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Ratings

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Research Update:

Kainga Ora-Homes And Communities Ratings Affirmed; Outlook Stable

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Overview

- Kainga Ora-Homes And Communities is a New Zealand government (Crown) agency, and it is deeply integrated in the implementation of the government's social housing policy.
- The agency's large development pipeline is driving weaker financial performance and interest coverage, leading us to revise our assessment of its stand-alone credit profile (SACP) downward to 'bbb+' from 'a-'.
- We equalize our ratings on Kainga Ora with the sovereign credit ratings on New Zealand. We therefore affirmed our long-term 'AA+' foreign-currency and 'AAA' local-currency issuer credit ratings on Kainga Ora. We also affirmed our 'A-1+' local- and foreign-currency short-term issuer credit ratings.
- The stable outlook on the long-term ratings reflects that on the New Zealand sovereign.

Rating Action

On Feb. 27, 2024, S&P Global Ratings affirmed its 'AA+' foreign currency and 'AAA' local currency long-term issuer credit ratings on Kainga Ora-Homes and Communities, a New Zealand-based social housing provider. At the same time, we affirmed our 'A-1+' local- and foreign-currency short-term issuer credit ratings on the agency. The outlook on the long-term ratings is stable. We have revised downward our assessment of the group's SACP to 'bbb+' from 'a-'.

Outlook

The stable outlook on Kainga Ora reflects that on the New Zealand sovereign as well as our expectation that the role of Kainga Ora will remain critical and its link to the New Zealand government will stay integral.

Downside scenario

We may lower our ratings on Kainga Ora during the next two years if we perceive the agency's role or link to the Crown to be weakening. We could also downgrade Kainga Ora if we were to take the same action on the New Zealand sovereign.

Upside scenario

We could raise our foreign-currency long-term rating on Kainga Ora during the next two years if we were to upgrade the New Zealand sovereign, all else being equal.

Rationale

Our ratings on Kainga Ora are equalized with those on New Zealand because we believe the likelihood is almost certain that direct, timely, and sufficient extraordinary support would be forthcoming from the sole owner of Kainga Ora, the Crown, in a stress scenario. Our assessment is based on the following Kainga Ora characteristics:

- Critical role, given that it is mandated by and operates on behalf of the Crown to provide a key public service (i.e., the provision of social housing to the most vulnerable segments of the New Zealand population) and enable, facilitate, and deliver housing and urban development projects.
- Integral link with the Crown due to its status as a Crown agency that can be considered an extension of the government. The Crown is responsible for appointing all board members of Kainga Ora, and subsidies and appropriations from the Crown represent the bulk of the agency's operating revenue. Kainga Ora is not required to pay dividends to the Crown. All borrowing is conducted through loans from the sovereign debt management office, further solidifying our view of Kainga Ora's integral link with the Crown.

We do not believe this likelihood of support is subject to any transition risk or negative intervention from the Crown.

Kainga Ora's financial risk profile has weakened because its large construction pipeline is causing financial performance and interest coverage to deteriorate. We therefore revised downward our assessment of the group's SACP to 'bbb+' from 'a-'.

Kainga Ora is New Zealand's largest residential landlord, owning or managing about 72,000 properties as of June 2023. Its large portfolio and geographically diversified footprint help it to minimize any operating volatility.

Globally, we classify social housing as a low-risk industry. It tends to be stable, with relatively high barriers to entry and ongoing government subsidies in many jurisdictions. Demand for Kainga Ora services is high and climbing, with about 25,000 applicants on New Zealand's public housing register as of September 2023, up about 9% from 12 months earlier. A persistent undersupply of housing, strong population growth, and low market interest rates over the past few years contributed to rapid property price appreciation and declining affordability.

Relative to international peers, Kainga Ora benefits from a very supportive regulatory framework. As a Crown agency, its public policy mandate is enshrined in legislation.

We view Kainga Ora's management as a strength. The management team has a high level of expertise. The government appoints the Kainga Ora board of nine members. The organization and its predecessors have a track record of market leadership, innovation, and achieving the strategy set by the government.

To help deliver on ambitious building targets set by the government, Kainga Ora's Project Velocity and subsequent Housing Delivery System aim to halve build times. Additionally, the agency has made greater use of multiyear supplier contracts, offsite manufacturing, and new technologies such as cross-laminated timber.

The expansion of social and affordable housing remains a key priority for the New Zealand government. Kainga Ora is on track as per Public Housing Plan 2022-2026, targeting to enlarge the stock of state and transitional housing properties by 4,500-6,000 homes from 2024 to 2026.

Kainga Ora expands its portfolio primarily by constructing new homes and growing its asset base, rather than through buy-ins or leasing. The agency's build program is necessary because many of its properties are nearing the end of their useful lives. In addition, New Zealand has a housing shortage, particularly in major urban centers such as Auckland.

Kainga Ora also has a role in working with private developers to construct affordable properties under the Crown's KiwiBuild scheme, and in providing certain property management and development services on behalf of the Crown. These activities are administered through the separate Housing Agency Account, which does not form part of the Kainga Ora group or its financial statements. As such, we do not believe Kainga Ora has any significant exposure to market price risks.

We forecast Kainga Ora's adjusted EBITDA margin will drop below 20% over 2023-2024, from more than 24% in 2022. It may recover in the outer years of our forecast period to 2026 as new rental properties come on stream.

We project a decline in margin due to higher repairs and maintenance expenses for existing properties, given that expenses are generally outpacing growth in market rents. Nevertheless, Kainga Ora's revenue streams are reliable because it receives most of its operating revenue directly or indirectly from the Crown. Most tenants pay no more than 25% of their net income on rent; the Crown then pays to Kainga Ora the difference between market rent and the tenant's income-related rent, in the form of an income-related rent subsidy.

Gross debt and interest costs will grow substantially across our forecast period to 2026. The non-sales adjusted EBITDA-to-interest ratio dipped below 1.0x in 2023. We estimate Kainga Ora's non-sales adjusted debt-to-EBITDA ratio will average about 38x for financial years 2022-2026 (ending June 30). These ratios incorporate all the group's commercial and Crown debt.

In November 2022, the New Zealand government announced that Kainga Ora will conduct all future borrowing through the sovereign debt management office, rather than in commercial markets in its own right. For the preceding four years, Housing New Zealand Ltd. (HNZL, a core subsidiary of the Kainga Ora group) had directly issued New Zealand-dollar denominated bonds to wholesale investors on behalf of the group.

The financing switch itself does not affect our rating on Kainga Ora. We assume the refinancing will be gradual (i.e., as HNZL's outstanding bonds mature and are refinanced with Crown loans), and the New Zealand Debt Management office does not buy back outstanding bonds.

The Kainga Ora group's outstanding commercial debt is spread across seven tranches of fixed-rate and inflation-indexed bonds with maturities ranging from June 2025 to September 2040.

The agency's liquidity position has improved in our review. This is due to an increase in expected ongoing debt financing and equity injections by the Crown to cover rising capital investment needs. The working capital facility with the New Zealand Treasury remains unchanged at NZ$500 million. Kainga Ora has sources of liquidity of NZ$7,960 million to cover uses of liquidity of NZ$6,738 million, resulting in a liquidity coverage ratio of 1.18x for the 12 months ending Feb. 28, 2025.

Sources of liquidity for the period include:

- Our forecast of cash generated from continuing operations (as proxied by adjusted EBITDA) of NZ$513 million.
- Cash and short-term liquid investments of NZ$574 million as of Feb. 28, 2024.
- Proceeds from asset sales of NZ$16 million.
- An undrawn working capital facility with the New Zealand Treasury of NZ$500 million.
- Our estimate of Crown financing of about NZ$6.357 billion.

Uses of liquidity over the same period include:

- Forecast capital expenditure of NZ$4,533 million.
- Forecast principal and interest payments of NZ$2,205 million.

Kainga Ora benefits from strong access to external liquidity through the Crown's debt management office and, historically, New Zealand's local capital markets. Kainga Ora manages its maturity profile so that no more than 25% of total debt matures in any 12-month period. The earliest of HNZL's medium-term notes will mature in June 2025.

Key Statistics

Table 1

Kainga Ora Homes and Communities--Key Statistics

	--Year ended June 30--				
(Mil. NZ$)	2022a	2023a	2024bc	2025bc	2025bc
Number of units owned or managed	69,509	72,035	75,535	78,335	78,335
Adjusted operating revenue	1,930	2,030	2,373	2,632	2,985
Adjusted EBITDA	480	263	340	599	752
Non-sales adjusted EBITDA	475	263	338	599	752
Capital expense	2,255	3,577	4,943	4,328	4,190
Debt	9,794	12,303	17,630	22,166	25,411
Interest expense	203	344	562	691	727
Adjusted EBITDA/Adjusted operating revenue (%)	24.9	13.0	14.3	22.8	25.2
Debt/Non-sales adjusted EBITDA (x)	20.6	46.8	52.2	37.0	33.8
Non-sales adjusted EBITDA/interest coverage(x)	2.3	0.8	0.6	0.9	1.0

a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Kainga Ora Homes and Communities--Ratings Score Snapshot

	Assessment
Enterprise risk profile	
Industry risk	2
Regulatory framework	1
Market dependencies	1
Management and governance	2
Financial risk profile	
Financial performance	5
Debt profile	6
Liquidity	3

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 30, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: November 2023, Nov. 16, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: November 2023, Nov. 16, 2023
- Regulatory Framework Assessment: New Zealand Crown-Owned Social Housing Providers Operate Under Uniquely Strong Policy Mandate, June 29, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023

Ratings List

Ratings Affirmed	
Kainga Ora-Homes and Communities	
Issuer Credit Rating	
Foreign Currency	AA+/Stable/A-1+
Local Currency	AAA/Stable/A-1+

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