



## RATING ACTION COMMENTARY

# Fitch Affirms New Zealand's LGFA at 'AA'/Positive and 'AA+'/Stable

Fri 29 Oct, 2021 - 2:52 AM ET

Fitch Ratings - Sydney/Hong Kong - 29 Oct 2021: Fitch Ratings has affirmed New Zealand Local Government Funding Agency Limited's (LGFA) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA' with a Positive Outlook, and its Long-Term Local-Currency IDR at 'AA+' with a Stable Outlook. Fitch has also affirmed LGFA's senior unsecured local-currency bonds at 'AA+' and its short-term domestic bond programme at 'F1+'.

Fitch classifies LGFA as a government-related entity (GRE) under our Government-Related Entities Rating Criteria and equalises its ratings with those of the New Zealand sovereign (AA/Positive, AA+/Stable, F1+). The rating affirmations reflect LGFA's strong links to the sovereign, which is a minority shareholder, liquidity provider and derivative counterparty. The affirmations also reflect the strong underlying credit quality of LGFA's council shareholders and borrowers, which operate under a strong institutional framework and fully guarantee LGFA's debt obligations via joint and several guarantees.

Our rating approach "looks through" the shareholder structure and control chain and links LGFA to the sovereign as we expect extraordinary support to come from the central government (the Crown).

## KEY RATING DRIVERS

### Status, Ownership and Control: 'Very Strong'

LGFA is 20% owned by the Crown, with the remaining 80% held by 30 local councils. LGFA's strong links to the sovereign are demonstrated through its centralised public policy role, supportive legislation and the Crown's ownership. The 'Very Strong' assessment of the

status, ownership and control is supported by the strong institutional framework of New Zealand and Fitch's view of the high likelihood of a liability transfer to the Crown, if needed.

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 and legislation that allows other forms of liquidity support if deemed in the public interest. LGFA is monitored by the Department of Internal Affairs, which also oversees local councils, and must comply with securities laws. It is not regulated by the Reserve Bank of New Zealand, but the issuance of LGFA securities to the public is compliant with the Financial Markets Conduct Act and regulated by New Zealand's Financial Markets Authority.

### **Support Track Record: 'Strong'**

LGFA received an initial equity contribution from the Crown but does not require or receive subsidies or transfers to support its operations. LGFA is the only dedicated financing vehicle for New Zealand's local government sector and, as of 30 September 2021, 65 of New Zealand's 78 local councils guaranteed LGFA's obligations, on a joint and several basis, covering the majority of the country's territorial authorities and population. All council shareholders and borrowers with a principal amount of borrowing exceeding NZD20 million are required to be guarantors. Guarantees are on demand and can be called without a board or court order following a payment default by LGFA, and are supported by debenture security over each council guarantor's rates revenue. This guarantee structure and the central role of LGFA in the national financial framework lead to our strong expectation that extraordinary support would be forthcoming, if needed.

### **Socio-Political Implications of Default: 'Strong'**

LGFA's primary role is to provide cost-efficient funding and diversified funding sources for councils, and it is able to lend to councils on more favourable terms than if they were to raise debt directly. Fitch believes that in an unforeseen default scenario, the local government sector would be able to access emergency financial support from the Crown and alternative funding sources, such as private-sector lenders. Still, the significant delays to public-sector projects and likely disruption to essential services provided by local authorities that would result from a LGFA default, including water supply and transport services, would have significant socio-political implications for the central government.

### **Financial Implications of Default: 'Very Strong'**

We regard LGFA as an important financing vehicle for New Zealand's local government sector, which has increased capital market liquidity and loan tenor while lowering councils' funding costs. LGFA is the country's second-largest local-currency bond issuer after the sovereign. The 74 current member councils represent around 90% of the local government

sector and LGFA lending accounted for around 82% of local government debt borrowing during the fiscal year ended June 2021 (FY21).

The Local Government Borrowing Act 2011 permits the Crown to lend money to LGFA to meet an exceptional and temporary liquidity shortfall if it is in the public interest to do so. This legislation, along with the council guarantees, ensures a default by LGFA could only occur, practically, in the event of the entity's insolvency and the inability of the Crown and council guarantors to honour their obligations. In such a scenario, the ability of the central government and other public-sector entities to source funding in a timely and cost-efficient manner is likely to be severely affected.

## Operating Performance

**Stable Operating Performance:** LGFA has the primary objective of optimising its participating borrowers' debt funding terms and conditions while achieving its own shareholder-agreed objectives and performance targets. Its mission is not to maximise its own profit, but it has recorded consistent profit over the last five years, which Fitch expects will continue via financial discipline from its experienced management team, governance structure and close oversight of its debt structure and liquidity.

**Strong Credit Quality:** Credit quality among New Zealand's local authorities is robust, with most of LGFA's lending being to council borrowers rated by major rating agencies at 'AA-' or higher, and supported by a strong institutional framework that includes significant disclosure and monitoring by the central government. This partially offsets concentration risk in LGFA's loan portfolio with regards to sector, geography and borrowers, with the two largest borrowers accounting for around 42% of LGFA's loan book.

## Derivation Summary

Fitch classifies LGFA as an entity linked to the New Zealand sovereign under our GRE criteria and applies a top-down rating approach based on our assessment of the strength of its linkage with and the incentive to support by the New Zealand sovereign. LGFA's 45-point GRE support score reflects the combination of 'Very Strong' and 'Strong' key rating drivers. The score also leads to LGFA's IDRs being equalised with those of the sovereign.

The ratings are assigned without an assessment of a Standalone Credit Profile (SCP).

## Short-Term Ratings

Equalised to that of sponsor when rated top-down.

## Issuer Profile

LGFA began operating as an optional centralised borrowing vehicle for New Zealand's councils in February 2012, following the enactment of the Local Government Borrowing Act 2011. Its main objective is to raise debt for local governments (councils) and optimise

their debt funding terms and conditions, which includes minimising interest costs, facilitating access to debt capital and providing borrowing flexibility, such as long-term loans.

LGFA had 18 foundation council shareholders at incorporation, of which nine were considered founding members, as well as the New Zealand government. There are currently 31 shareholders. Membership has increased steadily over the years; a total of 74 of the 78 New Zealand local councils and one Council-Controlled Organisation were eligible LGFA borrowers at 30 September 2021. LGFA borrowings currently account for around 80% New Zealand's local government sector debt.

## **RATING SENSITIVITIES**

### **Factors that could, individually or collectively, lead to negative rating action/downgrade:**

LGFA's Long-Term IDRs could be downgraded in the event of negative rating action for the New Zealand sovereign. A weaker assessment of LGFA's linkage to the central government or the government's incentive to support LGFA in a stress scenario that leads to a GRE support score of 42.5 or lower under our GRE criteria could also result in a downgrade.

### **Factors that could, individually or collectively, lead to positive rating action/upgrade:**

Positive rating action for the New Zealand sovereign would be mirrored in LGFA's ratings.

## **ESG Considerations**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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 Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

The ratings of LGFA are directly linked to the ratings of the New Zealand sovereign. A change in Fitch Ratings' assessment of the ratings of New Zealand would automatically result in a change in the ratings of LGFA.

## **Best/Worst Case Rating Scenario**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories

ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## 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.

### RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
New Zealand Local Government Funding Agency Limited (LGFA)	LT IDR	AA Rating Outlook Positive	Affirmed	AA Rating Outlook Positive
●	ST IDR	F1+	Affirmed	F1+
●	LC LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
●	LC ST	F1+	Affirmed	F1+

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 02 Sep 2021\) \(including rating assumption sensitivity\)](#)

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EU Endorsed, UK Endorsed

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