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Supplementary Analysis:

New Plymouth District Council

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Supplementary Analysis:

New Plymouth District Council

This report supplements our research update "Ratings On New Plymouth District Council Affirmed At 'AA/A-1+' With Stable Outlook," published on Oct. 8, 2013. 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
AA/Stable/A-1+

New Plymouth District Council's (New Plymouth) individual credit profile reflects the predictable and supportive institutional framework available to local and regional councils within New Zealand, plus our positive view of its financial management, high budgetary flexibility, and limited contingent liabilities. New Plymouth's moderate budgetary performance, high debt burden, and our neutral view of its economy partially offset these strengths.

We perceive the institutional framework within which New Zealand local governments operate as being one of the strongest and most predictable globally. The New Zealand local government system promotes a strong management culture and fiscal discipline among New Zealand councils. This provides a source of credit strength for New Plymouth, and allows it to support higher debt burdens than some of its international peers can tolerate.

The institutional framework in association with New Plymouth's budgeting, planning, and reserve and liquidity management support our positive view of its financial management practices.

Further, New Plymouth's budgetary flexibility is high, in our view. Modifiable revenues such as rates, user charges, fees, and fines account more than 55% of its consolidated operating revenues (after Standard & Poor's adjustments), and its capital expenditure is about 27% of total expenditure over the next two years. Modifiable revenues have fallen as a share of operating revenues in recent years because of increasing revenue from New Plymouth's council-controlled trading organizations (CCTOs).

New Plymouth's contingent liabilities are limited, with the council setting aside some provisions for potential liabilities.

Partially offsetting these strengths is New Plymouth's moderate budgetary performance. New Plymouth's operating surpluses are expected to average 14% from 2012-2016 (after Standard & Poor's adjustments) up from 7% in 2011. Average after-capital account deficits of about 9.7% from 2012-2016 offset these surpluses.

Further, we consider New Plymouth's debt burden to be high. New Plymouth's debt burden compares well to other local New Zealand governments, but remains high compared to international peers. Based on New Plymouth's projections, we expect the council's core debt as a percentage of operating revenues to be about 114% in 2016, with interest of 6.5% of operating revenues. Based on our definition of total tax-supported debt (including borrowings of Tasman Farms Ltd. (TFL), a CCTO consolidated on New Plymouth's accounts), we estimate New Plymouth's total tax-supported debt to be 115% in 2016 as a percentage of consolidated operating revenues (including TFL's revenues).

The council's total interest expense as a percentage of adjusted operating revenues is 7.3%.

We consider New Plymouth's economy to be a neutral ratings factor with high per capita income of US$40,000 partially offset by concentration within commodity-dependent sectors such as agriculture, oil, and gas. Further, New Plymouth's demographic profile could affect its revenue base with a number of younger residents moving away for better education and employment opportunities.

Liquidity

We consider New Plymouth's liquidity to be a neutral ratings factor. At June 30, 2013, New Plymouth's debt-servicing ratio of free cash, liquid assets, and unutilized bank facilities is about 112% of its next 12 months' debt and interest repayments.

At June 30, 2013, New Plymouth had unrestricted cash and liquid assets of about NZ$52 million (including liquid assets held in the Perpetual Investment Fund (PIF) after haircuts); unutilized bank facilities of NZ$36 million to cover its NZ$64 million of debt maturing over the next 12 months; and NZ$13.6 million of interest repayments.

We consider New Plymouth's access to external liquidity to be satisfactory. New Zealand's capital markets are comparatively liquid, but, given its small size, are not considered by Standard & Poor's as being 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.

New Plymouth is also participating in the New Zealand Local Government Funding Agency (LGFA). LGFA is a mutual body representing participating New Zealand local governments, and aims to access funding at a cheaper rate than many individual New Zealand councils can. Participation in the LGFA may further improve the council's liquidity by lengthening its maturity profile.

Outlook

The stable outlook reflects our expectations that New Plymouth will continue to manage its financial position within the current metrics of a 'AA' rating. We believe the likelihood that the rating will move in either direction over the next two years is low. Upward pressure on the ratings is currently constrained by the New Zealand sovereign rating.

The ratings on New Plymouth could be lowered if the council brought forward its capital program without a corresponding increase in revenues, resulting in average after-capital account deficits of more than 15% of consolidated operating revenues, and an increase in its debt and interest burdens to more than 150% and 9% of consolidated operating revenues, respectively. We consider this scenario to be unlikely over the next two years.

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 Ratings Factor With Limited Growth Prospects

New Plymouth's economy is a neutral ratings factor, in our view. New Plymouth's per capita income of about US$40,000 compares favorably with New Zealand's level of US$35,000. This strength is partially offset by concentration in commodity-dependent sectors, and its demographic profile.

New Plymouth is located on the west coast of New Zealand's north island. It is a major services center that is home to more than 74,200 people.

The local economy is strong, growing by 3% per year since 2006, with low unemployment. The New Plymouth district accommodates: one of New Zealand's main diary regions, one of its largest ports, and its largest oil and gas field. In 2012, New Plymouth's GDP was about NZ$3.8 billion. The oil and gas sector contributed more than NZ$1 billion, or 20% of the Taranaki region's GDP in 2012, resulting in high per capita GDP for New Plymouth. Dairy farming and related processing contributed a further NZ$1.2 billion toward the local economy. Meanwhile, key employers in 2012 were healthcare and social assistance, manufacturing, retail trade, and construction.

Offsetting some of the economy's strength is its concentration in commodity-dependent sectors (namely agriculture and oil and gas), which leads to a high correlation between commodity prices and local economic output. In 2008, the economy experienced rapid economic growth of more than 20%, due to rising income from higher commodity prices, rising volume of agriculture, and oil and gas exports. Conversely, as commodity prices weaken, New Plymouth's economic performance slows. In our view, this dependence may inhibit the council's ability to attract new ratepayers in the future if economic conditions weaken and commodity prices fall.

Further, New Plymouth's demographic profile could affect its revenue base with a number of younger residents moving away for better education and employment opportunities including in Australia. While still growing, New Plymouth's population growth is slowing to about 0.3% per year over the next 2-3 years, compared to New Zealand's population growth of about 1%.

The structure of a New Zealand council's local economy is not important in the short term for determining credit quality, primarily because the council's main source of revenue--property rates--is 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, plus a council's ability to attract ratepayers.

Financial Management: Positive, Supported By Long-Term Capital Planning And New Zealand's Institutional Framework

We consider New Plymouth's financial management to be a positive ratings factor. The preparation of a long-term plan (LTP) by all New Zealand local authorities at least every three years ensures councils have a forward-looking approach to prudent financial management, and sets an important baseline for the council's operating and capital-expenditure requirements, plus its funding strategy.

Like all New Zealand councils, New Plymouth prepares accrual accounts in accordance with New Zealand International Financial Reporting Standards (NZ IFRS) and New Zealand Generally Accepted Accounting Practices (NZ GAAP), which are audited by Audit New Zealand. Accounting policies are disclosed in the annual report, with liquidity and debt-management policies outlined in the LTP and liability management and investment policies.

In managing its borrowings, New Plymouth adopts a number of key financial targets. These targets, while not onerous, ensure a prudent debt-management strategy that focuses on borrowing for capital expenditure. Well-defined policy parameters manage the volume of borrowing as well as the maturity profile. The council also hedges interest rate risk.

New Plymouth's Perpetual Investment Fund (PIF) is prudentially managed by experienced and well-qualified managers and board of directors of Taranaki Investment Management Ltd., which make all investment decisions relating to the fund. The PIF has historically outperformed the council's weighted-average cost of capital. We note that there are some significant risks associated with the PIF's investment in alternative assets.

The PIF is currently outside of its targeted asset allocations because of its ownership of TFL (a Tasmanian dairy farm). Targeted asset allocations should be achieved once the PIF reduces its exposure to TFL at some time in the future. New Plymouth uses some of the PIF's annual investment earnings to subsidize rates through a "release rule". This release rule target has been gradually reduced from 5.6% to 3.3% per year in light of weakening investment returns, to preserve the fund's capital. The council has prepared for lower annual payments from the PIF from 2013.

The PIF is also exposed to some foreign exchange risks through its investments in TFL in Australia. The council currently hedges half of its Australian dollar-denominated assets. A proportion of its exposure is naturally hedged, with both revenue and expenditure being in Australian dollars.

New Plymouth's infrastructure assets are well-managed, and it continually monitors the health of the district's assets. We note that New Plymouth's policy of not fully funding the depreciation of intergenerational assets (such as roads and wastewater systems) is partially offset by grants and subsidies it receives from the New Zealand Transport Authority (NZTA), which make up the majority of this unfunded depreciation. The council remains in a good position to maintain and replace its assets, in our view.

Council elections are scheduled to be held on Oct. 12, 2013. Councillors are mostly independent, and vote in accordance with the issue rather than in a voting bloc. A number of qualified and skilled managers support the council.

Budgetary Flexibility: Higher Proportion Of Income From Non-Rates And User Charges Than Domestic Peers

New Plymouth's budgetary flexibility is high, with modifiable revenues of more than 55% of operating revenues (after Standard & Poor's adjustments) and capital expenditure of about 25% of total expenditure.

There are no restrictions on the ability of New Plymouth to increase rates, other than a strong political imperative to keep increases low. As part of the legislative requirements, New Plymouth has set a target for rate increases of no more than 7% in any one year, and no more than 5.5% annually over 10 years. This is not a hard cap. We do not expect either of these factors to be restrictive enough to reduce our view of New Plymouth's revenue flexibility.

New Plymouth's modifiable revenues of more than 55% of operating revenues are lower than its domestic peers, as the council earns additional income from the PIF and its investments. We expect income from the PIF's release rule to contribute less than 5% of operating revenues over the next three years—down from 7% in 2012 as the council reduces the PIF release payments to 4% in 2014. We expect rates, user charges, fees and fines, and dividends to fall as a percentage of operating revenues as income from TFL increases over the next three years.

In addition, New Plymouth expects the PIF's earnings from TFL to increase as TFL completes restructuring the business and increases milk production by about 70% from current levels. We expect TFL's income as a percentage of New Plymouth's consolidated operating income to increase to about 36% by 2016 from about 30% in 2012.

Although grants, subsidies, and financial contributions from other forms of government can diversify a council's revenue base, they do not necessarily enhance a council's budgetary flexibility, as they usually have specific purposes. We expect capital grants and subsidies, and proceeds from asset sales to contribute about 6% of total revenues this year, before falling to less than 4% in 2016.

The council has improved efficiencies within the administration, which supports its budgetary flexibility. The council expects to reduce operating expenditure by about NZ$1.5 million per year over the next three years from its LTP forecasts. Further, the council may be able to defer its capital expenditure (25% of total expenditure) over the next three years, which supports our view of its high budgetary flexibility.

Budgetary Performance: After-Capital Account Deficits Partially Offset Strong Operating Position

New Plymouth's budgetary performance is moderate. The council has strong cash operating surpluses on a consolidated basis, averaging 14% (after Standard & Poor's adjustments) from 2012-2016. Its average after-capital account deficits of less than 10% a consolidated basis partially offset the surpluses.

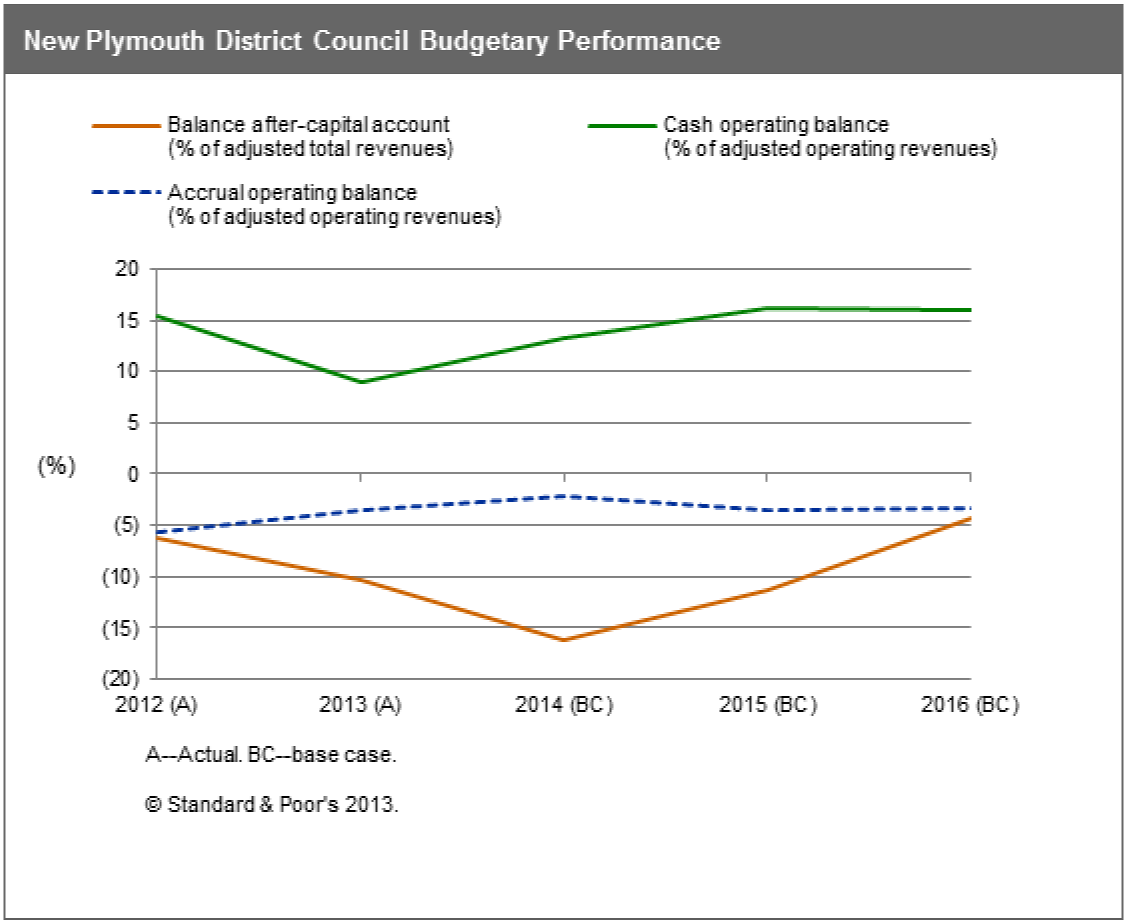
We expect New Plymouth's cash operating balance to reach more than 16% from lows of 7% in 2011, as rates income, user charges, and income from TFL increases. Our analysis of New Plymouth's consolidated budgetary performance includes our expectations of its council-controlled organizations--such as TFL, and the New Plymouth airport--over the next three years.

New Plymouth's average after-capital account deficit is about 9.7% between 2012 and 2016. We expect after-capital account deficits to peak at about 16% in 2014 as capital expenditure increases, before reducing to less than 5% in 2016 reflecting improved revenues and a smaller capital program. Our expectations reflect lower dividend income and the appreciation of the New Zealand currency against the Australian dollar experienced this year.

The size of these deficits depends on the council's ability to deliver capital projects (i.e. the longer the delay in delivering capital expenditure, the higher the surplus).

We expect New Plymouth's accrual operating deficit to be 3.6% (after Standard & Poor's adjustments) from 2012-2016, up from a deficit of 6% in 2012.

Chart 1



Standard & Poor's makes some accounting adjustments to New Plymouth's finances so that international comparisons can be made. The major adjustments relate to the exclusion of capital grants from both operating revenue and cash flow from operating activities. This adjustment is made because these grants generally are tied to specific capital projects and cannot be used to service debt if required. We consider developer contribution and vested assets as a key risk to fiscal outcomes being achieved, primarily because of uncertainty as to whether they are received as projected.

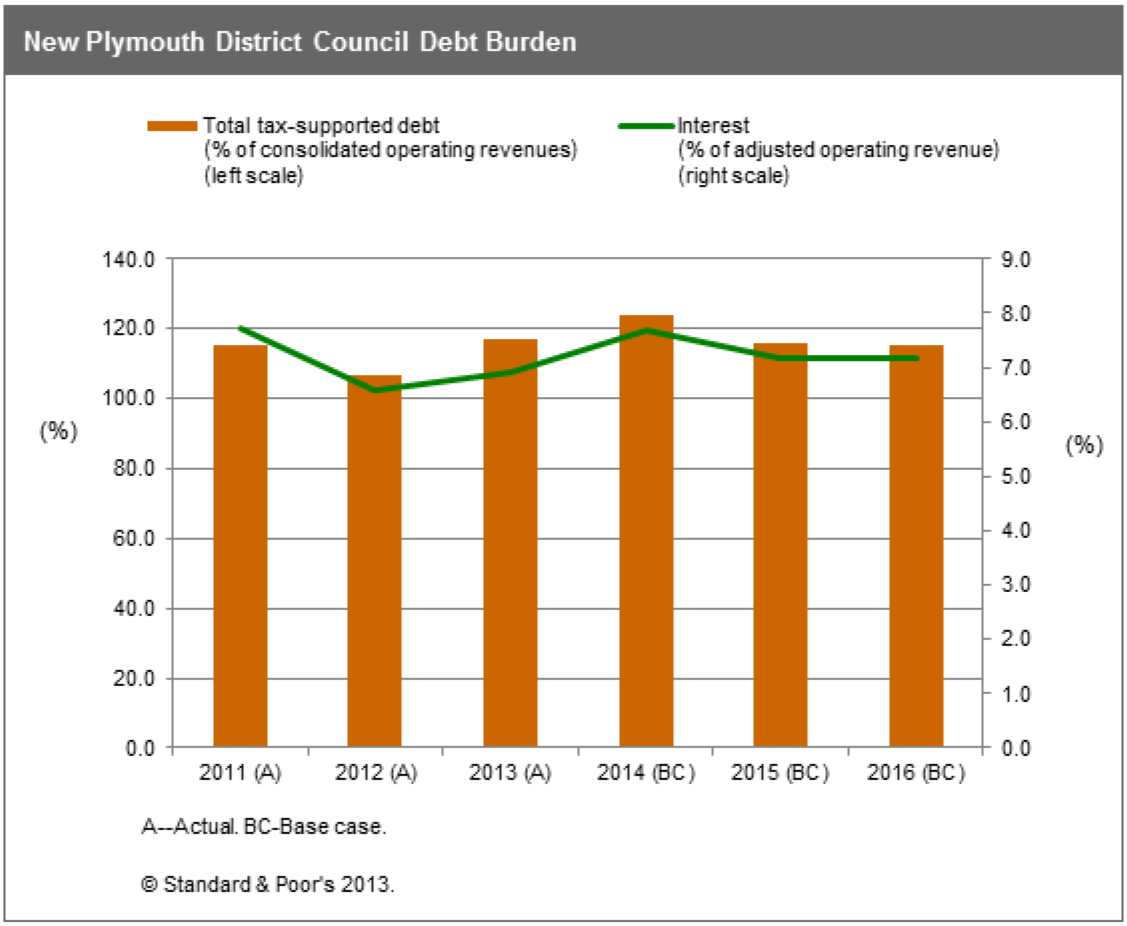
Debt Burden: High Relative To International Peers

New Plymouth's debt burden is high compared to international peers, but compares well to other local New Zealand governments, in our view. The New Zealand institutional framework provides a source of credit strength for New Plymouth, and allows it to support higher debt burdens than some of its international peers can tolerate.

Based on New Plymouth's projections, we expect the council's core debt as a percentage of operating revenues to be 114% in 2016, with interest of about 6.5% of operating revenues. The council's direct debt is used to fund long-term infrastructure to spread the costs between current and future ratepayers. Based on our definition of total-tax supported debt (including borrowings of TFL), we estimate New Plymouth's total tax-supported debt to be 115% in 2016 as a percentage of consolidated operating revenues (including TFL's revenues). We expect the council's total interest burden as a percentage of adjusted operating revenues to be 7.3% (see chart 2).

We note that borrowings of the PIF's investments (such as TFL) are not guaranteed by the council or secured over rates, but rather present potential risks to the PIF's capital base. Nevertheless TFL's borrowings are included in our assessment of New Plymouth's total tax-supported debt obligations. Our treatment of TFL's borrowings reflects our view that the PIF is likely to provide financial support to TFL to meet its financial obligations in the unlikely event of financial stress. In determining the council's total-tax supported debt, we have also included the estimated revenue of TFL in our assessment of consolidated cash operating revenues.

Chart 2



At June 30, 2013, the core council had about 58% of its debt maturing within one year, including commercial paper which accounts for about 30% of maturing debt. Participation in the LGFA is likely to improve the maturity profile of New Plymouth's debt obligations as it begins to borrow funds on longer tenors.

Contingent Liabilities: Limited Exposure

New Plymouth's non-debt and contingent liabilities are small, at less than 1% of operating revenues, and do not affect the credit ratings on the council. New Plymouth's contingent liabilities are mainly for potential weathertighness claims of NZ$670,000. New Plymouth has also extended a small guarantee to the LGFA.

As part of the arrangements supporting the LGFA, New Plymouth will be party to a joint and several guarantee that we consider a contingent liability. Given the strength of the institutional framework in New Zealand New Plymouth District Council and the requirement that all debt must be secured over rates, we believe that the likelihood of a default scenario that would trigger the joint and several guarantee is low.

Published Rating Factor Scores

Table 1

New Plymouth District Council: Summary Of Published Rating Factor Scores*

Rating Factor	Score
Institutional framework	Predictable and Supportive
Financial management	Positive
Liquidity	Neutral

*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

New Plymouth District Council: Financial Statistics

Consolidated Forecasts					
Years ending 30 June	**2016BC**	**2015BC**	**2014BC**	**2013A**	**2012A**
CASH OPERATING RESULTS (MIL. NZ$)					
Rates	76.8	73.3	69.9	67.4	64.3
User charges	37.6	35.9	34.5	32.1	31.7
Interest income	2.4	2.2	1.5	1.4	1.8
Other operating revenue	91.4	84.4	71.6	60.9	66.9
Adjusted operating revenue	208.1	195.8	177.6	161.8	164.7
Payments to suppliers and employees	160	150	140.6	136.2	128.2
Interest	14.9	14.1	13.6	11.2	10.8
Other operating expenditure	0	0	0	0	0.4
Adjusted operating expenditure	174.9	164.1	154.2	147.4	139.4
= Operating balance (cash)	33.2	31.7	23.4	14.4	25.3
+ Capital revenue	7.4	10	10.2	22.7	12.8
- Capital expenditure	50.1	65	64.1	56.2	49.3
Balance after-capital accounts (cash)	(9.4)	(23.4)	(30.6)	(19.0)	(11.2)

Table 2

New Plymouth District Council: Financial Statistics (cont.)					
FINANCIAL PERFORMANCE INDICATORS (Cash basis)					
Operating balance/adjusted operating revenues (%)	16	16.2	13.2	8.9	15.4
Balance after-capital accounts/total revenue (%)	(4.4)	(11.4)	(16.3)	(10.3)	(6.3)
Capital expenditure/total expenditure (%)	22.3	28.4	29.4	27.6	26.1
Modifiable revenues/adjusted operating revenues (%)	55	55.8	58.8	61.5	58.3
BALANCE SHEET (MIL.)					
Cash and liquid investments	16.2	16.2	8	13.5	39.2
Other current assets	47	35.1	37.4	55.5	32.6
Non-current assets	2,501.10	2,464.50	2,492.60	2,311.10	2,325.50
Total assets	2,564.30	2,515.70	2,538.10	2,380.00	2,397.30
Current loans	37.9	36.2	37.6	66.3	115.3
Other current liabilities	30.7	29.8	17.4	27.7	31.1
Non-current loans	202.3	190.2	182.1	122.6	60.2
Other non-current liabilities	46.7	46.7	51.5	45.4	56.1
Total liabilities	317.6	302.9	288.6	261.9	262.7
Net worth	2,564.30	2,515.70	2,538.10	2,380.00	2,397.30
Total net worth & liabilities	2,882.00	2,818.60	2,826.70	2,641.90	2,660.00
FINANCIAL POSITION INDICATORS					
Direct debt	147.9	138.4	135.9	110.4	104.4
Direct debt/adjusted operating revenue (%)	103.1	113.5	103.4	109.9	110
Total tax-supported debt	240.2	226.4	219.7	188.9	175.6
Total tax-supported debt/consolidated adjusted operating revenue (%)	115.4	115.6	123.7	116.8	106.6
Interest (cash basis)	14.9	14.1	13.6	11.2	10.8
Interest/consolidated adjusted cash operating revenue (%)	7.2	7.2	7.7	6.9	6.6
ACCRUAL OPERATING RESULTS (MIL.)					
Adjusted operating revenue	207.5	195.3	178	167.9	162.4
Adjusted operating expenditure	214.3	202.1	181.9	173.9	171.5
Adjusted operating balance	(6.8)	(6.8)	(3.8)	(6.1)	(9.1)
Operating balance/operating revenue (%) (accrual basis)	(3.3)	(3.5)	(2.2)	(3.6)	(5.6)

A--Actual. BC--Base case.

Key Sovereign Statistics

For sovereign statistics, see "Supplementary Analysis: New Zealand," published Aug. 29, 2013

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 7, 2013)

New Plymouth District Council		
Issuer Credit Rating		AA/Stable/A-1+
Commercial Paper		
Local Currency		A-1+
Senior Unsecured		AA
Issuer Credit Ratings History		
29-Sep-2011	*Foreign Currency*	AA/Stable/A-1+
21-Nov-2010		AA+/Negative/A-1+
10-Sep-2009		AA+/Stable/A-1+
12-Jan-2009		AA+/Negative/A-1+
29-Sep-2011	*Local Currency*	AA/Stable/A-1+
21-Nov-2010		AA+/Negative/A-1+
10-Sep-2009		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.