

New Zealand Local Government Funding Agency Limited (LGFA) (/gws/en/esp/issr/90037861)**Fitch Affirms New Zealand's LGFA at 'AA+'; Outlook Stable**

Fitch Ratings-Hong Kong/Barcelona-10 November 2017: Fitch Ratings has affirmed New Zealand Local Government Funding Agency Limited's (LGFA) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA', Long-Term Local-Currency IDR at 'AA+' and Short-Term Local- and Foreign-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 classifies LGFA as a credit-linked public-sector entity and equalises its ratings with those of the New Zealand sovereign (AA/AA+/F1+/Stable).

The affirmations reflect LGFA's strong links to the sovereign, which is a shareholder, liquidity provider and derivative counterparty. It 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**Legal Status Attribute Assessed as Stronger**

LGFA is a council-controlled organisation under the Local Government Act 2002. The sovereign's legal links to LGFA are demonstrated through its 20% shareholding and supportive legislation. The strong institutional framework provided by the central government also supports this assessment. In addition, the general-government sector, through the local councils, owns 100% of LGFA's shares.

Specific legislation has been created allowing all principal shareholders and borrowers with more than NZD20 million in loans must 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 LGFA. Should a guaranteeing council not pay its share, the shortfall is recoverable from the other guarantors on a pro rata basis.

Creditor protection is further strengthened through LGFA-lending to councils that is secured via a charge over the council's rates and rates revenue. The Local Government Act 2002 allows councils to secure borrowing with their assets. Council rate revenues are predictable and the main source of operating revenue for New Zealand's local authorities.

Integration Attribute Assessed as Stronger

The sovereign provides LGFA with a maximum of NZD1 billion in liquidity facilities, which is currently set at NZD800 million, via the New Zealand Debt Management Office (DMO). The DMO also provides derivative services. LGFA received an initial equity contribution from the sovereign, but does not require or receive subsidies and transfers to support its operations.

LGFA is the only dedicated financing vehicle for local governments in New Zealand and is guaranteed by councils containing the majority of New Zealand's population.

Strategic Importance Attribute Assessed as Stronger

We consider LGFA to be an important financing vehicle for councils in New Zealand. It was established with the support of the central government as a means of providing an alternative and cost-effective borrowing option for local governments. LGFA is New Zealand's second-largest bond issuer after the sovereign and the 53 participating local authorities include the country's largest local councils.

Control Attribute Assessed as Midrange

LGFA's board consists of six members, of whom five are independent and one represents the local-government sector. The New Zealand government does not have a representative on LGFA's board, but appoints a representative to the shareholders' council. 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.

Financial accounts are published half-yearly and the annual audit is completed by KPMG LLP, which is appointed by the Office of the Auditor General. LGFA is required to report on its performance to the board, bond trustee, local councils (shareholders), Treasury and the Department of Internal Affairs.

Strong Credit Quality

The credit quality of New Zealand's local governments is robust, with significant disclosure and central government control and

oversight. LGFA's loan pool is concentrated among New Zealand's larger councils, in particular, Auckland Council, which accounted for around 30% of total exposure at end-September 2017. This is where the majority of New Zealand's population resides and where most economic growth is occurring.

Total loans outstanding to the local authority sector were around NZD8 billion at end-August 2017 and LGFA provided 83% of the sector's long-term borrowing requirements in the financial year to end-June 2017. We estimate that eligible borrowing councils comprise more than 90% of all New Zealand ratepayers. In addition to lowering funding costs, LGFA has enabled councils to strengthen their debt profiles through longer-dated debt maturities and lower their refinancing risk.

RATING SENSITIVITIES

The ratings on LGFA 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

International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016)

(<https://www.fitchratings.com/site/re/878660>)

Rating of Public-Sector Entities – Outside the United States (pub. 22 Feb 2016) (<https://www.fitchratings.com/site/re/877128>)

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