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Supplementary Analysis:
Kapiti Coast District Council

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Supplementary Analysis:

Kapiti Coast District Council

This report supplements our summary analysis "Kapiti Coast District Council", dated Oct. 22, 2012. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

Rationale

Issuer Credit Rating
A+/Stable/A-1

The ratings on Kapiti Coast District Council (KCDC) reflect our opinion of the very strong institutional framework benefiting local governments in New Zealand, the council's strong liquidity and positive financial management, and limited contingent liabilities. Moderating these strengths are KCDC's very heavy debt burden and a weak budgetary performance with moderate fiscal flexibility.

New Zealand local governments benefit from a very strong institutional framework, in our view. The country's local government system promotes a strong management culture and fiscal discipline among New Zealand councils. This provides a source of credit strength for KCDC, and allows the council to support higher debt burdens than some of its international peers.

Standard & Poor's views the council's financial management capacity as positive. The national framework sets international best practices for its local governments. Despite KCDC's relatively small size, the council meets these standards, and, on occasions, surpasses them; for example, the council engages in long-term planning of up to 20 years, even though the central mandate calls for 10 years. Its debt management has a strong focus on intergenerational equity, and financial targets are well-defined. Nevertheless, the council's hastened capital program, which resulted in higher debt, does weigh somewhat on our assessment of its financial management.

The council's large capital program outlined in its last Long-Term Plan (LTP) has significantly elevated its debt burden. Its decision to accelerate a number of big-scale projects led to much larger borrowings between fiscal years 2012 (ending June 30) and 2014. The council also forecasts lower revenues over the forecast period in the LTP due to slower growth in the rate base. As a result, we project the tax-supported debt to rise and peak at 243% of revenue by fiscal 2014. In turn, the large capital program had weakened the council's budgetary performance. In fiscal 2013, the council's deficit after capital expenditure reached a record 51.9% of revenue. Over the five-year period of fiscal 2012-2016, we forecast the council's average after capital deficits will average 29.4%, which is significantly worse than benchmarks set out in our criteria. We expect debt levels and budget deficits to start consolidating from fiscal 2015, as most of the major projects would have been completed by then.

Kapiti Coast's demographics tend to influence the council's willingness to increase revenues, thereby reducing its budgetary flexibility. We consider that more than 90% of Kapiti's revenues are modifiable. There are no statutory restrictions on the council to increase rates, and we note that historically it has demonstrated some political willingness to do so. A constraint on the council's budgetary flexibility is the need to deliver an expanded infrastructure program. While Kapiti's capital investment, as a percentage of expenditure, is very high (at 48.7% in fiscal 2013), in our view, some of these projects are lumpy and not easily deferred.

Notably, the council does not operate any Council Controlled Organizations (CCOs), and it has no other known material contingent liabilities. This limits the potential for unforeseen shocks to KCDC's fiscal position, in our view.

Kapiti Coast's economy is a neutral factor in the credit ratings on the council. The district has a narrow economic base. The retail and residential construction sectors dominate the local economy. The social services sector is another significant area of activity and has been a key growth factor.

Liquidity

We assess Kapiti Coast's liquidity as positive, which is a key credit strength. Over the next 12 months, KCDC has NZ$14.2 million of debt maturing, and NZ$8.7 million of interest due. The council generally holds little cash on hand (NZ$5.94 million as of end June 2013), and its primary source of liquidity lies in its committed bank lines. These credit facilities currently total NZ$50 million. The committed credit facilities plus forecasted cash holdings over next 12 months would give KCDC a comfortable debt servicing coverage of 238%.

The council had replaced most of its short-term debt with longer-term borrowings in the past year. Its commercial paper program of NZ$60 million was taken out by five- and seven-year bonds borrowed through the New Zealand Local Government Funding Agency Ltd. (LGFA). This had alleviated much of the council's short-term liquidity risks.

We assess KCDC's access to external liquidity as satisfactory. New Zealand's capital markets are liquid, but, given their small size, we do not consider them particularly deep. This was highlighted during the severe market dislocation in 2008 and 2009, during which some New Zealand councils had difficulty issuing unrated commercial paper. In our opinion, Kapiti Coast's individual characteristics support its satisfactory access to external liquidity.

Outlook

The stable outlook reflects our expectation that the council's debt will peak at 243% of revenues in fiscal 2014, and thereafter stay below 240%. Likewise, we envisage the council's budgetary performance to improve from fiscal 2015 once major capital projects are completed. The stable outlook on the long-term rating extends up to two years.

The rating could come under pressure if the council's budgetary performance deteriorates over a prolonged period, with structural deficits of more than 25% of revenue after capital spending. This would derail KCDC's plans to gradually bring down debt and lead to an unsustainably high debt burden. Such a scenario can play out if the council decides to take on additional capital spending or if revenues are materially lower than projected.

The rating could be raised if we see a sustained improvement in the council's budgetary performance. But we note there its debt level is yet to peak and will remain high over the short to medium term.

Institutional Framework: Predictable And Supportive

We consider New Zealand's institutional framework to be predictable and supportive, and expect it to remain so. We view New Zealand's institutional framework as one of the strongest in the world (see "Public Finance System Overview: New Zealand Municipalities," published Dec. 17, 2012 on RatingsDirect).

Economy: Neutral Credit Factor

Kapiti Coast's economy is a neutral factor on the credit ratings on KCDC. We estimate GDP per capita for the local economy at slightly below US$25,000.

In our view, the structure of a New Zealand council's local economy is not an important factor in the short term for determining its credit quality, primarily because councils' main sources of revenue--property rates--are typically not affected by cyclical economic factors. Nevertheless, a council's economic structure will influence the body's credit quality over the medium term, as the economy affects the revenue and expense pressures placed on a council, as well as its ability to attract future ratepayers.

Kapiti Coast is located in the lower North Island. With a population of around 50,000, it is one of the six sub-regions in the Greater Wellington area. Kapiti Coast serves as a commuter district to Wellington, New Zealand's capital. About a quarter of the local population travels to the central business district daily for work. The population growth of Kapiti Coast has been strong over the past decade (2001 to 2006 population growth was 8.8%, according to last national census), driven largely by Wellingtonians moving to the coast to retire. Hence, its share of elderly population is far above the national average. Around a quarter of the population is above the age of 65, double the national average. This imposes some constraints on the council's ability to raise revenue. Statistics New Zealand projects Kapiti's long-term population growth rate will be about 1% annually.

Kapiti Coast has a narrow economic base. The retail and residential construction sectors dominate the local economy. The social services sector--retirement villages--is another significant area of activity and has been a key growth factor. The council has benefited from this through licensing fees collected from retirement villages.

Financial Management: Positive With Extensive Long-Term Planning

Standard & Poor's considers KCDC's financial management practices to be a credit strength. New Zealand's legislative framework promotes a culture of long-term planning, transparency, and consultation, ensuring a very strong management culture. The preparation of an LTP (long-term plan) by all New Zealand local authorities at least every three years ensures that councils have a forward-looking approach to prudent financial management and sets an important baseline for the council's operating and capital expenditure requirements, and its funding strategy. Due to many of its projects being large-scale, KCDC plans for up to 20 years, going beyond the national requirement of 10 years.

Like all New Zealand councils, KCDC prepares accrual accounts in accordance with New Zealand International

Financial Reporting Standards (NZ-IFRS). The accounts are audited by external auditors appointed by the Office of the Auditor-General.

The council has well-defined debt and treasury policies with key financial targets. They ensure a debt management strategy that focuses on borrowing only for capital spending. However, in our view, key targets (such as keeping net debt below 250% of operating income and interest payment to 25% of revenue) are not particularly onerous. The council has no foreign currency exposure, and all interest rate risks are hedged. Notably, Kapiti Coast's debt management has a strong focus on intergenerational equity. Loans on new works (from 2006) are stretched over a 20-to-30-year period.

Council elections were recently held in October 2013. Two-term incumbent Jenny Rowan lost to fellow councilor Ross Church. The incoming mayor has publicly stated his desire to consolidate debt. We do not expect material deviation in the council's current strategy under the new mayor. In addition, KCDC councilors have a track record of voting on issues rather than along voting blocs. Pragmatism tends to prevail over politics in decision-making. For example, the council went ahead with the installation of water meters to reduce peak demand of water despite public opposition.

Earlier in the year, International Accreditation New Zealand (IANZ) had indicated its concerns about KCDC's building consenting process, requiring the council to address these issues to maintain its accreditation. The council had since implemented corrective actions that IANZ has found to be satisfactory.

Moderate Budgetary Flexibility

Kapiti Coast's budgetary flexibility is moderate. With more than 90% of its operating revenues deemed modifiable, and capital expenditure averaging 42.9% of its total expenditure over the past three years, the council's starting point is high. However, tempering the council's flexibility is its need to deliver a substantial capital-expenditure program and constraints on revenue flexibility.

There are no legal restrictions on the ability of KCDC to increase rates, and the council does not have a rate cap policy that some other New Zealand councils have self-imposed. The council's LTP projects an average of 6.4% annual rates increase over fiscal 2012 to 2016. Actual rate increases in the past have been at or below the projected figures. Rate increases for fiscal 2014 has been trimmed to 5.15%, with the reduction being partially achieved through savings in interest rate costs.

The council's revenue flexibility is somewhat constrained by its large share of retirees in its local population. In addition, unlike councils in major urban centers, which can draw from commercial rate-payers, the bulk of Kapiti's rate burden falls on residential payers(more than 90%). The council has laid out development plans for the economy in its latest LTP, but in our view, it will be years before it can effectively diversify its rates base to businesses.

On the expenditure side, despite a high share of capital spending, Kapiti Coast's expenditure flexibility is somewhat constrained. The council's LTP 2012-2032 indicate that about 58% of capital spending will be on new infrastructure and 42% on asset renewal. Although asset renewal is generally more difficult to postpone, in the case of KCDC, capital spending on new projects is also not easily deferred, given the rising population and years of under-investment by previous councils. A lumpy capital-expenditure profile further constrains expenditure deferability.

Budgetary Performance: Weak Due To Substantial Capital Investment

In our opinion, Kapiti Coast's budgetary performance is weak, due to its extensive capital-expenditure program. Although KCDC's operating balance is strong with an average surplus of 20% of operating revenues over fiscal 2012-2016, its after-capital deficits are very high, averaging 29.4% of total revenue over the corresponding period. The after-capital deficits are significantly worse than benchmarks set out in our criteria. The large deficits reflect the council's focus on intergenerational equity by funding infrastructure assets with long-term loans rather than via rate increases.

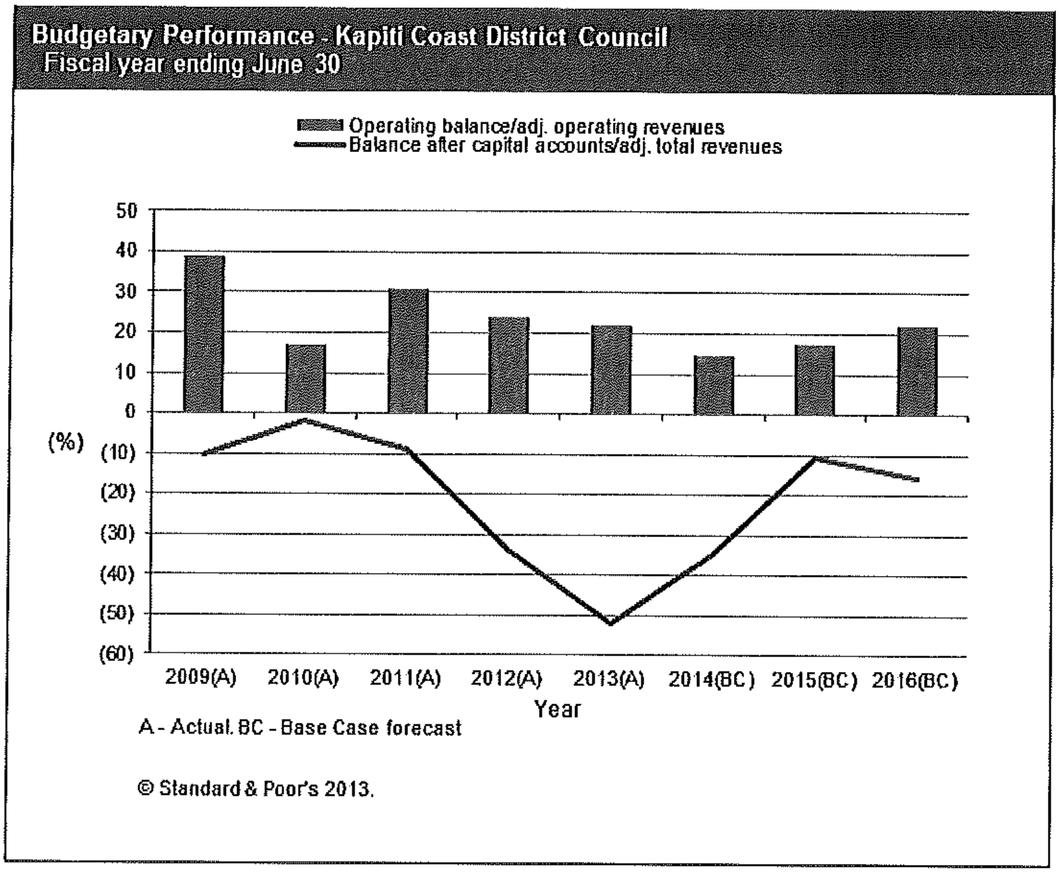
Standard & Poor's makes accounting adjustments to Kapiti Coast's finances so that international comparisons can be made. The major adjustment relates to the exclusion of capital grants from both operating revenue and cash flow from operating activities. We make this adjustment because these grants are generally tied to specific purposes and cannot be used to service debt, if required. We consider developer contributions and vested assets as key risks to the achievement of fiscal outcomes due to uncertainties on whether they are received as projected. Therefore, Standard & Poor's excludes developer contributions and vested assets from forecast figures. Given that KCDC has no CCOs, Standard & Poor's considers the council's budgetary performance at the core level only.

While the council's cash operating balance (Standard & Poor's adjusted) consistently records high surpluses, KCDC's accrual operating balance usually posts a small deficit or balanced figure. The divergence is due to the significant depreciation charge in the accrual accounts, arising from the council's high infrastructure spending. These depreciation charges are likely to increase as Kapiti Coast's asset base grows.

Kapiti's deficit after-capital expenditure as a percentage of revenue reached a peak of 51.9% in fiscal 2013. It is forecast for another high deficit of 34.9% in fiscal 2014 due to the council bringing forward a number of large-scale projects. Notably, the council had completed the multi-million dollar aquatic center in August, and the upgrade of the council's administration building earlier this year. Both projects have been completed on schedule without cost overruns. Other major projects in the pipeline include upgrades on the stormwater drainage system, water supply capacity, and the water-metering project to meet the district's long-term water conservation goals. We project Kapiti Coast's deficit after-capital expenditure to begin an improving trajectory from fiscal 2015, as most of the big-ticket items would have been completed by the end of fiscal 2014.

Notably, the size of future deficits depends on the council's delivery of capital projects (i.e. the longer the delay in delivering capital expenditure the lower the deficit) and its future revenue policies. In addition, we expect the council to maintain its strong operating cash position throughout the forecast period.

Chart 1



Debt Burden: Very High But Expected To Peak In 2014

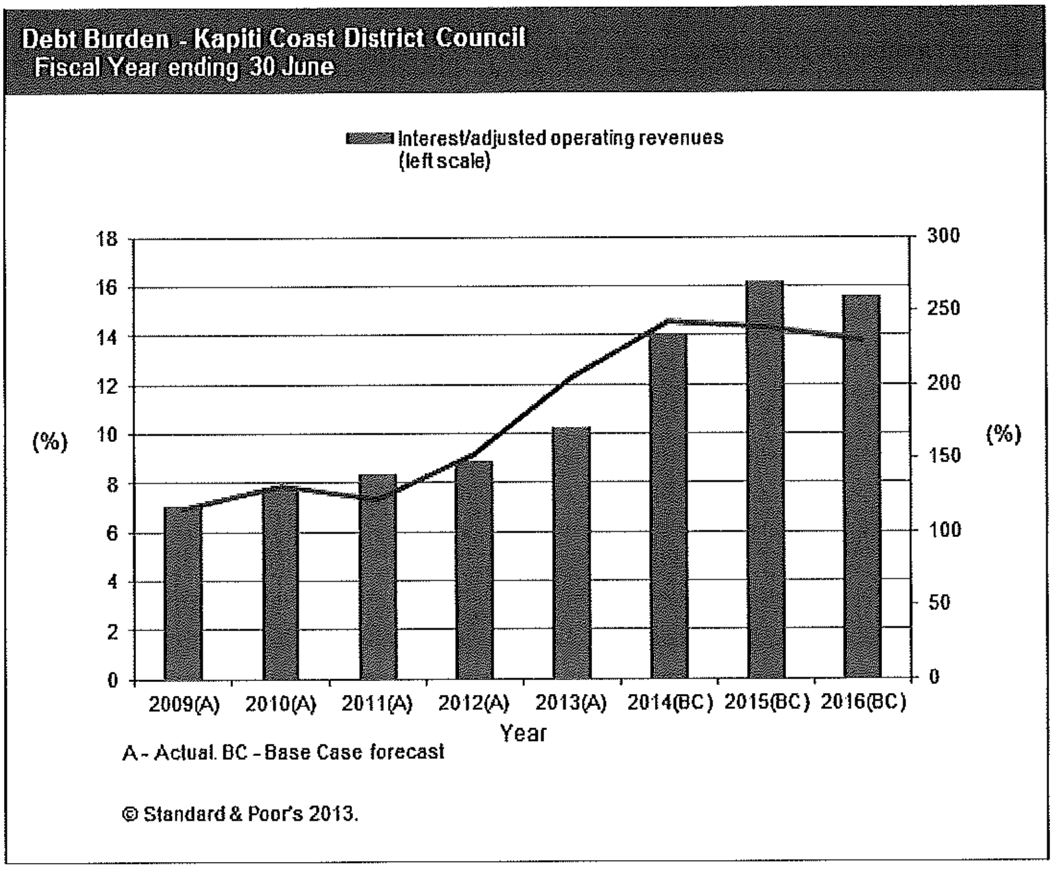
KCDC's heavy debt burden is a key credit weakness. The council has a large capital works program of NZ$681 million over the 20-year period of its latest LTP. This will see its tax-supported debt climb quickly to 243% of operating revenue by fiscal 2014, from 124% in fiscal 2011. Likewise, the high debt burden has exacerbated the interest servicing to 14.1% of operating revenue from 8.4% over the corresponding period.

We expect the council's debt ratio to peak in fiscal 2014. As much of Kapiti's capital program is front-loaded, capital spending will be reduced from fiscal 2015 onward, and debt repayment would be accelerated thereafter. Moreover, the council has a history of rolling over unspent capital expenses. Taking into account the possibility of under-execution by 20%-30%, it is possible that borrowings will not be as high as forecast.

Unlike some New Zealand councils who rely heavily on short-term loans, Kapiti Coast's debt-maturity profile is far more weighted toward medium- to long-term borrowings. As of end fiscal 2013, only 8% of the council's debt was in loans maturing less than one year. This is driven by the council's policy to ensure intergenerational equity by having long loan payment periods for new capital projects.

On interest servicing, Kapiti Coast's is high and estimated to stay in the range of 14%-16% of operating income over the forecast period. In mitigation, there is no foreign currency exposure, all interest rate risks are hedged, and the council mandates an interest rate risk control limit of having at least 55% of its borrowings on fixed rates. The council estimated that it had so far saved about 30 basis points in interest servicing through its LGFA borrowings, and more could come as LGFA becomes more established.

Chart 2



Limited Contingent Liabilities

KCDC has no CCOs, hence limiting its contingent liabilities.

In addition, the council is fully insured. Although premiums have increased substantially after the Christchurch earthquake, KCDC has been able to secure coverage for its underground assets via the Local Authority Protection Program. For its above-ground assets, premium savings were achieved via a collaborative insurance tender with three other councils in the Wellington region.

Published Rating Factor Scores

Table 1

Summary Of Published Rating Factor Scores*	
Institutional framework	Predictable and supportive
Financial management	Positive
Liquidity	Positive

*Standard & Poor's ratings on local and regional governments are based on, among other things, a scoring system that covers eight main rating factors, as further explained in our criteria (see below). We publish our scores for the three rating factors above.

Key Statistics

Table 2

Kapiti Coast District Council--Key Statistics

Years ending June 30	2012	2013	2014F	2015F	2016F
CASH OPERATING RESULTS (MIL. NZ$)					
Rates	46.2	48.3	50.4	52.6	55.8
User charges	8.0	8.4	0.0	0.0	0.0
Interest income	0.0	0.0	0.0	0.0	0.0
Other operating revenue	3.6	4.3	11.0	12.7	16.7
Adjusted operating revenue	57.8	61.0	61.5	65.3	72.5
Payments to suppliers and employees	38.7	41.3	43.8	43.4	45.4
Interest	5.2	6.3	8.7	10.6	11.3
Other operating expenditure	0.0	0.0	0.0	0.0	0.0
Adjusted operating expenditure	43.9	47.6	52.5	54.0	56.7
= Operating balance (cash)	13.9	13.5	9.0	11.3	15.8
+ Capital revenue	0.3	0.1	6.7	1.8	1.6
- Capital expenditure	33.7	45.2	39.6	20.3	29.0
Balance after-capital accounts (cash)	(19.5)	(31.7)	(23.8)	(7.3)	(11.5)
FINANCIAL PERFORMANCE INDICATORS (Cash basis)					
Operating balance/adjusted operating revenues (%)	24.0	22.0	14.6	17.3	21.9
Balance after-capital accounts/total revenue (%)	(33.6)	(51.9)	(34.9)	(10.8)	(15.6)
Capital expenditure/total expenditure (%)	43.4	48.7	43.0	27.4	33.9
Modifiable revenues/adjusted operating revenues (%)	93.8	93.0	97.2	97.6	93.0
BALANCE SHEET (MIL. NZ$)					
Cash and liquid investments	2.7	5.9	2.2	4.0	5.3
Other current assets	5.7	9.7	6.3	3.1	3.1
Non-current assets	845.0	861.9	951.4	1,018.2	1,032.3
Total assets	853.4	877.6	959.8	1,025.3	1,040.7
Current loans	68.1	10.1	20.1	13.4	11.9
Other current liabilities	20.8	20.3	22.0	23.8	25.3
Non-current loans	20.4	115.1	129.1	142.6	154.5

Table 2

Kapiti Coast District Council--Key Statistics (cont.)

Other non-current liabilities	9.6	5.9	9.2	5.1	5.3
Total liabilities	118.9	151.4	180.4	185.0	197.1
Net worth	734.5	726.1	779.4	840.3	843.6
Total net worth & liabilities	853.4	877.6	959.8	1,025.3	1,040.7
FINANCIAL POSITION INDICATORS					
Direct council debt	88.4	125.2	149.2	156.1	166.4
Direct council debt/adjusted cash operating revenue (%)	153.0	205.2	242.7	239.1	229.5
Total tax-supported debt	88.4	125.2	149.2	156.1	166.4
Total tax-supported debt/consolidated adjusted operating revenue (%)	153.0	205.2	242.7	239.1	229.5
Interest (cash basis)	5.2	6.3	8.7	10.6	11.3
Interest/consolidated adjusted cash operating revenue (%)	8.9	10.3	14.1	15.8	15.0
ACCRUAL OPERATING RESULTS (MIL. NZ$)					
Adjusted operating revenue	60.4	60.1	60.0	66.1	73.7
Adjusted operating expenditure	58.3	61.1	66.6	71.0	74.5
Adjusted operating balance	2.2	(1.0)	(6.7)	(4.9)	(0.8)
Operating balance/operating revenue (%) (accrual basis)	3.6	(1.6)	(11.1)	(7.4)	(1.0)

F-Forecast.

Table 3

Economics Statistics - New Zealand

Years ending June 30 (Mil. NZ$)	2012	2013	2014F	2015F	2016F
GDP per capita	46,944	47,497	49,201	50,765	52,382
GDP real growth	2.4	2.5	2.7	2.9	2.3
Consumer Price Index % change	2.2	0.8	1.3	1.9	2.1

F--Forecast.

Related Criteria And Research

- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Public Finance System Overview: New Zealand Municipalities, Dec. 17, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings Detail (As Of October 22, 2013)

Kapiti Coast District Council	
Issuer Credit Rating	A+/Stable/A-1
Issuer Credit Ratings History	
11-Oct-2012	A+/Stable/A-1
23-Aug-2011	AA-/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.