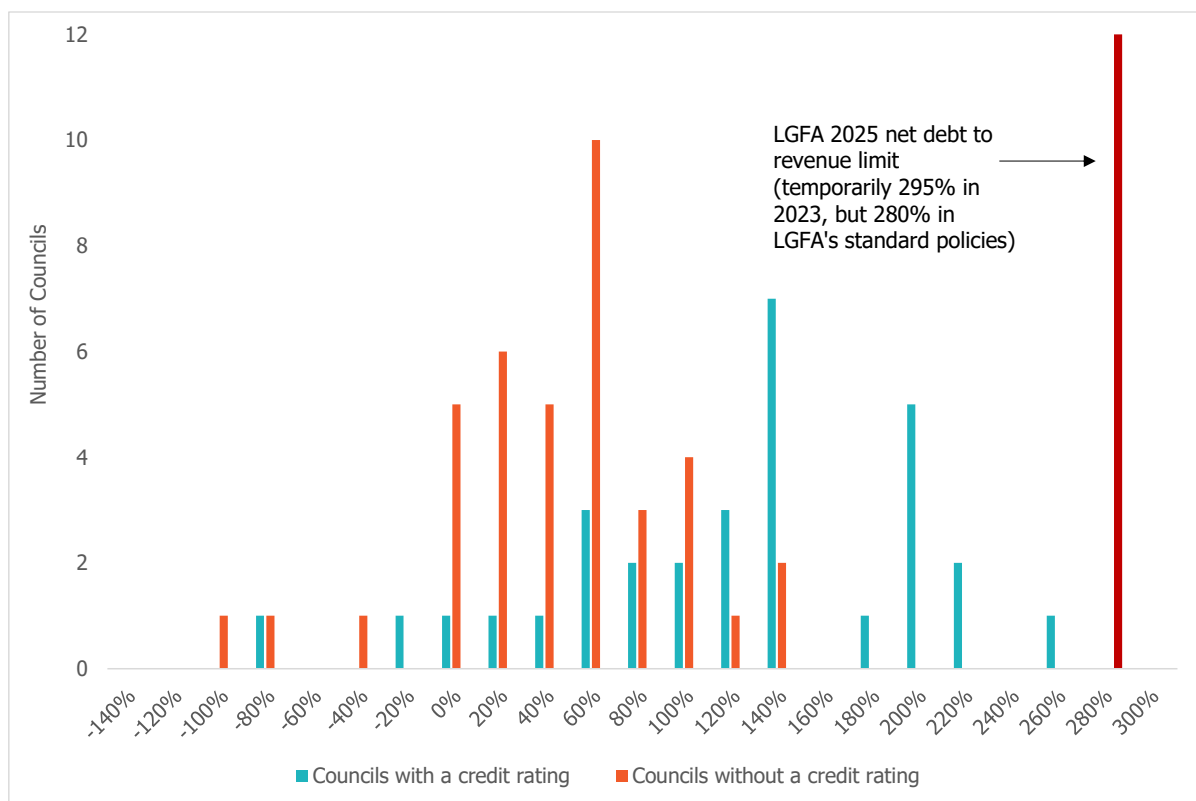
Finally, there are administrative costs to borrowing directly that are avoided by using LGFA. These are estimated to be in the five-basis point range.<sup>25</sup> There are also interest rate hedging costs that are covered in an LGFA loan that would be incurred by councils if they issued directly.

### How much debt headroom do councils have under LGFA limits?

While LGFA offers access to lower-cost debt finance, LGFA covenants, particularly the net debt to revenue covenant, limit the amount of debt that councils can take on.

As at the end of 2023, the median council with a credit rating had a net debt to revenue ratio of 110% while councils without a credit rating had a median ratio of 36%. As of the end of 2023 only Queenstown, Rotorua, and Horowhenua were beginning to approach the debt to revenue limit (Figure 8).

Figure 8: Distribution of council net debt to revenue ratios as of June 2023



Source: LGFA.

Larger councils and growth councils have higher ratios on average (Table 8).

<sup>25</sup> Based upon conversations with Auckland Council.

Table 8: Selected council performance against LGFA debt covenants, June 2023

Councils with a credit rating (<295% in 2023)							
Auckland	Christchurch	Wellington	Hamilton	Tauranga	Queenstown	Rotorua	Kāpiti
198%	109%	164%	187%	181%	247%	208%	183%
Councils without a credit rating (<175%)							
Gisborne	Masterton	Manawatū	Wairoa	Kaikōura	Grey	Far North	Hauraki
66.6%	44.4%	105.9%	7.1%%	10.8%	58.7%	51.6%	94.5%

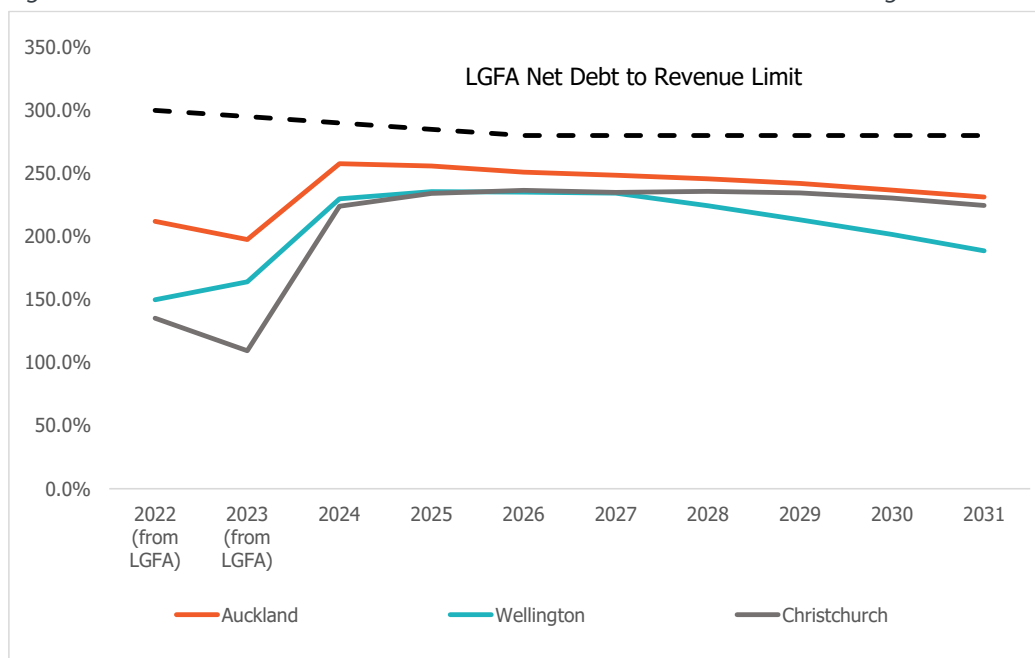
Source: LGFA.

Appendix B shows a full listing of council performance against all three covenants as of June 2023.

Future indications of borrowing suggest some councils may approach borrowing limits. 2021 council LTPs are, at present, the best indication of potential council headroom against the covenants. However, these were last completed in 2021. Identification of new infrastructure projects and cost inflation means that the level of debt in the upcoming 2024 LTPs are likely to be greater than projected in 2021. Many 2021 LTPs were also built on the assumption that water infrastructure investments may be part of a future water services entity.

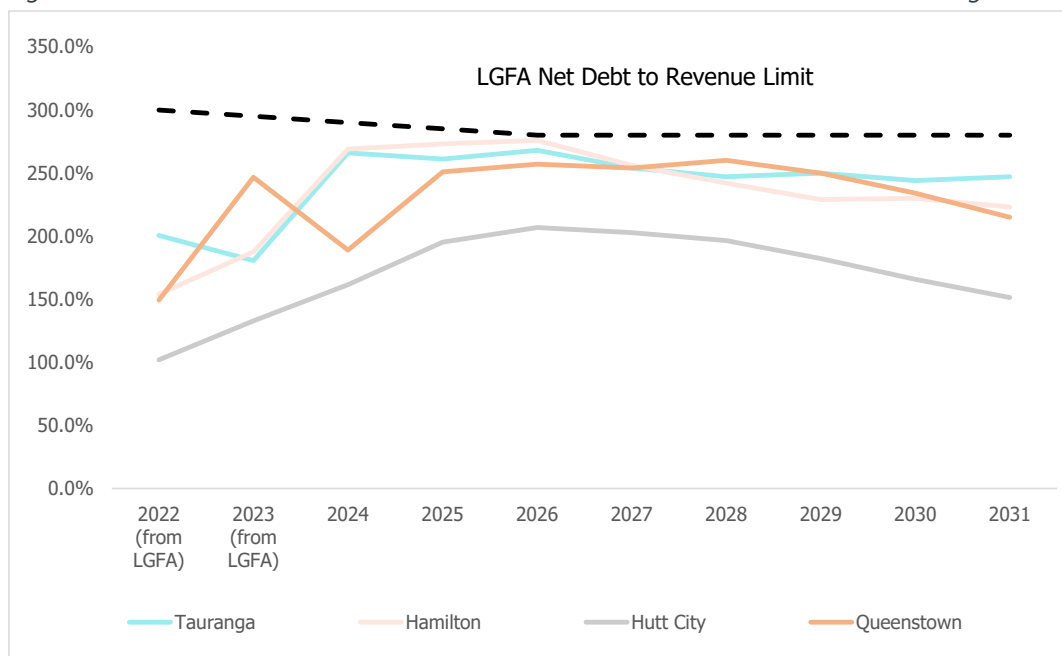
Te Waihanga surveyed a small portion of large and high-growth council LTPs to analyse their projected debt ratios. We found that these councils forecast nearing their limits, particularly over the period 2023 through 2028, but expect headroom to increase thereafter. This headroom after 2028 may be a function of councils not having a full understanding of needed projects beyond that point. It is possible this headroom will no longer exist after 2024 LTPs are finalised. The amount of headroom will also depend upon councils' abilities to undertake all the planned capital expenditure in their LTPs (Figure 9 and Figure 10)

Figure 9: Estimated select council net debt to revenue ratios in 2021 LTPs: large cities



Sources: Councils' 2021–2031 LTPs, LGFA, and Te Waihangā analysis. Note: Where possible, Te Waihangā used net debt to revenue ratios in LTPs. In cases where councils reported gross debt, Te Waihangā calculated net debt as borrowings plus financial derivatives minus cash and investments. Revenue was calculated as total revenue minus development and financial contributions and vested assets.

Figure 10: Estimated select council net debt to revenue ratios in 2021 LTPs: selected growth councils



Sources: Councils' 2021–2031 LTPs, LGFA, and Te Waihangā analysis. Note: Where possible, Te Waihangā used net debt to revenue ratios in LTPs. In cases where councils reported gross debt, Te Waihangā calculated net debt as borrowings plus financial derivatives minus cash and investments. Revenue was calculated as total revenue minus development and financial contributions and vested assets.

### Councils' self-imposed limits impact debt headroom

In addition to LGFA debt limits, councils impose stricter debt limits than LGFA that further limit their ability to debt finance. Wellington's internal debt limit is 225% and Hutt City's is 250% for example. This is to provide them with headroom for unexpected expenses like natural disasters and cost inflation.

Moreover, most councils surveyed for this analysis placed limits on either the level or growth in their rate revenue in their LTPs. For example, Wellington imposes a hard cap on rate revenue of \$475 million from 2022–2024, rising to \$630 million from 2025–2031. Hamilton sets limits on annual changes in rates at a maximum of 4.9%. Queenstown caps rate revenue growth at 9% per annum and states that rates cannot account for more than 55% of total revenue.

These revenue limits have a meaningful impact on council's ability to finance needed infrastructure. If debt-funded capital expenditure rises faster than these limits, then the ratio will rise. To give a sense of scale, in Wellington, we estimate that if rates were allowed to be 10% higher than projected in their 2021 LTP, their debt ratio could be brought down by approximately 14 percentage points. Alternatively, if Wellington raised rates revenues but maintained its same debt-to-revenue path as its 2021 LTP, it would have an additional \$116 million in debt headroom, on average (Figure 11).

Figure 11: Path of Wellington net debt under current LTP and a rates level 10% higher than LTP



Source: Wellington 2021–2031 LTP, Te Waihanga analysis.

### LGFA's debt limits are uniform regardless of council growth path

LGFA covenants are largely the same for councils and their CCOs, regardless of their future growth trajectories. The only differentiation between covenants is whether a council has a credit rating or not, with rated councils having a higher debt limit.

Rated councils tend to be faster-growing, larger areas, but there is still much variation in growth trends between them. This means that fast-growing councils like Queenstown face the same debt constraint as slower-growing ones like Palmerston North. Centralising finance in one place and enforcing common requirements about risk tolerance helps to reduce borrowing costs, but faster growing places may be more constrained in their ability to debt-finance investment as a result.

Another consideration is that high-growth councils, which tend to rely more on development contributions, may be disadvantaged by the covenants. Development contributions are not considered



revenue for the purposes of the debt covenant.<sup>26</sup> In theory, however, development contributions should be used to recoup the cost of infrastructure to service new housing development, including debt servicing costs.

Where a problem may arise is if growth from development either causes the need for infrastructure beyond the infrastructure covered by the development contributions, or if the development that occurs is less than expected. The New Zealand Infrastructure Commission’s submission on the 2022 Drury Development Contributions Policy highlighted the challenges and risks involved with development uncertainty.<sup>27</sup> Under one modelled scenario, growth that was 15% lower than expected in Drury resulted in \$0.5 billion in costs for ratepayers.

There is also an issue of timing that disadvantages councils that rely on development contributions to fund growth infrastructure. Debt-funded infrastructure, which counts towards a council’s debt limit, needs to be built before development can occur. Development contributions only pay for that infrastructure once development occurs. As such, there is a period where a council will be bearing a higher debt ratio without any associated revenues.

### LGFA financing may incentivise different types of assets

LGFA’s debt covenants treat all debt the same irrespective of whether it is being used to build an asset that directly produces revenues like user charges. For example, the construction of a new administrative office, which yields no direct revenue, would be treated the same as debt used to construct a bridge that is tolled.

LGFA completes risk analysis of councils’ overall portfolio of debt, assets, and revenue, but it does not necessarily evaluate whether new debt-financed investments are going to generate future liabilities, such as ongoing maintenance, or revenue streams, aside from general revenues, that could be used to service the debt.

This contrasts with project financing, which would require an asset’s revenue streams to match its whole-of-life costs. For councils with debt headroom, the lack of project financing makes social infrastructure easier to debt finance since low-cost LGFA financing is available regardless of the individual project’s financial feasibility.

As councils approach their debt limits, LGFA covenants may make projects that do not produce revenue less appealing. Debt funding a project that does not raise revenue on its own will require an increase in general rates to keep the council’s debt ratio from rising. This might be politically more difficult. Conversely, an asset that produces revenue at least partly offsets the effect on the debt ratio through its own revenues.

### Debt ratio definitions can lead to confusion

While all councils in LGFA need to comply with LGFA’s debt limits, councils often report their debt burdens either as *gross* debt or *net* debt. LGFA’s debt limits apply to a council’s net debt, which is debt minus liquid assets such as investments and cash which can be sold quickly to provide income if needed. Some councils, such as Auckland and Christchurch, focus on gross debt in their own financial reporting, which does not account for liquid financial assets. One reason for this is it may simply be their preferred measure of debt burden. A second reason is that some rating agencies, like Standard & Poor’s, appear to use gross debt as their benchmark for indebtedness.<sup>28</sup>

<sup>26</sup> Development contributions are considered as non-government capital contributions, similar to a vested asset, where a developer transfers an infrastructure asset to a local government after constructing it.

<sup>27</sup> <https://media.umbraco.io/te-waihanganga-30-year-strategy/0ahnuiys/submission-contributions-policy-2022-variation-a.pdf>

<sup>28</sup> See Auckland’s Treasury Management Policy (page 3), citing methodology and definitions of S&P Global. <https://www.aucklandcouncil.govt.nz/plans-projects-policies-reports-bylaws/our-policies/Documents/treasury-management-policy.pdf>

The way council-controlled organisations (CCOs) are treated for the purpose of calculating LGFA's debt limits can also vary. CCOs are entities that act like companies that control council assets. Councils generally control 50% or more of the voting rights. Examples include Watercare or Christchurch City Holdings.

CCO debt is considered separate from its parent council debt for LGFA purposes if the CCO generates revenues independent from the council that enable it to service debt on its own. For example, Watercare debt is not considered in the debt ratio for Auckland, as Watercare generates revenue from user and connection charges, and uses this to service its debt. Since the council still controls the organisation, it is considered a contingent liability.<sup>29</sup>

Conversely, if a CCO relies on a council for debt service or operating costs, LGFA will count that debt towards the parent council. An example of this is Dunedin Stadium Property Limited, a CCO that operates Forsyth Barr Stadium. Its debt is considered as part of Dunedin City Council because the stadium does not generate sufficient revenues to pay for its own operational costs or repay interest on stadium-related debt. Instead, it relies on ongoing council subsidies and is therefore considered a core council activity.

This treatment of CCOs is important because it implies that councils that are close to their LGFA debt limits could create LGFA debt headroom by transferring revenue-producing assets to an independent CCO. So long as the CCO can set its own charges independent of a council to finance its own debt, such debt would not count against the parent council's LGFA debt covenants.

However, because some rating agencies consider debt at the group level, that is, for the parent council and its CCOs combined, councils with their own borrowing limits to satisfy rating agencies may not see an advantage to separating assets into CCOs from a financing perspective.

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<sup>29</sup> Contingent liabilities are defined as an obligation for councils where there might be the potential for loss. In this case, while councils may not pay the debts of a CCO, because councils control them, they may be responsible for them in times of distress.

## 3. Council-issued debt

This section covers debt financing that councils directly issue themselves. At the moment, Auckland Council accounts for the majority of council-issued debt. Christchurch City Holdings and Dunedin City Treasury, which are CCOs for their respective cities, also issue bonds. Christchurch City Holdings operates major infrastructure assets on behalf of the council while Dunedin City Treasury provides funding and financial services to council entities in Dunedin.

### 3.1. Key structural features

Most councils borrow through LGFA, but there is no legislation that prevents them from issuing debt in their own name. The primary reason for councils to prefer LGFA borrowing appears to be cost.

Direct issuing carries administrative costs that LGFA borrowing does not. These include staffing, legal, and investor relations costs. Auckland Council estimates these costs at about 5 basis points.<sup>30</sup> For councils seeking to borrow small amounts of money (less than \$100 million) on an infrequent basis, there is no benefit to doing this.

For Auckland, there are other practical reasons to direct issue:

- LGFA risk management policies state that Auckland’s debt cannot comprise more than 40% of all LGFA lending to limit risk related to overexposure to a single borrower. At present, Auckland composes about 20% of LGFA’s loan portfolio.
- It is easier for Auckland to borrow at volume (greater than \$300 million) from international debt markets. Auckland trades off the simplicity of a single tranche of debt for a modestly higher cost of funds.
- Depending upon the maturity of the issue, Auckland may be able to achieve cheaper terms than LGFA. All LGFA lending comes with a 20-basis point lending margin. For short-term domestic lending, Auckland is able to achieve close to the same rates as LGFA and does not need to pay the lending margin.
- Auckland prefers to diversify its borrowing sources. Part of this is to maintain relationships with foreign and domestic borrowers. It also helps them spread maturities, as foreign and domestic lenders have different risk appetites for debt maturities.

All council-issued debt sits on council balance sheets and therefore counts towards LGFA’s debt limits. This can include CCO debt, depending upon the CCO’s reliance on council funding, as noted in the previous section.

### 3.2. Current and future lending

Since the founding of LGFA in 2011, the amount of debt issued by councils in their own name has fallen significantly. As of June 2023, over 90% of lending to councils was from LGFA, while the remaining was from council-issued debt.<sup>31</sup>

Debt issuance by Auckland and its CCOs is by far the biggest source of council-issued debt. Auckland had \$12.4 billion of debt as of June 2023. Almost 75% of this was direct issued (49% foreign currency, 25% New Zealand domestic) and 26% was borrowings from LGFA.<sup>32</sup>

<sup>30</sup> Based upon conversations with Auckland Council.

<sup>31</sup> Information from LGFA.

<sup>32</sup> <https://www.aucklandcouncil.govt.nz/about-auckland-council/investor-centre/information-for-investors/Documents/auckland-council-investor-update.pdf>

Total gross debt for Auckland Council is projected to grow from \$12.4 billion in 2023 to just over \$16 billion, according to their LTP. It remains to be seen how much will be financed with council-issued debt. The current debt management strategy in Auckland attempts to diversify their use of domestic council-issued, foreign council-issued, and LGFA borrowings.

### 3.3. Key lending features

Council-issued debt does not have a typical set of terms. Auckland intentionally borrows at different maturities. The weighted average term of its debt is five years. Auckland accesses short-term credit to smooth intra-year cash flows but also has 30-year bonds maturing in 2050.

Auckland's six issuances traded on the New Zealand Debt Exchange (NZDX), a marketplace of publicly issued debt, have varying interest rates depending upon when they were sold. As of November 2023, yields on these issuances are currently trading between 5.4% to 6.25% depending on the maturity.<sup>33</sup> This is very near what LGFA bonds yield. Yields on debt traded outside of the NZDX may differ.

Council-issued debt can be bought by domestic and foreign institutional investors, although most debt is held domestically. Large debt issuances may require borrowing from large institutional investors on foreign markets because the amount of funding available domestically is small in comparison.

#### Why couldn't councils break LGFA covenants and issue debt on their own?

Prior to the LGFA, councils would have needed to issue debt on financial markets (like Auckland Council currently does) or borrow privately from other sources such as banks.

With some councils planning to approach their debt limits, one option available to councils is to revert to issuing their own debt as they did in the past. However, councils have refrained from doing this and do not appear ready to consider it. There are a few reasons for this as discussed below.

First, the administrative costs of directly issuing are higher than borrowing from LGFA. Auckland Council estimates that the resources needed to issue debt are roughly equivalent to 5 to 10 basis points on a typical loan. It also requires staffing resources with experienced soliciting lenders and liaising with debt markets.

Second, the institutional interconnectedness of councils, the LGFA, and the Crown may disincentivise any councils from direct issuing. LGFA is able to borrow cheaply because of the financial strength of its members, particularly the major councils. If the major councils left LGFA and issued directly, an organisation of small councils would not be able to command the same low interest rates.

No council has defaulted on its debt since the 1930s, meaning that council debt is perceived as being very high quality overall. If some large councils issued on their own and one ran into financial distress, it could change the overall perception of council debt quality, leading to higher borrowing costs for all councils. The Crown may be impacted if it is perceived as guarantor or would be willing to provide financial assistance to distressed councils.

A third plausible reason is borrowing costs. A council that breached its LGFA limit would immediately need to refinance its existing stock of LGFA debt. This would likely be costly due to the need to finance a large amount of debt in a short period of time. Over the long run, issuing its their own debt could mean higher interest rates for councils.

<sup>33</sup> <https://www.nzx.com/companies/AKC>

Without LGFA, small councils would almost certainly face higher borrowing costs by borrowing privately from banks. For larger growth councils, the borrowing costs they would face on financial markets are difficult to predict for any given council. As noted, Auckland Council meets the majority of its borrowing needs by issuing its own debt, signalling that its own borrowing costs are not significantly higher than LGFA, if at all. It remains to be seen whether another large city like Christchurch or Wellington could do the same. If a council decided to direct issue, a market sounding process could yield an estimate in short order.

Finally, leaving LGFA may result in them receiving a credit rating downgrade. Credit ratings reflect the perceived risk that an organisation will default on its debt. S&P, one of the major credit rating agencies, rates debt on a scale from 'AAA' (indicating the safest debt) to 'D' (indicating a borrower that is in default). These ratings are directly correlated to the interest rates for debt. Worse credit ratings lead to higher interest rates.

It is important to put these potential borrowing costs into perspective. The actual fiscal costs of a downgrade appear relatively small compared to the costs of services councils provide. Auckland Council is rated AA, S&P's third-highest rating. It estimates that a one-notch downgrade (from AA to AA-) would increase interest rates on its debt by 0.05 to 0.15 percentage points.<sup>34</sup> Borrowing costs could rise more if a council was downgraded from investment grade (BBB- or higher) to speculative grade (BB+ or lower).

Based upon statements in their LTPs and annual budgets, we estimate the effect of a 100-basis point increase in borrowing costs for Auckland, Wellington, and Tauranga.

As Table 9 shows, if a rating downgrade caused Auckland Council to pay an additional 10 basis points on its interest rate, it would cost them roughly \$2 million in additional finance costs, or approximately \$1.15 per Auckland resident per year. This compared to over \$5.5 billion in expenses related to operations for the council.

Table 9: Estimated effect of a 100-basis point increase in interest rates on council expenses

Council	How much would a 100-basis point increase in interest rates affect operating expenditure?	Reference year
Auckland	+0.3% to 0.4%	2022/2023
Wellington	+1 to 2%	2023/2024
Tauranga	+2.2%	2021/2022

Sources: Wellington 2021–2031 LTP, Auckland 2023/2024 Annual Budget, Tauranga 2021–2031 LTP, and Te Waihanga analysis.

### Even if council-issued debt came with higher borrowing costs, it would still be considered high quality

Most rated councils in New Zealand are AA by Standard & Poor's, with some higher and some lower. All of them are still investment grade, meaning that they are seen to have strong capacity to meet their financial commitments.<sup>35</sup>

For reference, S&P rates New Zealand government debt, the risk-free benchmark, at AA+, the same rating as Wellington City Council. Even with high debt to revenue ratios, local government debt is rated well above other private sector infrastructure providers. For example, electricity generators and distributors Contact Energy and Genesis Energy have BBB and BBB+ credit ratings, respectively. Chorus

<sup>34</sup> Page 76: <https://www.aucklandcouncil.govt.nz/plans-projects-policies-reports-bylaws/our-plans-strategies/budget-plans/Documents/annual-budget-2023-24-volume-1.pdf>

<sup>35</sup> <https://www.spglobal.com/ratings/en/about/intro-to-credit-ratings>

Limited currently has a rating of BBB. Infratil's debt currently trades at 100 basis points above that of Auckland Council's depending upon the maturity.<sup>36</sup> These benchmarks would vary depending upon the council and the comparators.

Borrowing costs would increase as a result of a downgrade, but as noted above, the costs appear to be small relative to councils' overall operating budgets. And, as the next section will discuss, demand for SPV finance demonstrates that some councils are comfortable paying higher interest rates than LGFA to circumvent debt limits to finance needed infrastructure.

We consider it most likely that the primary cost to a downgrade is largely reputational. Council downgrades generate negative publicity that council finances are being poorly managed.

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<sup>36</sup> <https://www.nzx.com/companies/IFT>

## 4. Special-purpose vehicles

This section discusses debt financing available to councils via special-purpose vehicles (SPVs). While there are some projects in New Zealand that have used SPV-like arrangements, this section will primarily focus on the SPV model enabled by the Infrastructure Funding and Financing Act 2020 (IFF Act).

### 4.1. Key structural features

An issue for some councils that use debt for infrastructure is that the debt must be held on their balance sheet. For councils that are close to their LGFA limits, additional debt could drive them even closer. To mitigate this issue, the IFF Act created a formal process for councils to finance infrastructure through SPVs. In short, the new debt sits on the balance sheet of the SPV, meaning that the council is not directly responsible for it. This allows them to carry out infrastructure needs without affecting their debt position. While the off-balance sheet nature of SPVs is a key feature of SPV finance, councils that are not near their LGFA debt limits can also utilise SPV financing.

The process for financing infrastructure through an SPV is as follows:

- A council identifies an infrastructure project it would like to finance and build.
- With the help of Crown Infrastructure Partners (CIP), the council develops a proposal to finance and deliver the infrastructure through an SPV, using a levy on beneficiaries of the scheme to repay the debt over the lifespan of the project.
- The Ministry of Housing and Urban Development (HUD) assesses the levy proposal and recommends to the Minister of Housing that the levy be enacted. The levy is created by an Order in Council after approval by cabinet.
- The SPV is created to finance the new infrastructure.
- The SPV borrows to finance the new infrastructure, and grants these debt proceeds to councils that build the infrastructure.
- To repay debt, it issues a levy on property owners within a proposed catchment, which can be as broad as an entire city. The standard levy collection period is 30 years but could be up to 50 years. The council collects the levy as an agent for the SPV.

Once the asset is complete, it is transferred to the appropriate owner and once the repayment is complete, the SPV ceases to exist. CIP plays a facilitator role for SPVs. They assist councils in the creation of their proposals. They also help establish the SPV and solicit capital from domestic and foreign lenders.

Financing infrastructure through an SPV is very similar to project financing of a capital asset, where the repayment of debt is closely linked to the asset, in this case, the levy. Conceptually, this is also not unlike a debt issued by councils backed by a targeted rate. The key difference is that SPV debt does not sit on the council's balance sheet, meaning that it is not directly responsible for it like it is for a targeted rate financed through LGFA. As such, this debt does not count against LGFA debt covenants.

To demonstrate why a debt constrained council may opt to use an SPV financing arrangement, imagine a simple example of a council with \$1 billion in revenues and \$2.5 billion in net debt, and thus a ratio of 250%.<sup>37</sup>

- Under traditional LGFA financing, this council would have \$300 million in headroom to make needed infrastructure investments without raising additional revenues.
- For a \$500 million infrastructure project, if it used a targeted rate coupled with LGFA financing (assuming a 6% rate and a 30-year financing period), it would need to raise over \$70 million in annual revenue (targeted rate or otherwise) to keep its debt ratio under 280%.

<sup>37</sup> Private developers and iwi can also use SPV financing. This section primarily discusses SPVs in the local government context.

This is well above the needed debt servicing costs of the project. In order to stay under the debt limit, in effect, current ratepayers need to pay much more for new infrastructure that future ratepayers will benefit from. SPV financing allows councils approaching their debt limits to ensure more equitable financing between current and future ratepayers. By using an SPV, the council can move forward with the project without concern to the debt limit and the levy can be calibrated to match the needed debt servicing payments.

## 4.2. Current and future borrowing

Currently, only two infrastructure projects have used SPV financing under the IFF Act: Tauranga’s Transport System Plan and the Wellington Sludge Minimisation Facility, two projects worth a total of \$575 million (\$175 million for Tauranga and \$400 million for Wellington).<sup>38</sup>

CIP also facilitated the creation of a \$48.9 million SPV prior to the IFF Act to finance infrastructure for the Milldale development in Auckland. The use of SPVs was also explored for Hamilton’s Peacocke greenfield development.

Councils have expressed interest in this type of financing. CIP state that they have fielded interest from the following councils:<sup>39</sup>

- Tauranga, for growth infrastructure related to new development
- Hamilton, for transportation projects in the city, along with new growth infrastructure for developments
- Bay of Plenty Regional Council, for infrastructure for a greenfield industrial park development
- Palmerston North, for a wastewater plant similar to Wellington’s
- Queenstown, for potential transportation projects.

CIP’s Briefing to the Incoming Minister indicates that \$1.5 billion is available for SPV transactions.<sup>40</sup>

On the lender side, CIP is exploring alternative sources of finance to ensure there is capacity to meet SPV debt demand and to achieve better pricing for councils that use it. While SPV financing could play an important role in addressing local infrastructure needs, it is likely to be small relative to LGFA lending.

## 4.3. Key lending features

The terms of each SPV transaction are bespoke, but there are some typical characteristics.

Existing SPV borrowing has typically had terms that match the length of the levy period, which has been 30 years in the two transactions to date. The project draws down money from the loan during the drawdown period, which is matched with the construction phase of the project.

The gross, headline difference between the interest rates of SPV and LGFA financing is around 100 to 120 basis points. However, the two are not directly comparable. Key differences include:

- SPV loans tend to have longer maturities (30 years) than LGFA (typically five years or less). Longer dated debt generally carries higher interest rates to offset interest rate risk on the part of the lender. A direct comparison requires an analysis of a hypothetical 30-year LGFA loan.
- SPV loans are able to leverage more debt per dollar of revenue. An LGFA loan generates approximately \$3 of debt for every \$1 of revenue. SPV loans have a higher ratio, but the borrower pays a premium for it.

<sup>38</sup> Financing costs are in addition to these principal amounts.

<sup>39</sup> Based upon conversations with CIP.

<sup>40</sup> [https://www.crowninfrastructure.govt.nz/wp-content/uploads/CIP-Briefing-for-Incoming-Ministers-Digital-Connectivity-2023\\_Redacted.pdf](https://www.crowninfrastructure.govt.nz/wp-content/uploads/CIP-Briefing-for-Incoming-Ministers-Digital-Connectivity-2023_Redacted.pdf)



Once accounting for some of these key differences, a like-for-like comparison is about 60 to 70 basis points of difference between the two types of debt.

This difference can be attributed primarily to different risk profiles between the two. SPV debt is modestly riskier for lenders for the following reasons:

- Debt backed by general rate revenue, the main source for LGFA debt, is considered modestly less risky than a levy.
- SPV finance is also a relatively new instrument. LGFA debt is a well-known quantity for creditors.
- SPV debt cannot be easily bought or sold by creditors looking to transfer it.

Councils that opt to use SPV finance must weigh whether the additional benefits of longer terms and greater leverage against the additional costs. Right now, most of the lending comes from CIP's senior debt panel. CIP expects that as more interest and take up of the tool occur over time, they will be able to access cheaper finance from broader debt markets, narrowing the price premium with LGFA debt.

Finally, the SPV planning and development process for councils, which can last between six and nine months, also carries cost for councils.

## 4.4. Issues and considerations

### Strengths and limitations of using SPVs

Because SPV debt sits off council balance sheets, a council can provide more infrastructure without it affecting their LGFA covenants. This is particularly important for financially constrained councils.

Debt financing through an SPV also comes with a number of strengths:

- It links the repayment of debt directly to levy revenues associated with new assets.
- Once established, the SPV structure provides more certainty that the infrastructure will be delivered, regardless of changing council policy or budget decisions.
- SPVs typically have longer repayment periods, which allows councils to spread the costs over longer periods of time.
- The use of a levy may be more transparent for property owners than general rates.

Some of these advantages also exist for council-issued debt backed by a targeted rate, but SPV use ensures that all these elements are linked together.

SPV financing can be used for a wide variety of project types. However, the use of a levy and its comparatively higher transaction costs likely mean its outcomes are maximised by certain types of projects.

- Infrastructure projects with wide benefit catchment areas: This reduces levy risk.
- Larger projects: The higher transaction costs to plan and execute the tool make it more difficult for small-scale projects.
- Projects located in growth councils: As the resulting infrastructure is more likely to spur more levy-paying development.

SPV financing is more challenging for:

- Smaller greenfield developments with high infrastructure costs and narrow catchment areas. The smaller catchment areas result in high levies, which raise affordability concerns for councils.
- Projects where it is difficult to clearly identify the beneficiaries of the asset.
- Brownfield infrastructure development, where clearly identifying beneficiaries of new infrastructure may be harder due to the fact that it typically benefits both new and existing residents.

The long-term nature of SPV debt could also create frictions with other sources of money, particularly for local roads. For instance, a major road project in a council will be jointly funded by the council and

the National Land Transport Fund (NLTF). If a council opts to use SPV finance, it locks its commitment for 30 years, whereas NLTF is updated in three-year cycles. This timing mismatch may make it additionally difficult to develop an SPV financing proposal.

As noted, councils do pay an interest rate premium when using SPV finance. To give a sense of scale we estimate that for a 30-year term, the difference in interest costs between a 6% and 6.6% interest rate (60 basis points) on a \$400 million bond (the cost of Wellington’s Sludge Minimisation Facility) is roughly \$56 million.<sup>41</sup>

### Balance sheet separation does not eliminate council risk or affordability considerations

SPV finance sits off council balance sheets, meaning it is separate from councils. The SPV itself is primarily a financing vehicle. As such, unlike LGFA or council-issued debt, councils are not legally obligated to repay an SPV’s debt. The council is primarily responsible for building the asset and collecting the levy, but not the repayment of creditors.

However, just because an SPV is separate entity does not mean councils and the Crown are fully insulated from risks associated with more traditional forms of debt.

First, while councils are not legally obligated to ensure that debt held by an SPV is repaid, councils (and likely the Crown) may feel a reputational obligation to ensure that creditors are repaid.

Second, similar to other debt financed infrastructure, higher-than-expected construction costs that exceed levy revenues are the responsibility of council ratepayers. These are significant and real risks. Literature on major infrastructure projects has shown overruns on cost up to 90% of the time, with overruns of greater than 50% or more being common.<sup>42</sup>

Separate from councils, the Crown also shoulders a certain set of well-defined risks. These include the risk of the levy being subject to judicial review, law changes, the levy order being terminated by the Crown, and non-payment of levy by beneficiaries.

Beyond these risks, it is important to note that even though the debt is separate from councils, revenues to fund an SPV come from property owners, which are also the primary revenue source for LGFA finance and council-issued debt. HUD is required to assess the affordability of the levy for ratepayers. In the case of the Wellington Sludge Minimisation Facility, the threshold for affordability was that rates plus levies should not be greater than 5% of gross household income for a council.<sup>43</sup> This threshold was used as an approximate guide for assessing affordability of rates. Ultimately, it is the council, with HUD’s approval, that determine whether the levy is affordable for its residents.

Finally, like a typical loan, once the SPV is retired, operating costs, depreciation, maintenance, and renewals of the asset are ongoing responsibilities for the council. Council revenues will need to be made available for these responsibilities.

### SPVs and Public Private Partnerships (PPPs)

While the IFF Act pertains to SPVs and the use of a levy to fund infrastructure, PPPs could be another form of SPV-type financing arrangement. A private entity could finance the construction of an infrastructure asset using its balance sheet. Upon completion, it could make payments using revenues from user charges, or a service agreement with the local council.

<sup>41</sup> Discounted, this is about \$35 million in present value terms, with a 5% discount rate.

<sup>42</sup> Flyvbjerg, Bent. ‘Over budget, over time, over and over again: Managing major projects’. (2013): 321-44.

<sup>43</sup> <https://www.hud.govt.nz/assets/Uploads/Documents/Cabinet-papers/02a-Infrastructure-Funding-and-Financing-Act-2020-Wellington-Sludge-Minimisation-Facility-Levy-Order-REDACTED.pdf>

This threshold was established by the 2007 Local Government Rate Inquiry (also called the Shand Report).

However, such an arrangement would still be considered a contingent liability for the council. Depending upon how linked the council is to the funding and financing of the asset, it could also be treated as debt of the council. Treasury guidance has indicated that PPPs that are financed by service payments from government, which are the standard model for PPPs in New Zealand at present, should be treated as debt liabilities.<sup>44</sup> These types of arrangements, therefore, would not sit off-balance sheet and count towards LGFA's debt limits.

PPPs in New Zealand have historically focused on contracts based around outcomes (government pays a private entity based upon achievement of certain objectives) of a project. To achieve certain balance sheet separation, the PPP would need to be structured more as a private infrastructure asset with some public benefit, a situation that is not widely used in New Zealand. At a minimum, it would need to have the ability to determine its own revenues independent from council.

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<sup>44</sup> <https://www.interest.co.nz/sites/default/files/NZ%20PPP%20guide.pdf>

## 5. Conclusions and discussion

Recommendation 51 in the New Zealand Infrastructure Strategy emphasises the need to develop our ability to debt finance infrastructure. This paper has reviewed the key tools available to local government along with their strengths and limitations. Based upon this work, we make the following conclusions.

### LGFA financing is and will likely remain the primary financing tool for local government

LGFA financing, with its low borrowing and administrative costs, appears to be the preferred financing method for almost all councils. While some higher-growth, larger councils are approaching their debt covenants, most councils appear well under their limits. We expect them to continue to access the low-cost financing that LGFA offers.

SPVs provide value in the overall system, particularly in financially constrained councils. They also allow councils to leverage a significant amount of debt for a given amount of revenue. Increased take-up may drive down the cost difference between a comparable LGFA loan. At the moment, however, their use has been relatively limited and is likely to remain small next to LGFA.

Council-issued debt has largely been replaced by LGFA. Despite the constraints of the debt covenants, no council appears to be considering leaving LGFA to issue debt on their own as a way to circumvent LGFA's covenants.

### The current financing system forces fiscal discipline and a uniform low-risk tolerance

The local government financing system includes three main players: the LGFA, councils, and the Crown. In New Zealand, the ability to debt finance local infrastructure at low costs has depended upon the financial condition of each.

- Councils make up the LGFA, and the financial health of the councils determines the ability of the LGFA to borrow cheaply from domestic and international markets, the savings of which are passed on to councils.
- LGFA's own credit rating, in addition to being underpinned by the financial health of the councils, is directly related to the Crown's position, since rating agencies assume Crown support for the LGFA in a time of stress.
- Council financial health can affect the Crown if the Crown needs to offer financial support for councils or the LGFA in times of distress.

This system prevents individual councils from incurring too much debt. But it could be constraining infrastructure construction in areas that could support it. Councils with a greater willingness and ability to shoulder higher debt costs in exchange for the opportunity to debt finance their capital programmes cannot do this if LGFA is their primary source of finance. Instead, it forces councils at their debt limits to either forgo projects, establish SPVs for the majority of new investment, or adopt a pay-as-you-go system.

Changes to this system that allow for additional borrowing may be optimal from an infrastructure investment perspective but also creates higher risk of local government distress.

While the Crown does not explicitly guarantee council debt, it has historically shown an interest in constraining council debt and the overall financial health of councils. Over the past 100 years, it has exerted varying degrees of control over council indebtedness to prevent excess (for example, Local Government Loans Board approval was required for all council debt for over 40 years). The difference today is that LGFA membership isn't compulsory, and the covenants are established by the councils themselves.

This may be a desired outcome on the part of the Crown that has an interest in the financial health of councils. Nonetheless, because of this, difficult financial and political decisions must be made by councils that have competing priorities and the decisions they make may not align with those of the Crown.

## Setting aside LGFA debt covenants, there is capacity to increase council debt

### The fundamentals of council finances and debt are still relatively strong

Despite the high debt burdens of some councils, council performance against the other LGFA covenants, which measure council's ability to service debt, is strong. Net interest costs as a share of revenues, which LGFA limits at 20%, averaged 3% across rated councils in 2022, with the high debt councils averaging in the 6% range. Councils' weighted average interest rates and debt servicing costs for their debt portfolios will increase as a result of recent increases in interest rates, but the current positions of councils should give them headroom to buffer that risk. Further, most councils borrow at different terms and hedge against rising interest rates.

Council debt is still highly rated by credit rating agencies, especially when compared to other private infrastructure providers. While these rating agencies have signalled their concern over growing council debt burdens and have put some councils on negative outlooks,<sup>45</sup> the financial costs to any single council of a rating change are small relative to the costs of other operating expenses.

There is nothing preventing larger, high-growth councils from leaving LGFA and issuing debt directly, other than the need to refinance their existing stock of LGFA debt.<sup>46</sup> If a large council with a good credit rating did this, they would likely face some downgrade risk as a result of a higher debt burden. The increased borrowing costs, while possibly modest, would need to be balanced against council infrastructure priorities. It would also need to be weighed against the investment proposition for new infrastructure, which could increase councils' ability to raise revenues directly (for instance, from new user charges) or indirectly (for instance, if it increased economic growth and hence increased the affordability of higher rates).

The use of SPVs gives us some insight as to the potential costs associated with approaching or breaching LGFA limits. In their assessment of Wellington's sludge minimisation facility, the Ministry of Housing and Urban Development noted that Wellington would breach its LGFA covenant from 2025 through 2030 if it kept the debt of the facility on its balance sheet.<sup>47</sup> Despite this, Wellington was able to leverage \$400 million against projected annual average levy revenue of \$42 million over 30 years through an SPV. The debt is off-balance sheet, but the levy revenue is paid by the same ratepayers as it would have been if it were targeted rate.

Information on the interest rate of this debt is unavailable. As an approximation, we consider the financial and reputational cost of breaching the limit are similar to the costs of avoiding it, which in this case were likely between 70 to 100 basis points, which is the typical difference between interest costs for LGFA loans and CIP SPV loans.<sup>48</sup>

Moreover, by using an SPV, Wellington was able to borrow *more* per dollar of additional revenue than using an LGFA loan. An LGFA loan would have enabled them to borrow a maximum of \$2.80 for each

<sup>45</sup> 'Bridge over Troubled Waters: New Zealand Local Government Outlook 2024'. Standard & Poor's. 19 November 2023. <https://www.spglobal.com/ratings/en/research/articles/231119-new-zealand-local-government-outlook-2024-bridge-over-troubled-waters-12911552>

<sup>46</sup> This would require assessment of domestic market capacity to provide the needed capital.

<sup>47</sup> <https://www.hud.govt.nz/assets/Uploads/Documents/Wellington-Sludge-Minimisation-Facility-IFF-Act-Recommendation-Report.pdf>

<sup>48</sup> Alternatively, Wellington could have left LGFA, refinance all its debt, and pay a higher interest rate. This interest rate would not be as high as 100 basis points above LGFA. But we assess that Wellington opted for a SPV for this because it deemed the reputational cost as being very high and would rather pay the 100 basis points to avoid the difficulty of exiting LGFA.

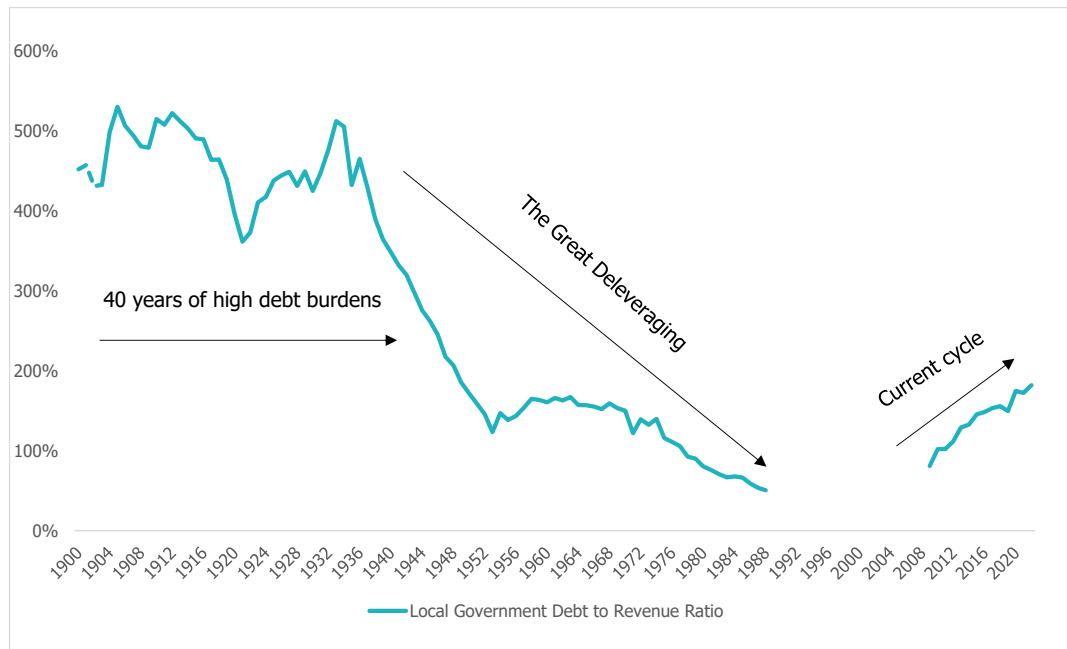
additional dollar of revenue as it approached its limit. The SPV approach, which leverages \$400 million against an average of \$42 million in annual levy revenue across 30 years, allowing for \$9.40 for every dollar of additional revenue.

Rather than a legal or market constraint, limits on debt financing for large or fast-growing councils appear to be more reputational in nature. Leaving the LGFA and direct issuing well above LGFA's debt limits could be judged as fiscally undisciplined. Downgrades carry significant negative publicity.

### Councils have been significantly more indebted in the past

While current local government debt burdens are growing, history also tells us that some councils have been significantly more indebted in the past, as measured by their debt-to-revenue ratios, the standard metric used by councils and rating agencies. In the 40 years prior to the Second World War, local government sustained debt burdens that were four to five times greater than they are today (Figure 12).

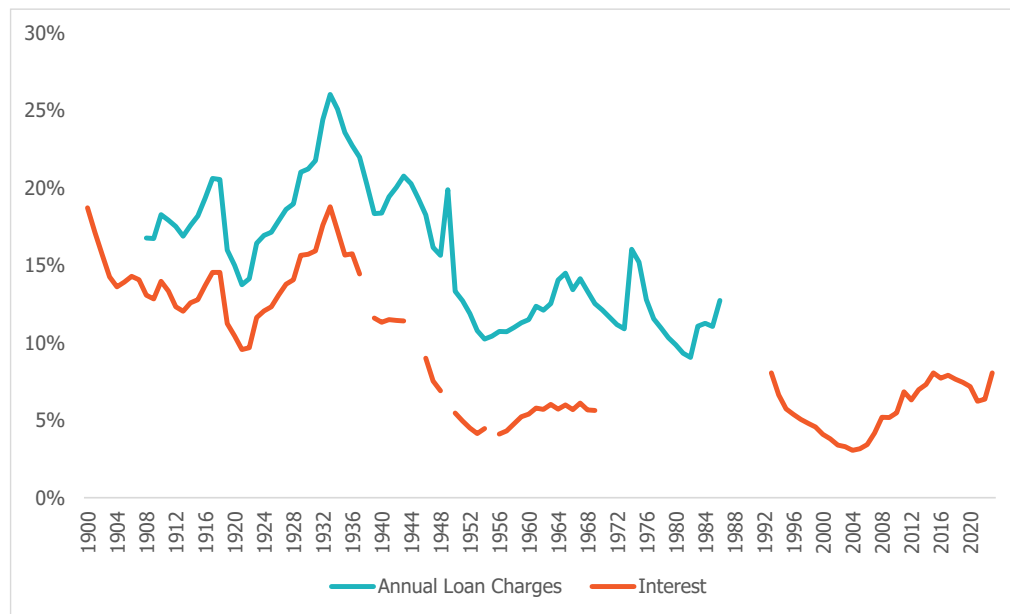
Figure 12: Local government debt as a share of revenue, 1900–2022



Sources: Data for local government debt is sourced from the Stats NZ Yearbook collection. The dashed blue line represents a period where local government debt is characterised as 'gross debentures' and does not include loans from central government. Data from 2009 onward are from Stats NZ local authority statistics. Note: No data are available for the 1989–2008 period.

Historically, councils also allocated a significantly larger share of their budgets to servicing this debt than they do now. Annual loan charges, which represent the payments councils needed to make on debt each year, accounted for between a fifth and a quarter of all council expenses for the first half of the century. Interest costs for councils are also low by historical standards (Figure 13).

Figure 13: Local government debt servicing costs as a share of total expenditure, 1900–2022



Sources: Data prior to 1993 is pulled from the Stats NZ Yearbook collection. Note: These data are defined as ‘annual loan charges’ or ‘interest’ as a share of ‘expenditure’, which generally includes public works, administration, amortisation, and hospitals. Interest data have gaps, the largest being from 1970 through 1992. Data from 1993 onward are from Stats NZ local authority statistics. ‘Expenditure’ in this period is defined as operating revenue.

### Are our financing tools up for the job?

We have assessed that LGFA’s financial covenants are relatively risk averse and uniform despite great variation in council’s ability to support higher debts. In their absence, we judge there would still be demand for council debt, albeit at a potential higher price. Lender and borrower appetite for SPV debt demonstrates this. And given rate affordability challenges, councils would likely consider greater debt depending upon public appetite.

Current tools allow councils to borrow at relatively low costs up to a certain level through LGFA. At that point, councils face either a hard constraint on their capital programmes or opt for SPV finance. The latter choice breaks the constraint but requires a project-financing approach and comes with higher costs.

The first view is that current debt limits are too low, and that there is therefore a need for policy changes to increase local government’s ability to spread the cost of infrastructure investments over time. Key evidence for this view includes:

- All councils in LGFA face uniform debt to revenue limits, regardless of the speed at which they are growing.
- Councils appear to have the ability to service more debt, as evidenced by higher debt to revenue ratios in the past.
- There would likely still be demand for council debt beyond LGFA limits.

The policy prescription might be to increase local government’s ability to spread the cost of infrastructure investments over time. An example of this would be a system with no limits or loose debt

restrictions, such as in Canada<sup>49</sup> or the United States, which has a relatively ad hoc system of debt limits or uses local referenda.<sup>50</sup>

The second view is that current debt limits are appropriate because the debt limits are only a soft constraint in reality and not legislatively mandated. Key evidence for this view includes:

- There are multiple ways for councils to access finance beyond LGFA's debt caps. Three options include:
  - opting out of LGFA and issue directly
  - using SPV finance for investments that generate new revenue
  - creating debt headroom by shifting revenue-producing assets to independent CCOs that can set their own charges and cover its own costs, as Auckland does with Watercare.
- The fact that many councils set internal debt to revenue limits that are significantly lower than LGFA covenants and/or caps on revenues or their growth.

Those subscribing to this view might argue that no policy change is needed to local government financing tools to loosen their constraints. Relative to other OECD countries, New Zealand's local government already has a high degree of freedom when it comes to fiscal rules imposed on them by central government.

Our conclusion is that, to assess the case for changing (or not changing) current local government financing tools, it's more important to consider *what* we are using the debt for.

## Is now the time to borrow heavily for local infrastructure?

### Debt financing infrastructure requires commensurate revenue growth

Debt financing is most effective when it is used to build assets that enhance a councils' ability to raise revenue from existing or new users. When we use debt to finance the construction of assets that don't do this, we get higher debt burdens funded at future generations' expense. In other words, if we debt finance everything now, we can do less in the future.

To demonstrate this, we've modelled outcomes for a hypothetical council with \$100m annual revenue that it can devote entirely to infrastructure investment, growing 2% per annum, and a starting debt to revenue ratio of 100%.

Suppose it wants to invest \$400 million right now. It has three options: it can finance investment with current revenues (pay-as-you-go). Or it can borrow over the next four years and pay it off over the next 20 years with one of the following approaches:

- using revenues from future ratepayers, or
- match its borrowing with revenue from current *and* future ratepayers.

Based on these assumptions, we calculate the council's total capacity for capital investment over the next five and 25 years, with and without new revenues that match the cost to repay the loan.

What we find is that a period of debt-financed investment that is **not** matched by additional revenues to repay the loan will allow the council to build more now, but the need to repay the loan reduces the ability to finance capital investment in the future.

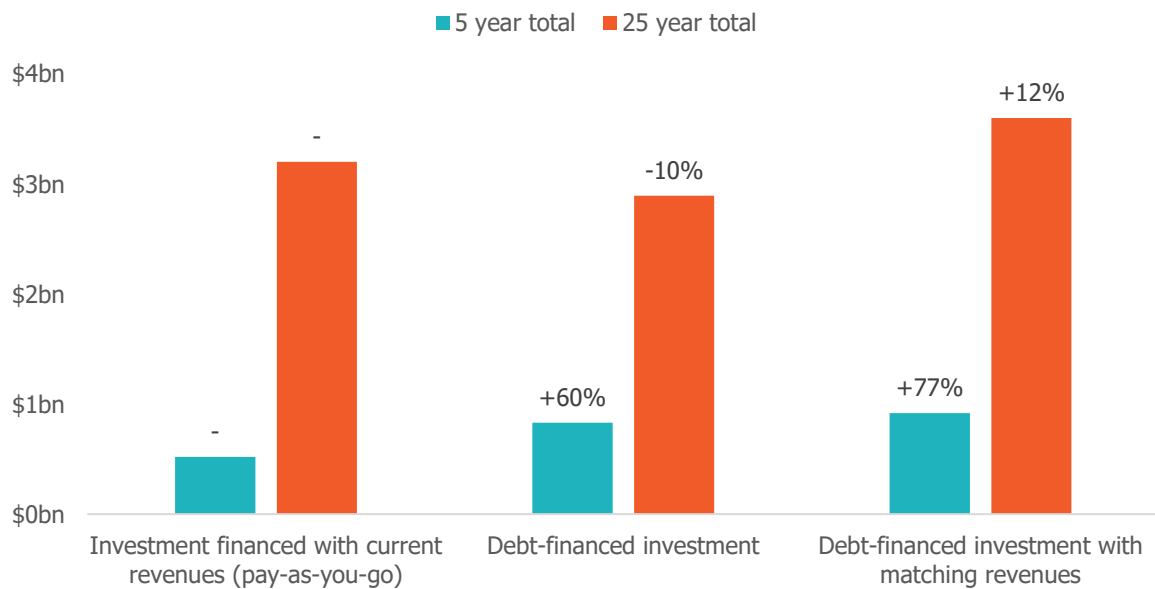
<sup>49</sup> [https://imfg.munkschool.utoronto.ca/uploads/226/context\\_of\\_municipal\\_borrowing\\_in\\_canada\\_col.pdf](https://imfg.munkschool.utoronto.ca/uploads/226/context_of_municipal_borrowing_in_canada_col.pdf)

<sup>50</sup> <https://library.unt.edu/gpo/ACIR/Reports/policy/A-10.pdf> and <https://www.cbpp.org/research/policy-basics-state-and-local-borrowing>



However, if debt finance is matched by an increase in revenues, either through increased economic activity or a dedicated revenue stream from user charges on new infrastructure or increases in rates for example, then overall capital investment will increase in both the short and long term (Figure 14).

Figure 14: Future capital investment of a hypothetical council using different financing methods

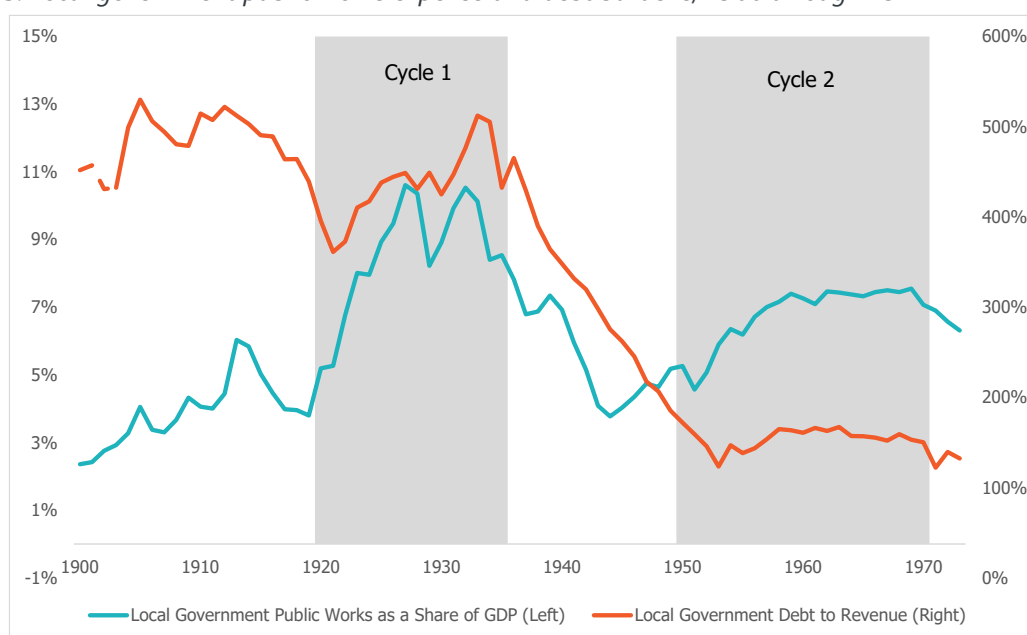


The lesson here is that councils cannot debt finance all their infrastructure needs indefinitely. Even if LGFA debt limits were relaxed and councils could shoulder a greater debt burden, if revenues do not grow, infrastructure investment will be lumpy and cyclical: we build now with debt and then we spend a generation paying for it at the expense of that period's infrastructure investment.

#### This infrastructure investment cycle lacks revenue growth

While local government in the past sustained significantly higher debt burdens than we do now, when they made major infrastructure investments, they typically matched it with close to commensurate revenue growth. This prevented debt burdens from rapidly rising. The investment surges from 1920 through 1936 and 1950 through 1970 saw modest or flat increases in debt-to-revenue ratios (Figure 15).

Figure 15: Local government public works expense and debt burdens, 1900 through 1972



Sources: Local government public works<sup>51</sup> expense data are sourced from Stats NZ Yearbook collection. Note: Local government debt and revenue data are sourced from the Stats NZ Yearbook collection and Stats NZ long-term data series.<sup>52</sup>

However, our current investment cycle which began in the mid-1990s appears to be the first where local government has undertaken major investments without close to commensurate revenue growth that has historically followed such investments. From 2009 to 2022, inflation-adjusted local government debt grew 226%, but total rate revenues increased only 42%, causing debt to revenue ratios to more than double (Table 10).

Table 10: Changes in inflation adjusted local government gross debt and revenue across investment cycles

Investment cycle	Debt stock growth	Rate revenue growth	Debt-to-revenue ratio at start	Debt-to-revenue ratio at end	Percentage change in ratio
1920–1936	196%	144%	396%	465%	Modest increase (+18%)
1950–1970	135%	106%	172%	150%	Modest decrease (-13%)
2009–2022 (see note)	226%	42%	81%	182%	More than double (+125%)

Sources: Te Waihanga analysis of Stats NZ Yearbook collection and long-term data series. For 2009 to 2022, revenue data are from Stats NZ local authority statistics. Note: The most recent local government investment cycle begins around 1995 and continues through the present day. However, local government debt figures are only available from 2009 onward so we report statistics for a shorter time period. Debt stock is from the local authority financial statistics and is measure as net debt (current and term debt minus cash and equivalents).

Infrastructure investment today is mostly in renewals which do not generally produce new revenues.

A potential reason why we do not see the commensurate revenue growth from our infrastructure investments today like we did in the past is because this round of investment includes a significant amount of renewal expense (Table 11).

<sup>51</sup> Public works are defined as immigration, railways, roads, telephone extensions, public buildings, goldfield development, water, power, lands and river improvement. It does not include hospitals or schools.

<sup>52</sup> <https://statsnz.contentdm.oclc.org/digital/collection/p20045coll35/id/94/rec/17>

Table 11: Estimated local government capital expenditure by type of expense

Capital Expenditure Spending Area	2013	2018	2023	2026
Capex for renewals	43%	48%	44%	52%
Capex for growth infrastructure	21%	20%	23%	19%
Capex to improve service levels	37%	31%	33%	29%

Sources: Department of Internal Affairs, 2012, 2015 and 2018 LTPs. 2013 figures are from 2012 LTPs, 2018 are from 2015 LTPs and, 2023 and 2026 figures are from 2018 LTPs.

While investing in renewals is important, this type of investment is the least likely to generate higher overall resident incomes or *new* direct revenues such as user charges or tolls. Consequently, debt ratios are unlikely to fall as a result of these investments.

### Where do we go from here?

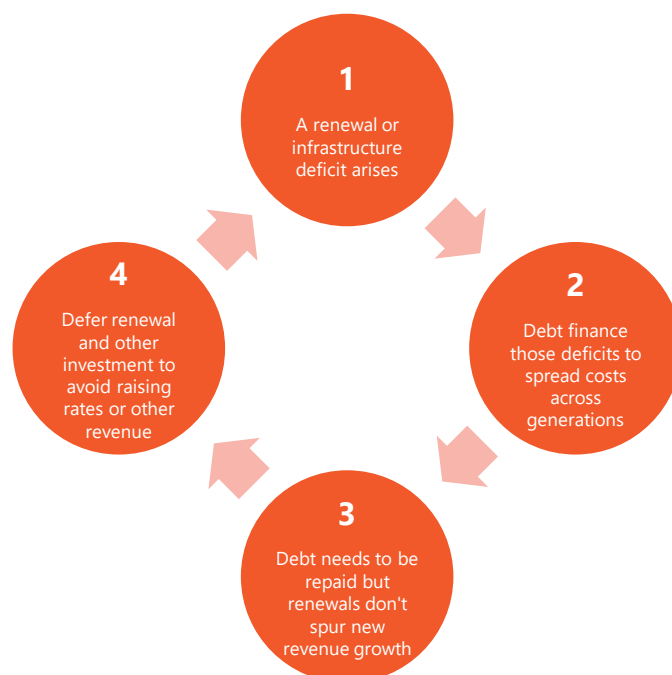
Recommendation 51 in *Rautaki Hanganga o Aotearoa*, the New Zealand Infrastructure Strategy, highlights the need to better use debt for infrastructure. What our analysis has shown is that regardless of where our debt limits should be or whether we need to update our financing tools, we can adopt some practices now that will preserve our ability to debt fund infrastructure into the future. These practices could apply to both local and central government infrastructure.

**We should consider the mix of debt financing versus pay-as-you-go for capital investments, particularly for renewals**

We often think of debt as being appropriate for infrastructure investment because it smooths the costs of long-lived assets across generations. But this approach may not be appropriate for renewals.

Because renewal investment is not followed by growing revenues, using debt means rising debt ratios. Eventually, this debt needs to be paid off, and as we've shown, this is likely to come at the expense of future infrastructure investment unless we raise revenues. If we don't eventually raise revenues, we will find ourselves in a defer-deficit-debt cycle (Figure 16).

Figure 16: The defer-deficit-debt cycle for renewal investment



Second, using debt to cover previous renewal deficits may be problematic for generational equity. The renewal deficit we face today is a result of our underinvestment in the late 1980s through about the mid-1990s.<sup>53</sup> We also know that local government was not legally required to fund depreciation, which is a proxy for future renewal investment, until 1996.<sup>54</sup>

Debt financing this deficit now would mean deferring or spreading the payment on this bill twice: first when we didn't fully fund depreciation expenses in the 1990s, and again if we choose to debt finance the catch-up investment now.

This suggests that for assets that requires semi-regular and predictable renewals within a generation, pay-as-you-go financing and funding depreciation may be the appropriate approach. However, for large lumpy or once-in-a-generation renewal projects, debt financing could be more appropriate because as a way of smoothing planned renewal investment within a council's asset portfolio.

### We should improve our asset management plans and project prioritisation

The first step to making sure we don't build up renewal deficits is to have a good understanding of what we have, identifying when it will need to be renewed, and setting aside the money to do it. These types of projects should be prioritised, as neglecting them means paying for them later, at the expense of future investments and usually at greater cost. Recommendation 39 in the New Zealand Infrastructure Strategy speaks to the importance of long-term planning and asset management for our infrastructure.

Once we have strong asset management practices in place, deciding on what we build for growth infrastructure is as important as how we finance it. In a world with debt limits, we should be picking those projects that maximise the growth potential for our investment dollars. This will require more robust planning and prioritisation processes. The New Zealand Infrastructure Strategy includes a list of recommendations (39, 40, and 43) which highlight the need for better planning and analysis of projects before they are built.

If a project does not deliver value for money, debt financing it will only contribute to higher debt and crowd out future investments that may have greater value.

### We should match debt financed infrastructure with associated revenue streams where possible

Consistent with Recommendations 52 and 53 in the New Zealand Infrastructure Strategy, this involves greater use of user charges, targeted rates, levies, and development contributions. These revenue streams should be set to match the whole-of-life costs of new infrastructure assets. In this way, we can better target how future infrastructure is funded across current and future generations. It will also mean that we end up with a greater stock of infrastructure. Debt-financing investment without commensurate increases in revenue results in a smaller stock of infrastructure in the long run.

Moreover, there are transparency and accountability benefits to matching revenues with a given project. Ratepayers may be more able to assess whether they are willing to pay for infrastructure upgrades if they know what it will cost.

<sup>53</sup> See Figure 11. Investment in infrastructure was well below depreciation during this time period. <https://oag.parliament.nz/2014/assets/part3.htm>

<sup>54</sup> Local Government Amendment Act (No.3) of 1996.

# Appendix A: A brief history of debt and infrastructure

This Appendix provides some historical perspective on the approaches central and local government have taken to finance significant infrastructure expenditure.

## Our infrastructure networks have been built and maintained in cycles, rather than long, sustained periods

It's easy to look at our future infrastructure spending needs and think they are unprecedented. Had we maintained a sustained, long period of investment in our networks, we wouldn't be facing the challenges we do today.<sup>55</sup> But our history shows us that this is how we have always done it: sudden, big ramp ups in infrastructure spending are the norm, rather than the exception.

Tracking infrastructure investment cycles in New Zealand can be tricky. Modern data are only available from 1970 onwards. However, data from New Zealand Official Yearbooks, long-term data series, and Stats NZ can give us some insight about periods of sustained public investment in infrastructure assets.

Next, how is an infrastructure investment defined? Is it from a trough in investment to a peak? Or is it trough to trough? We use a rough definition where a cycle begins with a level shift upwards in infrastructure investment and ends when we see a year or two of slowing investment. We recognise there is some subjectivity in this approach. We consider these cycles as roughly approximate.

Further, local and central government investment cycles do not line up together. Over the course of history, each level of government has been responsible for different infrastructure networks. Investment in our networks doesn't necessarily all happen at once. For example, we could potentially see water infrastructure (local government's responsibility) may see more investment than railroads (central government's responsibility).

For central government, since 1880, we see roughly four cycles (Figure A1):

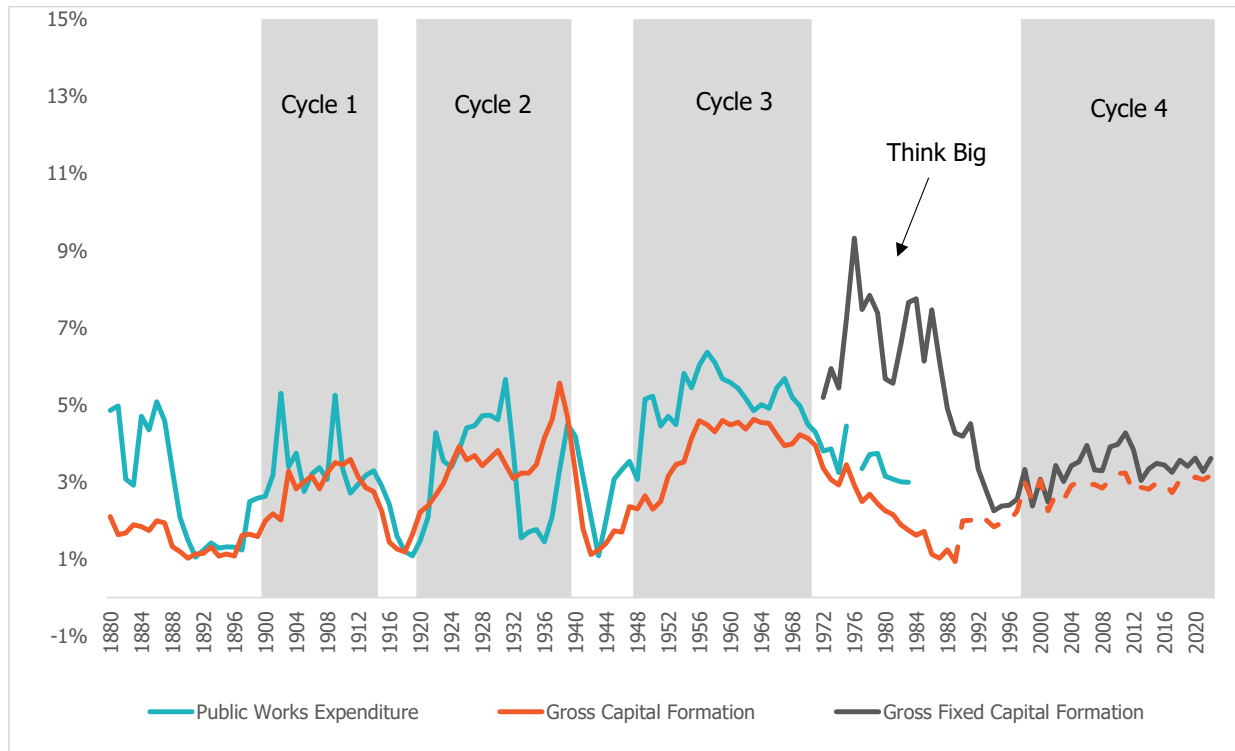
- Cycle 1: Pre-WW1, 1900–1914
- Cycle 2: Post WW1, 1920–1939
- Cycle 3: Post WW2, 1948–1970
- Cycle 4: 1998 to today, characterised by a long, sustained period of high investment levels relative to GDP.

While central government investment as a share of GDP did increase in the early 1980s as part of the Think Big Initiatives, we consider much of this investment to be in industrial works related to the energy sector, rather than in our infrastructure networks, with some exceptions.

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<sup>55</sup> 'New Zealand's infrastructure challenge: Quantifying the gap and the path to close it'. Sense Partners for Te Waihanga, October 2021. <https://tewaihanga.govt.nz/our-work/research-insights/new-zealand-s-infrastructure-challenge-quantifying-the-gap-and-path-to-close-it>

Figure A1: Historical central government infrastructure investment as a share of GDP in New Zealand, 1880–2022



Sources: Public works<sup>56</sup> and gross capital formation<sup>57</sup> series are from Stats NZ long-term data series. These series are from a variety of compiled sources. General government gross fixed capital formation is from Stats NZ series SNE025AA.

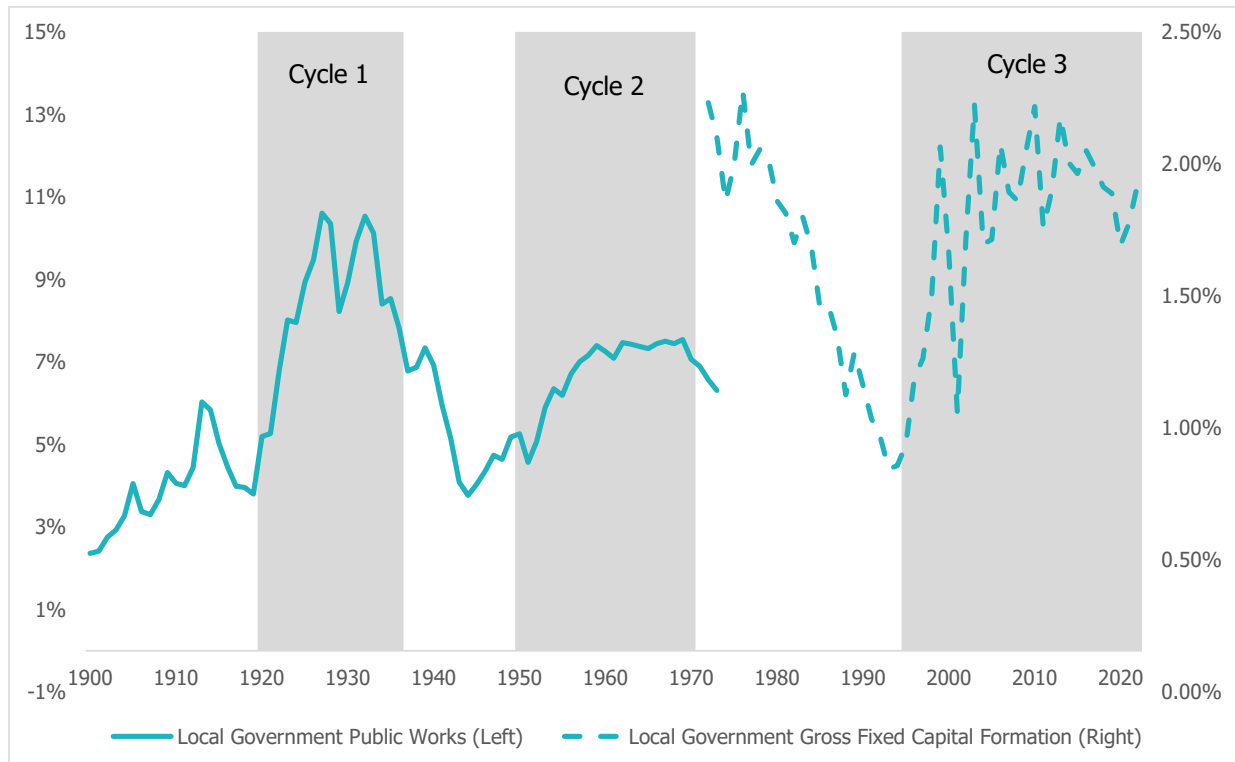
Local government has similar cycles with the exception of the cycle at the turn of the 20th century (Figure A2).

- Cycle 1: post WW1 to WW2, 1920 through 1936
- Cycle 2: post WW2, 1950 through 1970
- Cycle 3: 1995 to today, also characterised by a long, sustained period of high investment levels relative to GDP.

<sup>56</sup> From 1880 to 1943. Public works is defined as expenditure on immigration, railways, roads, telephone extensions, public buildings, waterpower, lands and river improvement. After 1943, immigration is excluded.

<sup>57</sup> Includes general government expenditure on roads, harbours, health care infrastructure, education infrastructure, and public administration infrastructure. Gross capital formation from 1990 (dashed orange line) is calculated as gross fixed capital formation for roads, hospitals, schools, and public administration.

Figure A2: Historical infrastructure local government investment as a share of GDP in New Zealand, 1900–2022



Sources: Public works<sup>58</sup> series are from Stats NZ Yearbook collection. Local government gross fixed capital formation is from series Stats NZ series SNE025AA.

<sup>58</sup> From 1880 to 1943. Public works is defined as expenditure on immigration, railways, roads, telephone extensions, public buildings, waterpower, lands and river improvement. After 1943, immigration is excluded.

## Our current debt levels are low, by historical standards

Central and local government over the past 10 years have increased their debt burdens. Central government debt rose in response to the Global Financial Crisis. Local government became increasingly indebted as they increased capital expenditure. Both debt levels have raised concern.<sup>59, 60</sup>

History tells us that both central and local government have been significantly more indebted in the past. Recognising that the responsibilities of the respective governments have changed over time, we see two notable trends in government debt in New Zealand (Figure A3).

### 1880–1935: 50 years of debt

From 1880 through about 1935 both levels of government shouldered significant debt burdens. From 1880 through 1935, central government debt to GDP averaged 131% of GDP (it is about 24% now). For local government, debt as a share of revenues averaged 459% (it was 182% in 2022). These high debt burdens were sustained during a variety of economic conditions.

### 1935–2008: The Great Deleveraging

From 1935 through the start of the Global Financial Crisis (2008), both levels of government in New Zealand undertook a 60-year period of reducing debt burdens as a share of revenues or GDP, with some breaks, a period we call the Great Deleveraging. Central government debt to GDP went from 201% in 1935 to 17% in 2008. Local government debt as a share of revenue went from 432% in 1935 to 51% in 1988, where available data stops.

Central government took two noticeable breaks during the Great Deleveraging. The first was during the Second World War, after which it quickly resumed reducing its debt load. The second was during early 1980s, corresponding to Think Big initiatives. This period was also followed by a rapid deleveraging period during the 1990s.

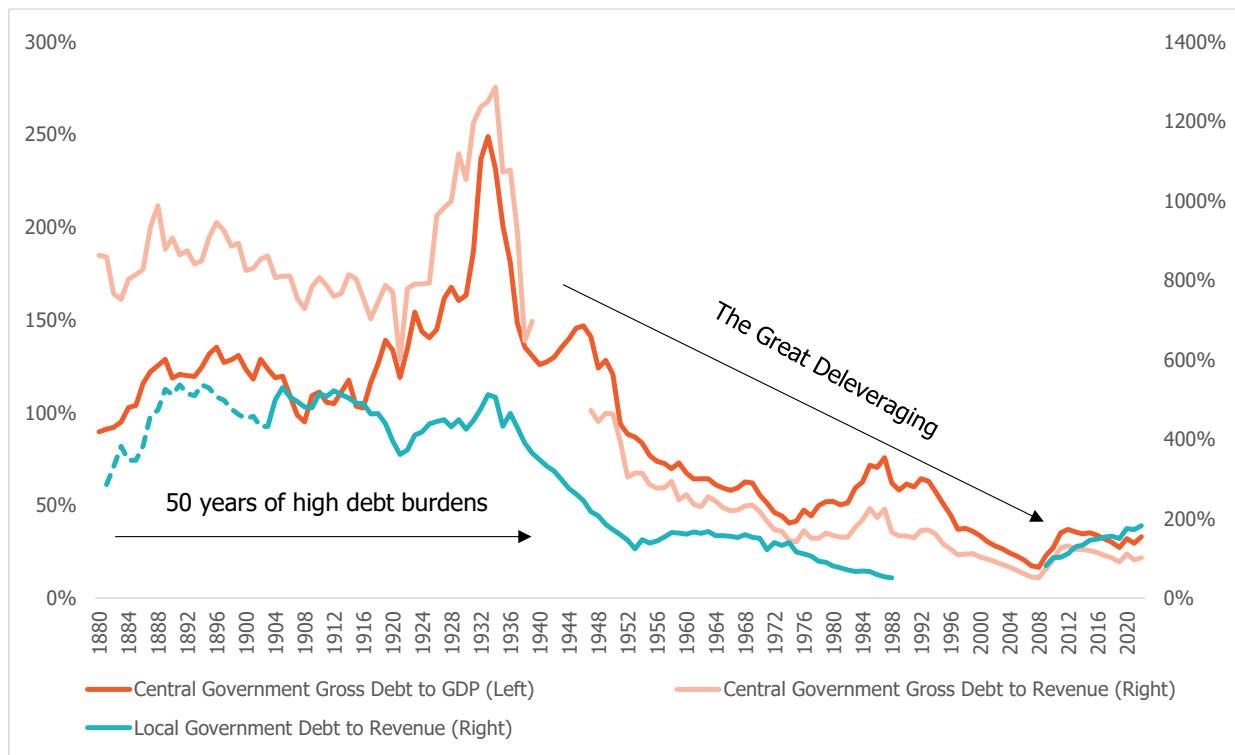
For local government, we see an uninterrupted period of rapid deleveraging from 1935 through 1955. Debt ratios then plateau for about 20 years and then slowly decline until about the 1990s. The next available data show local government ramping up debt in the wake of the Global Financial Crisis.

<sup>59</sup> 'Nation of Debt: Govt's seismic borrowing is coming at a huge cost'. *NZ Herald*. <https://www.nzherald.co.nz/business/nation-of-debt-govts-seismic-borrowing-is-coming-at-a-huge-cost/EVYPNHJPQVFHNPLLEWYUH36XJY/>

<sup>60</sup> 'Ratepayers face record debt levels'. *NZ Herald*. <https://www.nzherald.co.nz/nz/ratepayers-face-record-debt-levels/6XCPGADOHUKQSRSSMDLJJWIU/>



Figure A3: Central and local government debt burdens in New Zealand, 1880–2020



Sources: Data for local government debt is pulled from New Zealand statistical yearbooks. The dashed blue line represents a period where local government debt is characterised as ‘gross debentures’ and does not include loans from central government. Data for central government from 1880 through 1971 are from Stats NZ long-term data series for central government gross domestic debt. From 1972 to present, data are from Treasury Fiscal Time Series for Historical Fiscal Indicators.<sup>61</sup>

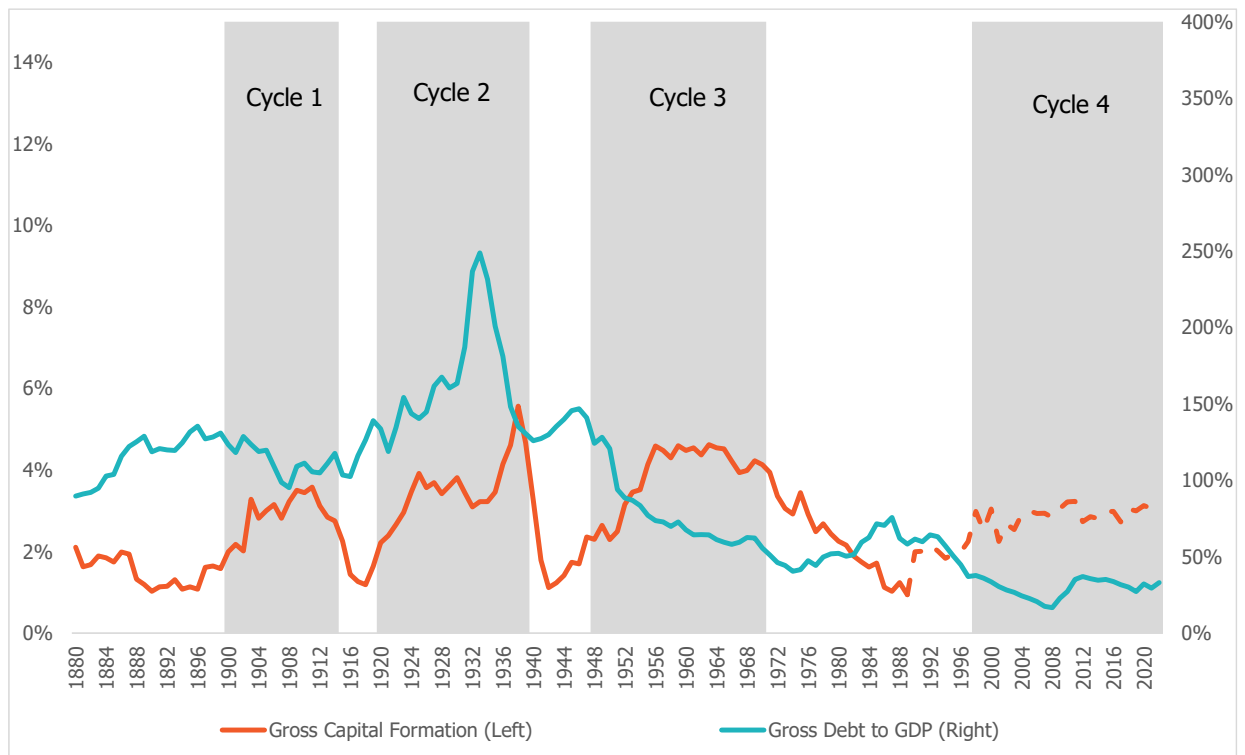
## Major periods of infrastructure investment haven’t always coincided with significant increase in debt burdens

For both central and local government, the historical path of debt to revenue or GDP ratios don’t follow infrastructure investment, indicating that for some cycles, economic growth or new revenue streams helped keep these ratios from precipitously rising.

For central government, the 1920 through 1939 (cycle 2) investment cycle did appear to coincide with a run up in debt. The main period of debt accumulation was 1920 through 1934, where the total stock of debt rose almost doubled in real terms. This pushed the debt to GDP ratio from 134% to 232% over the same period (Figure A4). While not an infrastructure investment cycle as we define it, the central government did see its debt to GDP ratio rise during the early 1980s as it borrowed heavily to finance the Think Big initiatives.

<sup>61</sup> <https://www.treasury.govt.nz/publications/information-release/data-fiscal-time-series-historical-fiscal-indicators>

Figure A4: Central government debt and infrastructure investment as a share of GDP, 1900–2022



Sources: Gross capital formation<sup>62</sup> series are from Stats NZ long-term data series. These series are from a variety of compiled sources. Data for central government debt from 1880 through 1971 are from Stats NZ long-term data series. From 1972 to present, data are from Treasury Fiscal Time Series for Historical Fiscal Indicators.<sup>63</sup>

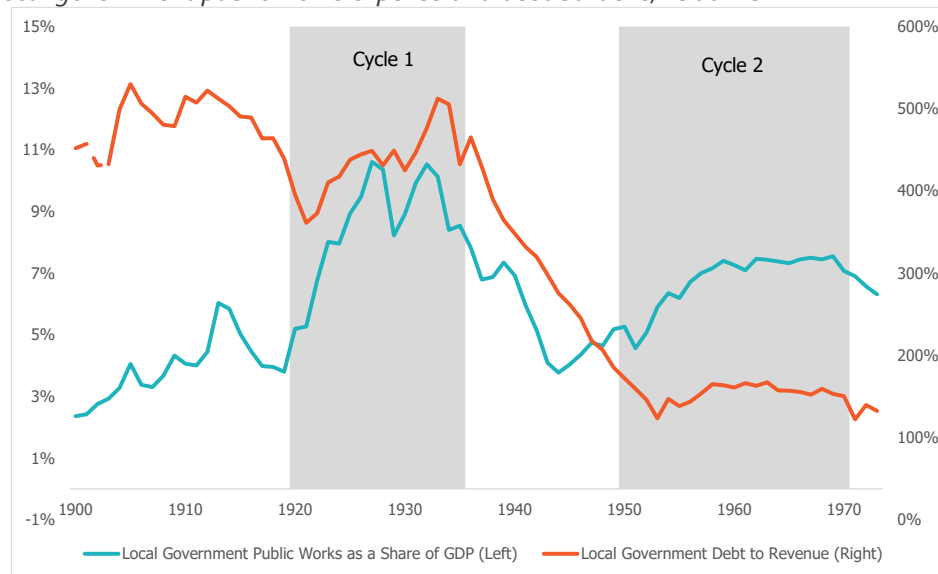
Aside from that cycle, the other cycles do not display a clear relationship between infrastructure investment and rising debt ratios. The 1950 to 1970 cycle coincided with significant deleveraging. The current cycle saw some rising debt ratio during the Global Financial Crisis, but that was primarily for the financing of operating deficits.

For local government, the 1920 to 1936 cycle, like central government, did coincide with increases in debt ratios. Debt stock in real terms increased almost three-fold, driving debt to revenue ratios from 396% to 465%. In the wake of this cycle, local government deleveraged rapidly, such that by the second cycle, 1950 through 1970, local government debt ratios were still declining. During this period, ratios arrested their precipitous decline but did not rise significantly, all while investment in public works surged (Figure A5).

<sup>62</sup> Includes general government expenditure on roads, harbours, health care infrastructure, education infrastructure, and public administration infrastructure. Gross capital formation from 1990 (dashed orange line) is calculated as gross fixed capital formation for roads, hospitals, schools, and public administration.

<sup>63</sup> <https://www.treasury.govt.nz/publications/information-release/data-fiscal-time-series-historical-fiscal-indicators>

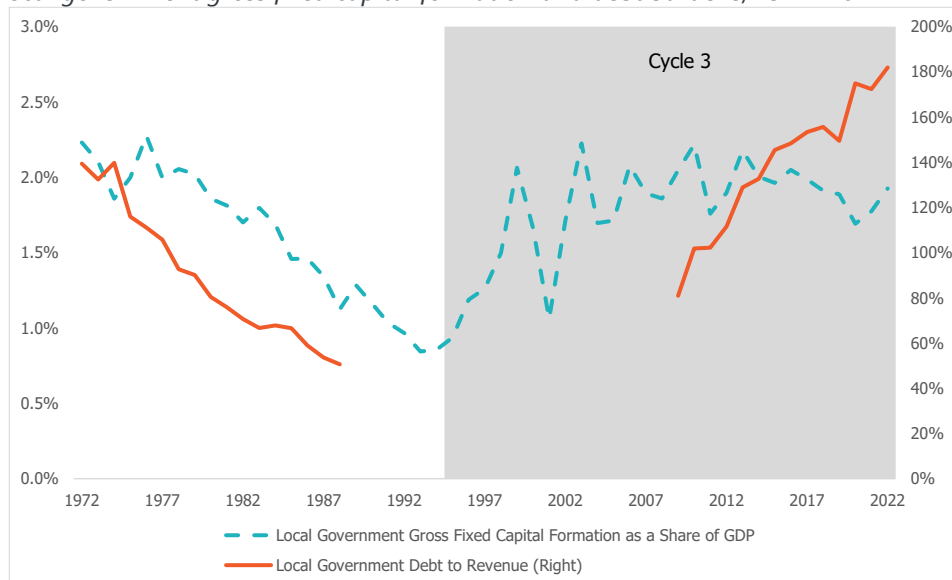
Figure A5: Local government public works expense and debt burdens, 1900–1972



Sources: Local government public works<sup>64</sup> expense data are sourced from Stats NZ Yearbook collection. Local government debt and revenue data are sourced from the Stats NZ Yearbook collection and Stats NZ long-term data series.<sup>65</sup>

In the latest cycle, from 1995 to present, it appears that much of the investment has been debt financed without commensurate revenue growth. From 2009 to 2020, the dates for which we have local government debt data, the stock of debt grew 226%, but rate revenues only increased 45% in real terms. This led debt ratios to surge from 81% in 2009 to 182% in 2020 (Figure A6).

Figure A6: Local government gross fixed capital formation and debt burdens, 1972–2022



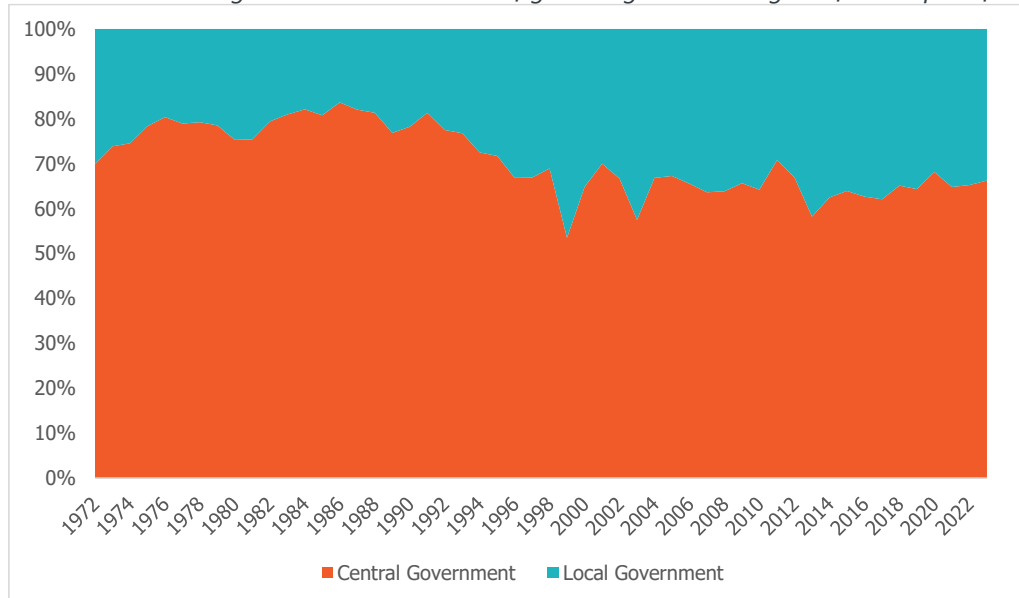
Sources: Gross fixed capital formation data sourced from Stats NZ Infoshare series SNE025AA. Data on debt and revenues are sourced from Stats NZ Yearbook collection and long-term data series prior to 1988. From 2009 onward, data are from Stats NZ local authority financial statistics. Note: Data on local government debt are unavailable from 1989 through 2008.

<sup>64</sup> Public works are defined as immigration, railways, roads, telephone extensions, public buildings, goldfield development, water, power, lands and river improvement. It does not include hospitals or schools.

<sup>65</sup> <https://statsnz.contentdm.oclc.org/digital/collection/p20045coll35/id/94/rec/17>

Local government is also not responsible for more infrastructure spending today than it was in the past. Prior to the 1930s, local government's share of infrastructure investment was indeed higher than it was today: at least 50% of infrastructure spending was done by local government.<sup>66</sup> But by 1958, local government's share of public infrastructure investment was 33% and about 25% of overall infrastructure investment.<sup>67</sup> In 2023, it was 34% of total public investment (Figure A7).

Figure A7: Local and central government as a share of general government gross fixed capital formation



Source: Stats NZ.

## The cost of borrowing has not historically driven how and when we finance infrastructure

When we debt finance infrastructure investment, we need to pay for it later. The cost of debt financing is the interest rate. The decision how about to finance infrastructure investment, either with debt or with current revenues (pay-as-you-go), will depend upon the relative costs of each approach. At a high level, elevated interest rates might make debt financing less appealing, and vice versa.

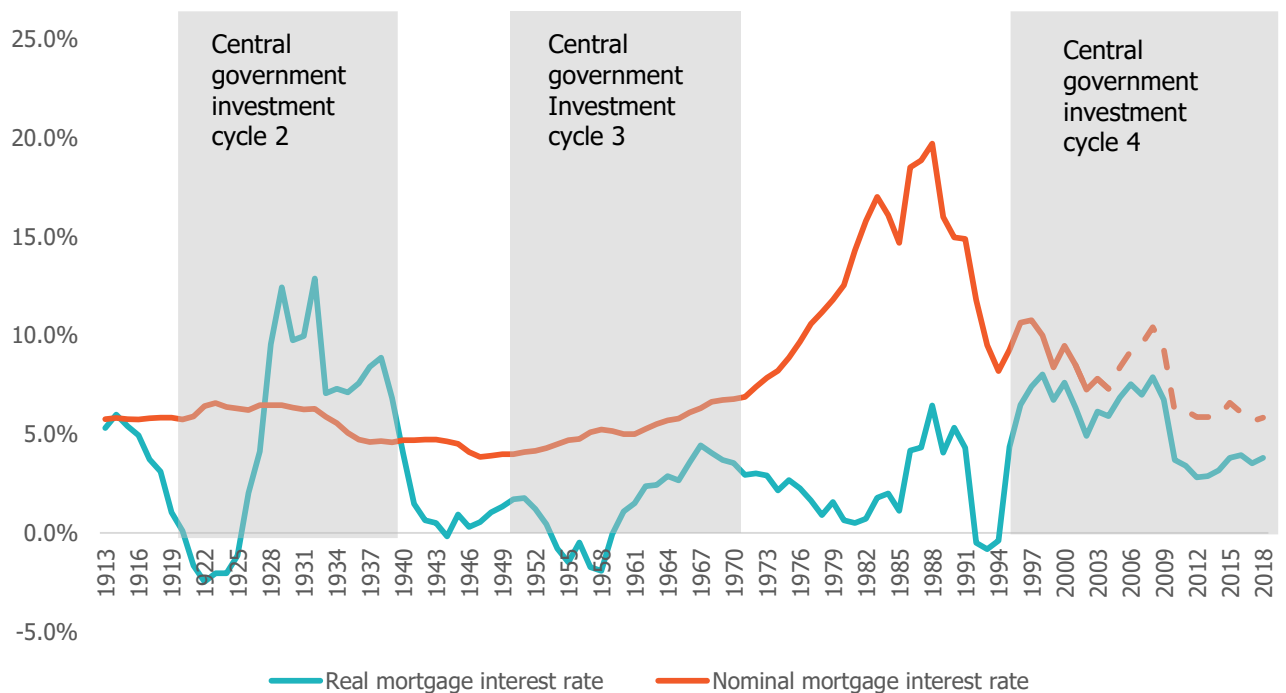
So how do our historical investment cycles correspond to interest rate fluctuations? It appears as though we made investments regardless of what the cost of borrowing was. The 1920 through 1939 cycle occurred during a period of relatively high real interest rates. This is also the case with our current cycle.

Conversely, the 1945 through 1970 investment cycle corresponded to a period of near-zero or negative real interest rates but both levels of government reducing their debt burdens (Figure A8).

<sup>66</sup> Cookson, 2019 notes 'As late as the 1920s local body expenditure on works accounted for over 50% of total public expenditure on works, and there is no suggestion that the figure had ever been lower'. <https://ojs.victoria.ac.nz/pq/article/view/5365/4694>

<sup>67</sup> See table J on page 113 from the 1958 Royal Commission on Local Finance: <https://gg.govt.nz/sites/default/files/2023-04/Local%20Authority%20Finance%201958.pdf>

Figure A8: Historical mortgage interest rates, 1913 through 2018



Source: Stats NZ long-term data series, Reserve Bank of New Zealand, NZIER's Data 1850 tool, and Te Waihanga analysis. Note: Dashed line indicates series break between long-term data series and RBNZ data.

Further, we also know that our run-ups in infrastructure spending were not the primary driver of higher or lower interest rates over the past 100 years. The path of New Zealand's interest rates has broadly followed global real interest rates since the turn of the 20th century.<sup>68</sup>

## Local government debt finance has evolved over the past 150 years

Our debt burdens and investment levels have fluctuated over the course of the last 150 years. Through these cycles, the characteristics of local government financing tools have evolved.

Prior to the turn of the 20th century, most debt financing for infrastructure occurred on a project-by-project basis. Central government also lent directly to local authorities.<sup>69</sup> Financing came from small individual investors domestically and abroad. There was very little restriction on local borrowing, and it was largely ad hoc.

Beginning in the early 20th century, in the wake of a wave of local body financial distress, central government became more involved, passing legislation to limit excesses by local government. The Local Bodies' Loan Act 1913 required local referenda to approve debt incurred for public works. The Local Government Loans Board was established in 1926 to approve local borrowing. A 1958 Royal Commission on local authority finance even recommended the creation of an agency to centralise all local government borrowing.<sup>70</sup> Prior to the previous 50 years, lenders came from larger pools of capital: insurance funds, banks, and other companies.<sup>71</sup>

<sup>68</sup> See 431, Homer, S., & Sylla, R. (2011). A History of Interest Rates, Fourth Edition. John Wiley & Sons.

<sup>69</sup> Under the Roads and Bridges Construction Act of 1882 and Government Loans to Local Bodies Act 1886.

<sup>70</sup> Report of the Royal Commission on Local Authority Finance, 1958. [Local Authority Finance 1958.pdf \(gg.govt.nz\)](#)

<sup>71</sup> See Mulholland 1967, 'Local Authorities Capital Market in New Zealand'.

Councils borrowed on their own, with central government oversight, for most of the 20th century until the creation of the Local Government Funding Agency (LGFA) in 2011. Ever since, most local government lending has occurred through the LGFA, that borrows on their behalf on domestic and international markets. In recent times, we've added a series of financing options, such as special-purpose vehicles (SPVs) and public private partnerships (PPPs) but most major infrastructure financing at the local level occurs through the LGFA.

This evolution of the local government infrastructure financing has led to the development of a system that affords local government a high degree of autonomy relative to international peers.<sup>72</sup> Local government is able to borrow with limited central government oversight. They also have a comparatively high number of funding tools to repay debt. Rather than the loan boards of the past, fiscal discipline is maintained by the financial requirements of the LGFA.

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<sup>72</sup> Vammalle and Bambalaite. "Funding and financing of local government public investment: A framework and application to five OECD countries." March 2021. <https://www.oecd-ilibrary.org/docserver/162d8285-en.pdf?expires=1702262522&id=id&accname=guest&checksum=80B3D2C2ABB76C9C688719EB6EE429B5>

## Appendix B: Council performance against LGFA covenants

Table B1: Council compliance with LGFA covenants as of end-2023

	Councils with a credit rating			
	Net Debt / Total Revenue <295%	Net Interest / Total Revenue <20%	Net Interest / Rates <30%	Liquidity >110%
Ashburton District Council	78.5%	2.4%	5.0%	112.7%
Auckland Council	197.6%	7.2%	14.0%	112.8%
Bay of Plenty Regional Council	-7.9%	-0.3%	-0.7%	204.6%
Christchurch City Council	109.4%	5.6%	10.5%	149.4%
Environment Canterbury Regional Council	15.7%	0.2%	0.4%	141.0%
Greater Wellington Regional Council	112.5%	4.7%	11.2%	138.6%
Hamilton City Council	187.4%	7.5%	12.4%	136.5%
Hastings District Council	120.3%	4.5%	10.4%	111.1%
Horowhenua District Council	207.4%	7.1%	10.5%	126.0%
Hutt City Council	132.7%	4.2%	6.8%	127.2%
Invercargill City Council	53.3%	0.4%	0.8%	154.8%
Kapiti Coast District Council	183.3%	6.9%	9.3%	128.8%
Marlborough District Council	33.4%	1.1%	2.7%	166.2%
Nelson City Council	113.1%	4.1%	7.0%	118.8%
New Plymouth District Council	-93.1%	3.9%	6.0%	266.9%
Palmerston North City Council	125.4%	4.3%	6.2%	118.9%
Porirua City Council	126.9%	2.0%	3.0%	125.1%
Queenstown Lakes District Council	246.6%	8.3%	16.5%	121.7%
Rotorua District Council	208.0%	8.0%	8.0%	113.0%
Selwyn District Council	60.9%	1.1%	1.7%	135.1%
South Taranaki District Council	-23.3%	7.1%	11.8%	231.9%
Tasman District Council	133.5%	5.5%	9.7%	119.0%
Taupo District Council	47.5%	4.4%	6.5%	194.1%
Tauranga City Council	180.5%	6.2%	10.5%	122.7%
Timaru District Council	131.1%	3.8%	6.2%	132.1%
Waimakariri District Council	136.7%	5.5%	7.8%	116.9%
Waipa District Council	180.3%	4.6%	6.6%	114.9%
Whanganui District Council	95.8%	3.9%	5.7%	133.3%
Wellington City Council	164.2%	6.5%	10.4%	125.5%
Western Bay of Plenty District Council	58.2%	1.9%	2.8%	150.2%
Whangarei District Council	97.4%	4.1%	6.7%	130.2%

Councils without a credit rating

	Net Debt / Total Revenue <175%	Net Interest / Total Revenue <20%	Net Interest / Rates <25%	Liquidity >110%
Buller District Council	0.3877	0.0165	0.0048	1.645
Carterton District Council	-0.4%	0.4%	0.6%	198.1%
Central Hawkes Bay District Council	51.8%	1.4%	3.3%	127.2%
Central Otago District Council	10.7%	0.6%	1.0%	170.0%
Clutha District Council	69.4%	2.8%	4.7%	155.1%
Far North District Council	51.7%	1.2%	1.9%	123.5%
Gisborne District Council	66.6%	2.4%	4.7%	151.1%
Gore District Council	134.4%	4.7%	7.7%	120.3%
Grey District Council	58.8%	2.4%	4.2%	144.3%
Hauraki District Council	94.5%	3.3%	4.8%	124.0%
Hawkes Bay Regional Council	-102.8%	0.8%	2.5%	307.8%
Horizons Regional Council	37.5%	0.7%	1.3%	152.2%
Hurunui District Council	84.3%	2.8%	5.8%	114.1%
Kaikoura District Council	10.8%	1.1%	2.0%	164.4%
Kaipara District Council	33.0%	1.9%	3.4%	160.5%
Mackenzie District Council	-6.9%	-0.4%	-0.6%	214.1%
Manawatu District Council	105.9%	3.9%	6.6%	126.7%
Masterton District Council	44.4%	2.2%	3.9%	157.2%
Matamata Piako District Council	47.3%	2.3%	3.4%	143.0%
Northland Regional Council	-81.1%	-0.2%	-0.3%	524.5%
Opotiki District Council	29.3%	1.2%	2.0%	136.8%
Otago Regional Council	-16.5%	0.2%	0.4%	209.9%
Otorohunga District Council	17.6%	1.4%	2.3%	134.2%
Rangitikei District Council	40.8%	0.9%	1.6%	138.4%
Ruapehu District Council	88.8%	3.3%	6.2%	131.6%
Southland District Council	8.5%	0.2%	0.3%	162.6%
South Waikato District Council	30.4%	3.2%	4.6%	164.3%
South Wairarapa District Council	47.8%	1.3%	2.0%	144.5%
Stratford District Council	99.0%	2.0%	3.5%	121.4%
Taranaki Regional Council	-15.0%	-2.3%	-6.0%	231.4%
Tararua District Council	79.9%	2.6%	6.0%	110.7%
Thames Coromandel District Council	41.7%	2.3%	3.6%	131.6%
Waikato Regional Council	-51.4%	-0.3%	-0.5%	519.4%
Waitomo District Council	58.5%	2.6%	5.8%	137.0%
Wairoa District Council	7.1%	0.3%	0.9%	176.3%
Waitaki District Council	2.2%	-0.5%	-0.9%	113.8%
West Coast Regional Council	-12.3%	2.1%	4.9%	228.1%
Westland District Council	56.6%	2.0%	3.4%	131.2%
Whakatane District Council	130.3%	5.2%	8.0%	114.1%

Source: LGFA



## Appendix C: Credit Ratings

Table C1: Council credit ratings as at January 2024

Council	S&P	Fitch	Moody's
Ashburton District Council		AA+	
Auckland Council	AA		Aa2
Bay of Plenty Regional Council	AA (neg outlook)		
Christchurch City Council	AA		
Dunedin City Council	AA		
Canterbury Regional Council		AA+	
Far North District Council		AA	
Hamilton City Council	AA- (neg outlook)		
Hastings District Council	AA-		
Horowhenua District Council	AA-		
Hutt City Council	AA (neg outlook)		
Invercargill City Council		AA+	
Kapiti Coast District Council	AA (neg outlook)		
Marlborough District Council	AA (neg outlook)		
Nelson City Council	AA		
New Plymouth District Council	AA+		
Palmerston North City Council	AA		
Porirua City Council	AA		
Queenstown-Lakes District Council		AA-	
Rotorua District Council		AA-	
Selwyn District Council		AA+	
South Taranaki District Council	AA		
Tasman District Council	AA		
Taupo District Council	AA+		
Tauranga City Council	A+		
Timaru District Council		AA-	
Upper Hutt City Council	A+		
Waimakariri District Council	AA		
Waikato District Council		AA+	
Waipa District Council		AA-	
Wellington City Council	AA+ (neg outlook)		
Wellington Regional Council	AA+		
Whanganui District Council	AA		
Western Bay of Plenty District Council	AA		
Whangarei District Council	AA		