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Research Update:

Housing New Zealand Corp. Ratings Affirmed; Outlook Stable

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Overview

- The New Zealand government in November 2018 announced that it intends to merge Housing New Zealand Corp. into a new Housing and Urban Development Authority. Legislation to establish the authority will be introduced into parliament in 2019. This has no immediate credit implications for HNZC.
- HNZC plans to increase its commercial borrowings during the next few years to finance a significant expansion of social housing supply. Nevertheless, we expect its financial profile to remain solid.
- HNZC continues to be the dominant provider of social housing in New Zealand. Recent reforms enacted by the government further support its near-monopoly position.
- HNZC benefits from an almost-certain likelihood of extraordinary support from its sole owner, the New Zealand government.
- We are affirming our 'AA+/A-1+' local-currency and 'AA/A-1+' foreign-currency ratings on HNZC. The outlook on the ratings is stable.

Rating Action

On Nov. 29, 2018, S&P Global Ratings affirmed its 'AA+/A-1+' local-currency and 'AA/A-1+' foreign-currency issuer credit ratings on Housing New Zealand Corp. The outlook on the ratings is stable.

Rationale

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

HNZC is a statutory Crown entity responsible for providing high-quality state housing to people in need, alongside supporting the government's priorities in the supply of emergency, transitional, KiwiBuild, and market housing. It is the largest residential landlord in New Zealand, owning about 61,500 properties and leasing a further 2,500, which collectively house about 185,000 people. Our analysis is based on HNZC and its three wholly owned subsidiaries: Housing New Zealand Ltd. (HNZL), HLC Ltd., and Housing New Zealand Build Ltd.

On Nov. 24, 2018, the Crown government announced the proposed formation of a new Housing and Urban Development Authority. The new authority will bring together HNZC, HLC Ltd. and a third Crown entity called KiwiBuild Unit. It will continue to act as a state housing landlord, with no change for HNZC's existing tenants. It will also lead the government's large-scale urban development projects, including its signature KiwiBuild program, which aims to deliver 100,000 new affordable homes over a decade. The government intends to introduce legislation to establish the authority into parliament in 2019. We understand that HNZL, the legal entity issuing medium-term notes to the market (discussed below), will either continue as a subsidiary of the authority or, if there is a reorganization, the new authority will assume all the obligations of HNZL in respect of the issued notes. This announcement has no immediate credit implications. However, we may reappraise the situation once we have further details about the proposed legislation.

In the interim, we expect that HNZC's near-monopoly status in the provision of social housing will be further reinforced by reforms currently being enacted by the Crown government. One of the government's key priorities is to grow the supply of housing and public housing in New Zealand. The government has cancelled the Social Housing Reform Programme, which had aimed to encourage more diverse ownership of public housing, and cancelled the "stock transfer" program, which saw HNZC transfer several thousand properties to other community housing providers. Small-scale, business-as-usual property sales will continue to take place.

The government in August 2018 released its 2018-2022 Public Housing Plan. The plan outlines a strategy for securing around 6,400 net additional public housing properties across New Zealand by June 2022. HNZC will deliver about 70% of these new properties (i.e., around 1,100 net additional properties per year) and community housing providers will deliver the remaining 30%. The plan should see HNZC's total portfolio grow to over 68,000 properties by June 2022. While much of the growth will be in Auckland, the country's largest city, HNZC has also launched significant build programs in Wellington, Christchurch, and in multiple regional locations. HNZC added a net 720 properties to its stock in the 2017-2018 financial year.

Our assessment of HNZC's SACP reflects 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 1.9% in the year to June 2018. There is a high level of demand for HNZC's services, with the number of applicants on New Zealand's Social Housing Register increasing by 111% between June 2016 and June 2018.

In the near term, we believe that the HNZC group will continue to focus predominantly on the provision of low-income housing. Most tenants pay no more than 25% of their net income on rent. The Crown then pays to HNZC the difference between market rent and the tenant's income-related rent, in the form of an income-related rent subsidy. The HNZC group engages in a number of other activities, including offering home ownership financial products and HLC's role in the provision of land planning and development services. HNZC in May 2018 established its third subsidiary, Housing New Zealand Build Ltd., which we understand will construct and sell affordable properties to the public. However, these activities represent a fraction of the group's overall revenues and expenses.

We view HNZC'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 ambitious building targets, HNZC is making greater use of offsite manufacturing and new technologies such as cross-laminated timber. It will also implement multiyear contracts, providing greater certainty to suppliers, and roll out specific, repeatable designs for different housing types. HNZC 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 government in July 2018 appointed four new nonexecutive members to HNZC's board, including a new deputy chairperson, while reappointing the current chairperson until May 2019. Further, the government in September 2018 announced that it will seek to enshrine in legislation new social objectives for HNZC, which include assisting tenants to sustain their tenancies and being a "fair and reasonable landlord." These objectives will continue to apply to the new Housing and Urban Development Authority, if it proceeds. The government also proposes changing the presumption that HNZC will return surpluses to the Crown. While HNZC has paid dividends to the Crown in the past, we do not expect that it will make any such payments during the next few years.

HNZC's financial performance remains solid. We project that EBITDA, as a percentage of revenues, will average about 36% during the five-year period between financial years 2017 and 2021. HNZC's financial policies are prudent. Annual financial reports are produced on a consolidated basis, and are audited by a firm appointed by the Auditor-General of New Zealand. HNZC prepares statements of intent and annual statements of performance expectations that contain detailed medium-term financial and operational targets and are tabled in parliament. HNZC also provides its Crown minister with quarterly performance monitoring reports. Long-term debt is used only for capital expenditures, and not operating costs. After taking into account the effect of interest-rate swaps, about 79% of HNZC's borrowings are at a fixed rate of interest.

We expect HNZC's borrowings to rise during the next few years, though its debt profile should remain relatively strong. A key change from the past is that HNZC, through its subsidiary HNZL, has begun issuing domestic bonds to meet the upfront capital cost of its build program. In June 2018, HNZL finalized a dual-tranche issuance of NZ$250 million in five-year notes and NZ$250 million in seven-year notes. HNZL forecasts its commercial term debt to grow to NZ$2.9 billion by June 30, 2022, from NZ$500 million as of June 30, 2018. HNZL also had NZ$200 million of short-term commercial paper outstanding as of June 30, 2018, and we expect it to continually roll over about NZ$150 million in the future to manage its working capital requirements. HNZC's commercial borrowings are governed by a borrowing protocol set by the Crown's minister of finance and minister for housing and urban development. An updated borrowing protocol took effect from June 1, 2018, with the limit for commercial (i.e., non-Crown) debt raised to NZ$3.05 billion from NZ$1.08 billion.

Meanwhile, the HNZC group has an additional NZ$1.94 billion in borrowings from the Crown. We expect that this figure will remain steady during the next few years, as Crown debt is rolled over at maturity. We forecast that HNZC'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 incorporate all of the group's Crown and commercial debt. Our base-case forecasts are based on data available to us before the government's announcement on Nov. 24, 2018. We do not yet have details about how the new Housing and Urban Development Authority--if it is established--will operate and what its financial strategies will be.

HNZC's reporting requirements changed recently with the establishment of the government's new Ministry of Housing and Urban Development, which from Oct. 1, 2018, assumed the housing functions formerly undertaken by the Ministry of Social Development, the Ministry of Business, Innovation, and Employment, and the Treasury. We do not expect this change to have any material effect on HNZC's relationship with the Crown.

Our 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 Crown would provide timely and sufficient extraordinary support to HNZC in the event of financial distress. Our assessment 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 (i.e., the provision of social housing to the most vulnerable). We believe that recent reforms--such as the cancellation of the stock transfer program and the government's proposal to enshrine social objectives in HNZC's governing legislation--further cement this role.
- Integral link with the Crown, due to its status as an agency that can be considered an extension of the government. Further, the Crown is responsible for appointing members of HNZC's board, and it provides a significant proportion of HNZC's current debt.

Liquidity

We view HNZC'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:

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

HNZC 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 HNZC also benefits from exceptional access to external liquidity through the Crown's debt management office. As noted above, the Crown has historically provided all of HNZC's debt funding, and we expect that it would resume doing so in the event of capital markets stress. HNZC manages its debt maturity profile so that no more than 25% of total debt matures in any 12-month period.

Outlook

The stable outlook reflects our expectation that HNZC's role with remain critical and its link to the Crown will remain integral during the next two years. Consequently, our ratings on HNZC will continue to be equalized with those on the New Zealand government.

We would raise or lower our ratings on HNZC if we were to take the same action on the New Zealand sovereign, all else being equal.

We could lower our local-currency long-term ratings in the next two years if we perceive HNZC's role or link to the Crown to be weakening. This might occur, for example, if HNZC were amalgamated into the proposed Housing and Urban Development Authority and the new entity's strategies or governance are such that we no longer believe it plays a critical role or has an integral link to the Crown.

Table 1

Key Statistics

	--Year ended June 30--				
(mil. NZ$)	**2017A**	**2018A**	**2019BC**	**2020BC**	**2021BC**
Number of units owned or managed	63,000	64,000	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§	1,317	1,326	1,490	1,543	1,875

Table 1

Key Statistics (cont.)

	--Year ended June 30--				
(mil. NZ$)	**2017A**	**2018A**	**2019BC**	**2020BC**	**2021BC**
Share of revenue from nontraditional activities (%)	9.9	6.0	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	1,337	1,267	1,206
Debt	1,969	2,653	3,523	4,423	4,724
Housing properties (according to balance sheet valuation)	24,922	26,700	27,792	29,280	30,435
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

Ratings Score Snapshot	
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Strategy and management	2
Asset quality and operational performance	1
Financial profile	2
Financial performance	3
Debt profile	1
Liquidity	3
Financial policies	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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Housing New Zealand Corp.	
Housing New Zealand Ltd.	
Issuer Credit Rating	
Foreign Currency	AA/Stable/A-1+
Local Currency	AA+/Stable/A-1+
Analytical Factors	
Local Currency	aa
Housing New Zealand Ltd.	
Senior Unsecured	AA+
Short-Term Debt	A-1+
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.