Corp-18-633

Chairperson and Committee Members
OPERATIONS & FINANCE COMMITTEE

4 OCTOBER 2018

Meeting Status: **Public**

Purpose of Report: For Information

THE STANDARD AND POOR'S CREDIT RATING

PURPOSE OF REPORT

1 This report updates the Council on Standard and Poor's most recent Credit Rating Report for the Kāpiti Coast District Council.

DELEGATION

2 The Operations and Finance Committee has the delegation to consider this matter. The current Governance Structure and Delegations for the 2016-19 triennium states that the Operations and Finance Committee has been delegated:

> *the responsibility to deal with monitoring and decision-making on all broader financial management matters*.

BACKGROUND

3 Council's credit rating, as issued by Standard and Poor's on 25 September 2018 was improved from A+ with a Stable Outlook in 2017 to A+ with a Positive Outlook.

4 Standard and Poor's provides an annual credit rating which provides an assessment of Council's financial management based on its historical and planned performance. Standard and Poor's use a number of key rating factors including liquidity, budgetary management and debt burden to determine the overall credit rating.

5 The credit rating, as well as being internationally recognised also impacts Council's ability to secure debt funding. Unrated councils, or councils with a long-term credit rating lower than 'A' equivalent have more restrictive borrowing requirements than councils with a long-term credit rating of 'A' or higher. The better the rating from Standard and Poor's the higher the credit limit Council has for its borrowings and the better the margins at which these borrowings can be made.

6 The current report was published on 25 September 2018 and is attached as Appendix 1.

ISSUES AND OPTIONS

Issues

7 The key finding of the report is that Kāpiti Coast District Council has retained its Issuer Credit Rating of A+ with its outlook upgraded from stable to positive. The

2018 rating largely reflects the same strengths evidenced in previous year's ratings, for example, the predictable and supportive institutional framework that exists in New Zealand.

8 However notable Council improvements in some of its key rating factors have been recognised. This includes the Council's improved budgetary performance and the impact of strong financial management policies including the continuing effects of having a pre-funding strategy in place.

9 Continuing on this path of improvement could lead to an improved rating in years to come. Equally, a decline in performance and/or some of the highlighted risks eventuating could result in a downgrade of Council's rating.

Key rating factors that remain strong and / or have improved

10 Council's liquidity is improving through its pre-funding of long term-debt, ensuring that it has more than enough cash holdings on hand to manage its debt repayment and interest charges.

11 The Council's improving budgetary performance support its credit rating. Operating surpluses are expected to remain strong from 2017 to 2021 and the pared down capital expenditure programme will lead to lower after-capital account deficits, a key financial metric used by Standard and Poor's.

12 Standard and Poor's view Council's management as strong compared with its peers and it is confident that the management team will successfully deliver the financial outcomes set out in the 2018 long term plan (LTP).

13 Council is also viewed as having strong budgetary flexibility, meaning that it can increase or decrease almost all its revenue streams, should the need arise. However, it is noted that Council is mindful of the impact of a large rates hike on its community.

14 Standard and Poor's also notes that Council has very low known contingent liabilities and no controlling interests in council-controlled organisations. This is positive as it limits the potential for unforeseen shocks to Council's fiscal position.

Other key rating factors

15 Standard and Poor's has acknowledged Council's 2018 LTP strategy of reining in capital expenditure and focussing on paying down its debt earlier. However because of the Council's high tax-supported debt (more than 300% of operating revenues in 2017) and high interest costs (forecast to be 13% of operating revenues between 2018 and 2020) Standard and Poor's will continue to closely monitor the Council's debt position. Note that these figures relate to gross debt and take no account of the significant pre-funding which offsets it and results in a net debt of $148M.

16 In terms of the rating factors, the positive impact of higher liquidity is double the impact of the high gross debt. For this reason the pre-funding programme is regarded positively.

17 Standard and Poor's also sounded a note of concern with regard to the Council's improved budgetary performance and its financial management, which it has always regarded as being very sound. If performance weakened in either of these two areas then Standard and Poor's may have to review its decision to upgrade the Council's outlook from stable to positive.

CONSIDERATIONS

Policy considerations

18 There are no policy implications.

Legal considerations

19 There are no legal considerations.

Financial considerations

20 If Council maintains its current credit rating then all new and rolled over debt will benefit from interest continuing to be charged at an attractive rate. An upgrade in the next 12-24 months would translate to improved rates.

Tāngata whenua considerations

21 There are no issues requiring specific consideration by Tāngata whenua.

Strategic considerations

22 The attainment of a strong credit rating contributes to the key 10-year outcome of improved financial position against financial constraints by allowing the Council to achieve lower interest rate costs.

SIGNIFICANCE AND ENGAGEMENT

Significance policy

23 This matter has a low level of significance under Council's Significance and Engagement Policy.

Consultation already undertaken

24 No consultation has been undertaken in the development of this report.

Engagement planning

25 An engagement plan is not needed for this report to be considered.

Publicity

26 The Council issued a media release on the day after the Credit Rating Report was received from Standard and Poor's.

RECOMMENDATIONS

27 That the Operations and Finance Committee notes the content of Standard & Poor's Report on Kāpiti Coast District Council's credit rating.

Report prepared by	Approved for submission	Approved for submission
Jacinta Straker	Ewen Church	Kevin Black
Chief Financial Officer	**Acting Group Manager Corporate Services**	**Acting Group Manager Strategy and Planning**

ATTACHMENT

Appendix 1: Standard and Poor's 2018 credit rating for the Kāpiti Coast District Council

S&P Global
Ratings

RatingsDirect®

Research Update:

Kapiti Coast District Council Outlook Revised To Positive On Improved Budgetary Performance; Ratings Affirmed

Primary Credit Analyst:
Anthony Walker, Melbourne + 61 3 9631 2019; anthony.walker@spglobal.com

Secondary Contact:
Rhys Corry, Melbourne + 61 3 9631 2006; rhys.corry@spglobal.com

Table Of Contents

Research Update:

Kapiti Coast District Council Outlook Revised To Positive On Improved Budgetary Performance; Ratings Affirmed

Overview

- Kapiti's budgetary performance continues to improve, with smaller after-capital account deficits and strong operating surpluses. The council's liquidity policies, including its prefunding strategy, are leading to better coverage of upcoming debt service than in the past.
- We are revising the rating outlook on the council to positive from stable.
- At the same time, we are affirming our 'A+' long- and 'A-1' short-term issuer credit ratings on Kapiti.
- Kapiti's rating is supported by the council's institutional settings, and its high budgetary flexibility. Meanwhile, its debt levels remain very high compared with its peers.

Rating Action

On Sept. 25, 2018, S&P Global Ratings revised the outlook on the long-term rating on Kapiti Coast District Council to positive from stable. At the same time, we affirmed our 'A+' long- and 'A-1' short-term issuer credit ratings on the New Zealand local government.

Outlook

We would upgrade our rating on Kapiti if the council's liquidity policies, including its prefunding strategy, ensure strong, ongoing coverage of upcoming debt service, while maintaining recent improvements in its budgetary performance.

Downside Scenario

We could revise the outlook to stable if we believe financial management is weakening through a higher risk appetite. This could occur if we perceive the council to be taking more risk through its debt and liquidity policies. Further, we could revise the outlook to stable if Kapiti's budgetary performance were to substantially weaken, with larger-than-expected deficits.

Rationale

Kapiti's budgetary performance continues to improve, with lower capital expenditure forecasts resulting in smaller after-capital account deficits. The council's liquidity policies, including its prefunding strategy, are leading to stronger coverage of upcoming debt service than in the past. While this is supporting Kapiti's liquidity position, it also means that its total tax-supported debt is now the highest among the councils we rate in New Zealand. Institutional settings, management, and its high budgetary flexibility remain supportive. We have updated and extended our forecasts for Kapiti until 2021.

Improving liquidity coverage and budgetary performance partly offset by very high debt burden

Kapiti's liquidity is improving, with cash and liquid assets covering about 140% of upcoming debt service, compared with about 95% with unutilized bank lines last year. The council is prefunding long-term debts about 12 months before they mature to reduce refinance risk, and take advantage of favorable market conditions. This has resulted in higher cash holdings of about NZ$57 million during the next 12 months, which more than cover upcoming debt of NZ$30 million and interest of about NZ$11 million in the next 12 months. Kapiti also has unutilized bank facilities of about NZ$20 million.

Kapiti participates in the New Zealand Local Government Funding Agency (LGFA). This mutual body can allow participating New Zealand councils to gain market access at lower costs. Participation in the LGFA has helped improve the council's liquidity by lengthening its maturity profile, supporting its liquidity management.

While internal liquidity coverage is currently high, it could fall if market conditions change. This could occur if returns on bank term deposits decreased or cost of debt increased. Further, we consider Kapiti's access to external liquidity to be satisfactory. New Zealand's capital markets are comparatively liquid, but lack depth, given their relative small size. During the severe market dislocation in 2008 and 2009, some New Zealand councils had difficulty issuing unrated commercial paper.

Although prefunding upcoming maturities reduces refinancing risks, it also results in higher debt levels. Kapiti's total tax-supported debt is the highest among the councils we rate in New Zealand and one of the highest globally, at more than 300% of operating revenues in 2017. We forecast debt to remain between 270% and 300% of operating revenues during the next three years, reflecting Kapiti's prefunding strategy and lower borrowing needs than in the past. Interest costs are also high, at about 13% of operating revenues between 2018 and 2020. Kapiti's debt levels rose sharply from about 120% of operating revenues in 2011 following the council's decision to front-load its capital expenditure in the 2012-2022 long-term plan.

Kapiti's budgetary performance supports the rating and is improving with smaller after-capital account deficits than in the past. We forecast after-capital account deficits to average about 3% of total revenues between 2017 and 2021, compared with 7% during our previous assessment. This mainly reflects Kapiti's capital program being smaller than in the past, as well as continual underspends on its capital budget that we have factored into our assessment. Kapiti incurred very large after-capital account deficits of about 34% of total revenues in 2012 and 57% in 2013, driving debt higher. Its operating surpluses will remain strong and average about 20% from 2017 to 2021.

Budgetary flexibility remains high, with modifiable revenues, mainly property rates, contributing 95% of operating revenues from 2017 to 2021. In its recent 2018-38 long-term plan, the council announced property rate increases of about 5% per year over the next three years. It has a self-imposed rate increase limit of 5.5% per year, but can raise rates above this limit if needed. Capital expenditure of 28% of total expenditure between 2017 and 2021 provides some flexibility. With a number of projects already removed from Kapiti's budget, however, we don't consider there to be substantial room for further delays without creating backlogs.

Kapiti's contingent liabilities are low, given the small likelihood of a natural disaster in the region and potential impact on the council. The council is part of the Outer Wellington shared services syndicate with four other councils in the region and is jointly insured to cover aboveground and belowground assets.

New Zealand's institutional framework and Kapiti's management support the rating

The institutional framework within which New Zealand councils operate is a key strength supporting Kapiti's credit profile. The New Zealand local government system promotes a strong management culture, fiscal discipline, and high levels of financial disclosure among local councils. Additionally, the framework is supportive of councils' rate-collection abilities. This system allows Kapiti to support higher debt levels than some of its international peers can tolerate at the current rating.

We consider Kapiti's management to be strong compared with its peers. We expect its experienced management team to successfully execute its 2018-2038 long-term plan and manage its financial position. Kapiti prepares a long-term plan every three years, setting an important forward-looking approach to prudent financial management, which sets an important baseline for the council's operating and capital expenditure requirements, and its funding strategy. The council is seeking to fully fund depreciation by 2022. It has prudent liquidity policies in its prefunding strategy. We consider the council's current debt policies to be prudent, with Kapiti using debt to fund capital expenditure and refinance long-term borrowings, no issuance of foreign-currency debt, and mostly hedging interest exposure. The use of debt for other purposes could indicate management has a higher risk appetite than we currently expect.

The district's economy is broadly supportive of the council's credit profile. Kapiti has a population of around 52,700 and is one of the six subregions in the Greater Wellington area. Economic growth has been relatively strong in recent years after being stagnant for the decade to 2013. Some of this growth is being held up by an expanding population and higher levels of investment in housing due to overflow from Wellington's housing market.

Kapiti's per capita GDP of about US$15,300 is lower than in the past due to a new central government data source. We believe the GDP figure slightly understates the actual income level of the local economy because Kapiti serves as a commuter district to the wealthier Wellington region, New Zealand's capital city. 25% of the local population travels to Wellington's central business district and surrounding areas for work. We believe Kapiti's demographic profile and the council's revenue-raising capability is stronger than the GDP per capita data suggests. This is evident from Kapiti's median household income levels in 2017 of about NZ$70,000, which is nearer, though still lower than, the NZ$90,000 national average.

Key Statistics

Table 1

Key Statistics

	--Year ended June 30--					
(mil. NZ$)	**2016**	**2017**	**2018E**	**2019BC**	**2020BC**	**2021BC**
Selected Indicators						
Operating revenues	66	69	73	80	84	87
Operating expenditures	56	55	57	65	66	69
Operating balance	10	14	16	15	18	19
Operating balance (% of operating revenues)	14.5	20.5	21.8	18.9	20.9	21.3
Capital revenues	2	7	5	5	2	8
Capital expenditures	18	24	23	24	23	29
Balance after capital accounts	-7	-2	-2	-3	-4	-2
Balance after capital accounts (% of total revenues)	-10.3	-3.0	-2.2	-4.1	-4.1	-2.0
Debt repaid	36	43	105	30	45	20
Gross borrowings	56	92	100	68	24	22
Balance after borrowings	13	47	-7	35	(25)	0
Modifiable revenues (% of operating revenues)	95.0	97.3	96.3	94.1	94.8	94.5
Capital expenditures (% of total expenditures)	24.7	30.2	28.3	26.7	25.7	29.4
Tax-supported debt (outstanding at year-end)	161	211	206	244	223	238
Tax-supported debt (% of consolidated operating revenues)	244.5	304.3	280.3	307.1	266.3	272.3
Interest (% of operating revenues)	12.7	13.5	12.6	13.8	12.0	12.3

Table 1

Key Statistics (cont.)						
	--Year ended June 30--					
(mil. NZ$)	2016	2017	2018E	2019BC	2020BC	2021BC
Local GDP per capita (single units)	21,405	22,188	0	0	0	0

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. E--Estimate. BC--Base case.

Ratings Score Snapshot

Table 2

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

S&P Global Ratings bases its ratings on local and regional governments on the eight main rating factors listed in the table above. Section A of S&P Global Ratings' "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 foreign currency rating on the government.

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 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'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; CreditWatch/Outlook Action

	To	From
Kapiti Coast District Council		
Issuer Credit Rating	A+/Positive/A-1	A+/Stable/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of

RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.