13 OCT 2024

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

Fitch Ratings - Sydney/Singapore - 13 Oct 2024: Fitch Ratings has affirmed New Zealand Local Government Funding Agency Limited (LGFA)'s Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'AA+' with a Stable Outlook. Fitch has also affirmed LGFA's Short-Term IDR at 'F1+', senior unsecured bonds at 'AA+' and short-term debt programmes at 'F1+'.

The affirmation under our *Government-Related Entities (GRE) Rating Criteria* recognises the New Zealand government's (AA+/Stable) significant responsibility and incentives to support LGFA's debt servicing, given the agency's key policy role in providing the majority of local government financing. LGFA's ratings are equalised with New Zealand's accordingly.

The affirmation also reflects the strong underlying credit quality of LGFA's council shareholders and borrowers, the majority of which guarantee LGFA's debt obligations.

KEY RATING DRIVERS

Support Score Assessment 'Virtually certain'

We believe extraordinary support from the New Zealand government to LGFA would be 'Virtually Certain' if needed, as reflected in a support score of 55 out of a maximum 60 under our GRE criteria. This is based on our assessment of the government's responsibility and incentive to provide support.

Responsibility to Support

Decision Making and Oversight 'Very Strong'

The LGFA serves as the main lender to New Zealand's local governments, with a public policy mission to provide cost-effective and flexible financing to the sector, which is of significant strategic importance to the government. The ownership structure consists of 20% held by the government and 80% by 30 local councils. Despite the minority shareholding, we believe the government effectively controls the agency. LGFA maintains a close working relationship with the government, facilitated through regular reporting to the Department of Internal Affairs on its financial status and performance in meeting its objectives.

Precedents of Support 'Strong'

The central government provides a committed liquidity facility to LGFA of up to NZD1.5 billion, which was extended to 2031 in 2021 and is typically renegotiated every three years. LGFA's enabling legislation also allows the government to lend to LGFA if this is in the public interest and provide temporary liquidity support if necessary. This provides LGFA with a special status in New Zealand's public sector.

Incentives to Support

Preservation of Government Policy Role 'Very Strong'

LGFA's substantial market share of local government debt - around 90% - means that its default would cause widespread disruption to local government projects, including essential public services like water supply and transportation. This would have a significant impact on the domestic economy and living standards, leading to a political crisis. Alternative financing options for councils, such as bank lending or direct access to capital markets, would not meaningfully lessen the impact of an LGFA default, given the agency's extensive sector coverage, favourable financing terms and the considerable size of its lending.

Contagion Risk 'Very Strong'

LGFA has a large presence in the debt market as the country's second-largest New Zealand-dollar bond issuer, after the sovereign. We believe its default would demonstrate the government's unwillingness or inability to intervene, given legislation enabling government support to LGFA. In such a scenario, it is highly likely that the ability of the government and other public-sector entities to source financing in a timely and cost-efficient manner would be severely impaired.

Derivation Summary

We classify LGFA as an entity linked to the New Zealand sovereign under our GRE criteria and apply a top-down rating approach based on our assessment of the responsibility and incentive to support factors. This results in a total of 55 points out of 60 under the criteria and leads to LGFA's IDRs being equalised with those of the sovereign. We do not currently assign a Standalone Credit Profile to LGFA. The ratings are driven by the assessment of government support.

Short-Term Ratings

LGFA's Short-Term IDRs are equalised with those of the sovereign, given the equalisation of the Long-Term IDRs.

Debt Ratings

LGFA's long-term debt obligations are rated in line with its Long-Term IDR and short-term programme ratings are aligned to its Short-Term IDR.

Issuer Profile

LGFA began operating as a centralised borrowing vehicle for New Zealand's councils in 2011 following the enactment of the Local Government Borrowing Act 2011. Its main objective is to raise debt for local governments and their associated entities to optimise finance terms and conditions.

LGFA had 18 foundation council shareholders at incorporation as well as the New Zealand government. There are currently 31 shareholders. Governance includes a six-person shareholder-appointed board along with the LGFA shareholders' council, consisting of appointees from the government and council shareholders.

Liquidity and Debt Structure

The majority of LGFA's debt comprises New Zealand dollar-denominated bonds, which are listed on the NZX debt market, although the agency has recently extended its market access via issuance of Australian dollar bonds across four maturities. This complements the 10 maturities for domestic bonds out to 2037. LGFA also began issuing under a Euro commercial paper programme during the fiscal year ending June 2024 (FY24), alongside its domestic short-term issuance.

Total debt expanded to NZD21.3 billion by FYE24, from NZD15.9 billion at FYE23, to cater for increased borrowing needs in the local government sector. LGFA targets a minimum of NZD1.0 billion per maturity for domestic issuance to support liquidity in the secondary market and a maximum of NZD3.0 billion, with tenders spread throughout the year and across maturities for consistent supply.

We believe LGFA maintains sufficient liquidity to meet its financial commitments. In addition to the government liquidity facility, LGFA has steadily increased its liquid assets portfolio in recent years to buttress its liquidity and support its standby facility offering, which stood at NZD747 million at FYE23.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

LGFA's ratings could be downgraded on negative rating action on the New Zealand sovereign or a weaker assessment of the government's responsibility or incentive to provide support factors that leads to a support score of less than 45 under our GRE criteria.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Positive rating action on the New Zealand sovereign would result in the same action on LGFA's ratings.

ESG Considerations

Fitch does not provide ESG relevance scores for LGFA.

In cases where Fitch does not provide ESG relevance scores in connection with the credit rating of a transaction, programme, instrument or issuer, Fitch will disclose any ESG factor that is a key rating driver in the key rating drivers section of the relevant rating action commentary. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products

Public Ratings with Credit Linkage to other ratings

LGFA's ratings are directly linked to those of the New Zealand sovereign.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
New Zealand Local Government Funding Agency Limited	LT IDR	AA+	Affirmed		AA+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
(LGFA)					
	ST IDR	F1+	Affirmed		F1+
	LC LT IDR	AA+	Affirmed		AA+
	LC ST IDR	F1+	Affirmed		F1+
• senior unsecured	LT	AA+	Affirmed		AA+
• senior unsecured	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Government-Related Entities Rating Criteria (pub.09 Jul 2024)

Public Policy Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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