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Ratings

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Research Update:

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

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Research Update:

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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.