Research Update:

Housing New Zealand Ltd. Ratings Affirmed Following Organizational Restructuring; Outlook Positive

October 1, 2019

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Overview

- Housing New Zealand Corp., the parent entity of Housing New Zealand Ltd. (HNZL), was disestablished on Oct. 1, 2019. Its former activities are being subsumed under a new entity, Kainga Ora-Homes and Communities.
- We believe HNZL will continue business as usual. We also continue to believe that there is an almost certain likelihood the New Zealand government would provide extraordinary support to HNZL, if needed.
- We are affirming our 'AA+/A-1+' local-currency and 'AA/A-1+' foreign-currency ratings on HNZL.
- The outlook on the long-term ratings remains positive, reflecting that on the New Zealand sovereign.

Rating Action

On Oct. 2, 2019, S&P Global Ratings affirmed its 'AA+/A-1+' local-currency and 'AA/A-1+' foreign-currency issuer credit ratings on Housing New Zealand Ltd., a social housing provider. The outlook on the long-term ratings remains positive.

Rationale

Our ratings on Housing New Zealand Ltd. (HNZL) reflect our view that it will not be substantially affected by the organizational restructuring of its parent entity on Oct. 1, 2019. Our ratings also reflect our view that there is an almost certain likelihood that extraordinary support would be forthcoming from HNZL's sole owner, the New Zealand government (the Crown), in a stress scenario. We therefore equalize our ratings on HNZL with those on the New Zealand sovereign.

Housing New Zealand Corp. (HNZC), the parent entity of HNZL, was disestablished on Oct. 1, 2019.

Its former activities are being subsumed under a new entity, Kainga Ora-Homes and Communities (Kainga Ora). Kainga Ora, like its predecessor, is a New Zealand Crown agency. It will lead urban development projects that expand the supply of public, affordable, and market housing, while also providing social housing services through its subsidiary HNZL. We believe that HNZL will continue business as usual. HNZL is the largest residential landlord in New Zealand, owning or managing approximately 65,500 properties, which collectively house more than 187,000 people. Although Kainga Ora will expand its development activities over time, we believe the group's exposure and HNZL's exposure to the residential real-estate market will remain contained in the medium term.

We assess HNZL's stand-alone credit profile at 'aa', reflecting its very strong enterprise and financial profiles. Globally, we classify social housing as a low-risk industry. The industry tends to be stable, with relatively high barriers to entry and ongoing government subsidies in many jurisdictions. Economic fundamentals in New Zealand remain robust, and Stats NZ estimates that the population grew by 1.6% in the year to June 2019. There is high and growing demand for HNZL's services, with the number of applicants on New Zealand's public housing register up by 131% over the past two years.

Most of HNZL's tenants pay no more than 25% of their net income on rent. The Crown then pays the difference between market rent and the tenant's income-related rent, in the form of an income-related rent subsidy. We view HNZL's strategy and management as strong, and a key factor supporting the ratings. The organization has a track record of market leadership and innovation. To help deliver on its building targets, it has made greater use of offsite manufacturing and new technologies such as cross-laminated timber. HNZL has a large and mature asset base, with its housing portfolio having an average age of 45 years. Vacancy rates have averaged about 2.8% during the past three years.

The expansion of social and affordable housing remains a key priority for the New Zealand government. The legislation that established Kainga Ora precludes any sales of state housing properties, and removes the requirement to pay a dividend to the Crown. There is no change to previously-announced plans to increase the stock of social housing by a net 6,400 properties over the four years to June 2022. The net increase in the 2018-2019 year was approximately 1,200. HNZL grows its housing portfolio primarily by constructing new homes, rather than through buy-ins or leasing. In September 2019, the Crown appointed an inaugural chief executive, five board members, and an interim chair to Kainga Ora. HNZC produced audited annual financial reports, and we expect this to continue under Kainga Ora. However, at the time of writing, the government had not released detailed financial or strategic plans for Kainga Ora.

To finance its pipeline of new housing construction, HNZL issues New Zealand dollar bonds to wholesale investors. In September 2019, it issued NZ$600 million of fixed-rate medium-term 'wellbeing bonds,' a type of sustainability bond. This followed an earlier issuance of NZ$500 million in April 2019, and brings HNZL's total outstanding commercial term debt to NZ$1.9 billion.

We expect HNZL to continue to issue new bonds during the next few years. Its commercial borrowings are governed by a borrowing protocol set by the Crown's Minister of Finance and Minister of Housing. An updated protocol took effect from June 1, 2018, with the limit raised to NZ$3.05 billion from NZ$1.08 billion. It is possible that the borrowing limit will need to be raised in the future to maintain the housing construction pipeline. HNZL also had NZ$250 million of short-term commercial paper outstanding as of June 2019. This figure is temporarily elevated, and we expect it to fall back to around NZ$150 million. HNZL recently increased its standby facilities with commercial banks to NZ$500 million.

The former HNZC group had an additional NZ$2 billion in loans from the Crown, of which NZ$1.55 billion is attributable to HNZL and NZ$441 million was attributable to HNZC. These loans are automatically refinanced by the Crown at maturity. The HNZC loans will be novated to Kainga Ora.

We previously forecast that the HNZC group's EBITDA-to-interest ratio will average about 4.6x and its debt-to-EBITDA ratio will average about 6.3x during financial years 2017 to 2021. These ratios incorporated all of the group's Crown and commercial debt.

Our ratings on HNZL are equalized with those on its owner, the New Zealand government, reflecting our view that there is an almost certain likelihood that the Crown would provide direct, timely, and sufficient extraordinary support in the event of financial distress. Our assessment is based on our view of HNZL'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 (i.e., the provision of social housing to the most vulnerable). We believe that recent reforms--such as the cancellation of state housing sales and the embedding of HNZL's social objectives in legislation--further cement this role.
- Integral link with the Crown, due to its status as part of a Crown agency that can be considered an extension of the government. The Crown is responsible for appointing members of Kainga Ora's board, and subsidies and appropriations from the Crown represent the bulk of HNZL's operating revenue.

We do not believe this likelihood of support is subject to transition risk, nor do we believe HNZL may become subject to negative intervention from Kainga Ora or other entities.

Liquidity

We view HNZL's liquidity position as strong. Sources of liquidity during the 2018-2019 financial year include:

- Forecast cash generated from continuing operations (net of interest payments) of NZ$324 million.
- Cash and liquid investments of NZ$671 million.
- Proceeds from asset sales of NZ$41 million.
- Undrawn committed bank facilities of NZ$350 million.

Uses of liquidity include:

- Capital expenditure of NZ$1,337 million.
- Maturing Crown loans of NZ$127 million.
- Maturing commercial paper of NZ$200 million.

HNZL has sources of liquidity of NZ$1,386 million to cover uses of liquidity of NZ$1,664 million, resulting in a liquidity coverage ratio of 0.83x. We consider that HNZL also benefits from exceptional access to external liquidity through the Crown's debt management office. Until a few years ago, the Crown historically provided all of HNZL's debt funding, and we expect that it would resume doing so in the event of capital market stress. HNZL manages its debt maturity profile so that no more than 25% of total debt matures in any 12-month period.

Outlook

The positive outlook on HNZL reflects that on the sovereign, meaning that we could raise the ratings on HNZL within the next two years should we do the same for New Zealand.

Our ratings on HNZL also reflect our expectation that its role will remain critical and its link to the Crown will remain integral during the next two years. Consequently, we continue to equalize the HNZL ratings with those on New Zealand.

We could lower our local-currency long-term ratings during the next two years if we perceive HNZL's role or link to the Crown to be weakening. We would also lower our ratings on HNZL should we do the same for the New Zealand sovereign ratings.

Table 1

Housing New Zealand Key Statistics

	--Year ended June 30--				
(Mil. NZ$)	**2017a**	**2018a**	**2019bc**	**2020bc**	**2021bc**
Number of units owned or managed	63000	64000	N.A.	N.A.	N.A.
Vacancy rates (% of rent net of identifiable service charge)	2.8	1.8	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	1.3	N.A.	N.A.	N.A.	N.A.
Revenue§	1317	1326	1490	1543	1875
Share of revenue from nontraditional activities (%)	9.9	6	N.A.	N.A.	N.A.
EBITDA†	453	512	531	578	624
EBITDA/revenue (%)	34.4	38.6	35.6	37.5	33.3
Interest expense	87	84	117	152	186
Debt/EBITDA (x)	4.3	5.2	6.6	7.7	7.6
EBITDA/interest coverage** (x)	5.2	6.1	4.5	3.8	3.4
Capital expense†	586	957	1337	1267	1206
Debt	1969	2653	3523	4423	4724
Housing properties (according to balance sheet valuation)	24922	26700	27792	29280	30435
Loan to value of properties (%)	7.9	9.9	12.7	15.1	15.5
Cash and liquid assets	528	671	500	491	266

*Rent and service charge arrears. §Adjusted for grant amortization. †Adjusted for capitalized repairs. **Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Table 2

Housing New Zealand Ltd. – Ratings Score Snapshot

Enterprise profile	**2**
Industry risk	2
Economic fundamentals and market dependencies	1
Strategy and management	2
Asset quality and operational performance	1
Financial profile	**2**
Financial performance	3
Debt profile	1
Liquidity	3

Table 2

Housing New Zealand Ltd. – Ratings Score Snapshot (cont.)

Financial policies	1

S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The State Of Social Housing: Is The English Model Catching On?, July 25, 2019
- New Zealand Outlook Revised To Positive On Improving Fiscal Position; 'AA+' LC And 'AA' FC Ratings Affirmed, Jan. 31, 2019
- Global Social Housing Risk Indicators: December 2018, Dec. 4, 2018

Ratings List

Ratings Affirmed	
Housing New Zealand Ltd.	
Issuer Credit Rating	
Foreign Currency	AA/Positive/A-1+
Local Currency	AA+/Positive/A-1+
Housing New Zealand Ltd.	
Senior Unsecured	AA+
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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.