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Supplementary Analysis:

New Plymouth District Council

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This report supplements our research update "Ratings On New Plymouth District Council Affirmed At 'AA/A-1+'; Outlook Remains Stable," published on Oct. 30, 2015. 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+

The ratings reflect the extremely predictable and supportive institutional framework available to local and regional councils within New Zealand, plus the New Plymouth District Council's strong financial management, budgetary flexibility and liquidity; and its very low contingent liabilities. Partially offsetting these strengths are New Plymouth's average budgetary performance and economy, and high debt burden, compared to international peers.

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.

Correspondingly, we view New Plymouth's financial management as strong. The current council was elected in 2013 on a platform of more prudent financial management. This is amid lower returns from the investment fund that the council uses to supplement revenues from ratepayers, and the previous councils decisions to withdraw funds to an extent that reduced the fund's value. The current council's more frugal approach is reflected in more sustainable withdrawals from its fund, as well as a somewhat scaled-back capital investment program in its latest 10-year long-term plan. Beyond that, councilors are also increasing their focus on risk management.

Further, we expect the council's focus on improving operating efficiency to continue, while a recent restructure of the council's administration, and a new crop of senior executives reporting to the chief executive, appear to be going smoothly. New Plymouth prepares 10-year long-term plans and 30-year asset management strategies that ensure the council's infrastructure assets are well-managed and continually monitored. Although reducing its reliance on revenues from its investment fund, the council does at the same time have a policy of temporarily borrowing internally against special funds (although the level of borrowing is now declining), and funds capital renewals at a level less than straight-line depreciation. This approach could negatively affect our view of New Plymouth's financial management, if its reserves are not replenished over time or asset quality diminishes. The council's debt management is prudent in our view.

We consider New Plymouth's economy to be average compared to peers'. While the council's GDP per capita is high at about US$63,000 on average over 2012 to 2014, we consider that this high level largely reflects the region's significant liquefied natural gas sector, with profits mainly being repatriated outside the region; by contrast, its residents' wage and salary income, which more closely reflects the council's revenue base, is similar to the New

Zealand average. The council's industry concentration in commodity-dependent sectors such as agriculture, and oil and gas, also adds some economic vulnerability in our view.

New Plymouth's budgetary flexibility is strong, albeit not as strong as is typical for New Zealand councils. Modifiable revenues such as rates, user charges, fees, and fines account for about 60% of its consolidated operating revenues; and we expect capital expenditure to remain relatively high at well above 15% of total expenditure between 2014 and 2018, affording some added flexibility. Modifiable revenues have fallen as a share of total operating revenues in recent years because of increasing revenue from New Plymouth's trading organizations, but should remain about 60% over the next three years.

While the council's budgetary flexibility is strong, we consider its budgetary performance to be average. We expect New Plymouth's operating surpluses to average about 12% over fiscal years 2014 to 2018, up from 8% in 2011. After-capital-account deficits are likely to be small at about 3% of total revenues over the same period. New Plymouth's after-capital balance was unusually strong in 2014 and 2015, owing to significant capital underspend. We don't expect these strong results to be sustained. Aside from the council's core operations, its consolidated budgetary performance exhibits volatility, reflecting the performance of the company owned by the council's investment fund: Tasmanian Land Co., which holds major dairy farm interests in Tasmania, Australia.

New Plymouth's debt burden compares well to other local New Zealand governments', but remains high compared to international peers'. We estimate New Plymouth's total tax-supported debt (including borrowings of Tasmanian Land Co., which is our preferred measure) to be 115% of consolidated operating revenues (including Tasmanian Land Co.'s revenues) in fiscal year 2018. Excluding Tasmanian Land Co., the council's core debt ratio is a little lower than that for the consolidated council entity. The council's total interest expense as a percentage of adjusted operating revenues is about 6%, and a little higher, at about 7%, if we exclude Tasmanian Land Co.

New Plymouth's contingent liabilities are very low, with the council setting aside some provisions for potential liabilities. As we fully consolidate its major trading organizations onto its accounts, these do not present an additional contingent liability.

Liquidity

We consider New Plymouth's liquidity position to be strong. We estimate that the council's free cash and liquid assets (after we apply haircuts) will be just over 100% of its maturing debt and interest expense over the next 12 months, although it may dip next financial year when the council has a higher level of debt maturing. We estimate that New Plymouth will have, on average, free cash and liquid assets of about NZ$62 million (including liquid assets held in the council's investment fund) to cover its NZ$48 million of debt maturing within the next 12 months and NZ$12 million of interest repayments. The council has three unutilized committed bank facilities totaling NZ$32 million available for liquidity purposes.

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. While we recently revised our Banking Industry Country Risk Assessment (BICRA) score for the New Zealand banking system to '4' from '3' (indicating higher risk in the banking sector), we continue to believe the major New Zealand banks would receive support from their stronger Australian parents in a stress scenario.

New Plymouth is a member of the New Zealand Local Government Funding Agency (LGFA). LGFA represents 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, based on our measures, by allowing it to lengthen its average debt maturity.

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. Should we raise the sovereign rating at some stage, upward rating pressure could occur if the council increased revenue sufficiently to achieve after-capital-account surpluses and materially lower debt relative to revenue, while also structurally improving its liquidity position.

Downward pressure could occur if the council brought forward its capital program without a corresponding increase in revenues, deteriorating its key credit metrics. These include its average after-capital account deficits widening to more than 15% of operating revenues, leading to higher debt and an interest expense rising to more than 9% of operating revenues; such a scenario would also include weaker liquidity coverage of upcoming debt-servicing expenses. Downward pressure on the rating may also occur if we perceive that financial management is weakening—as evidenced, for example, in a resumption of unsustainable withdrawals from the council's investment fund.

Extremely Predictable And Supportive Institutional Framework

We consider New Zealand's institutional framework as being 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 "New Zealand's Reforms Are Strengthening Councils' Financial Management And Long-Term Planning," published Nov. 24, 2014 on RatingsDirect).

Average Economy: High-Income Economy, But Only Average Worker Incomes And Concentration In Commodity-Dependent Sectors

New Plymouth's economy is average compared to peers. The council's estimated per capita GDP of about US$60,000 compares favorably with New Zealand's of US$38,600. Partially offsetting this high income in our view is the economy's concentration in energy and soft commodity sectors.

New Plymouth, with a population of about 74,000, is the major center in the Taranaki region of New Zealand's north island.

The standard measure of economic income, gross domestic product per capita, in our view overstates the region's wealth—at least from the perspective of the council's revenue base. With the oil and gas sector an important part of the economy, much of the income generated accrues to the outside owners of the sector's capital, rather than to the region's residents. Indeed, the Taranaki region's average annual wage of about NZ$44,000 is similar to that of New Zealand's overall.

Economic growth has been relatively strong in recent years, although it may slow in the near term due to the recent collapses in global oil and dairy prices. Aside from oil and gas, the dairy sector makes an important contribution to the economy, as does dairy-related food manufacturing.

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.

Strong Financial Management Responding To Lower Investment Returns

We consider New Plymouth's financial management to be strong. The preparation of a 10-year long-term plan at least every three years and 30-year asset management plans by all New Zealand local authorities ensures councils have a forward-looking approach to prudent financial management, and sets an important baseline for the council's long-term capital and financial planning.

The council, elected in October 2013, is taking a more prudent approach to managing its finances in the face of lower investment returns and a desire to lower its increases in residential rates from fiscal year 2017 onward.

New Plymouth holds substantial investments in its Perpetual Investment Fund, which holds the proceeds of the 2004 sale of its shares in energy network company Powerco. The council accesses some of the fund's annual investment earnings to subsidize rates. Investment returns have fallen sharply since 2008 although, between fiscal years 2009 and 2012, the council had drawn down over 8% of the fund's value each year, and as a result, the value of the fund fell by about 30% over this period. In recent years the council has recognized that this is not sustainable, and has reduced its reliance on revenue from the fund significantly. The council has reduced its drawdown to about two-and-a-half per cent in the past couple of years, and has recently set a drawdown policy of 3.3% of the fund's capital value per year, to help preserve the value of the fund in the long term.

Notwithstanding lower withdrawals from the fund, the council plans to reduce its annual increases in residential rates, commencing from fiscal year 2017. To make this financially viable, the council is scaling back its capital investment program by reducing spending on discretionary projects, while also lengthening the assumed useful life of existing assets (allowing lower spending on asset renewal). The council and management are also focusing on achieving lower operating costs, and have already made progress in this area.

Still, some financial pressure is evident due to the lower revenue from the fund. The council has for the past couple of years been drawing down on operational reserves, although this drawdown is now decreasing. The council had also not been fully funding depreciation; it does now fully fund depreciation, although at a level below straight-line depreciation. Unless operational and discretionary capital spending can be adequately constrained, the council might require higher rates increases than currently planned, or else a gradual deterioration in infrastructure quality could result that will eventually need to be addressed.

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, and managing liquidity. Policy parameters manage the volume of borrowing as well as the maturity profile and its interest rate hedging strategies.

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 also publicly outlined in the long-term plan and liability management and investment policies.

Strong Budgetary Flexibility, But Reliance On Investment Income Lowers Flexibility Compared To Domestic Peers

We consider New Plymouth's budgetary flexibility to be strong, with just over 60% of its operating revenues modifiable, and capital expenditure of about 20% of total expenditure between fiscal years 2014 and 2018.

There are no restrictions on New Plymouth's ability to increase rates, other than a strong political imperative to keep increases low. As part of the legislative requirements, New Plymouth 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 and 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 just over 60% of operating revenues are lower than its domestic peers', as the council earns additional income from its Perpetual Investment Fund and its investments. Revenue from Tasmanian Land Co., which is owned by this fund, and which in turn owns the largest dairy farm in Australia, forms the vast majority of these nonmodifiable revenues. (We consolidate the revenue and expenditure of Tasmanian Land Co. with those of the core council.)

A high level of capital expenditure typically provides more budgetary flexibility, as it suggests that capital spending can be deferred or cancelled if necessary. New Plymouth's capital expenditure, as a share of total expenditure, is gradually declining, but we expect it to remain well above 15% and provide some additional budgetary flexibility as a result.

Average Budgetary Performance: Moderate Capital Program Offset Strong Operating Position

New Plymouth's budgetary performance is average. We expect cash operating surpluses of about 12% of operating revenues between fiscal years 2014 and 2018. We forecast New Plymouth's after-capital account deficits will average about 3% of total revenues from fiscal years 2014 to 2018.

We estimate New Plymouth's cash operating balance to have peaked at about 15% of operating revenues in 2015 from lows of 8% in 2011, as rates and user charges, and income from Tasmanian Land Co. increased. We expect New Plymouth's operating surplus to dip in 2016 with stronger expenditure growth in that year, but improve thereafter. Our analysis of New Plymouth's consolidated budgetary performance includes our expectations of its council-controlled organizations—such as Tasmanian Land Co., and the New Plymouth airport—over the next three years. On a core council basis, we also expect New Plymouth to continue posting strong cash operating surpluses.

We expect New Plymouth's average after-capital-account deficit to be about 3% between fiscal years 2014 and 2018. The council's after-capital account moved into surplus in 2015, partly due to underspend on the council's capital program. We expect an after-capital-account deficit of about 9% in fiscal year 2016, reflecting a weaker operating balance in that year, but for after-capital-account deficits to remain less than 5% of total expenditure in following years. We expect New Plymouth's after-capital account balances on a core council basis to be broadly similar to its consolidated performance.

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. Developer contributions and vested assets are considered a key risk to fiscal outcomes being achieved, primarily because of uncertainty as to whether they are received as projected.

Relatively High Debt Burden Compared 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.

We forecast New Plymouth's total tax-supported debt burden to be about 115% of operating revenues in 2018. Interest expenses are likely to be a little over 6% of operating revenues between fiscal years 2015 and 2017.

We expect New Plymouth's core council debt to be about 92% of operating revenues in fiscal year 2018, with interest of about 7% of operating revenues. Based on our definition of total-tax supported debt (including the borrowings of its trading organizations such as Tasmanian Land Co.), we estimate New Plymouth's total tax-supported debt to be a little higher at about 115% of consolidated operating revenues in fiscal year 2018.

We note that borrowings of the Perpetual Investment Fund investments (such as Tasmanian Land Co.) are not guaranteed by the council or secured over rates, but rather present potential risks to the fund's capital base. Nevertheless, we include Tasmanian Land Co.'s borrowings in our assessment of New Plymouth's total tax-supported debt obligations. Our treatment of Tasmanian Land Co.'s borrowings reflects its current ownership structure and our view that the fund is likely to provide financial support to Tasmanian Land Co. 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 Tasmanian Land Co. in our assessment of consolidated cash operating revenues.

New Plymouth's maturity profile is lengthening. At June 30, 2015, the core council had reduced the amount of debt maturing within the next three years to 42%, from 58% in 2013, although this is a little higher than the 37% achieved in 2014. A large proportion (about NZ$30 million) of this was commercial paper. Participation in the New Zealand Local Government Financing Authority is likely to improve the maturity profile of New Plymouth's debt obligations as it begins to borrow funds on longer tenors.

Very Low Contingent Liabilities: Very Small Exposure To Potential Weathertightness Claims

New Plymouth's contingent liabilities are very low at less than 1% of operating revenues. New Plymouth's contingent liabilities are mainly for potential "weathertightness", or building moisture damage, claims of NZ$1 million. New Plymouth has also extended a small guarantee to the Local Government Financing Authority (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 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.

Ratings Score Snapshot

Table 1

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Average
Financial Management	Strong
Budgetary Flexibility	Strong
Budgetary Performance	Average
Liquidity	Strong
Debt Burden	High
Contingent Liabilities	Very low

Key Statistics

Table 2

New Plymouth District Council Key Statistics					
	--Year end June 30--				
Cash basis; mil. NZ$	**2014 (A)**	**2015 (A)**	**2016 (BC)**	**2017(BC)**	**2018 (BC)**
OPERATING RESULTS					
Council rates	69.6	74.8	76.0	78.3	81.6
User charges	33.5	33.1	32.9	33.7	33.1
Interest income	1.7	2.8	1.4	1.8	2.0
Other operating revenues	55.8	67.1	68.6	74.1	74.1
Adjusted Operating Revenues	160.5	177.8	178.8	187.8	190.7
Payments to suplliers and employees	131.6	141.0	152.2	153.6	153.3
Interest payments	11.5	9.3	12.3	12.2	12.0
Other operating expenditure	0.0	0.4	0.5	0.1	0.1
Adjusted Operating Expenditures	143.1	150.7	165.0	165.9	165.4
Operating Balance	17.4	27.1	13.8	21.9	25.3
+ Adjusted capital revenues	19.7	15.5	6.6	6.6	6.8
- Adjusted capital expenditures	37.7	40.0	36.9	37.6	38.8
Balance After Capital Accounts	(0.6)	2.6	(16.6)	(9.1)	(6.7)
FINANCIAL PERFORMANCE INDICATORS					
Operating balance (% of adj. operating revenues)	10.9	15.2	7.7	11.7	13.3
Balance after capital accounts (% of adj. total revenues)	(0.3)	1.3	(8.9)	(4.7)	(3.4)
Modifiable revenues (% of adj. operating revenues)	64.2	60.7	60.9	59.6	60.1
Capital expenditures (% of total expenditures)	20.9	21.0	18.3	18.5	19.0
FINANCIAL POSITION INDICATORS					
Tax-supported debt	181.9	187.1	203.6	212.6	219.3
Tax-supported debt (% of cons. operating revenues)	113.3	105.2	113.9	113.2	115.0
Interests (% of adj. operating revenues)	7.2	5.2	6.9	6.5	6.3

A--Actual. BC--Base case.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 12, 2015. Interactive version available at http://www.spratings.com/sri

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- 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

Related Research

- Rating Activity Among Non-U.S. Local And Regional Governments Muted In Second-Quarter 2015, Aug. 6, 2015
- New Zealand's Reforms Are Strengthening Councils' Financial Management And Long-Term Planning, Nov. 24,

2014

Ratings Detail (As Of November 3, 2015)		
New Plymouth District Council		
Issuer Credit Rating		AA/Stable/A-1+
Commercial Paper		
Local Currency		A-1+
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+
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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.