Fitch Affirms New Zealand's LGFA at 'AA+'; Outlook Stable

Fitch Ratings-Sydney/Hong Kong-08 November 2018: Fitch Ratings has affirmed New Zealand Local Government Funding Agency Limited's (LGFA) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA', its Long-Term Local-Currency IDR at 'AA+' and its Short-Term Foreign- and Local-Currency IDRs at 'F1+'. The Outlook on the long-term ratings is Stable. At the same time, Fitch has affirmed LGFA's senior unsecured local-currency bonds at 'AA+' and its short-term domestic debt programme at 'F1+'.

Fitch has classified LGFA as a corporate mission, government-related entity (GRE) under its Government-Related Entities Rating Criteria. This reflects our assessment of the entity's very strong legal status, control and oversight, strong level of historical financial support, and strong socio-political and very strong financial implications of a potential default. This assessment translates into an overall support score of 45 under Fitch's GRE criteria and the application of an 'equalised' approach, without assessment of the entity's standalone credit profile.

Consequently, Fitch equalises LGFA's ratings with those of the New Zealand sovereign (AA/AA+/Stable/F1+), which is a shareholder, liquidity provider and derivative counterparty to the GRE. The affirmation also reflects the robust underlying credit profiles and asset quality of LGFA's other council shareholders and borrowers, which operate under a strong institutional framework and provide full support for LGFA's debt obligations through joint and several liability guarantees (JSLG).

KEY RATING DRIVERS

'Very Strong' Status, Ownership, Control: LGFA is a council-controlled organisation under the Local Government Act 2002 and is enabled by the Local Government Borrowing Act 2011. The sovereign's legal links to LGFA continue to be demonstrated through supportive legislation and the central government's (Crown) 20% ownership of LGFA's shares alongside the local councils' ownership (80%). The strong institutional framework provided by the Crown also supports this assessment.

Specific legislation has been created to require all principal shareholders and borrowers with more than NZD20 million in loans to sign the JSLG, which is on demand and can be called without a board or court order. Under this guarantee, a security trustee can call on guarantors directly following a payment default by the LGFA. Should a guaranteeing council not pay its share, the shortfall is recoverable from the other guarantors on a pro rata basis.

The LGFA is not guaranteed by the Crown but its special status is underpinned by the continuous availability of a committed liquidity facility from an arm of the New Zealand Treasury. LGFA is monitored by the Department of Internal Affairs, which also oversees local councils, and must comply with securities laws as if it were a New Zealand local council. It is not regulated by the Reserve Bank of New Zealand.

'Strong' Support Record, Expectations: The New Zealand Debt Management Office (DMO) has provided a 10-year, committed liquidity facility to LGFA since its inception in December 2011. The facility's maximum aggregate principal amount is set at NZD1.0 billion unless LGFA chooses a lower amount. As of 30 June 2018, this undrawn facility had been set at a maximum limit of NZD600 million. The DMO also assists the LGFA to mitigate counterparty credit risk by acting as the GRE's derivatives counterparty.

LGFA received an initial equity contribution from the sovereign but does not require or receive subsidies and transfers to support its operations. LGFA remains the only dedicated financing vehicle for the New Zealand local government sector and, as of 8 November 2018, it is guaranteed by 48 councils covering the majority of the country's population.

'Strong' Socio-Political Implications of Default: LGFA's primary role is to provide more efficient costs and diversified sources of funding for New Zealand local authorities. The GRE has been able to raise debt on behalf of local authorities on more favourable terms than if they were to raise the debt directly. Fitch believes that in an unforeseen default scenario, the local government sector would have the ability to access emergency financial support from the sovereign and alternative funding from private-sector lenders.

However, a default would have significant socio-political implications as it is likely to cause significant delays to public-sector projects and affect the provision of essential services by local authorities. Consequently, we believe a default would carry significant economic and political implications due to the wider impact on New Zealand's citizens and economy.

'Very Strong' Default Financial Implications: We consider LGFA to be an important financing vehicle for the New Zealand local-government sector. It was established with the support of the Crown as a means of providing an alternative and cost-effective borrowing option for local governments and since inception, the LGFA has helped to increase domestic capital market liquidity and tenor while lowering funding costs to local councils. LGFA is New Zealand's second-largest bond issuer after the sovereign and, as of 8 November 2018, the 59 participating local authorities (including the country's largest local councils) represent 97% of New Zealand local government debt.

The Local Government Borrowing Act 2011 also permits the Crown to lend money to LGFA to meet an exceptional and temporary liquidity shortfall if it is necessary or expedient in the public interest to do so. The presence of the legislation and the JSLG ensures that a LGFA default could realistically occur only in the event of the entity's own insolvency and the inability of the Crown and the entity's other shareholders to honour their obligations. In such a scenario, the ability of the central government, other GREs and state-sector borrowers to source funding in a timely, cost-efficient manner may be significantly affected.

RATING SENSITIVITIES
LGFA's ratings are credit-linked to those of the New Zealand sovereign. Positive or negative rating action would stem from a similar move on the sovereign's ratings.

A weakening in the strength of LGFA's integration with the sovereign, such as the removal of liquidity support, lower creditor protection and a poorer general credit profile of New Zealand's local governments, could result in LGFA being rated lower than the New Zealand sovereign.

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Applicable Criteria

Government-Related Entities Rating Criteria (pub. 25 Oct 2018) (https://www.fitchratings.com/site/re/10047173)
International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/878660)

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