

Research Update:

New Plymouth District Council 'AA+/A-1+' Ratings Affirmed; Outlook Negative

April 28, 2024

Overview

- New Plymouth's budgetary metrics have weakened as it faces ongoing inflationary pressures and large infrastructure needs. Like many domestic peers, higher costs of delivering services will result in after capital account deficits of more than 10% of total revenues over the next two years.
- We expect the council to implement sizable rates increases and deliver up to NZ\$10 million in annual cost savings from an organizational restructure to offset growing costs. New Plymouth's Perpetual Investment Fund (PIF) is a credit strength compared to peers. It allows the council to subsidize its budgets and is a substantial liquidity buffer.
- Our view of the weakening institutional settings in the New Zealand local government sector places additional downward pressure on our ratings on New Plymouth.
- We affirmed our 'AA+' long-term and 'A-1+' short-term issuer credit ratings on New Plymouth. The outlook on the long-term rating remains negative.

Rating Action

On April 29, 2024, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on New Plymouth District Council, a New Zealand local government. The outlook on the long-term rating remains negative.

Outlook

The negative outlook reflects both downward pressure on the institutional settings for New Zealand's local government sector and a weakening in New Plymouth's budgetary metrics.

Downside scenario

We could lower our ratings on New Plymouth if the New Zealand local government sector's overall

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commitment to strong finances continues to deteriorate, as indicated by large sectorwide cash deficits and further growth in the sector's already-elevated debt burden. This could result from inadequate revenue growth to fund capital expenditure (capex), or changes in central government policy that undermine the financial outcomes of the sector.

We could also lower our ratings on New Plymouth if the council's after capital account deficits rise. This could occur if the council doesn't implement its large proposed property rate increases or planned operational savings, or if capex exceeds our expectations.

Upside scenario

We could revise our rating outlook on New Plymouth to stable if the New Zealand local government sector's overall commitment to strong finances improves.

We could also revise our outlook to stable if New Plymouth's stand-alone credit metrics improve substantially. A sustained upturn in budgetary performance, leading to a declining debt burden, could indicate this.

Rationale

Higher service delivery costs, rising insurance premiums and increased borrowing costs are driving operating expenses higher than we previously forecast. New Plymouth recorded a 9% operating surplus in fiscal 2023 (year ending June 30), about half of our previous forecast. We also expect after capital account deficits to moderate following the deficit of 23% of total revenues in fiscal 2023. Annual capex will rise to NZ\$134 million in 2026 from NZ\$60 million in 2022.

While the council's financial metrics are stronger than many domestic peers, they are weaker than most 'AA+' subnational governments globally. Aggregate fiscal metrics have weakened across New Zealand's local government sector more broadly.

The council is taking steps to preserve fiscal buffers, targeting NZ\$100 million in operational savings across the next 10 years as part of its draft 2024-2034 Long Term Plan (LTP). We expect large increases in property rates and savings from an organizational restructure to keep New Plymouth's debt metrics steady. This will help to keep debt in check, remaining steady around 140% of operating revenues over the next two years.

The council's access to its Perpetual Investment Fund (PIF) is a key credit strength compared to peers and underpins the 'AA+' ratings. The PIF provides an additional source of income and supports New Plymouth's exceptional liquidity coverage, providing a buffer to cover potential short-term financial shocks. The council's strong financial management and wealthy local economy also support credit metrics.

Our base case assumes the council will continue to deliver all water-related activities. In February 2024, the newly elected New Zealand central government (the Crown) repealed the former government's "Affordable Water Reforms" legislation. The government will implement its "Local Water Done Well" program, with the first of two planned pieces of legislation due by mid-2024.

Increased pipeline of capital spending will result in moderate deficits; this is counterbalanced by New Plymouth's exceptional liquidity.

New Plymouth's operating margins are healthy but slightly weaker than we previously forecast. We expect operating surpluses will average 17% of operating revenues between fiscals

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2022-2026, compared to our previous forecasts of 21%. In 2023, operating margins fell to 9% of operating revenues as the council absorbed rising operating expenses and interest costs, higher insurance premiums and additional maintenance works due to weather events. Cost savings from the organizational restructure should curtail growth in operating expenses over the next two years.

In response to rising operating expenses, the council raised rates by 12.4% in fiscal 2024, the highest general rates increase in over 15 years and well above the 7% planned increase outlined in the 2021 Long-Term Plan. We expect general rates increases will be about 10% per year in fiscal 2025 and fiscal 2026.

New Plymouth's PIF bolsters its operating revenues. The PIF had a balance of NZ\$362 million as of January 2024, which would be enough in itself to fund about two years of the council's operating expenses. PIF targets a total return on its portfolio over the medium term of 3.3% a year plus inflation. This allows it to pay an annual "release" to the council to subsidize the latter's budgets. The cash release will be NZ\$11.8 million in fiscal 2024.

We expect the council to post large after capital account deficits averaging 11% of total revenues over the next three fiscal years. We forecast annual capex to reach NZ\$134 million by fiscal 2026, more than double the NZ\$60 million spent in fiscal 2022. Our forecasts incorporate a 10%-25% haircut compared with the council's forecasts, reflecting historical underspending. We assess New Plymouth on a group basis and consolidate Papa Rererangi i Puketapu Ltd. (PRIP; New Plymouth Airport), the recent expansion of which the council funded.

New Plymouth's draft 2024-2034 LTP outlines a large budget for upgrades to the district's water network, including the construction of a new thermal dryer for wastewater treatment and the last stages of a water meter rollout for residents. The thermal dryer project was originally budgeted for NZ\$43 million in 2020 with NZ\$37 million funded from the Crown. Rescoping of the project design and rising construction costs mean the project will now cost about NZ\$85 million to complete, with the shortfall to be covered by the council.

The LTP also outlines a revised budget for the development of the Tuparikino Active Community Hub. The council previously proposed to contribute NZ\$40 million of the NZ\$91 million for the project in the 2021 LTP, with the remaining funding to come from external sources. However, the project has since been rescoped to reduce the total cost to only NZ\$40 million.

We believe New Plymouth has strong flexibility to adjust its budget compared with global peers. The council's largest source of revenue is rates, which can be readily adjusted and are relatively immune to economic downturns. Furthermore, the PIF provides the council with an additional source of income and contingency funding in the case of a major natural disaster or other crisis. New Plymouth is also delaying and cutting nonessential capex as part of the upcoming LTP in response to budgetary pressures.

New Plymouth's gross debt ratio should remain steady, reaching 139% of operating revenues by fiscal 2026. This debt burden is high in a global context, despite being at the lower end of domestic peers. Our measure of total tax-supported debt includes NZ\$15 million borrowed by the council and on-lent to PRIP. We estimate interest expenses will average about 5.3% of operating revenue over fiscals 2023-2025. New Plymouth had negligible contingent liabilities as of June 30, 2023.

New Plymouth's PIF underpins its exceptional liquidity coverage. The council's total free cash position--after applying our standard haircuts to noncash assets, and after budget needs--should be sufficient to cover about 196% of debt service during the next 12 months. Upcoming debt-servicing needs include NZ\$21 million in term debt maturing in April 2025, NZ\$50 million in short-dated commercial paper, and about NZ\$11 million in annual interest payments. In addition, New Plymouth has access to undrawn committed standby facilities totaling NZ\$20 million.

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The New Zealand Local Government Funding Agency (LGFA) provides New Plymouth, and most of its domestic peers, with strong access to a well-established source of external liquidity. In our view, LGFA benefits from an "extremely high" likelihood of extraordinary central government support (see "New Zealand Local Government Funding Agency Ltd. Ratings Affirmed; Outlook Stable," published Feb. 27, 2024). It has helped councils to both lengthen their maturity profiles and reduce borrowing costs.

New Zealand's institutional framework may be weakening; A resilient local economy, and robust financial management underpin New Plymouth's creditworthiness.

The institutional framework within which New Zealand councils operate is a key factor supporting New Plymouth's credit profile. We believe this framework is currently one of the strongest and most predictable globally. It promotes a robust management culture, fiscal discipline, and high levels of transparency and disclosure.

However, rising infrastructure budgets and responsibilities are exerting pressure on the finances of the New Zealand's local government sector. Furthermore, policy uncertainty for the sector is elevated. The Crown repealed the previous government's water reforms and has promised its own version of reforms. We do not know the structure, timing, or implications on the local government sector of these potential reforms. If the trend continues, we could lower the institutional framework settings for local councils in New Zealand (see "New Zealand Council's Extremely Predictable And Supportive Institutional Settings Are At Risk," published Feb. 18, 2024).

Higher interest rates have restricted spending and weighed on GDP growth in New Zealand. We forecast growth will pick up to 1.4% in calendar 2024 after two consecutive quarters of negative growth to end 2023 (see "Economic Outlook Asia-Pacific Q2 2024: APAC Bides Its Time On Monetary Policy Easing," published March 25, 2024). Strong population growth will keep economic growth afloat, with net migration at record levels. The New Zealand population grew 2.8% in calendar 2023, the largest annual increase since 1946.

The New Plymouth economy is one of the wealthier districts across New Zealand, due in part to its large oil and gas sector. According to economics consultancy Infometrics the district had a GDP per capita of about NZ\$80,800 in the year to March 2023. New Plymouth's demographic profile is slightly weaker than the New Zealand average, with 19.3% of its population aged 65 and above, compared to 16.5% nationally. Mean household income was about NZ\$110,900 as of March 2023, about NZ\$15,000 lower than the national average. The New Plymouth district had a population of about 88,900 people as of June 30, 2023.

We consider New Plymouth's fiscal processes to be credible and well established. The council prepares long-term plans every three years, annual plans in the intervening years, and audited end-of-year annual reports, in line with New Zealand requirements. It has internal policies that set prudent limits on external borrowing, liquidity, and interest-rate risk. New Plymouth borrows only in the local currency, in accordance with legislation. The council is currently consulting with the public on its draft 2024-2034 LTP, which it will adopt in June 2024.

Like all New Zealand councils, New Plymouth is governed by an elected group of councilors. Day-to-day management is delegated to a full-time chief executive. The council has nearly completed a comprehensive organizational restructure, which is due to conclude by June. The restructure has so far resulted in the disestablishment of three tier-two executive roles and about 20 tier-three management positions. The council expects the reduction in headcount and consolidation of business units to account for most of the council's NZ\$10 million annual

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operational savings target.

Supporting our strong financial management assessment is New Plymouth's prudent management of the PIF. Assets are diversified across listed equities, fixed income, alternative assets, private equity and cash. The council has outsourced management to Mercer (N.Z.) Ltd. and an independent "board of guardians" monitors the PIF. The New Plymouth District Council (Perpetual Investment Fund) Act 2023 was passed in the New Zealand Parliament in July 2023. The Act aims to ringfence the benefits from the PIF to current New Plymouth residents. The bill also outlines general principles for sustainable management of the fund.

Key Statistics

Table 1

New Plymouth District Council--Key Statistics

(mil. NZ\$)	2022	2023	2024bc	2025bc	2026bc
Selected Indicators					
Operating revenues	159	180	204	229	249
Operating expenditures	147	164	166	178	179
Operating balance	12	16	37	51	69
Operating balance (% of operating revenues)	7.7	9.0	18.4	22.3	27.9
Capital revenues	23	23	60	33	31
Capital expenditures	61	87	119	112	134
Balance after capital accounts	(25)	(48)	(21)	(27)	(33)
Balance after capital accounts (% of total revenues)	(14.0)	(23.5)	(8.1)	(10.4)	(11.6)
Debt repaid	11	40	35	21	31
Gross borrowings	11	100	56	48	64
Balance after borrowings	(26)	12	(0)	(0)	(0)
Tax-supported debt (outstanding at year-end)	204	264	286	313	345
Tax-supported debt (% of consolidated operating revenues)	128.0	146.3	140.2	136.6	138.8
Interest (% of operating revenues)	3.9	4.9	5.4	5.5	5.8
National GDP per capita (single units)	71,076	76,478	77,280	79,319	82,131

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

New Plymouth District Council--Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	2
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	4
Stand-alone 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 our "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 <http://www.spratings.com/sri>

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Economic Outlook Asia-Pacific Q2 2024: APAC Bides Its Time On Monetary Policy Easing, March 25, 2024
- New Zealand Local Government Funding Agency Ltd. Ratings Affirmed; Outlook Stable, Feb. 27, 2024
- New Zealand Council's Extremely Predictable and Supportive Institutional Settings Are At Risk, Feb. 18, 2024
- Various Rating Actions Taken On New Zealand Local Councils On Weakening Institutional Framework Trend, Feb. 18, 2024
- Global Ratings List: International Public Finance Entities January 2024, Jan. 18, 2024

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- Local and Regional Governments' Workarounds Are Running Out Of Time, Dec. 6, 2023
- New Zealand Local Government Outlook 2024: Bridge Over Troubled Waters, Nov. 19, 2023
- Global LRGs Rating History List, July 6, 2023
- Default, Transition, and Recovery: 2022 Annual International Public Finance Default And Rating Transition Study, May 23, 2023

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

New Plymouth District Council

Issuer Credit Rating AA+/Negative/A-1+

New Plymouth District Council

Commercial Paper 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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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