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Summary:
New Plymouth District Council

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Credit Rating: AA+/Negative/A-1+

Rationale

The ratings on New Plymouth District Council (New Plymouth) reflect the strong institutional framework benefiting local governments in New Zealand, plus the council's excellent financial management, limited capital expenditure pressure, and limited ownership of council-controlled trading organizations (CCTOs). These strengths offset the Taranaki regional economy's relatively narrow structure.

New Zealand local governments benefit from a strong institutional framework. The New Zealand local government system promotes a strong management culture and fiscal discipline among New Zealand councils. This provides a source of credit strength for New Plymouth and allows it to support higher debt burdens than some of its international peers.

New Plymouth's key strength is its excellent financial management. Standard & Poor's considers New Plymouth's asset-management strategies and the management of the council's Perpetual Investment Fund (PIF) as being sophisticated--given they are inextricably linked to the council's financial-management tools. The council manages both external and internal risks through a credible management framework. New Plymouth's budgeting, long-term capital and financial planning, and reserve and liquidity management are also very strong.

The council has limited capital-expenditure requirements. This stems from its low level of new and replacement infrastructure needs. New Plymouth's population growth is low by New Zealand standards, and does not create the growth pressures encountered by other peer councils, such as the merged Auckland and Tauranga City councils. Importantly, rather than facing new infrastructure or maintenance backlogs, the council's water and sewerage infrastructure spending priorities focus on raising water-quality standards and on building capacity in advance of future system demand.

With 55% of its adjusted operating revenues modifiable, and capital expenditure as a percentage of total expenditures at around 28%, New Plymouth's budgetary flexibility is high. New Plymouth's revenue flexibility is bolstered by the absence of internal or external restrictions on raising rates. It also has a diversified tax base, as well as several very large sources of raising one-off revenues. New Plymouth core services are limited to those areas generally provided by local governments, and it does not have an infrastructure or maintenance backlog.

With tax-supported debt at 115% of operating revenues, New Plymouth's gross debt levels are high for an 'AA+' rating and compared with both its domestic and international peers. However, New Plymouth's cash and liquid assets have historically exceeded its debt levels, reflecting the key role the council's Perpetual Investment Fund (PIF) plays in supporting its liquidity and fiscal flexibility. The rise in gross debt levels to fund capital expenditure and the progressive reallocation of the PIF portfolio to alternative assets from cash and liquid assets resulted in the council moving from four successive years of strong net asset positions to recording modest net debt levels in 2009 and 2010. While net debt levels are forecast to rise as these trends continue, the council's debt burden, after allowing for liquid assets, is expected to remain among the lowest of the New Zealand councils over the medium term.

Moreover, given New Plymouth's history of rolling over unspent capital expenditures, we expect that borrowings will not be as high as forecast and that debt levels will likely to remain lower over the forecast period.

Diversity within the Taranaki regional economy has increased with the emergence of the oil and gas, tourism, and service sectors. The regional economy nonetheless remains strongly dependant on milk and milk-products production. In spite of the relative narrowness of its economy, the Taranaki region has outperformed the national average in the past year.

Persistent accrual operating (S&P adjusted) and after capex deficits ensures that New Plymouth's budgetary performance is moderate. New Plymouth's adjusted accrual operating deficit reflects Standard & Poor's practice of adjusting for capital grants, developer contributions, and vested assets that cannot be used to service debt, while a comparatively large capex program that requires external funding contributes to New Plymouth's medium-term after-capex deficit. While the council's after-capex deficit is forecast to remain in deficit over the short-to-medium term, its nominal size will rely on the council's delivery of capital projects (i.e. the longer the delay in delivering capex, the lower the deficit).

Liquidity
New Plymouth's short-term rating is 'A-1+', reflecting our view of the council's positive liquidity. Over the next 12 months, New Plymouth has NZ$35 million debt maturing, which is supported by undrawn committed bank facilities of NZ$30 million. At March 31, 2011, New Plymouth also had NZ$59.3 million in unrestricted cash. New Plymouth's low reliance on external liquidity (i.e. committed facilities) rather than internal cash and liquid assets strongly supports its liquidity position.

Outlook

The negative outlook on New Plymouth reflects the negative outlook on the 'AA+' foreign currency rating of the New Zealand sovereign rather than a concern for the stand-alone credit profile of the council. There is also no upside to the ratings, while the foreign currency ratings on the New Zealand sovereign are 'AA+'. Both factors reflect our view that there is a high correlation in economic and financial performance between the New Zealand sovereign and New Plymouth. Furthermore, we believe that New Plymouth does not have sufficient operational and financial flexibility to deal with potential stresses better than the sovereign, and its credit characteristics are likely to deteriorate together with those of the sovereign in severe macroeconomic or geopolitical stress scenarios.

We expected that New Plymouth will maintain its prudent approach to managing its finances. This includes maintaining expenditure control and positive liquidity management in line with recent performances. We also assume the council's economic fundamentals will remain stable and that the council's balance sheet, supported by the PIF, will provide flexibility to respond to any foreseeable challenges in the near term.

The ratings may be lowered if the council's resources were used to support the PIF or there were a sustained run down of the PIF's capital base to bridge the council's operating revenue shortfalls. New Plymouth's credit quality would also be weakened if net-debt levels deteriorate as a result of heavier PIF investment in alternative in assets, or if diminished independence and management capability led to weaker PIF performance. There may also be pressure on the ratings in the unlikely event of a change in New Zealand's strong institutional framework of government support.