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Research Update:

Housing New Zealand Ltd. 'AA+/A-1+' Local Currency, 'AA/A-1+' Foreign Currency Ratings Affirmed; Outlook Remains Stable

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Overview

- Housing New Zealand Ltd. (HNZL) is fully owned by Housing New Zealand Corp. (HNZC), which has a critical public policy role and integral link with the New Zealand government, resulting in an almost certain likelihood of receiving extraordinary support.
- We assess HNZL's enterprise profile to be very strong, based on its large and diverse property portfolio and strong demand for its services. HNZL's financial profile is also very strong with relatively low debt levels.
- We are affirming our 'AA+/A-1+' local currency ratings and 'AA/A-1+' foreign currency ratings on HNZL.
- The outlook remains stable, reflecting that on HNZC and our expectation that there will be no substantial change in the relationship between HNZL and HNZC.

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 Ltd. (HNZL). The outlook remains stable.

Rationale

HNZL is the main subsidiary of Housing New Zealand Corp. (HNZC), its 100% owner. HNZL makes up the bulk of the group's operations and manages about 63,000 dwelling units around New Zealand on behalf of HNZC. HNZL is integral to HNZC's identity and future strategy. Therefore, we consider HNZL to be core, as defined by our group rating methodology, to HNZC's operations. We consider our ratings on HNZL and HNZC to be intrinsically linked.

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.

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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Housing New Zealand Ltd.	
Issuer Credit Rating	
Foreign Currency	AA/Stable/A-1+
Local Currency	AA+/Stable/A-1+
Housing New Zealand Ltd.	
Commercial Paper	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.