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New Plymouth District Council

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ISSUER CREDIT RATING

New Plymouth District Council

Issuer Credit Rating *Local currency*	AAA/Stable/A-1+
Issuer Credit Rating *Foreign currency*	AA+/Stable/A-1+

Issuer credit rating history:

	Local Currency	Foreign Currency
Nov. 21, 2004	AAA/A-1+	AA+/A-1+
July 22, 2002	AA+/A-1+	AA+/A-1+

Major Rating Factors

Strengths:

- Negative net debt position
- High liquidity
- Limited capital expenditure pressure

Weaknesses:

- Small and relatively narrow economic structure

Rationale

On Nov. 16, 2006, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' local currency and 'AA+/A-1+' foreign currency ratings on New Plymouth District Council (New Plymouth). The outlook is stable.

Negative net debt

The council's balance sheet remains very strong, with its negative net debt position (cash and liquid assets less borrowings) forecast to continue over the medium term, despite an expected increase in gross debt. Following the sale of its ownership interest in Powerco Ltd. in 2004, New Plymouth invested the proceeds (NZ$259 million) in an independently managed diversified portfolio of investments, ranging from highly liquid cash to equities, fixed interest securities, and SPARCS (Subordinated Prime Adjusting Reset Convertible Securities). Standard & Poor's believes that a well-diversified portfolio is less risky than holding shares in an individual business, and that the portfolio strengthens the council's credit quality. Moves in the past fiscal year to further diversify the portfolio add additional strength to the rating.

High liquidity

At June 30, 2006, cash and security holdings of NZ$210 million and NZ$1.6 million in an undrawn committed bank line more than offset short-term debt obligations of NZ$12.2 million.

Limited capital expenditure requirements

New Plymouth enjoys limited infrastructure replacement needs and no renewal pressures, nor does it have the growth pressures experienced by centers such as Auckland City Council and Tauranga City Council. Rather than addressing an infrastructure or maintenance backlog, the council's upcoming investment in water and sewerage infrastructure relates more to raising water quality standards developed by the central government.

Economy

Diversity within the Taranaki regional economy has increased with the growth of the oil and gas, tourism, and service sectors. However, there is still a strong reliance on the milk and milk products industry. The size of the economy, relative to its New Zealand peers, is also a credit weakness.

Short-term credit factors:
New Plymouth's liquidity position is strong. At June 30, 2006, cash and security holdings of NZ$210 million and NZ$1.6 million in an undrawn committed bank line more than offset short-term debt obligations of NZ$12.2 million.

Outlook

New Plymouth's stable outlook reflects Standard & Poor's expectation that the council will maintain its fiscally responsible and prudent approach to the council's finances, including its independently managed Perpetual Investment Fund (PIF). In particular, the outlook reflects the expectation that the council will continue to meet its stated investment goals without persistent capital deterioration.

Downward pressure would be placed on the ratings in the event that the council's resources were used to support the PIF or if capital was drawn from the fund to meet the revenue requirements of the council. A poorly performing fund may reflect imprudent management of the fund or an increased risk appetite, both of which would negatively impact upon the council's credit quality. The likelihood that this would occur to an extent that would threaten the 'AAA' rating, however, is minimal.

Comparative Analysis

New Plymouth is the highest-rated local government in New Zealand. Its current strengths relative to its domestic and international peers include its strong accrual operating position and negative net debt. Offsetting these strengths is its overall cash balance deficit. New Plymouth also benefits from extremely strong liquidity.

Domestic peers
On balance, New Plymouth rates stronger than its closest peers, Auckland City Council (AA+/Stable) and Christchurch City Council (AA+/Negative). New Plymouth's strengths relative to its New Zealand peers include its strong accrual operating position. Despite recording a deficit in fiscal 2005, the council's three-year average remains stronger than both Auckland and Christchurch. New Plymouth does not have a maintenance or infrastructure backlog such as the one faced by Auckland, and, like Christchurch, it has limited ownership of council-controlled organizations (CCTOs). Both these factors add support to the ratings on New Plymouth. CCTOs expose the consolidated council's revenue base to higher-risk industries compared to the stable revenue stream of council-collected property rates. These strengths, as well as New Plymouth's extremely strong balance sheet, offset any perceived weakness in its cash position, and ensure that its comparative performance remains solid. A weakness for the ratings on New Plymouth relative to its New Zealand peers is its small and less diversified economy.

International peers
Internationally, New Plymouth's low net debt levels are comparable with its 'AAA' rated peers such as the Canadian Municipality of Durham, the Australian City of Melbourne, and the Swedish City of Taby. New Plymouth's capital expenditure program as a percentage of total expenditure is larger than its peers and as a consequence this is reflected in its lower overall cash balance. New Plymouth's strong credit quality is further supported by its high degree of financial flexibility. Similar to Melbourne, New Plymouth has taxes that are low relative to those of neighboring local governments.

Table 1

New Plymouth City Council 2005 Peer Comparisons

	New Plymouth	Auckland	Christchurch	Melbourne	Durham	Taby*
Long-term issuer credit rating	AAA	AA+	AA+	AAA	AAA	AA+
Outlook	Stable	Stable	Negative	Stable	Stable	Stable
Country	NZ	NZ	NZ	Australia	Canada	Sweden
Population	69,200	425,400	356,030	69,200	572,700	60,422
Total revenue (mil. NZ$)	135.3	530.7	336.3	288.8	922.1	555.4
Three-year averages						
Accrual operating balance (% of operating revenue)	18.4	5.7	12.4	4.2	N.A	N.A
Operating cash balance (% of operating revenue)	25.1	29.1	32.0	16.2	16.9	2.6
Capital expenditure (% of total expenditure)	39.3	41.0	29.6	19.0	22.8	5.1
Balance after capital expenditure (% of operating revenue)	(4.7)	1.3	4.4	5.5	(4.0)	(2.6)
Year ended June 30, 2005						
Total direct debt (mil. NZ$)	66.8	180.0	92.5	0	277.9	23.4
Direct debt (% of operating revenue)	96.1	38.5	74.4	0	31.9	4.2
Net debt (% of operating revenue)	(68.4)	(10.8)	(69.5)	(64.6)	(59.1)	1.8

New Plymouth–New Plymouth District Council. Auckland–Auckland City Council. Christchurch–Christchurch City Council. Melbourne-Melbourne City Council. Durham – Regional Municipality of Durham. Taby – Municipality of Taby. N.A—Not available. *Based on 2004 figures

System Support and Predictability

The New Zealand local government system promotes a strong management culture and fiscal discipline among New Zealand councils, therefore providing a source of credit strength. The Local Government Act (2002) as the empowering legislation;

- Promotes tight financial management provisions;
- Requires funding and financial policies that are reviewed at least every three years;
- Promotes transparency around decision-making; and
- Requires extensive community consultation on the running of the council.

Long-Term Council Community Plans (LTCCPs) are required every three years, and must provide financial forecasts that span ten years. These forecasts are integrated with the council's Annual Plan. The production of LTCCPs promotes a full review of the council's priorities and includes a review of funding and financial policies. The ten-year forecasts are audited by Audit New Zealand.

Other strengths of the New Zealand system that support the rating include:

- Strict financial and non-financial reporting requirements;
- Balanced budgets that include meeting the cost of depreciation or providing the rationale for not doing so;
- Clear revenue and expenditure responsibilities between local and national governments, with an adequate level of taxation powers;
- Central government's track record of dismissing non-performing councils or taking remedial action prior to the council defaulting; and
- A strong possibility that the Crown will provide emergency support, if required.

Economy

In the short term, the structure of the council's local economy is not an important factor in regard to credit quality. However, over the longer term a council's economic structure will influence its credit quality as it affects the revenue and expense pressures placed on the council, as well as its ability to attract future ratepayers. New Plymouth's local economy provides little support to its credit quality.

The Taranaki region, of which new Plymouth is the primary economic center, has recorded positive net migration since 2001, contributing to a larger rates base. The strong growth levels seen in fiscal 2002 and fiscal 2003 have not been repeated since, and the council is expecting modest growth rates up until fiscal 2011.

The Taranaki region's economy relies heavily on the agriculture sector (particularly milk and milk products), meaning that a large proportion of the region's economy is vulnerable to exchange rate and cyclical fluctuations. However, the economy is becoming more diversified with strong growth in mining and exploration, tourism, and the service sectors. Growth has been consistently strong since 2000 and in general the Taranaki region is one of the better performing New Zealand regions. Economic activity increased by 3.2% in the year ended June 2006 compared with 2.3% for New Zealand as a whole. There is an expectation that the New Zealand economy will slow over the next two years, although forecasts suggest that the bottom of the cycle may not be as hard as in previous slowdowns.

Unemployment remains low with the availability of labor seen as the most important economic development issue for the region. As in other New Zealand regions, strong employment and high participation rates are beginning to constrain capacity. This will not only impact upon the growth of the local economy but is also likely to affect the council's ability to deliver high levels of capital expenditure.

Management Capacity And Credibility

New Plymouth's rating is supported by its sound management capacity and commitment to fiscal discipline. The Crown's legislative environment, which promotes a culture of planning, transparency, and consultation, ensures a very strong management culture. New Plymouth, in particular, has been recognized by the receipt of a national award.

Management prepares practical long-term plans that include realistic budgets set to support and implement the plan. As a consequence, New Plymouth does not tend to lag in its capital expenditure program and spending on specific projects is generally conservative and comes in under budget each year. Over-budget capital spending for a particular year reflects timing issues of cash flow between financial years, while capital spending on projects that have not been budgeted is minimal.

Taranaki Investment Management Ltd. (TIML), the organization established to manage the Perpetual Investment Fund, also exhibits a strong governance structure. The TIML Board provides independent commercial management and includes a small number of expert directors who employ a full-time investment manager to actively manage the fund. Its management structure, including the separation between TIML and the council, ensures that the council cannot unduly influence the Board. Furthermore, appropriate governance structures are in place to enable fraudulent activities to be better detected.

TIML itself is governed by a contract setting out the founding principles for the fund, together with a statement of policies, standards, and procedures for management of the fund. PricewaterhouseCoopers has audited the appropriateness of these policies and procedures.

There has been little change in the makeup of the council since the election in 2004. The next election will be held in October 2007 and it is anticipated that the mayor will contest the election. There have been some proposed electoral changes such as the election of councillors at large, rather than councillors representing individual wards while retaining community boards. To date, these proposals have not been finalized.

Financial flexibility

A key factor supporting New Plymouth's credit quality is the council's high degree of control over revenues and expenditure.

Revenue

While council rates revenue can be easily modified to accommodate the increased need for expenditure (thereby increasing the council's revenue flexibility), the availability of targeted rates to raise monies for specific projects is a further bonus. New Plymouth is a low-to-moderate taxing council relative to other New Zealand governments, ranking 54th out of 72 councils.

Of some concern however, is the recently announced central government inquiry into local government revenue raising. There has been some suggestion that rates should be capped. If such a legislative restriction were placed on councils, it would reduce the council's revenue flexibility. In turn, councils would need to either increase their debt burden or reduce their expenditure.

Although grants, subsidies, and financial contributions from other forms of government can diversify a council's revenue base, it can also restrict a council's financial flexibility as they are usually for specific purposes. As a general rule, New Plymouth does not receive operating grants and subsidies from the Crown. It does, however, receive subsidy funding for road expenditure.

Expenditure

New Plymouth's core services are limited to those areas generally provided by local government such as road maintenance, street cleaning, water supply, wastewater, stormwater, refuse collection and disposal, and sport and recreational facilities. The council does not perform any significant welfare functions, which can be linked to economic cycles and are highly volatile, nor is New Plymouth responsible for the high-growth health, education, or justice sectors. These factors offer some support to the rating.

Further supporting New Plymouth's rating is the absence of a significant infrastructure or maintenance gap.

Taranaki Investment Management Ltd.
The 100% council owned Taranaki Investment Management Ltd. (TIML) was established by the council to manage the funds it received from the sale of its shares in Powerco Ltd. The funds were converted into the Perpetual Investment Fund (PIF). The sale of these shares has allowed the council to diversify its revenue streams, and Standard & Poor's considers that the reallocation of funds away from its sole investment in Powerco Ltd. to a balanced and diversified investment portfolio will result in a less risky revenue stream. This revenue stream does, nevertheless, carry a higher risk than council rates revenue.

Budgetary Performance

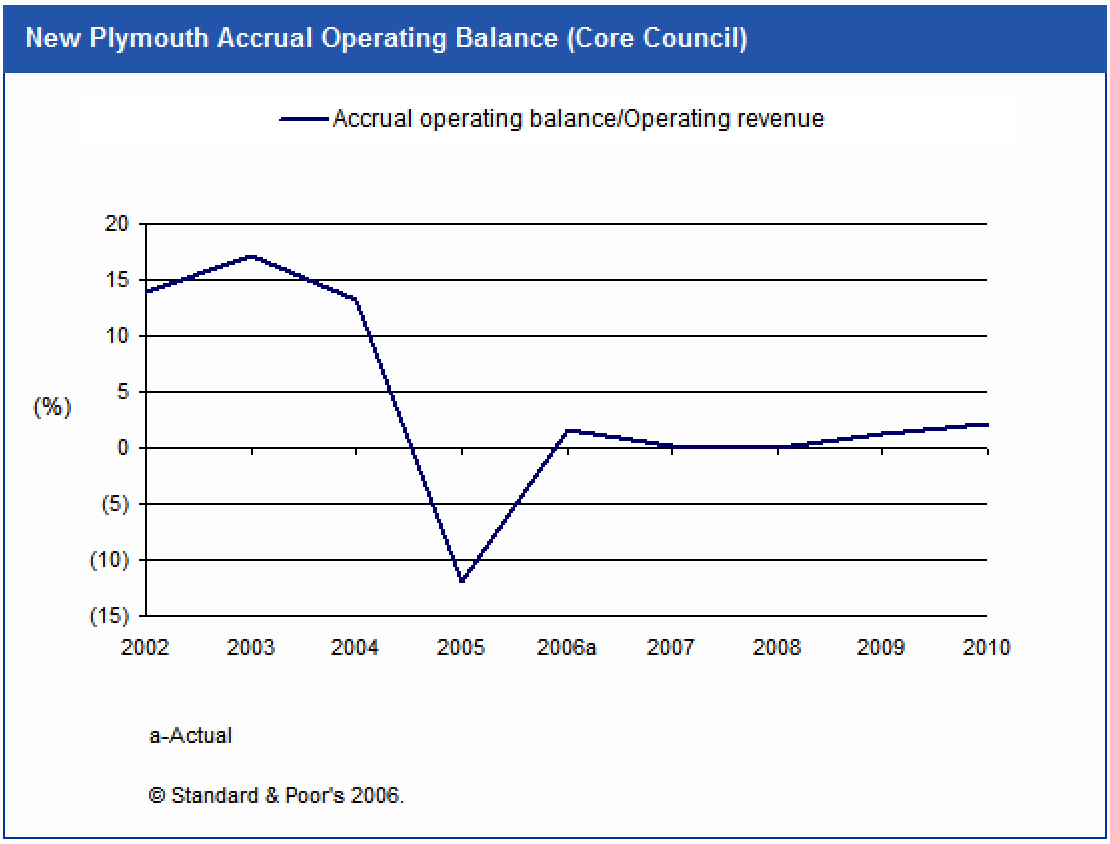
Standard & Poor's makes some accounting adjustments to New Plymouth's finances so that its analysis is consistent with that of other rated local governments. Specifically, the major adjustment made relates to the exclusion of capital and operating grants, primarily because they are generally tied to specific capital projects and cannot be used to service debt if required. Similarly, vested assets that are included in operating revenue are left out, as they too cannot be used to service debt.

Given the small contribution New Plymouth's CCTOs make to the council's finances, Standard & Poor's considers the council's budgetary performance at the core council level.

Historically, New Plymouth's budgetary performance has provided support to its ratings. Forecasts suggest that the council's budgetary performance will generally remain strong.

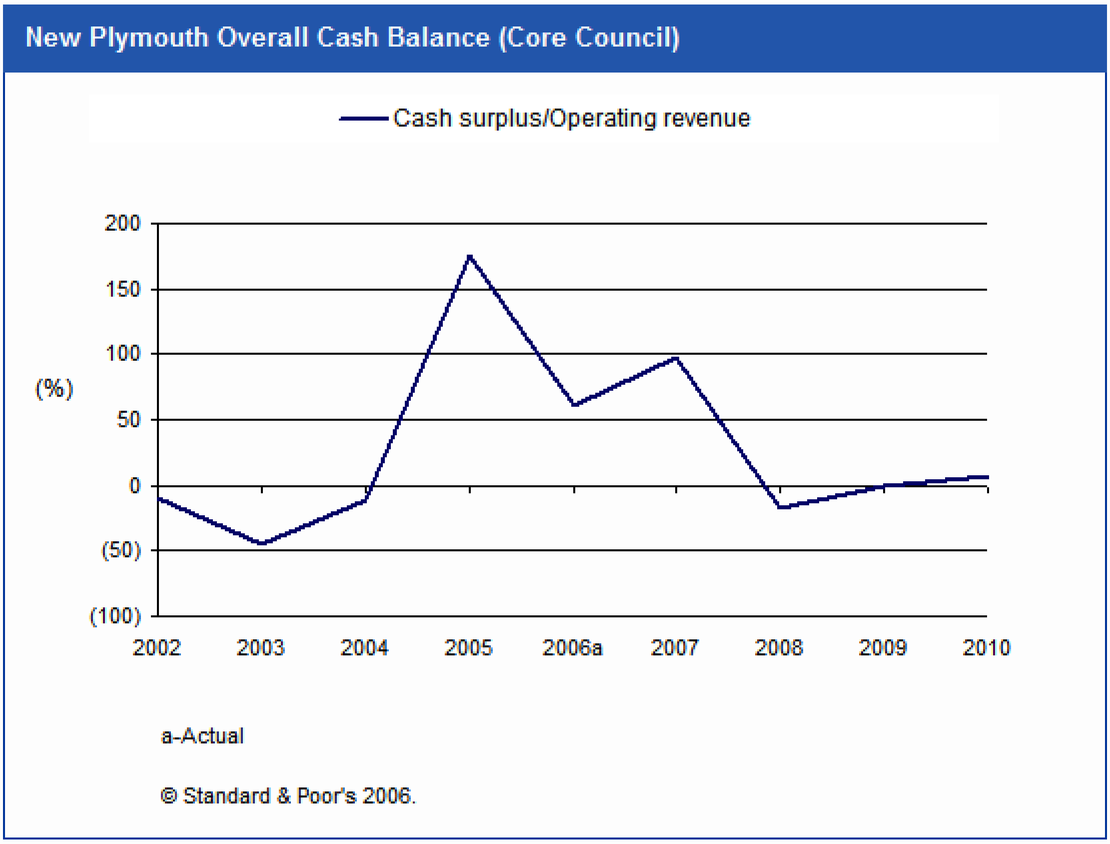
After recording a deficit in fiscal 2005 and a large surplus in fiscal 2006, New Plymouth is forecasting its accrual operating position to remain around zero until 2008. The council is then predicting that it will increase steadily at least until fiscal 2010 (see chart 1). The deficit in fiscal 2005 was due to a 13% increase in expenditure--largely a result of increasing depreciation expenses as assets are revalued and the council moves toward full funding of the depreciation required. Revenues decreased by a similar amount in fiscal 2005 due to Standard & Poor's adjustment for profit on the sale of Powerco Ltd. and capital revenues. In 2006, expenses increased by a further 5.1% (depreciation related), but this was outweighed by the 7.9% increase in operating revenue when the receipt of the first PIF release was received from TIML.

Chart 1



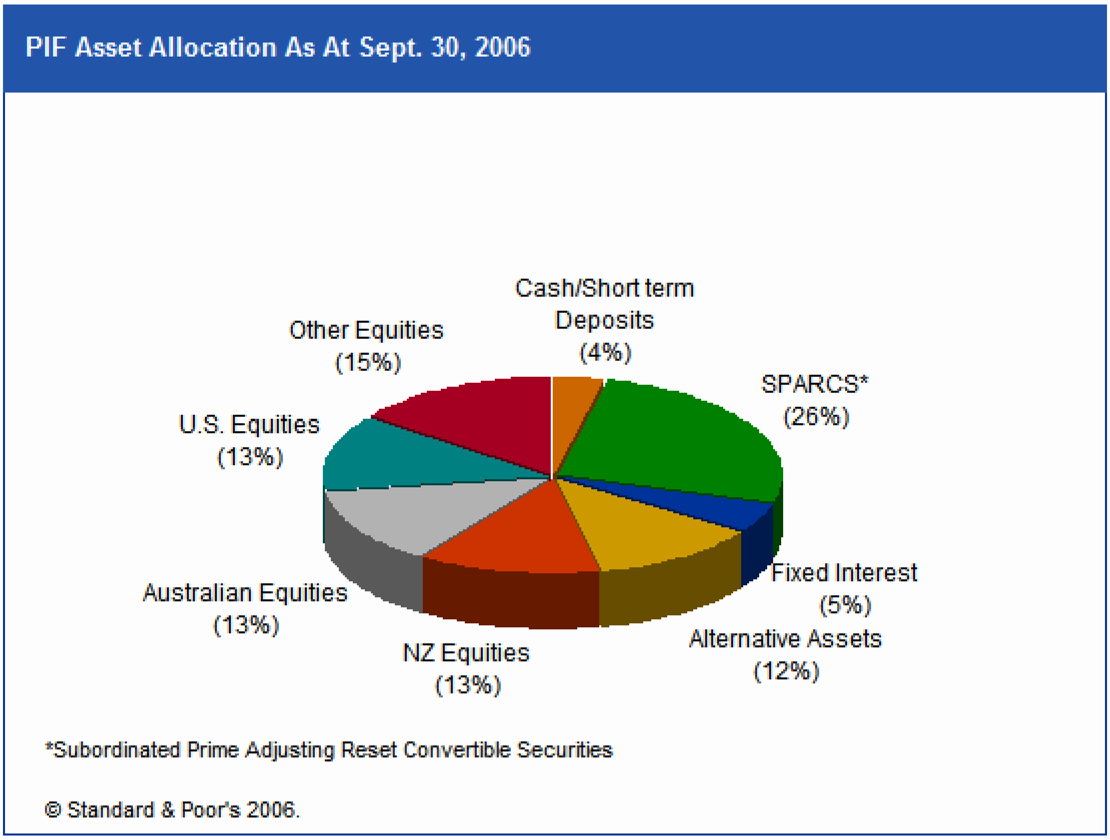
New Plymouth's cash operating position as a percentage of operating revenue remains strong and is forecast to remain above 27% over the life of the LTCCP. Its overall cash position after capital expenditure, however, is expected to remain weak. After recording strong overall cash surpluses in fiscal 2005 and fiscal 2006--driven by changes in equity investments and capital receipts--deficits are forecast to continue until 2009 (see chart 2). This is the direct consequence of New Plymouth's capital expenditure program. The size and timing of these deficits will be dependant on New Plymouth's ability to meet its capital expenditure forecasts. If there is a delay in the commencement of the proposed water and sewerage projects then this will impact on the size and timing of the deficits. In any event, expected cash deficits should be absorbed by the council's balance sheet at the current rating level.

Chart 2



PIF and TIML Performance
In order to manage the proceeds from the sale of Powerco, which were invested as the Perpetual Investment Fund (PIF), New Plymouth established the company TIML. TIML's primary task is to deliver at least NZ$19.3 million a year for the first three years of operation (equal to the full-year dividend from Powerco Ltd. in fiscal 2004). Fiscal 2006 saw the completion of the first full year of the PIF. Results were strong and TIML easily met its target of NZ$19.3 million and reviewed the annual release for the next three years upwards to NZ$21.5 million. The size of the fund also grew. The company has undertaken further diversification through the selection and review of the size and types of its investments as well as a flexible approach to asset allocation (see chart 3). Diversification is set to continue into fiscal 2007.

Chart 3



While this approach of dictating a specific return may raise the portfolio risk, Standard & Poor's is comforted by the fact that it will only be applied for the first three years. Thereafter, a release formula will be used to smooth annual fluctuations within the portfolio. Furthermore, if the fund does not meet its required income levels, discretionary capital expenditure by the council is likely to be deferred or reduced to compensate for the reduction. The council may also elect to record a deficit if the reduction in the release is set to be temporary.

Liquidity and debt management

New Plymouth liquidity is strong. Despite Standard & Poor's not giving credit to the council's holdings of SPARCs for liquidity calculations, New Plymouth still has close to $210 million in liquid investments--more than offsetting the NZ$12.2 million of debt due in the 12 months to June 2007 (see table 2). In an emergency, the council would be able to access these funds quickly as a council resolution is not required.

Table 2

New Plymouth's Debt Maturity Profile

Category	Fiscal 2006 (mil. NZ$)	Fiscal 2005 (mil. NZ$)
Current	12.219	38.496
1-2 years	7.216	0.504
3-5 years	10.553	4.017
5-10 years	39.381	23.787

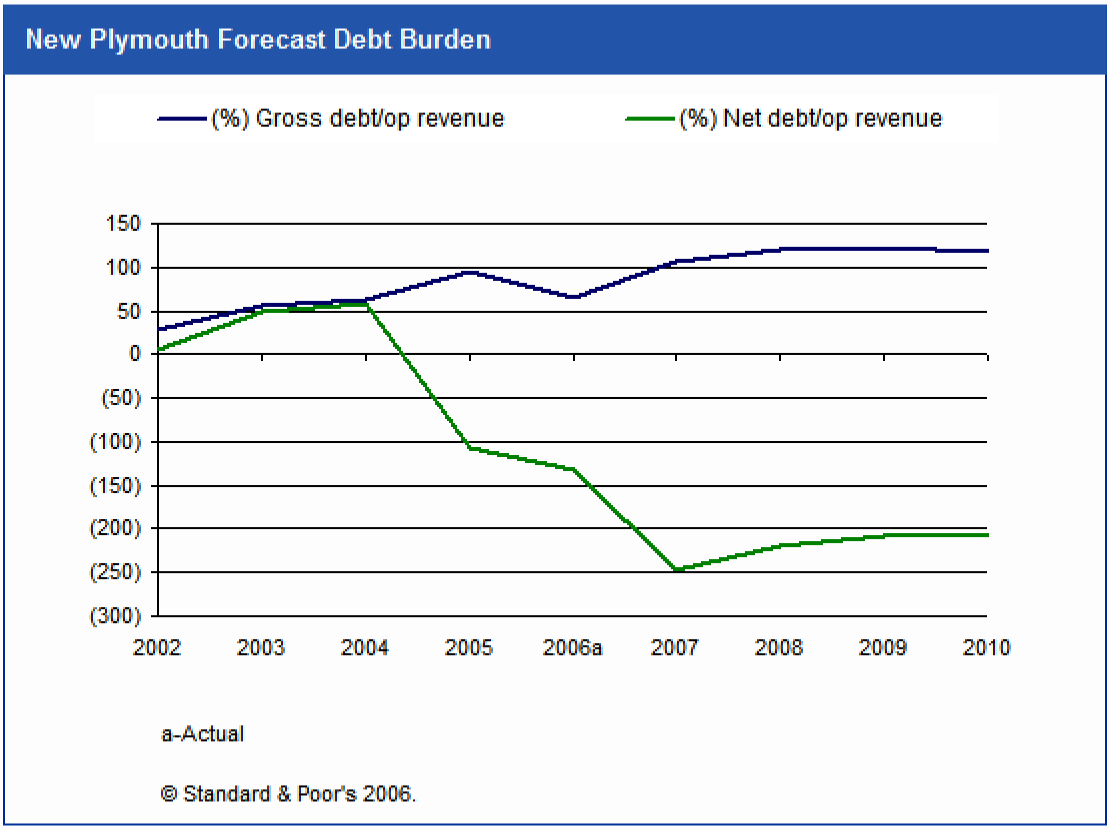
The council's debt is managed to limits outlined as part of the council's long-term plan. The council is easily within these targets, but they are not onerous. Indeed, if the council's financial strength deteriorated to a point that threatened these ratios, then it is likely that the council's ratings would be downgraded. The targets are:

- Gross debt is not to exceed 20% of total assets (4.3% as at June 30, 2006);
- Net debt is not to exceed 135% of total revenues, including rates (As at 30 June 2006, 57.9%); and
- Funds from operations (FFO) to exceed net interest expense by at least 2.5x (As at 30 June 2005, 6.4x).

Debt burden
When assessing New Plymouth's debt burden, Standard & Poor's give credit to any bonds, shares, or other liquid investments that are available to the council. While a degree of market risk exists (the risk that the market value of the investment may change), Standard & Poor's considers the price volatility of the equity holdings are within acceptable limits given the portfolio's diversification and the credit quality of the instruments in it. Standard & Poor's does not give credit to the SPARCS component of the PIF nor would it credit any derivatives or investments in private equity should the PIF allocate investments to them.

Historically, the council has relied on its strong cash flows to fund most of its capex program. The development of the 2006 action plan has changed the focus away from cash funding to using debt to fund some capital expenditure, particularly if the project will have intergenerational benefits for the community. A large increase in gross debt is expected in the next few years as the council borrows to fund sewerage projects over the next 10 years. Despite a forecast increase in gross debt, New Plymouth's substantial liquid assets will keep the council in a net creditor position (see chart 3).

Chart 3



Contingent Liabilities
New Plymouth has low contingent liabilities, with limited legal disputes and no significant guarantees. Legal proceedings related to the Waitara Endowment Land are still outstanding and current estimations suggest that individual claims could range between NZ$50,000-NZ$300,000. The exact liability is unquantifiable. The loans to sport or other bodies guaranteed by council are valued at NZ$925,000. The council also owns a 50% share (with the Crown) in the local airport and its holding is included in the council's consolidated accounts. It is a small regional airport with low risks and no debt.

Table 3

New Plymouth District Council (Core Council)

	Years ending June 30				
	2006a	2005	2004	2003	2002
Operating Results (mil. NZ$)					
Rates	39.2	37.1	34.7	33.7	32.7
Fees, fines, and user charges	0	0	0	0	0
Interest received	14.1	13	0.4	0.8	1.3
Other operating revenue	52.3	20	45.2	41.1	33.7
Total operating revenue	105.6	70.1	80.3	75.6	67.7
Interest expense	4.9	4.1	3.2	2	1.7
Depreciation	21.3	15.9	14.3	12.5	12.1
Other operating expenditure	62.1	58.7	52.1	48.2	44.5
Total operating expenditure	88.3	78.6	69.6	62.6	58.2
Operating balance (accrual)	17.3	(8.5)	10.7	13	9.5
+ Depreciation	21.3	15.9	14.3	12.5	12.1
+ Other adjustments	(11.8)	(0.5)	(11.0)	(3.0)	1.1
Cash operating balance	26.9	7.0	14.0	22.4	22.7
+ Asset sales	0.9	1.2	0.2	0.4	3.0
+ Other capital receipts (payments)	192.3	6.1	3.3	4.5	6.2
- Capital expenditure	27.4	29.7	27.7	40.4	38.2
- Net equity investment (policy)	127.8	(138.2)	(1.0)	20.9	(0.2)
Overall balance	64.8	122.8	(9.3)	(34.1)	(6.2)
Financial Performance Indicators					
Operating revenue growth (%)	50.5	(12.6)	6.1	11.7	(2.4)
Operating expenditure growth (%)	12.3	12.9	11.1	7.6	(0.3)
Accrual operating balance/operating revenue (%)	16.4	(12.1)	13.3	17.2	14.0
Cash operating balance/operating revenue (%)	25.4	9.9	17.4	29.6	33.5
Overall balance/operating revenue (%)	61.4	175.1	(11.6)	(45.1)	(9.1)
Gross interest expense/operating revenue (%)	4.6	5.8	4.0	2.6	2.5
Adjusted net interest expense/operating revenue (%) *	(8.7)	(12.8)	3.5	1.6	0.6
Adjusted cash operating balance net interest cover (x)*	(1.9)	0.2	5.9	19.4	57.8
Capital expenditure/total budgetary expenditure (%)	23.7	27.4	28.4	39.2	39.6
Balanec Sheet (mil. NZ$)					
Cash and liquid investments	210.0	142.7	2.9	4.9	16.2
Other non-current assets	9.8	9.5	174.2	5.9	7.0
Non-current assets	1,385.5	1,420.4	887.6	1,039.1	1,024.2
Total assets	1,605.4	1,572.6	1,064.6	1,049.9	1,047.4
Current loans	12.2	38.5	14.2	16.8	4.7
Current employee and other provisions	0.0	0.0	0.0	0.0	0.0
Other current liabilities	14.5	12.8	15.4	16.5	13.3
Non-current loans	57.2	28.3	35.6	25.8	15.1
Non-current employee and other provisions	2.0	2.1	2.0	1.8	2.0
Other noncurrent liabilities	0.0	0.0	(0.0)	0.0	0.0
Net worth	1,519.6	1,490.9	997.5	989.0	1,012.3
Total net worth & liabilities	1,605.4	1,572.6	1,064.6	1,049.9	1,047.4
Memorandum Items					
Gross debt	69.4	66.8	49.8	42.5	19.8
Net debt	(140.7)	(75.9)	46.9	37.7	3.6
Present value of operating lease obligations	0.1	0.2	0.2	0.2	0.1
Contingent liabilities	0.0	0.0	0.0	0.6	1.4

(Table continued on next page)

Financial Position Indicators					
Debt obligations					
Gross debt/operating revenue (%)	65.7	95.2	62.0	56.3	29.2
Net debt/operating revenue (%)	(133.2)	(108.2)	58.5	49.8	5.3
Adjusted net debt/operating revenue (%)*	(133.1)	(107.9)	58.7	50.1	5.4
Gross debt/cash surplus payback (years)	2.6	9.6	3.6	1.9	0.9
Adjusted net debt/cash surplus payback (years)*	(5.2)	(10.9)	3.4	1.7	0.2
Non-debt obligations					
Employee and other provisions/operating revenue (%)	1.9	3.0	2.4	2.4	2.9
Contingent liabilities/operating revenue (%)	0.0	0.0	0.0	0.8	2.1
Net worth indicators					
Net worth/total assets (%)	94.7	94.8	93.7	94.2	96.7
Change in net worth (%)	1.9	49.5	0.9	(2.3)	(1.2)

Note: All data is rounded. *Adjusted for imputed interest and debt burden of lease obligations. A-Actual