

HEARTLAND

New Zealand Limited

NZX Release

Fitch Affirms Credit Rating for Heartland Bank

16 October 2015

Heartland New Zealand Limited (**Heartland**) (NZX: HNZ) is pleased to announce that Fitch Australia Pty Ltd (**Fitch**) has affirmed its long term issuer credit rating on Heartland subsidiary Heartland Bank Limited (**Bank**) of 'BBB' outlook stable. The full report from Fitch is attached.

The Fitch report notes the Bank's continuing improvements to its risk management practices and its simple and transparent business model which provides the Bank with pricing power in its target markets. Fitch expects the Bank's "core asset quality to remain sound, benefiting from continued improvement in underwriting standards and good economic conditions". Fitch notes its expectation that New Zealand's economic growth will continue, albeit at a slower pace than the last two years.

Heartland is pleased with the report and the affirmation of the Bank's 'stable' outlook which reflects Fitch's view that the Bank is likely to continue its solid performance over the next 12 to 24 months.

- Ends -

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Fitch Affirms Heartland Bank at 'BBB'; Outlook Stable

Fitch Ratings-Sydney-15 October 2015: Fitch Ratings has today affirmed Heartland Bank Limited's (HBL) Long-Term and Short-Term Issuer Default Ratings (IDR) at 'BBB' and 'F2' respectively, as well as its Viability Rating (VR) of 'bbb'. The Outlook on the Long-Term IDR remains Stable. HBL's Support Rating and Support Rating Floor have also been affirmed at '5' and 'No Floor', respectively.

The affirmation of HBL's IDRs and VR reflects the bank's more sophisticated risk management practices, which support its higher risk appetite relative to peers. This allows the bank to have a leading franchise in niche but small segments of the market. The Stable Outlook reflects our view that HBL is likely to continue its solid performance over the next 12 to 24 months.

We expect New Zealand's economy to continue to grow, albeit at a slower pace than in the last two years. The contribution to growth from the Christchurch rebuild has peaked and some commodity prices remain under pressure, impacting parts of agricultural output. Consequently, the Reserve Bank of New Zealand (RBNZ) has entered into a phase of monetary easing, lowering the official cash rate (OCR) by 75bp to 2.75% since June 2015, which should support asset quality across the banking system.

High household leverage and New Zealand's high property prices remain risks to the financial system. Following strong house price growth, the RBNZ announced the implementation of additional macro-prudential measures from 1 November 2015. However, the impact for HBL is limited as its residential mortgage exposure is insignificant. Risks are building in the agricultural sector as low dairy prices, should they persist, may contribute to asset-quality issues in this sector. HBL conducted stress tests to assess the impact of prolonged low dairy prices, which were found to be manageable as of August 2015. HBL's IDRs and VR are not constrained by the operating environment.

KEY RATING DRIVERS

IDRS and VR

HBL's Long- and Short-Term IDRs and VR reflect the bank's continuing improvements of its risk management practices, including tightening policies, enhancing underwriting processes and strengthening risk controls. These improvements should result in better quality business generation. However, HBL's risk appetite remains riskier relative to peers. HBL continued to reduce its non-core property finance portfolio. The size of the portfolio is insignificant and almost fully provided for. We believe any future losses from this portfolio will be immaterial.

HBL has a simple and transparent business model. It operates in New Zealand, focusing on niche markets such as vehicle finance for households and businesses, as well as home-equity-release

(HER) mortgages, and equipment, livestock and invoice finance for businesses. This gives HBL pricing power in its target markets, offsetting the potential higher risk associated with some of these lending products. As a result, HBL generates a stronger net interest margin than peers. Fitch expects HBL's core asset quality to remain sound, benefiting from continued improvement in underwriting standards and good economic conditions.

HBL's funding and liquidity profile is adequate for its rating level. The bank benefits from a more balanced asset-liability-maturity profile relative to domestic peers as HBL's lending products typically have a shorter-term maturity. However, following the acquisition of the HER mortgages, the asset maturity has lengthened, reducing the portion of assets maturing within 12 months. Nevertheless, HBL's asset-liability mix remains shorter-term relative to domestic peers. HBL's on-balance sheet liquidity is adequate, consisting only of cash and securities. The bank has no internal securitisation capabilities for RMBS due to its limited standard residential mortgages exposure. However, HBL's ABS transactions are repo-eligible with the RBNZ if held by a New Zealand bank.

HBL's capital position benefits from strong profitability and sound levels of retained earnings. The bank - through its holding company parent - has access to equity markets and successfully raised fresh common equity during 2014. We expect the bank to maintain solid levels of capital despite the recent strong asset growth.

SUPPORT RATING AND SUPPORT RATING FLOOR

HBL's Support Rating and Support Rating Floor reflect that while support from the New Zealand sovereign is possible, it cannot be relied upon. In our view, the Open Bank Resolution Scheme (OBR) reduces the propensity of the sovereign to support its banks. The OBR allows for the imposition of losses on depositors and senior debt holders to make up capital shortfalls if a deposit-taking institution has failed.

RATING SENSITIVITIES

IDRS and VR

HBL's IDRs and VR are sensitive to changes in its risk appetite, especially if HBL were to expand its franchise into new and existing market segments by compromising the improved risk management practices. We are concerned that such a development, should it occur, could weaken HBL's financial profile and therefore places pressure on HBL's VR and IDRs. Positive rating action is unlikely in the short to medium term.

SUPPORT RATING AND SUPPORT RATING FLOOR

HBL's Support Rating and Support Rating Floor are sensitive to any change in assumptions around the propensity or ability of the New Zealand government to provide timely support to the institution.

The rating actions are as follows:

Heartland Bank Limited:

Long-Term IDR affirmed at 'BBB'; Outlook Stable;

Short-Term IDR affirmed at 'F2';

Viability Rating affirmed at 'bbb';
Support Rating affirmed at '5'; and
Support Rating Floor affirmed at 'No Floor'.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Global Bank Rating Criteria (pub. 20 Mar 2015)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=992316)

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