FitchRatings

Fitch Revises Outlook on New Zealand's LGFA's Long-Term Foreign-Currency IDR to Positive

Fitch Ratings - Sydney/Hong Kong - 27 January 2020:

Fitch Ratings has revised the Outlook on New Zealand Local Government Funding Agency Limited (LGFA)'s Long-Term Foreign-Currency Issuer Default Rating (IDR) to Positive from Stable.

The rating action follows the revision of the Outlook on New Zealand's Long-Term Foreign-Currency IDR to Positive from Stable (see 'Fitch Revises Outlook on New Zealand's Foreign Currency IDR to Positive; Affirms at 'AA'', dated 22 January 2020 at www.fitchratings.com). We opine that the corresponding Outlook on LGFA is in line with that on sovereign given the strong credit linkage between the two.

Using Fitch's Government-Related Entities (GRE) Rating Criteria, the Key Rating Drivers below concluded a total assessment score of 45. Given that it is not possible to fully de-link the GRE from central government, Fitch opines that the Standalone Credit Profile is not meaningful and applies the 'Equalised' approach for LGFA's ratings which equates the rating of a GRE with its sponsor.

Key Rating Drivers

'Very Strong' Status, Ownership and Control: LGFA is a council-controlled organisation under the Local Government Act 2002, which is enabled by the Local Government Borrowing Act 2011 and incorporated under the Companies Act 1993. The sovereign's legal links to LGFA are demonstrated through supportive legislation and the central government's (Crown) 20% ownership of LGFA's shares alongside the local councils' 80% ownership. The strong institutional framework provided by the Crown supports this assessment.

Legislation requires all principal shareholders and borrowers with more than NZD20 million in loans to sign joint and several liability guarantees, which are on demand and can be called without a board or court order. Under the 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 based to rates revenue.

The LGFA is not guaranteed by the Crown, but its special status is underpinned by 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 local council. Issuance of LGFA securities to the public must comply with the Financial Markets Conduct Act and is regulated by New Zealand's Financial Markets Authority, even though LGFA is not regulated by the Reserve Bank of New Zealand.

'Strong' Support Record, Expectations: The New Zealand Debt Management Office has provided a 10-year committed liquidity facility to LGFA since its inception in 2011. The facility has a maximum aggregate principal amount of NZD1 billion unless LGFA chooses a lower amount. The undrawn facility had been set at a maximum of NZD600 million for the period to February 2020. The Debt Management Office also assists LGFA mitigate counterparty credit risk by acting as its sole derivatives counterparty.

LGFA received an initial equity contribution from the sovereign, but does not require or receive subsidies or transfers to support its operation. LGFA is the only dedicated financing vehicle for New Zealand's local-government sector and, as of 11 October 2019, is guaranteed by 53 local 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 funding sources for local authorities. It 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 would be 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 regard LGFA to be an important financing vehicle for New Zealand's local-government sector. The entity was established with the support of the Crown as a means of providing an alternative and cost-effective borrowing option for local government and has since increased capital-market liquidity and tenor while lowering funding costs. LGFA is the country's second-largest bond issuer after the sovereign; as of 2 September 2019, the 64 participating local authorities, including the country's largest local councils, represent 97% of local-government debt.

The Local Government Borrowing Act 2011 permits the Crown to lend money to LGFA to meet an exceptional and temporary liquidity shortfall if necessary or expedient in the public interest. This legislation, along with the joint and several liability guarantees, ensures an LGFA default could realistically occur only in the event of the entity's insolvency and the inability of the Crown and other local-council shareholders to honour their obligations. In such a scenario, the ability of the central government, other government-related entities and state-sector borrowers to source funding in a timely, cost-efficient manner is likely to 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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit https://www.fitchratings.com/site/esg

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
New Zealand Local Government Funding Agency Limited (LGFA)	LT IDR AA		AA

	Affirmed		

Additional information is available on www.fitchratings.com

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Applicable Criteria

Rating Criteria for International Local and Regional Governments (pub. 13 Sep 2019)
Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

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