



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

Fitch Ratings-Sydney-14 November 2016: Fitch Ratings has affirmed New Zealand Local Government Funding Agency Limited's (LGFA) Long-Term Local-Currency Issuer Default Rating (IDR) at 'AA+' and Long-Term Foreign-Currency IDR at 'AA'. Fitch has also affirmed the 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 the senior unsecured local-currency bonds at 'AA+', and the short-term domestic debt programme at 'F1+'.

The affirmation of LGFA's ratings reflects its strong links to the sovereign, which is a shareholder in the company, and liquidity provider and derivative counterparty. It also reflects the robust underlying credit profiles and asset quality of LGFA's other council shareholders and borrowers, who operate under a strong institutional framework and provide full support of LGFA debt obligations through joint and several liability guarantees (JSLG). Fitch classifies LGFA as a credit-linked public-sector entity and equalises the ratings of LGFA with those of the sovereign.

New Zealand's Long-Term Foreign-Currency IDR is 'AA' and Long-Term Local-Currency IDR is 'AA+'. The Outlook is Stable.

KEY RATING DRIVERS

Legal Status Attribute Assessed as Stronger

LGFA is a council-controlled organisation under the Local Government Act 2002, and we believe the sovereign's strong legal links to LGFA are demonstrated through its 20% shareholding, the legislation created to support LGFA's development and operation, and the strong institutional framework provided by the central government.

Specific legislation was created so that all principal shareholders, and borrowers with more than NZD20m in loans, can sign the required 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 revenues. The Local Government Act 2002 allows councils to secure borrowing with their assets. The councils' rates revenues are highly predictable and are the main source of operating revenue for New Zealand's local authorities. It totalled NZD5.0bn in 2015, or 60% of total operating revenues.

Integration Attribute Assessed as Stronger

The sovereign provides LGFA with a NZD1bn liquidity facility (currently set at NZD400m) 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. The strong institutional framework mitigates potential credit losses from council borrowers and reduces the need for capital support.

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

Strategic Importance Attribute Assessed as Stronger

We consider the importance of LGFA as a financing vehicle for councils to be very strong. LGFA was established with the support of the central government as a means of providing an alternative and cost-effective borrowing option for local governments in New Zealand. LGFA is the second-largest bond issuer in the country after the sovereign, and the 51 participating local authorities include the largest local councils in the country.

Control Attribute Assessed as Midrange

LGFA's board currently 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 it 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 was appointed by the Office of the Auditor General. LGFA is required to report on its performance to its board, bond trustee, local councils (shareholders), the Treasury and the Department of Internal Affairs.

Strong Credit Quality

The credit quality of New Zealand's local governments is robust, and is supported by a strong institutional framework that includes significant disclosure, and control and oversight by central government. LGFA's loan pool is concentrated among the larger New Zealand councils, in particular Auckland Council, which accounted for around 34% of total exposure at end-September 2016. This reflects where the majority of New Zealand's population resides and where most economic growth is occurring.

Total loans outstanding to the local authority sector increased by 28% yoy to NZD6.5bn at end-June 2016, and LGFA provided 70% of the sector's long-term borrowing requirements in the financial year to June 2016 (FY16). 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 reduce potential refinancing risk.

RATING SENSITIVITIES

The ratings on LGFA are credit linked to those of the New Zealand sovereign; a positive or negative rating action would stem from a similar move on the sovereign's ratings.

A reduction in the strength of LGFA's integration with the sovereign, such as removal of liquidity support, reduced creditor protection and legal strength from removal of the JSLG, or reduced strategic importance, could result in LGFA being rated lower than the New Zealand sovereign.

Contacts:

Primary Analyst

John Birch
Director
+61 2 8256 0345
Fitch Australia Pty. Ltd.
Level 15, 77 King Street, Sydney NSW 2000

Secondary Analyst

Fernando Mayorga
Managing Director
+34 93 323 8407

Committee Chairperson

Raffaele Carnevale
Senior Director
+39 02 87 90 87 203

Media Relations: Leslie Tan, Singapore, Tel: +65 67 96 7234, Email: leslie.tan@fitchratings.com.

Additional information is available on www.fitchratings.com

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>)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1014708)

Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1014708)

Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings) (<https://www.fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2016 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.