S&P Global
Ratings

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Research Update:

Kapiti Coast District Council Outlook Revised To Negative On Widening Deficits; 'AA/A-1+' Ratings Affirmed

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Overview

- Kapiti's financial position is weakening as it embarks on an ambitious capital program in its 2021-2041 long-term plan. This spending is driving deficits and debt levels materially higher than we previously expected.
- While the council's prefunding debt strategy results in exceptional liquidity coverage, this coverage could structurally weaken, given the council's large spending plans.
- We therefore have revised our outlook on Kapiti to negative from stable. At the same time, we are affirming our 'AA/A-1+' long- and short-term ratings.
- The council's experienced management and New Zealand institutional settings support the ratings while the district's economic profile tempers these strengths.

Rating Action

On July 27, 2021, S&P Global Ratings revised the outlook on its long-term ratings on the New Zealand council of Kapiti Coast District Council to negative from stable. At the same time, we affirmed our 'AA' long-term and 'A-1+' short-term credit ratings on Kapiti.

Outlook

The negative outlook reflects our view that the council's aggressive capital program could materially worsen its credit metrics.

Downward scenario

We could lower our ratings within the next two years if we believe the council's liquidity management will lead to structurally weaker coverage while delivering its large capital budget. We could also lower our ratings if the large capital budget results in materially higher deficits and debt levels than we forecast. This could cause us to reassess our view of the council's strong financial management.

Upward scenario

We could revise the outlook to stable if we believe the council's liquidity coverage will remain strong or there is an improvement in the council's budgetary performance or debt trajectory. The latter could occur if after-capital account deficits were substantially smaller than our forecasts.

Rationale

We have updated our ratings and financial forecasts on Kapiti following the publication of the council's 2021-2041 long-term plan. We expect Kapiti's financial position will weaken as the council significantly increases its capital spending. The large capital program will shift the council's after-capital account balance into large deficits during 2022 and 2024. This will drive debt levels higher.

The council's liquidity policies, such as its prefunding debt strategy, generally ensures debt-service coverage remains high, offsetting weaknesses associated with its very high debt levels relative to peers. This coverage could structurally weaken, however, given the council's large capital spending plans.

Strong financial management, access to the New Zealand Local Government Funding Agency (LGFA), and New Zealand's excellent institutional settings continue to support the council's credit profile. The district's economic profile meanwhile tempers these strengths.

Ambitious capital program driving large deficits and higher debt levels; liquidity coverage could weaken as a result

We forecast the council's budgetary performance to be weaker than our previous expectations. We expect the council's average after-capital account deficits will widen to more than 20% of total revenue in 2023 and 2024. This is because of higher capital spending within the council's 2021-2041 long-term plan. Given the large increase in capital budgets at the council and within the wider Wellington region, we expect the council will deliver about 80% of its planned NZ$217 million of capital expenditure between 2022 and 2024. This budgeted capital expenditure is more than triple the amount Kapiti delivered from 2018-2020.

Before the release of the 2021-2041 long-term plan, we expected after-capital account deficits to average less than 5% of total revenues. This came after Kapiti recorded surplus in 2019--its first surplus in more than a decade.

Higher rate increases and new user charges will support operating margins. The council's operating balance will remain strong, with a five-year average strengthening to 22% of operating revenue during 2020 and 2024, aided by a 7.8% rate increase in 2022. The council's operating balance will recover from a low of 13.1% of operating revenues in 2020, when the COVID-19 pandemic struck revenues and required additional spending.

We believe Kapiti has a high level of flexibility within its budget to increase rates and user charges, as seen in 2022. It could also defer some nonessential capital expenditure to support financial outcomes and its credit profile, given the large capital program contained in its 2021-2041 long-term plan.

The council's large capital program and its prefunding debt strategy are adding to its debt level. Kapiti has a high level of debt compared with its peers. We forecast the council's debt to operating revenues will reach about 270% in 2024 from 253% in 2020. The council's total tax-supported debt is currently among the highest among the local governments that we rate globally. It peaked at 313% of operating revenues in 2017. 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 its 2012-2022 long-term plan as well as its prefunding debt strategy.

Kapiti's liquidity coverage is exceptional, aided by its prefunding debt strategy. The council prefunds debt maturities up to 18 months in advance. The council's internal cash and liquid assets cover about 181% of upcoming debt maturities, interest costs, and budget needs. However, this coverage could structurally weaken, given the council's large capital spending plans. We estimate the council to have about NZ$50.9 million in cash at the end of 2021 and NZ$10 million in bank lines to cover NZ$45 million term debt maturities as part of its prefunding strategy, NZ$8.3 million interest, and spending needs in 2022. The council will soon start prefunding its NZ$20 million debt maturing in October 2022.

Access to the LGFA provides Kapiti and other local New Zealand councils with additional sources of external liquidity, particularly during periods of stress in financial markets. In our view, the LGFA benefits from an extremely high likelihood of central government support and has helped Kapiti lengthen its maturity profile and reduce its interest costs.

We consider Kapiti's contingent liabilities to be small, given the small likelihood of a natural disaster in the region and potential effect 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 above- and below-ground assets. The council altered its insurance policy. It no longer insures noncritical infrastructure and will instead direct savings into a self-insurance fund.

A supportive institutional framework and experienced financial management underpin Kapiti's creditworthiness

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. The framework is also 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. We expect its experienced management team to deliver the majority of its 2021-2041 long-term plan and manage its financial position within our forecast during this period. 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. We consider the council's debt and liquidity policies to be prudent. Preparing the prefunding strategy up to 18 months in advance of debt maturities minimizes refinancing risks. Kapiti doesn't use debt to fund operating expenses, has no issuance of foreign-currency debt, and mostly hedges its interest exposure.

The district's economy is broadly supportive of the council's credit profile. Kapiti has a population of around 56,000 and is one of the six subregions in the greater Wellington area. The economy has been growing in recent years; it was stagnant for the decade to 2013. Like its peers, Kapiti has felt the effects of the pandemic and associated government-imposed shutdown.

In recent years, growth has been supported by population expansion, higher levels of investment in housing due to overflow from Wellington's housing market, and significant infrastructure investment by the New Zealand central government in the region. Growth has lagged the broader national average for several years, resulting in lower local GDP per capita, incomes levels, and growth per capita compared with the national average. For the year to March 2019, GDP per capita is low, at NZ$23,433, compared with a national average of NZ$60,939. According to central government statistics, Kapiti's dependency ratio of residents aged under 15 years and over 65 years is higher than the national average. About 26% of residents are aged 65 years or over compared with a national average of about 15%. This could pressure the council's ability to raise revenues over the longer term.

Key Statistics

Table 1

Key Statistics

	--Year ended June 30--				
(mil. NZ$)	**2020**	**2021e**	**2022bc**	**2023bc**	**2024bc**
Selected indicators					
Operating revenues	83	88	95	101	110
Operating expenditures	72	72	67	78	83
Operating balance	11	16	28	24	28
Operating balance (% of operating revenues)	13.1	18.7	29.6	23.4	25.1
Capital revenues	3	13	14	15	5
Capital expenditures	23	33	54	62	58
Balance after capital accounts	(8)	(3)	(11)	(23)	(25)
Balance after capital accounts (% of total revenues)	(9.5)	(3.1)	(10.4)	(20.0)	(22.0)
Debt repaid	76	40	45	40	40
Gross borrowings	76	60	47	75	75
Balance after borrowings	(8)	17	(10)	11	10
Direct debt (outstanding at year-end)	211	236	237	272	307
Direct debt (% of operating revenues)	253.2	267.9	249.9	268.4	278.6
Tax-supported debt (outstanding at year-end)	211	236	237	272	307
Tax-supported debt (% of consolidated operating revenues)	253.2	267.9	249.9	268.4	278.6
Interest (% of operating revenues)	10.9	9.5	8.7	9.4	9.8
Local GDP per capita (single units)	23,982	24,702	0	0	0
National GDP per capita (single units)	62,596	65,858	68,430	71,353	74,383

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. 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	3
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	5
Standalone credit profile	aa
Issuer credit rating	AA

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 https://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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, June 4, 2021
- New Zealand Councils' Infrastructure Spending Could Erode Rating Headroom, April 12, 2021
- Local Government Debt 2021: Infrastructure Needs Will Boost Borrowing In Developed Markets, March 25, 2021
- Local Government Debt 2021: Global Borrowing To Hit $2.25 Trillion, March 25, 2021
- New Zealand Ratings Raised To 'AA+' FC And 'AAA' LC As Pandemic Risks Moderate; Outlook Stable, Feb. 22, 2021
- Local And Regional Governments Outlook 2021: Gradual Recovery Will Test Rating Resilience,

Dec. 10, 2020

- Default, Transition, and Recovery: 2019 Annual International Public Finance Default And Rating Transition Study, Dec. 8, 2020
- Public Finance System Overview: New Zealand's Institutional Framework For Local And Regional Governments, Oct. 28, 2020
- Comparative Statistics: Asia-Pacific Local And Regional Government Risk Indicators, July 29, 2020
- Ratings History List: Asia-Pacific Local And Regional Government Ratings Since 1975, May 29, 2020

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	AA/Negative/A-1+	AA/Stable/A-1+