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Research Update:

New Plymouth District Council 'AA/A-1+' Ratings Affirmed; Outlook Remains Stable

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Table Of Contents

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Overview

- New Plymouth District Council (New Plymouth)'s experienced financial management, institutional settings, and high budgetary flexibility support its ratings.
- We expect New Plymouth's debt burden to remain moderate as the council maintains its strong operating position and exceptional liquidity coverage compared with global peers.
- We have affirmed our 'AA' long-term foreign-currency and local-currency ratings and 'A-1+' short-term ratings on New Plymouth.
- The stable outlook reflects our expectation that the rating on the sovereign will continue to constrain the rating on New Plymouth, while we see only a low likelihood that the council's stand-alone credit profile will deteriorate substantially. It also reflects our expectation that New Plymouth will continue to strengthen its budgetary performance by reducing after-capital account deficits, while the council's debt burden will remain moderate compared with global peers.

Rating Action

On Oct. 31, 2017, S&P Global Ratings affirmed its 'AA' long-term foreign currency and local currency rating and 'A-1+' short-term issuer credit ratings on New Plymouth District Council, a New Zealand local government. The outlook on the ratings remains stable.

Outlook

The stable outlook reflects our expectation that the rating on the sovereign will continue to constrain the rating on New Plymouth, while we see only a low likelihood that the council's stand-alone credit profile will deteriorate substantially. It also reflects our expectation that New Plymouth will continue to strengthen its budgetary performance by reducing after-capital account deficits, while the council's debt burden will remain moderate compared with global peers.

Downside scenario

Given the current strength of New Plymouth's stand-alone credit profile, we consider downward pressure on the rating to be unlikely and that it would take a substantial deterioration in the council's credit profile to warrant lowered ratings. We could lower the rating if the council were to change its policy direction in such a way that it weakened its financial position substantially and lowered our view of its financial management. Alternatively, we could lower our rating on New Plymouth if we lowered our rating on the New Zealand sovereign.

Upside scenario

If we were to raise our rating on the sovereign, then we would likely raise our ratings on New Plymouth because the council's standalone credit profile is currently stronger than our foreign currency rating on the sovereign.

Rationale

We have updated and extended our forecasts for New Plymouth until 2020. Following this update, we still expect the council's financial management, high budgetary flexibility, exceptional liquidity and institutional settings to support New Plymouth's credit profile. The council continues to make structural improvements to its operating balances and we expect balances after capital accounts to remain a small deficit, while debt levels remain moderate compared with global peers.

A supportive institutional framework, buoyant local economy and experienced management underpin New Plymouth creditworthiness

New Plymouth's management is focused on prudent financial management and has contributed to the council's strong financial position. New Plymouth has an experienced and stable management team, though the recent resignation of the chief executive will see a change in this key position in the near term. The council is able to adopt budgets and long-term plans without delay, and it remains focused on being financially disciplined with its approach to borrowing and insurance policies. The council has well-defined debt and treasury policies with key financial targets. Debt and liquidity management policies are prudent, with no foreign-currency issuance and interest exposure is mostly hedged. We believe New Plymouth's liquidity and debt management have strengthened during the past few years, as demonstrated by its moderate level of debt and exceptional liquidity coverage.

We believe the council's governance and oversight of its council-controlled organizations (CCOs) is well managed. The key development during the past year relate to the transition of the management of the Perpetual Investment Fund (PIF) to a fully outsourced model. The management was moved from Taranaki Investment Management Limited, a council-controlled organization, to Mercers New Zealand Ltd. As a result, the council has removed the proximity risk by limiting political interactions in the PIF, ensuring a transparent PIF management model. Further, the PIF was diversified and invested in more liquid assets based on the strategic asset allocation policy following the sale of the unlisted Tasman Farms Ltd. Under the current PIF limits, no more than 10%

of its assets should be invested in a single asset to prevent concentration and liquidity risks that previously existed. The size of PIF as of June 2017 was about NZ$275 million.

In addition, the purchase of the Crown's 50% share of New Plymouth Airport council's(joint venture) was concluded in June 2017 and the airport operations were transitioned to a new council-controlled organization, Papa Rererangi i Puketapu Ltd. The council now has 100% ownership of New Plymouth Airport.

We consider New Plymouth's economy to be strong compared with global peers'. New Plymouth District, with a population of about 79,800, is the major center in the Taranaki region of New Zealand's north island. The district's estimated per capita GDP of about US$61,000 compares favorably with New Zealand's US$41,000. While the council's GDP per capita is high, we consider that this high level largely reflects the region's significant liquefied natural gas sector, with profits mainly being repatriated outside the region. In contrast, its residents' wage and salary income, which more closely reflects the council's revenue base, is similar to the New Zealand average. The council's industry concentration in commodity-dependent sectors such as agriculture, and oil and gas, also adds some economic vulnerability, in our view.

The institutional framework within which New Zealand local governments operate is a key strength supporting New Plymouth's credit profile. We believe the framework is one of the strongest and most predictable globally. The New Zealand local government system also promotes a strong management culture, fiscal discipline, and high levels of financial disclosure among local councils. The system allows New Plymouth to support higher debt levels than some of its international peers can tolerate at its current rating.

Moderate debt burden compared with global peers while liquidity coverage remains exceptional

The council's budgetary performance has weakened slightly compared with our previous year's assessment. Weaker budgetary performance this year is a direct result of changes in the council's treatment for cash dividend income from the PIF in its cash-flow statement. From FY2018 onward, the council will no longer recognize cash dividend income in the cash flow statement, but only the movement in the unit price as unrealized gains in the income statement. This directly weakens New Plymouth's budgetary performance, in cash terms, by reducing its cash revenues. Because of this change, the council will post average after-capital deficits of 2% of total revenues between 2016 and 2020 unless it seeks alternative revenue sources, such as higher property rates or user charges.

These small deficits offset its high operating surpluses, which we expect to average 18% of operating revenue during the corresponding period. Nevertheless, New Plymouth's operating position remains strong and, combined with its broadly stable capital-expenditure program, will continue to underpin its moderate debt burden in 2020.

While New Plymouth's debt burden remains moderate compared with international peers, we believe debt is likely to increase slightly during the next three years. This is largely due to on-lending funds to the New Plymouth Airport for the terminal redevelopment project. The estimated costs for the airport project range between NZ$21.7 million and NZ$28.7 million over the next three years. The new airport project is scheduled for completion by mid-2019 and all loan financing will be repaid from operating cash flows from the New Plymouth Airport over the next 20 years. We project the council's debt to increase by about 98% of adjusted cash operating revenue in 2020 from 90% in 2017. The council's average interest expense will remain relatively low overall, at about 5% of operating revenue in 2017-2020. We note the possibility of an under-execution of the capital projects, and that borrowings might not be as high as we forecast.

The council continues to maintain a high level of revenue flexibility, with an average of about 91% of its operating revenues between 2015 and 2019 being modifiable, including council rates, user charges, fees, and fines. The council is targeting a rates increase of around 4.5% in FY2018. Like all New Zealand councils, there are no legal restrictions on New Plymouth's ability to increase rates other than its political commitment to keep rate increases low. While it currently isn't council policy to significantly access the PIF to support the budget, financial assets accumulating in the PIF could provide the council with additional flexibility if it was ever in financial distress. On the expenditure side, New Plymouth has some expenditure flexibility regarding the upgrade or development of infrastructure. We expect capital expenditure to remain relatively high, at well above 20% of total expenditure. While some projects are lumpy and difficult to postpone once commenced, the council can delay smaller projects if the need arises.

New Plymouth's liquidity coverage remains exceptional, with free cash and liquid assets (after haircuts) equivalent to about 364% of the next 12 months' debt maturities and interest payments. When including unutilized bank facilities of NZ$32 million, New Plymouth's debt-servicing ratio reaches 413%. We estimate that New Plymouth will have, on average, free cash and liquid assets of about NZ$216 million, including liquid assets held in the PIF (after haircuts), to cover its NZ$60 million of debt maturing within the next 12 months and NZ$6 million of interest repayments. New Plymouth has already prefunded NZ$21 million of long-term debt maturing in December 2017, further reducing refinancing risk.

New Plymouth's quantifiable contingent liabilities are very small, reflecting potential "weathertightness," or building moisture damage claims, and represent less than 2% of council's operating revenues.

Key Statistics

Table 1

Key Statistics					
	--Year ended June 30--				
	2016	2017	2018BC	2019BC	2020BC
Selected Indicators (mil. NZ$)					
Operating revenues	124	123	124	131	136
Operating expenditures	103	101	104	108	109
Operating balance	21	21	20	22	27
Operating balance (% of operating revenues)	17.2	17.5	16	17.1	19.8
Capital revenues	8	7	6	7	7
Capital expenditures	33	34	35	30	29
Balance after capital accounts	-3	-6	-9	0	4
Balance after capital accounts (% of total revenues)	-2.6	-4.3	-7	0	3
Debt repaid	50	0	0	0	4
Gross borrowings	46	0	9	0	0
Balance after borrowings	-7	-6	0	0	0
Modifiable revenues (% of operating revenues)	90	90.2	92.8	90.7	91.5
Capital expenditures (% of total expenditures)	24.2	25.3	25.1	21.5	21.3
Tax-supported debt (outstanding at year-end)	110	110	124	134	133
Tax-supported debt (% of consolidated operating revenues)	88.7	89.7	100.2	102.7	97.7
Interest (% of operating revenues)	4.7	4.2	4.7	4.9	4.7
Local GDP per capita (single units)	75,222	N/A	N/A	N/A	N/A

BC--Base case. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Strong
Financial management	Strong
Budgetary flexibility	Strong
Budgetary performance	Strong
Liquidity	Exceptional
Debt burden	Moderate
Contingent Liabilities	Very low

Note: S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Rating's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators. Interactive version available at http://www.spratings.com/sri.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Public Finance System Overview: New Zealand's Institutional Framework For Local And Regional Governments, Dec. 11, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that budgetary performance has weakened. All other key rating factors were unchanged. Key rating factors are reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion.

The chair or designee reviewed the draft report to ensure consistency with the

Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

Ratings Affirmed

New Plymouth District Council	
Issuer Credit Rating	AA/Stable/A-1+
New Plymouth District Council	
Commercial Paper	A-1+

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