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Research Update:

**Housing New Zealand Corp.
'AA+/A-1+' Local Currency And
'AA/A-1+' Foreign Currency Ratings
Affirmed; Outlook Stable**

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Overview

- Housing New Zealand Corp. (HNZC)'s enterprise and financial profiles are very strong, based on high demand for its large and diverse property portfolio, and its relatively low debt levels compare with international peers.
- HNZC benefits from an almost certain likelihood of receiving extraordinary support from its owner, the New Zealand government (Crown), based on its critical public policy role and integral link.
- We are affirming our 'AA+/A-1+' local currency ratings and 'AA/A-1+' foreign currency ratings on HNZC.
- The stable outlook reflects our expectation that HNZC will remain the Crown's primary social provider. While HNZC's role will continue to evolve, it will remain critical to the government. Consequently, the ratings will continue to be equalized with those on the New Zealand government.

Rating Action

On Nov. 30, 2017, S&P Global Ratings affirmed its 'AA+/A-1+' local currency ratings and 'AA/A-1+' foreign currency ratings on Housing New Zealand Corp. (HNZC). The outlook remains stable.

Rationale

The ratings on HNZC reflects its 'aa' stand-alone credit profile (SACP) and our view of its almost-certain likelihood of extraordinary support from its owner, the New Zealand government (the Crown).

New Zealand general election took place in September 2017. Housing is a key policy priority of the new Labour government. However, the government has given no official direction regarding any changes to HNZC.

Among the government's policies is a plan within the next 10 years to build 100,000 affordable homes and continue to increase supply of new public housing across the country, particularly in Auckland. Furthermore, the government is terminating the former government's stock transfer program, which aimed to achieve greater involvement of third-party providers in the delivery of social

housing. This includes the stock transfer of about 2,500 Christchurch properties scheduled in mid-2018. In our view, these policy changes will further strengthen HNZC's role and dominant position in the market. Beyond that, it is too early to know whether the new government will announce further changes to HNZC's role to facilitate its broader housing policies. We do not expect any significant changes to HNZC's core business or structure in a near term.

Supporting this view is HNZC's involvement in the Crown's Auckland Housing Program (AHP) and Emergency Housing Response Team (EHRT). The AHP is intended to address housing supply shortages and affordability challenges in Auckland by increasing social, market, and affordable housing supply in New Zealand's largest city. The AHP, which was launched in 2017, will be the largest residential build program undertaken in New Zealand for many decades. In addition, HNZC has taken a direct role in providing emergency housing as part of the Crown's Emergency Housing Response Team. It will also be responsible for leasing the housing stock and managing the commercial leases to emergency housing providers.

Our assessment of HNZC's SACP reflects the company's very strong enterprise and financial profiles. Supporting its enterprise profile is the sector's low industry risk, and HNZC's status as the monopoly provider of social housing in New Zealand, with almost 63,000 properties in its portfolio. Consequently, we consider its economic fundamentals and its market position to be excellent. Furthermore, HNZC has a secure revenue stream, with about 63% of its rental revenue coming from government rent-related subsidies, and about 21% through the assignment of welfare benefits directly to HNZC. HNZC's asset quality and operational performance are very strong, with an average population growth of about 2.1% per year driving high demand for HNZC's services.

We view HNZC management as prudent and a key ratings factor. We take into account its experience, track record of expertise and conservatism with regard to exposure to risky market-rated activities. HNZC's strategy is dictated, and monitored, by the Crown and incorporates a sophisticated, well-developed, and consistent strategic planning process.

HNZC's financial profile remains sound, particularly when compared with international peers'. HNZC's financial performance is strong, with an adjusted EBITDA margin of about 39% between 2016 and 2020, down from the 42% average posted in 2016. This is mainly due to significant spending plans during next three years. Nevertheless, financial performance remains sound and EBITDA margins provide HNZC with a strong ability to support the ongoing provision of its services.

Further, HNZC's debt profile remains excellent. We forecast debt to increase in the medium term due to the significant funding needs of the AHP. We expect HNZC will fund AHP from a mix of internally generated cash and financing through a domestic bond program. We have incorporated these expectations in our forecast of HNZC's average EBITDA-to-interest ratio of 4.9x and debt-to-EBITDA ratio of 4.6x from 2016-2020. We believe these ratios support

HNZC's ability to cover future interest and debt repayments.

The ratings on HNZC are equalized with those on its owner, the New Zealand government, reflecting our view that there is an almost certain likelihood that the New Zealand government would provide timely and sufficient extraordinary support to HNZC in the event of financial distress. Our rating approach is based on our view of HNZC's:

- Critical role, given that its main purpose is mandated by the Crown and it operates on behalf of the Crown to provide a key public service.
- Integral link with the Crown due to its status as a government agency that can be considered as an extension of the government. We also consider its reporting and monitoring requirements, and the framework that allows the Crown to financially support HNZC, such as financing all of its existing debt.

We base this assessment on the assumption that HNZC obtains governmental support due to significant financial self-interest for the Crown. Further, any disruption to the essential service that HNZC provides likely would have serious social and political implications for the government.

Liquidity

We view HNZC's liquidity position as strong, and supported by the fact that all of its current borrowings are being sourced from the Crown. We consider HNZC's liquidity benefits from its exceptional access to external liquidity through the Crown's debt management office. As of June 30, 2017, HNZC had sources of liquidity of NZ\$1,042 million to cover uses of liquidity during the next 12 months of NZ\$1,346 million, resulting in a liquidity coverage ratio of 0.77x.

HNZC's treasury policy is conservative, with the sum of debt and committed facilities maturing in any 12-month period not to exceed 25% of total debt. This year, HNZC re-established a committed standby facility for NZ\$150 million to support its NZ\$150 million commercial-paper program, which is in place to cover the short-term working capital requirements.

Outlook

The stable outlook reflects our expectation that HNZC will remain the Crown's primary social provider. While HNZC's role will continue to evolve, it will remain critical to the government. Consequently, the ratings will continue to be equalized with those on the New Zealand government. Therefore, any upward momentum of the ratings would be linked to the New Zealand sovereign rating.

We could lower the rating if there is a change in government policy that we believe significantly weakens HNZC's critical role or integral link with the Crown while HNZC's enterprise or financial profile weaken from their current

positions. We view this scenario as unlikely during the next two years.

Table 1

| (mil. \$NZ) | --Year ended June 30-- | | |
|-------------------------------|-------------------------------|--------------|--------------|
| | 2015A | 2016A | 2017A |
| Number of units | 67,000 | 64,000 | 63,000 |
| Revenue | 1,203 | 1,281 | 1,318 |
| Operating expense | 841 | 1,005 | 1,110 |
| EBITDA* | 622 | 562 | 460 |
| EBITDA/revenue (%) | 51.7 | 43.8 | 38.7 |
| Interest expense | 108.1 | 93 | 87 |
| Debt/EBITDA (x) | 3.3 | 3.6 | 3.7 |
| EBITDA/interest coverage (x)§ | 5.8 | 5.4 | 5.5 |
| Capital expense | 322 | 492 | 586 |
| Debt† | 2,038 | 2,009 | 2,120 |
| Cash and liquid assets | 620 | 520 | 528 |

*Adjusted for capitalized repairs and operating leases. §Including capitalized interest. †Adjusted for operating leases. A--Actual E--Estimate. BC--Base case, reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Table 2

| Scores Assigned To Housing New Zealand Corp. | | | |
|---|--------------------|----------------------|-----------------------|
| | 2017 scores | Weighting (%) | Weighted score |
| Enterprise profile | | | |
| Industry | 2 | 30 | 0.6 |
| Economic fundamentals | 1 | 25 | 0.25 |
| Strategy and management | 2 | 22.5 | 0.45 |
| Asset quality | 2 | 22.5 | 0.45 |
| Total for business profile | 2 | | 1.75 |
| Financial profile | | | |
| Debt profile | 1 | 30 | 0.3 |
| Liquidity | 3 | 25 | 0.75 |
| Financial performance | 3 | 30 | 0.9 |
| Financial policies | 1 | 15 | 0.15 |
| Total for financial risk | 2 | | 2.1 |

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And

Nonprofit Social Housing Providers, Dec. 17, 2014

General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Housing New Zealand Corp.

Issuer Credit Rating

Foreign Currency

AA/Stable/A-1+

Local Currency

AA+/Stable/A-1+

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