

Research Update:

# New Plymouth District Council 'AA/A-1+' Ratings Affirmed; Outlook Positive

September 4, 2019

## Overview

- New Plymouth District Council's capital outlays are temporarily elevated as it rolls out infrastructure improvements and an airport terminal upgrade.
- The council's debt burden remains moderate compared with its peers, and its very high liquidity is buttressed by its Perpetual Investment Fund.
- We are affirming our 'AA/A-1+' long- and short-term issuer credit ratings on New Plymouth.
- The positive outlook reflects that on the New Zealand sovereign. New Plymouth's standalone credit profile is currently higher than New Zealand's, but we cap our ratings on New Plymouth at those on the sovereign.

## Rating Action

On Sept. 4, 2019, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on New Plymouth District Council, a New Zealand local government. The outlook remains positive, reflecting our positive outlook on the New Zealand sovereign's foreign-currency rating.

## Outlook

The positive outlook on New Plymouth reflects that on the sovereign, because the ratings on the council are constrained by the long-term foreign-currency rating on New Zealand.

## Upside scenario

We could raise our ratings on New Plymouth within the next two years if we were to do the same for New Zealand, all else being equal.

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## **Downside scenario**

We would revise the outlook on New Plymouth to stable if we were to do the same for the New Zealand sovereign or if New Plymouth's own creditworthiness deteriorates. The latter could occur if after-capital-account deficits are larger or more prolonged than we currently expect, resulting in a steep rise in the council's debt burden.

## **Rationale**

We have updated our analysis for New Plymouth through fiscal 2022 (i.e., the year ending June 30, 2022), following publication of the council's annual plan and pre-election report. We expect New Plymouth to record after-capital-account deficits during the next few years as it continues to roll out a program of infrastructure improvements and upgrade its airport terminal. However, debt remains moderate compared with its peers, and New Plymouth's relatively large Perpetual Investment Fund helps it to sustain a very high level of liquidity.

Although New Plymouth has a standalone credit profile higher than the sovereign's, we cap our ratings on New Plymouth at the level of the foreign-currency rating on New Zealand. New Plymouth does not meet the conditions to be rated above the sovereign, in accordance with our criteria. We do not believe any New Zealand local council, including New Plymouth, could maintain stronger credit characteristics than the sovereign in a stress scenario.

## **Financial management and institutional framework support the ratings; economy solid despite oil and gas exploration ban**

New Plymouth is governed by an elected mayor and 14 elected councilors, who together delegate day-to-day management of the council to a full-time chief executive. A new chief financial officer commenced in March 2019, having held various senior roles at Auckland Council. The council prepares 10-year long-term plans every three years and annual plans in the intervening years, in line with statutory requirements. Like most of its peers, New Plymouth borrows only in local currency, and mitigates its interest-rate risk exposure through hedging. The next council elections are scheduled for October 2019.

Local industry is concentrated in oil and gas and dairy, resulting in an economy that is relatively wealthy but volatile. In April 2018, the New Zealand central government announced a moratorium on new offshore oil and gas exploration, with existing permits unaffected. While we do not believe this will have a significant impact in the short term, there will be longer-term ramifications from lower new business investment. As part of its strategy to transition New Zealand's economy toward a low-emissions model, the government has announced a new NZ\$27 million clean energy center in Taranaki and funding for research into energy technology. New Plymouth has a population of about 82,000, and its gross domestic product (GDP) per capita was about US\$49,800 in fiscal 2018, significantly higher than the New Zealand average of NZ\$42,300. However, household income is roughly in line with the national average.

The institutional framework in which New Zealand councils operate is a key strength supporting New Plymouth's credit profile. The framework promotes a robust management culture, fiscal discipline, and high levels of disclosure. It allows New Zealand councils to support higher levels of debt than some international peers can tolerate at similar ratings. We note that there are a number of government reviews underway that could affect New Zealand councils, including a Productivity Commission inquiry into local government funding, but we consider it unlikely that

these will lead to any major changes in the near term.

## **Debt rising but remains moderate compared with peers; fiscal flexibility and very high liquidity remain key strengths**

We expect New Plymouth to post moderate after-capital-account deficits, averaging about 9% of total revenues, during the next two years as it continues to roll out a program of infrastructure improvements and upgrade its airport terminal. After Tropical Cyclone Gita caused damage in February 2018, a council review led to additional budgeted capital expenditure to improve the resilience of water and wastewater networks. In addition, New Plymouth Airport is redeveloping its terminal at a cost of up to NZ\$28.7 million; the terminal is due to be operational by the beginning of 2020. We consolidate the airport's financial metrics with those of the parent council, following the council's move to full ownership on July 1, 2017. Meanwhile, operating surpluses, as a proportion of operating revenues, should remain solid, averaging about 22% during the five years from fiscal 2018 to 2022.

New Plymouth has a high degree of fiscal flexibility compared with its domestic and international peers. The council's largest single source of revenue is property rates, which can be adjusted from year to year and are relatively stable through economic cycles. Unlike international peers, New Zealand councils receive little by way of intergovernmental transfers. In addition, we believe that New Plymouth could delay or reschedule nonessential capital expenditure if required.

To fund its capital program, we expect New Plymouth's debt burden to rise to about 111% of operating revenues by the end of fiscal 2022, up from 86% at the end of fiscal 2018. We also expect interest expenses to remain low, averaging about 4.3% of operating revenues. New Plymouth had no reported quantifiable contingent liabilities as of June 30, 2018.

New Plymouth's liquidity remains excellent. Buttressing its liquidity is the council's Perpetual Investment Fund (PIF), which had a balance of about NZ\$296 million at the time of writing. The council has outsourced management of the PIF to Mercer (NZ) Ltd. An independent board of guardians monitors the PIF, and its assets are diversified across listed equities, fixed income, alternative assets, private equity, and cash. The PIF aims to pay an annual "release" to the council of 3.3% of assets under management, equivalent to about NZ\$8 million to NZ\$9 million per annum. We treat these releases as operating revenues because they are effectively used to subsidize rates.

After applying our standard haircuts to noncash assets, we estimate that New Plymouth's total free cash position is sufficient to cover about 444% of debt service during the next 12 months. We expect debt-servicing needs to comprise NZ\$39 million in commercial paper and about NZ\$6 million in interest payments. New Plymouth also has two undrawn bank facilities totaling NZ\$24 million. In addition, the New Zealand Local Government Funding Agency (LGFA) provides New Plymouth, along with most of its domestic peers, with strong access to a well-established source of external liquidity. In our view, the LGFA benefits from an 'extremely high' likelihood of extraordinary central government support, and it has helped New Plymouth to both lengthen its maturity profile and reduce its interest expenses.

## **Key Statistics**

Table 1

**Key Statistics**

(mil. NZ\$)	--Year ended June 30--					
	2017	2018	2019e	2020bc	2021bc	2022bc
<b>Selected Indicators</b>						
Operating revenues	123	137	140	143	155	162
Operating expenditures	101	103	111	119	120	121
Operating balance	21	34	28	24	36	40
Operating balance (% of operating revenues)	17.5	25.1	20.4	16.6	22.9	25.0
Capital revenues	7	8	10	22	13	12
Capital expenditures	34	50	73	60	65	59
Balance after capital accounts	(6)	(8)	(34)	(14)	(16)	(6)
Balance after capital accounts (% of total revenues)	(4.3)	(5.2)	(22.9)	(8.7)	(9.4)	(3.7)
Debt repaid	0	21	17	(0)	15	11
Gross borrowings	0	29	51	14	31	17
Balance after borrowings	(6)	0	(0)	(0)	(0)	(0)
Tax-supported debt (outstanding at year-end)	110	118	143	157	173	180
Tax-supported debt (% of consolidated operating revenues)	89.7	86.1	102.5	109.9	111.4	111.2
Interest (% of operating revenues)	4.2	3.8	4.1	4.4	4.4	4.4
National GDP per capita (single units)	57,429	59,465	61,082	63,139	65,307	67,745

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

**Ratings Score Snapshot**

Table 2

**Ratings Score Snapshot**

**Key Rating Factors**

Institutional framework	1
Economy	2
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	3
Standalone credit profile	aa+

Table 2

## Ratings Score Snapshot (cont.)

Issuer credit rating

AA

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S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

## Key Sovereign Statistics

Sovereign Risk Indicators. An interactive version is available at <http://www.spratings.com/sri>.

## Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Global Ratings List: Local And Regional Governments 2019, Aug. 3, 2019
- Non-U.S. Local And Regional Government Had A Good Half, Ratings-Wise, July 16, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 5, 2019
- New Zealand Councils Remain Highly Rated Even As Debt Expands, June 25, 2019
- Ratings History List: Asia-Pacific Local And Regional Government Ratings Since 1975, March 8, 2019
- Local Government Debt 2019: Global Debt Stock, Outside The U.S., To Exceed US\$11 Trillion By 2020, Feb. 26, 2019
- New Zealand Outlook Revised To Positive On Improving Fiscal Position; 'AA+' LC And 'AA' FC Ratings Affirmed, Jan. 31, 2019
- 2019 Outlook: Prospects For Non-U.S. Local And Regional Governments Remain Sound, Although A Few Risks Loom For Some Entities, Dec. 11, 2018
- Public Finance System Overview: New Zealand's Institutional Framework For Local And Regional Governments, Nov. 12, 2018

## Research Update: New Plymouth District Council 'AA/A-1+' Ratings Affirmed; Outlook Positive

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's assessment of the key rating factors is 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

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#### New Plymouth District Council

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Issuer Credit Rating AA/Positive/A-1+

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#### New Plymouth District Council

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Commercial Paper A-1+

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