6 Whangarei District Council Credit Rating

Reporting officer: Alan Adcock (General Manager - Corporate/CFO)

Date of meeting: 25 May 2017

1 Purpose

To inform Council of the updated WDC credit rating from Standard and Poors.

2 Recommendation/s

That the Finance and Corporate Committee receives the 2017 Standard and Poors credit rating report and notes its contents.

3 Background

Whangarei District Council uses the ratings agency Standard and Poors (S&P) to provide our credit rating, which allows LGFA, banks and other funders to determine the risks involved in lending to WDC and thus the interest rates our debt incurs. The better our credit rating, the less interest we are charged on debt. In addition, the credit rating process provides a hardnosed independent commercial assessment of WDC's financial position, financial policies and management capability. This serves to provide evidence to Councillors and ratepayers of the state of WDC's financial position and strategy.

4 Discussion

Whangarei District Council's Credit Rating AA (Stable)

S&P have confirmed WDC's long term credit rating at AA with a "Stable" outlook (see Attachment 1). This is the highest credit rating WDC can receive as WDC cannot be rated ahead of the NZ Government.

Strong financial management has seen WDC lift its credit rating from AA- to AA in the two years since the current financial strategy was adopted in the 2015 – 2025 Long Term Plan.

WDC Credit Profile stronger than NZ Government

In the commentary S&P state that WDC's stand alone credit profile is "*currently stronger than our foreign currency rating on the sovereign*". This is an exceptional result and is directly attributable to Council preparing a robust financial policy and sticking to it.

Future Outlook

S&P note that they expect WDC *"will continue to improve its operating surplus by sticking to its rates policy, further strengthening its after-capital accounts surplus and reducing its debt."*

As noted above WDC's credit profile is 'capped' at AA, but S&P note that *"If we were to raise our rating on the sovereign, then we would likely raise our ratings on Whangarei…"*

However, they also indicate that a significant deviation from our current financial strategy, such as a major lift in capital expenditure without a corresponding increase in revenue, would see our credit strength diminish. This information should be considered as the financial strategy in the 2018 – 2028 Long Term plan is developed.

Strong Management Capability

As part of their assessment S&P interview the Mayor, Finance Committee Chair, CEO, CFO and key financial and management staff. Their conclusion from that assessment is:

"Whangarei's management is focused on prudent financial management and has contributed to the council's strong financial position. The council is undergoing a management restructure that will help to align its business activities and enable better delivery of services."

Rates, Debt, Key Infrastructure and Capital Works Programme

Standard and Poors have also assessed our rates, debt, infrastructure and capital works programme. Their conclusions are as follows:

- *"Whangarei's rates compare favourably with the average rates paid throughout New Zealand, even after a one-off increase in overall rates of 9% in 2016."*
- *"We project Whangarei's debt metrics to continue improve in the medium term. The council's rate policy has strengthened its operating position and after-capital account balances. This decision is helping the council to be less reliant on borrowings and asset sales to fund capital expenditures, therefore reducing its debt burden to 116% of operating revenues in 2019 from 136% in 2016."*
- *"The absence of a significant infrastructure backlog provides Whangarei with some expenditure flexibility around capital works, and the council can delay smaller projects if the need arises."*
- *"We forecast the council will spend between NZ$41 million and NZ$44 million per year on infrastructure, which is equivalent to about 31.6% of total expenditure. We expect Whangarei's capital expenditure to peak at about 32.9% in 2018, mainly due to the development of a new water treatment plant in Whau Valley."*

S&P assess our debt burden to be "High". However, this assessment compares our debt levels on a global, rather than national basis, and partly reflects the wide responsibilities that the NZ local government sector has for infrastructure investment. In many other jurisdictions much of this burden sits with federal or state authorities, meaning local government is less reliant on debt funding.

5 Conclusion

Standard and Poors have assessed WDC credit worthiness in considerable detail and concluded that our credit rating is extremely strong. While our debt burden is still higher than average WDC is doing well by every other measure.

This is an exceptional result for Council and reinforces the decision to set a strong financial strategy and stick to the plan over the past two years.

6 Significance and engagement

The decisions or matters of this report do not trigger the significance criteria outlined in Council's Significance and Engagement Policy, and the public will be informed via report publication on the website.

7 Attachment

1. 2017 Credit Rating Report

ATTACHMENT

S&P Global
Ratings

RatingsDirect®

Research Update:

Whangarei District Council Ratings Affirmed At 'AA/A-1+', Outlook Remains Stable

Primary Credit Analyst:
Anthony Walker, Melbourne (61) 3 9631 2019; anthony.walker@spglobal.com

Secondary Contact:
Ieva Erkule, Melbourne (61) 3-9631-2085; ieva.erkule@spglobal.com

Table Of Contents

Overview

Rating Action

Outlook

Rationale

Key Statistics

Ratings Score Snapshot

Key Sovereign Statistics

Related Criteria

Related Research

Ratings List

Research Update:

Whangarei District Council Ratings Affirmed At 'AA/A-1+', Outlook Remains Stable

Overview

- Whangarei District Council (Whangarei)'s excellent financial management, institutional settings and budgetary flexibility support its ratings.
- We expect Whangarei's debt burden to decline relative to revenues as the council maintains its strong operating position, while improving its liquidity coverage.
- We have affirmed our 'AA' long-term foreign-currency and local-currency ratings and 'A-1+' short-term ratings on Whangarei.
- The stable outlook reflects our expectations that Whangarei will continue to strengthen its budgetary performance and reduce its debt burden below 120% of operating revenues.

Rating Action

On May 19, 2017, S&P Global Ratings affirmed its 'AA' long-term foreign currency and local currency rating and 'A-1+' short-term issuer credit rating on Whangarei District Council, a New Zealand local government. The outlook on the ratings remains stable.

Outlook

The stable outlook reflects our expectation that Whangarei will continue to strengthen its budgetary performance and reduce its debt burden below 120% of operating revenues.

Upside scenario

If we were to raise our rating on the sovereign, then we would likely raise our ratings on Whangarei because the council's standalone credit profile is currently stronger than our foreign currency rating on the sovereign.

Downside scenario

With a stand-alone credit profile stronger than the foreign currency rating on the sovereign, it would take a substantial deterioration in the council's credit profile to warrant lowered ratings. We may lower the rating if the council's after-capital account deficits weakened significantly, resulting in a sharp rise in its debt burden. This could occur if the council changed its current policy and added a significant amount of capital expenditure to its budget, resulting in significant increases in its after-capital account deficits, without offsetting adjustments to revenue or expenditure. This could also weaken its liquidity coverage and our view of its financial management.

Rationale

We have updated and extended our forecasts for Whangarei until 2019. Following this update, we still expect the council's financial management and budgetary flexibility to support Whangarei's credit profile. We expect Whangarei will continue to improve its operating surplus by sticking to its rates policy, further strengthening its after-capital accounts surplus and reducing its debt.

A supportive institutional framework and excellent management underpin Whangarei's creditworthiness

The institutional framework within which New Zealand local governments operate is a key strength supporting Whangarei'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 Whangarei to support higher debt levels than some of its international peers can tolerate at its current rating.

Whangarei's management is focused on prudent financial management and has contributed to the council's strong financial position. The council is undergoing a management restructure that will help to align its business activities and enable better delivery of services. Further supporting our view of the council's management strength is the council's commitment to raise income through higher rates than in the past to strengthen its financial position. We consider its debt and liquidity policies to be prudent, as shown in its decreasing level of debt and higher liquidity coverage. The council does not borrow in foreign currency and interest exposure is mostly hedged.

Whangarei is the Northland region's main urban and servicing center, and its economy is broadly supportive of Whangarei's credit profile. Economic growth has been relatively strong in recent years, rising to about 3% in 2016 compared with average growth of 1.7% 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 Auckland's buoyant housing market. We estimate Whangarei's GDP per capita was about US$32,600 on average between 2014 and 2016, which is relatively high in an international context, but lower than New Zealand's national level of US$43,100. Whangarei benefits from being home to New Zealand's only oil refinery, which contributed about 16% of districts GDP in 2016. Because much of the income generated from the oil refinery accrues to its nonresident owners, Whangarei's estimated per capita income doesn't fully reflect the council's ability to raise revenue through property rates charged to local residents. In addition, Whangarei's industry concentration in manufacturing, including the oil sector, is about

24% of the GDP output, which adds some economic vulnerability to the district.

After-capital account surplus supports Whangarei's fiscal position and debt continues to decline, while liquidity coverage is improving

About 93.1% of Whangarei's cash operating revenues are modifiable, showing exceptional budgetary flexibility. The council's revenue flexibility is supported by the council's policy to increase property rates above inflation; the council is targeting an overall rate increase of 4.8% in 2018. Whangarei's rates compare favorably with the average rates paid throughout New Zealand, even after a one-off increase in overall rates of 9% in 2016. The absence of a significant infrastructure backlog provides Whangarei with some expenditure flexibility around capital works, and the council can delay smaller projects if the need arises. We forecast the council will spend between NZ$41 million and NZ$44 million per year on infrastructure, which is equivalent to about 31.6% of total expenditure. We expect Whangarei's capital expenditure to peak at about 32.9% in 2018, mainly due to the development of a new water treatment plant in Whau Valley.

We expect Whangarei's after-capital account to remain in surplus of about 1.9% of total revenues between 2017 and 2019, reflecting strong operating balances and capital expenditure underspend. Whangarei's operating position continues to improve, with average surpluses of about 25% of operating revenues. This improvement reflects the council's commitment to increase operating revenues through rate increases to fund operating and capital expenditure.

We project Whangarei's debt metrics to continue improve in the medium term. The council's rate policy has strengthened its operating position and after-capital account balances. This decision is helping the council to be less reliant on borrowings and asset sales to fund capital expenditures, therefore reducing its debt burden to 116% of operating revenues in 2019 from 136% in 2016. Interest expenses reflect this decreased debt level, dropping to about 6.8% of operating revenues between 2017 and 2019 from 7.1% in our previous forecast. By taking into account the possibility of under-execution of the capital projects, borrowings might not be as high as we forecast.

Whangarei's liquidity coverage is high and it has improved during the past year. We forecast free cash, liquid assets, and bank facilities will average NZ$55 million during the next 12 months, covering about 145% of Whangarei's debt service. This compares favorably with 119% liquidity coverage last year. The council is prefunding NZ$20 million of debt maturing in December 2017, which will reduce refinancing risk.

Whangarei's contingent liabilities are small and represent about 2% of council's operating revenues. Most of the council's contingent liabilities reflect future claims arising from a weather-tightness building issue, at about NZ$2.4 million, small loan guarantees, and Marsden City's industrial subdivision. In 2015, the council discovered issues with the quality of new stormwater and wastewater concrete infrastructure assets in the Marsden City subdivision. The investigation identified a number of underground assets that are deteriorating due to erosion caused by acid sulphate soils. This has resulted in the council impairing about NZ$8.7 million of assets and initiating legal proceedings to seek damages against contractors involved.

Key Statistics

Table 1

Whangarei District Council Key Statistics

	—Year ending June 30—					
	2014	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**
Selected Indicators						
Operating revenues	102	107	113	118	123	129
Operating expenditures	79	85	83	90	91	93
Operating balance	23	22	31	29	32	36
Operating balance (% of operating revenues)	22.2	20.3	27	24.2	25.7	27.9
Capital revenues	17	12	18	14	14	12
Capital expenditures	29	31	43	42	45	45
Balance after capital accounts	10	3	6	1	0	3
Balance after capital accounts (% of total revenues)	8.6	2.3	4.4	0.8	0.1	1.8
Debt repaid	93	69	57	2	1	3
Gross borrowings	92	56	64	0	0	0
Balance after borrowings	10	(10)	13	(1)	(1)	(1)
Modifiable revenues (% of operating revenues)	93.2	90.8	94.4	93.7	93.1	93.4
Capital expenditures (% of total expenditures)	27	26.7	34.1	31.6	33	32.6
Tax-supported debt (outstanding at year-end)	158	145	154	153	153	150
Tax-supported debt (% of consolidated operating revenues)	155.1	136.2	136.4	129.3	124.3	116.9
Interest (% of operating revenues)	8.4	7.9	7.4	6.6	6.6	6.3
Local GDP per capita (single units)	40,869	42,451	46,283	N/A	N/A	N/A

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. Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot

Key Rating Factors	
Institutional Framework	**Extremely predictable and supportive**
Economy	Average
Financial Management	Very strong

Table 2

Ratings Score Snapshot (cont.)	
Key Rating Factors	
Institutional Framework	**Extremely predictable and supportive**
Budgetary Flexibility	Very strong
Budgetary Performance	Very Strong
Liquidity	Strong
Debt Burden	High
Contingent Liabilities	Low

*S&P Global Ratings issuer ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "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. Interactive version 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: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- 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 liquidity and budgetary performance had 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

Whangarei District Council	
Issuer Credit Rating	AA/Stable/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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.