The Treasury

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Government Guarantee Fee Policy for Government Businesses

Policy & Guidelines Paper

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1. Preface

The *Government Guarantee Fee Policy* is a component of the NSW Government's Commercial Policy Framework.

The Framework aims to replicate within Government businesses the disciplines and incentives that lead private sector businesses towards efficient commercial practices.

The purpose of the *Government Guarantee Fee Policy for Government Businesses* is to ensure competitive neutrality between Government businesses and their private sector counterparts with respect to the cost of debt. This working paper outlines the methodology to determine the amount of the guarantee fee.

This policy supersedes the previous NSW Treasury policy document, *Government Guarantee Fee Policy for Government Businesses* (TPP 10-4, September 2010). This revised policy applies from 1 July 2014.

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Note
General inquiries concerning this document should be initially directed to the Business Policy and Performance Unit within NSW Treasury.

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2. Purpose of the policy

When Government businesses borrow funds through NSW Treasury Corporation (TCorp) at interest rates based on the credit rating of the State of New South Wales, they obtain a financial advantage over private sector businesses.

The *Government Guarantee Fee Policy* is specifically designed to improve the competitive neutrality between Government businesses and their private sector counterparts. Treasury seeks to replicate private sector debt practices by:

- establishing stand-alone credit ratings from private sector credit rating agencies.
- matching guarantee fee charges to the business' credit rating.
- referencing the prevailing credit spread for each rating from an independent and credible data source.
- maintaining credit charges for every line of debt.

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Treasury also recognises that the *Government Guarantee Fee Policy* can create perverse incentives from a whole-of-state perspective. For that reason, it limits the private sector debt practise by:

- applying the guarantee fee rate to a fixed credit spread tenor. For regulated businesses, the credit spread tenor will match the Regulator's debt allowance benchmark. For all other businesses, it will be set at five years.

3. Application

3.1. Criteria

A guarantee fee applies to Government businesses that satisfy all of the following criteria:

- undertake commercial operations.
- have borrowings greater than $1 million.
- are authorities, as defined in the PAFA Act or scheduled under any other Act that refers to the Treasurer's role in providing a guarantee.

The generic term 'Government business' includes:

- Public Trading Enterprises (or Public Non-financial Corporations under ABS classifications). This includes State Owned Corporations that are distinguished by their corporatised status.
- Public Financial Enterprises (or Public Financial Corporations under ABS classifications).
- General Government businesses (or General Government agencies under ABS classifications), which are also non-Budget dependent and operate under the Commercial Policy Framework.

3.2. Exemptions

The guarantee fee does not apply to authorities that receive a significant subsidy from the Consolidated Fund for day-to-day operating revenue, including non-commercial public trading enterprises (PTEs).

The premise is that Government businesses that require significant Government assistance to supplement their operating revenues are not sufficiently commercial to warrant inclusion in the guarantee fee scheme. The Treasurer, however, has the discretion to levy a guarantee fee on any authority with respect to a guarantee given for specific borrowings.

TCorp is not subject to guarantee fees since it acts as an intermediary and is not a primary borrower.

Special exemptions from the guarantee fee or reductions in the guarantee fee may be granted from time to time in exceptional circumstances to suit the specific situation of a Government business. Such exemptions or reductions should be applied for through NSW Treasury for consideration by the Treasurer. Any special exemption or reduction given will be for a fixed term.

4. Method to determine Guarantee Fees

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The guarantee fee is calculated with reference to:

- the business' stand-alone credit rating.
- the credit spread on corporate debt with similar credit ratings.
- the notional term of the debt (for regulated businesses, will depend on the Regulator's notional debt allowance tenor).
- the amount of debt held by the business.

4.1. Credit ratings

All Government businesses subject to the guarantee fee must obtain a credit rating annually on a stand-alone basis. The stand-alone credit rating measures a business' financial standing independent of explicit or implicit financial support from the Government. This information is required to assess a business' level of competitive advantage from access to guaranteed borrowings.

Government businesses pay for their individual rating assessments.
NSW Treasury selects the credit rating agency on the basis of a competitive tender. This requirement ensures that there is a consistent and unbiased approach to the assessment and allocation of credit ratings. The use of an independent credit rating agency also ensures that the NSW Government is separate from the rating process. This separation is necessary given that the NSW Government holds the dual role of owner and provider of debt finance.

Government businesses with a total guaranteed debt level exceeding $10 million must obtain a rating from the agency nominated by NSW Treasury. Those businesses with a total guaranteed debt between $1 million and $10 million have the option of obtaining an estimate of their stand-alone credit rating from the rating agency or NSW Treasury. This threshold is set because the cost of the rating assessment would be relatively high for Government businesses with low debt levels.

Credit rating agencies undertake assessments that are forward looking and therefore a credit rating of a Government business is an assessment of its ability to meet its current and forecast debt obligations.

Where a business' credit rating changes, no change will be made to the guarantee fee on historic borrowings. The changed credit rating will be applicable from the start of the month following the date of the official downgrade or upgrade.

4.2. Guarantee Fee rate

The guarantee fee will apply a single rate to all debt whether short- or long-term debt.

The guarantee fee rate is the difference between a market interest rate for a business of similar risk and the cost of debt obtained from TCorp (exclusive of debt management fees), which borrows using the State's credit rating.

Guarantee fee rates for all credit ratings are based on the difference between Non-Financial Corporation (NFC) and TCorp yields obtained from the Reserve Bank of Australia tables F.2 and F.3. The RBA publish NFC yields for A/A2 and BBB/Baa2 credit ratings. For other credit ratings, rates will be imputed using a straight line projection from observed rates. Rates for each credit rating are calculated and distributed to businesses by TCorp on a monthly basis.

Guarantee fee rates that apply in any month are based on observations from the previous month. This allows the fee to be estimated and accrued by businesses during each year.

For regulated utilities, the guarantee fee rate will be determined using the debt tenor adopted by Regulator's debt allowance benchmark tenor.

For non-regulated utilities, the market rate will be based on long-term lending rates (five year).

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4.3. Short and long-term debt

Guarantee fees are based on the current capital value of debt over the life of the borrowing for guaranteed debt held by Government businesses in a financial year.

Short-term debt is debt of less than 12 months' maturity at the time of the borrowing. For short-term debt, the Government Guarantee Fee rate for that month will be applied to the average value of short-term debt over the month.

For long-term debt, new loans entered into or loans repaid will only attract the guarantee fee for the portion of the month the loan is entered into.

When a new loan is arranged the guarantee fee will be charged at the prevailing guarantee fee rate for that month. This guarantee fee rate will apply to the loan until its maturity or a reset date elected by businesses at the time of establishment of each loan. Where a rate reset is agreed, the prevailing guarantee fee at the time of the reset will be that applicable for the credit rating of the business.

If a loan is repaid early (prior to the agreed maturity date), the weighted average rate for that particular debt security on the date of repayment will be applied to the amount repaid. This rate applied to the amount repaid is matched to the debt security until maturity. This will ensure that when a loan is fully or partially repaid there are no ongoing fees applied to the repaid portion of the loan.

If a loan is repaid early and refinanced to a longer date, the guarantee fee rate set at the time of the new loan will also be the weighted average rate over the residual life of the repaid loan. The prevailing guarantee fee on the new loan will also only apply from the maturity of the repaid loan.

Loans will be classified according to the term of the funding not the term of the interest rate reset period. Accordingly, term floating rate loans will qualify as long-term debt rather than short-term debt.

The guarantee fee is applied to the current capital value of the business' loan portfolio, but is not applied to other outstanding liabilities (including derivatives).

For fixed forward contracts the guarantee fee rate will be set at the time the contract is entered into, using the government guarantee fee rate for that month. The tenor selected at the time the contract is entered into will be applicable from the date the physical debt is drawn down. This replicates only charging a fee once financial accommodation has been received and provides for simplicity of administration.

The guarantee fee will not include borrowing costs in relation to:

- financial accommodation other than borrowings.
- establishment fees.
- undrawn facility fees.

While this could be considered a departure from private sector lending practices, this approach reduces complexity and administrative costs while providing incentives for businesses to manage the cost of funds.

Where a Government business has guaranteed 'own-name debt' (debt arranged externally to TCorp) they are required to supply NSW Treasury annually with the details.

4.4. Calculation

TCorp will calculate and provide Government businesses with a monthly report of the guarantee fee amount.

4.5. Projections for Budget Estimates and SCI/SBIs

Businesses are required to provide estimates of future Government Guarantee Fee expenses and liabilities for the State Budget and Statements of Corporate Intent (SCI) or Statements of Business Intent (SBI).

TCorp will provide the government guarantee fee rates for each credit rating to be used in budget estimates, which will ultimately be endorsed by NSW Treasury as the official forecasting rates.

Debt will be as per forward estimates provided by businesses to Treasury in the Budget and SCI/SBI context.

5. Administration

5.1. Payment terms

The guarantee fee is to be paid in arrears, with the fee payable upon invoice from TCorp (on behalf of NSW Treasury).

5.2. Roles and responsibilities

NSW Treasury is responsible for the development of the *Government Guarantee Fee Policy* and aspects of its administration which involves:

- developing, promulgating and promoting the policy.
- updating and revising the policy where necessary.
- selecting the credit rating agency to conduct the stand-alone credit rating of Government businesses, and

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- processing the receipt of the guarantee fee payments.

NSW Treasury Corporation (TCorp) is responsible for:

- providing funds for the borrowing program of Government businesses.
- advising Treasury and businesses of applicable government guarantee fee rates.
- providing Treasury with information on businesses' borrowings with TCorp and any guarantee fee rate resets for long-term loans upon request.
- providing technical advice to Treasury where required.
- collecting the necessary information to calculate the guarantee fee payable.
- advising Government businesses of their accrued guarantee fee amounts, and
- issuing invoices to business on behalf of NSW Treasury.

Boards and management of Government businesses are responsible for:

- providing balances of TCorp and non-TCorp debt levels to Treasury at Budget and Half Year Review, and at other times upon request.
- estimating current year and forecast guarantee fees payable at Budget, Half Year Review, in Statements of Corporate Intent / Statements of Business Intent, and at other times upon request.
- obtaining a credit rating from the agency nominated by NSW Treasury.
- confirming invoiced amounts, and
- ensuring payment of the guarantee fee within the designated timeframe.

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5.3. Transitional arrangements

The new policy will apply to new borrowings and short-term debt from 1 July 2014.

Government guarantee fees calculated or paid prior to 1 July 2014 will not be amended. However, the new policy will apply retrospectively to calculate the weighted average effective rate applicable on existing borrowings. That is, all historical borrowings will use debt current capital values rather than debt face values to calculate the guarantee fee liability.

Debt drawn down before 30 June 2010 will be levied a Government Guarantee Fee using the bank panel rates that prevailed at the time each loan was drawn down. This rate will continue to apply for the term of that debt.

As individual debt tranches mature or are repaid, refinanced debt will attract the prevailing guarantee fee rates.

6. Legislative Framework

The *Public Authorities (Financial Arrangements) Act, 1987 (*'PAFA Act'*)* provides the legislative basis for administering guarantee fees.

6.1. Borrowing requirements

Sections 7 and 8 of the PAFA Act provide that Government businesses, which are declared to be authorities for the purposes of the Act, can obtain financial accommodation subject to approval from the Treasurer and the Governor.[1]

Under section 10 of the PAFA Act, Government businesses are required to obtain all financial accommodation from NSW Treasury Corporation (TCorp), unless the Treasurer grants an exemption.

6.2. Guaranteed debt and guarantee fees - application to government businesses

In accordance with section 22D of the PAFA Act, the Treasurer may charge Government businesses a fee in respect of debt guaranteed by the NSW Government. The Treasurer determines the amount and the timing of the fee.

The ordinary debt of Government businesses is automatically guaranteed under the PAFA Act, provided that it has been obtained from TCorp.[2] Debt obtained from other lenders is not guaranteed, unless a specific debt has been explicitly guaranteed in writing by the Treasurer.

State Owned Corporation (SOCs) to which the *Government Guarantee Fee Policy* applies have in place agreements that TCorp debt is guaranteed. A statutory guarantee explicitly applies only when the board of the SOC and voting shareholders agree in writing, in accordance with section 22A(2) of the PAFA Act and sections 16 or 20U of the *State Owned Corporations (SOC) Act 1989*.

The same sections of the *SOC Act* provide that guarantee fees for SOCs may be separately fixed by the voting shareholders, in consultation with the board, at times determined by the Treasurer.

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[1] Financial accommodation as defined in the PAFA Act typically includes debt instruments such as loans, promissory notes, debentures, bonds and discounted securities. For a full definition, refer to section 4 of the PAFA Act.

[2] See section 22A PAFA Act and clause 54, *Public Authorities (Financial Arrangements) Regulation* 2013.

Appendix

Government Guarantee Fee Calculation – An Example

In this example, a business has a credit rating of BBB+ (S&P scale) /Baa1 (Moody's scale) in the 2012-13 year and an improved rating of A (A2) in the2013-14 year.

The Government Guarantee Fee rate (GGF rate) that applies for borrowings in 2012-13 is 2.80%, based on bank panel rates for that year under the former Government Guarantee Fee policy (TPP 04-2). For new borrowings in 2013-14, the monthly rate varies with market rates. For July borrowings, the rate is 1.81% and for August borrowings it is 1.62%. In the example, this rate is held constant for the remainder of the year, whereas in practice, it will vary each month.

The business has chosen not to reset its Government Guarantee Fee rate before each loan matures. Each month, the Government Guarantee Fee charge is [(Short-term debt average monthly balance) x (GGF rate applying that month/12)] + sum of [(Long-Term loans) x (GGF rate that applied when each loan contract was arranged/12)].

Total Government Guarantee Fee payable in 2013-14 is $9,106,5475 = $697,442 (July charge) + 11 x $764,467 (August to June charge, same each month).

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	Government Guarantee Fee rate: example				Jun-13	Jul-13	Aug-13			FY 2013-14
	Credit rating				BBB+	A	A			
	Monthly GGF Rate			RBA differential to TCorp rate	2.80%	1.81%	1.62%			
	Reset within maturity?			No/Yes (months)	No	No	No			
	Total Debt (has GGF applied)			Current Capital Value	$203,000,000	$353,000,000	$403,000,000	$0	$0	$403,000,000
	Total GGF for month (Sum of 1,2,3,4)				$473,667	$697,442	$764,467			$9,106,575
	Short-term debt (average monthly balance)				$3,000,000	$3,000,000	$3,000,000			$3,000,000
1	**GGF on short term debt**				$7,000	$4,525	$4,050			$49,075
	Long term debt									
	Borrowing date	Maturity date	Original Face Value	GGF fee monthly charge, LT debt	$466,667	$692,917	$760,417			$9,057,500
	1/6/2013	1/8/2012	$200,000,000	Debt outstanding has GGF applied	$200,000,000	$200,000,000	$200,000,000			
			Nominal	No. months until rate reset	N/A	N/A	N/A			
				GGF rate	2.80%	2.80%	2.80%			
2				GGF fee monthly charge	$466,667	$466,667	$466,667			$5,600,000
	1/7/2013	1/8/2020	$150,000,000	Debt outstanding has GGF applied		$150,000,000	$150,000,000			
			Nominal	No. months until rate reset		N/A	N/A			
				GGF rate		1.81%	1.81%			
3				GGF fee monthly charge		$226,250	$226,250			$2,715,000
	1/8/2013	1/9/2025	$50,000,000	Debt outstanding has GGF applied			$50,000,000			
			Nominal	No. months until rate reset			N/A			
				GGF rate			1.62%			
4				GGF fee monthly charge			$67,500			$742,500