S&P Global Ratings

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Research Update:

Kapiti Coast District Council 'A+/A-1' Ratings Affirmed; Outlook Remains Stable

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Overview

- Kapiti Coast District Council's (Kapiti Coast) experienced financial management, institutional settings and budgetary flexibility support its ratings.
- We expect Kapiti Coast's plans to reprioritize its capital works program will likely materialize in lower after-capital deficits and help strengthen its budgetary performance, while debt burden remains high compared to peers.
- We have affirmed our 'A+' long-term foreign-currency and local-currency ratings and 'A-1' short-term ratings on Kapiti.
- The stable outlook reflects our expectation that Kapiti Coast will continue to strengthen its budgetary performance by reducing after-capital account deficits, yet the council's debt burden will remain elevated compared to global peers.

Rating Action

On Sept. 22, 2017, S&P Global Ratings affirmed its 'A+' long-term foreign currency and local currency rating and 'A-1' short-term issuer credit rating on Kapiti Coast District Council, a New Zealand local government. The outlook on the ratings remains stable.

Outlook

The stable outlook reflects our expectation that Kapiti Coast will continue to strengthen its budgetary performance by reducing after-capital account deficits, yet the council's debt burden will remain elevated compared to global peers.

Downside scenario

We could lower our rating if the council changed its current financial strategy and added a significant amount of capital expenditure in its upcoming long-term plan without offsetting adjustments to revenue or operating expenditure, resulting in significantly higher after-capital account deficits. This could also weaken its liquidity coverage and our view of its financial management.

Upside scenario

We could raise the rating if the council's after-capital account deficits improve for a sustained period, significantly reducing its debt burden relative to revenue. This could also improve our view of its financial management. This might occur if the council actively seeks to reduce deficits and debt more quickly than we currently assume in our base case.

Rationale

We have updated and extended our forecasts for Kapiti Coast until 2020. Following this update, we still expect the council's financial management, budgetary flexibility, and institutional settings to support Kapiti Coast's credit profile. The council continues to improve its budgetary performance, with generally moderate after–capital-account deficits, while debt levels remain high compared with global peers.

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

The council elected in October 2016 plans to consolidate and improve its financial position, after the previous council embarked on high, debt-funded capital spending. Debt reduction is its stated main priority over its term of office, and the council has indicated that it does not plan to embark on additional large-scale projects in the medium term. The council's next long-term plan, likely to be released around mid-2018, is its first real opportunity to significantly shift priorities and will bring more clarity to the council's medium-term plans.

The council's consolidation plans would represent a major shift in focus. In recent years, the previous council accelerated the implementation of a number of large-scale projects between fiscal 2012 and 2014. This large capital program significantly weakened Kapiti Coast's budgetary performance, with after-capital-account deficits reaching a record 53% of revenue in fiscal 2013. As a result, the council's debt rose to 230% of operating revenues in fiscal 2013 from 123% in 2011. This is a high debt burden compared to both domestic and international peers, and is the key constraint on Kapiti Coast's credit rating.

More generally, we view the council's financial management as strong. The council prepares a 20-year long-term plan every three years, ensuring a forward-looking approach to prudent financial management, and setting an important baseline for operating and capital expenditure requirements and funding strategy. Kapiti Coast has an experienced management team--although the recent resignation of the chief executive will see a change in this key position in the near term.

The council has well-defined debt and treasury policies with key financial targets. Debt and liquidity management policies are prudent, with no foreign-currency issuance and interest exposure is mostly hedged. Its insurance policies cover above and underground assets in case of natural disaster, thereby limiting its contingent liabilities. Furthermore, Kapiti Coast is also looking to gradually build a "self-insurance fund," which would be used to cover the costs of natural disaster recovery, including covering any insurance excess. The council has implemented the second year of its depreciation funding program and is planning to fully fund depreciation by fiscal 2022.

The institutional framework within which New Zealand local governments operate is a key strength supporting Kapiti Coast's credit profile. We believe the framework is one of the strongest and most predictable globally. The New Zealand local government system also promotes a strong management culture, fiscal discipline, and high levels of financial disclosure among local councils. The system allows Kapiti Coast to support higher debt levels than some of its international peers can tolerate at its current rating.

The district's economy is broadly supportive of the council's credit profile. With a population of around 52,000, Kapiti Coast is one of the six subregions in the Greater Wellington area. Economic growth has been relatively strong in recent years, rising to about 3.7% in 2016 compared with average growth of 1.9% during the past 10 years. Some of this growth is being held up by an expanding population and higher levels of investment in housing due to the overflow from Wellington's housing market. Kapiti Coast's per capita income of about US$22,200 is relatively high in an international context, but lower than the national average of US$41,400.

We consider Kapiti Coast's estimated per capita income slightly understates the actual income level of its local economy. This is because Kapiti Coast serves as a commuter district to Wellington, New Zealand's capital city, with around a third of the local population traveling to the central business district and surrounding areas for work. Nevertheless, we do not consider this enough to raise our view of Kapiti Coast's economy, considering Kapiti Coast has a narrow economic base. Retail and residential construction are the dominant sectors. Another significant area of activity is the social services sector, particularly retirement villages.

Improved budgetary performance due to lower capital investment, while debt burden remains very high compared with global peers

Kapiti Coast's budgetary performance has improved significantly from our previous forecast. We project the council will post an average after-capital deficit of 8% of total revenue between 2016 and 2020, down from 12% between 2015 and 2019. The improvement in the council's budgetary performance is largely due to a reprioritization of the capital projects and expected lower capital expenditure during next three years. We expect Kapiti Coast's after-capital deficits to begin to improve because most of the large-scale projects have been completed. Large deficits in the past, peaking at 53% in fiscal 2013, reflected the council's focus on intergenerational equity by funding infrastructure assets with long-term loans rather than upfront via rate increases. The council's operating position continues to improve, with average surpluses of about 20% of operating revenues.

We expect Kapiti Coast's debt burden to remain high in the medium term due to the council's decision to front-load its large capital program in 2012 long-term plan. We forecast Kapiti Coast's debt to increase to 242% of adjusted cash operating revenue in 2020. Interest expenses reflecting this increase in debt and will be about 13% of operating revenue in 2017-2019. This makes Kapiti Coast's debt burden one of the highest among New Zealand councils that we rate. By taking into account the possibility of an under-execution of the capital projects, borrowings might not be as high as we forecast and its debt burden will peak later and lower than our current forecast but will still be high.

Kapiti Coast's liquidity position remains adequate. The council's free cash, liquid assets, and bank facilities will average NZ$85.2 million during the next 12 months, covering about 95% of Kapiti Coast's debt-servicing needs. The council is borrowing funds early to manage its maturity risk profile, by investing these funds in interest earning term deposits until they are required to repay maturing debt. The council is prefunding NZ$80 million of long-term debt maturing on December 2017 and May 2018, which will reduce refinancing risk. Kapiti Coast generally holds little cash on hand, and its primary source of liquidity relies in its committed bank lines. The council has a NZ$20 million committed bank facility to manage its short-term cash flow needs.

About 96% of Kapiti Coast's cash operating revenues are modifiable, resulting in high budgetary flexibility. Kapiti Coast's revenue flexibility is supported by the council's unrestricted ability to set property rates, fees, and charges supports its revenue flexibility. The council is targeting an average rate increase of 5.7% in FY2018, above the 5.5% limit set as part of the council's financial strategy in its 2015 long-term plan. In our view, higher modifiable revenues will help the council to achieve smaller average after-capital account deficits that will help to reduce its debt burden in the long term. Kapiti Coast's capital expenditure represents a high share of the council's budget, at about 32% of total expenditure between 2016 and 2020. During the next few years, the council will be focusing on renewals in water infrastructure and roading projects; we do not believe that this affords the council a great deal of added budgetary flexibility.

Kapiti Coast's contingent liabilities are very low, in view of the small likelihood of a natural disaster in the region and its potential effect on the council. We consider Kapiti Coast's insurance policies to be comprehensive, and that the Crown would likely provide extraordinary support to the region in the event of a natural disaster. 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 assets.

Key Statistics

Table 1

Key Statistics						
	--Year ended June 30--					
(mil. NZ$)	2015	2016	2017E	2018BC	2019BC	2020BC
Operating revenues	62	66	68	72	77	81
Operating expenditures	54	56	55	58	59	61
Operating balance	8	10	13	15	18	20
Operating balance (% of operating revenues)	13	14.5	18.5	20.5	22.9	24.1
Capital revenues	4	3	7	5	5	3
Capital expenditures	28	18	24	29	28	26
Balance after capital accounts	-16	-6	-4	-10	-6	-3
Balance after capital accounts (% of total revenues)	-23.5	-8.1	-5.4	-12.5	-7.4	-4.1
Debt repaid	5	36	43	79	20	5
Gross borrowings	15	56	92	56	36	17
Balance after borrowings	-6	14	44	-33	10	8
Modifiable revenues (% of operating revenues)	98.6	95	96.8	96.2	95.7	95.6
Capital expenditures (% of total expenditures)	34	24.7	30.2	33.8	32.3	29.8
Tax-supported debt (outstanding at year-end)	141	161	211	188	185	196
Tax-supported debt (% of consolidated operating revenues)	228.2	244.5	312	259.3	239	242.4
Interest (% of operating revenues)	12.5	12.7	13.5	12.9	11.8	12
Local GDP per capita (single units)	28,988	29,750	N/A	0	0	0

E--Estimated. 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	Average
Liquidity	Adequate
Debt burden	Very high
Contingent Liabilities	Very low

Note: S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Rating's "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 rating.

Key Sovereign Statistics

Sovereign Risk Indicators. An interactive version is 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 agreed that budgetary performance has improved. All other key rating factors were unchanged. Key rating factors are 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

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