Research Update:

Western Bay Of Plenty District Council 'AA/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- Western Bay of Plenty District Council will incur large after-capital account deficits as it increases infrastructure spending. As a result, the council's debt and interest costs could rise modestly, reversing from recent downward trends.
- The credit profile of the New Zealand-based council remains strong, underpinned by its financial management, exceptional liquidity coverage, and institutional settings.
- We affirmed our 'AA' long-term and 'A-1+' short-term issuer credit ratings on Western Bay.
- The outlook on the long-term rating is stable.

Rating Action

On Sept. 28, 2023, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term ratings on Western Bay. The outlook on the long-term rating is stable.

Outlook

The stable outlook reflects our expectation that Western Bay will continue to prudently manage its budgetary performance and debt over the next two years amid higher capital expenditure (capex).

Downside scenario

Downward pressure on the ratings could emerge if Western Bay's liquidity coverage deteriorates structurally to less than 120% of upcoming debt service. Alternatively, we could lower the ratings if the council's fiscal metrics weaken because the council displays less ability to raise revenue or reduce expenditure than we believe it can.

Upside scenario

We could raise our ratings on Western Bay if the council's budgetary performance is significantly better than our forecasts, reducing debt and interest relative to operating revenue. This could cause us to reassess our view of its financial management. The "Affordable Waters" Reforms is an instance that could cause Western Bay's budgetary performance and debt to improve.

Rationale

Western Bay, like many domestic peers, is facing inflationary pressure on its budget. The council increased its capex in 2023 and is still increasing it. As a result, its after-capital account deficits could widen to an average of 12.9% of total revenue between 2024 and 2026. Furthermore, higher debt and interest rates could push Western Bay's average interest expenses to more than 5% of operating revenue by 2025.

The weakening of Western Bay's financial position follows a decade of exceptionally strong fiscal outcomes. The council's after-capital account averaged surpluses of more than 9% of total revenue between 2013 and 2022. During this period, the council reduced its debt by more than 200% of operating revenue. Debt dropped to 68% of operating revenue in 2022.

Our base case excludes the potential effect of the Crown government's (New Zealand sovereign) proposed Affordable Waters reforms. The reform program, as currently envisaged, could see responsibility for drinking water, wastewater, and stormwater assets taken away from Western Bay from October 2025. The reforms are still under development and are subject to Crown elections in October 2023.

New Zealand's institutional settings and Western Bay's management support the council's creditworthiness.

The institutional framework within which New Zealand local governments operate is a key factor supporting Western Bay's credit profile. We believe this framework is one of the strongest and most predictable globally. It promotes a robust management culture, and high levels of financial disclosure. The framework allows New Zealand councils to support higher debt levels than some international peers can tolerate at similar ratings.

Western Bay has credible and well-established fiscal processes. To offset some inflationary pressures, the council increased general property rates by more than 7% for 2024. This was more than its self-imposed limit of 4% outlined in its financial strategy.

Western Bay prepares long-term plans every three years, annual plans in the intervening years, and audited annual reports, in line with New Zealand's requirements. The council's treasury policy sets internal limits on borrowing, liquidity, and interest-rate risk. The council recently breached its hedging policies in the lead up to the potential Affordable Waters reforms which could shift debt to third-party entities. This strategy could increase interest-rate risks for Western Bay, particularly if rates rise or remain elevated for a long period, and the reforms do not proceed as envisaged.

The performance of Western Bay's agricultural sector bolsters its economy, which has lower exposure to the tourism and education sectors than domestic peers. Tourism and education sectors have been struggling since the onset of the COVID-19 pandemic. Agriculture, forestry, and fishing dominate the region's economy. They make up about 20% of the district's economic output. The region grows about 80% of New Zealand's kiwifruit.

Western Bay has a population of about 59,700. We expect this to grow steadily, given the district's proximity to the land-constrained Tauranga city. Tauranga is one of the fastest-growing metropolitan areas in New Zealand.

According to data from New Zealand's Ministry for Business, Innovation, and Employment (MBIE), Western Bay's population has been increasing by 3.3% a year since 2013. The district had GDP per capita of NZ$44,000 for the year to March 2020, according to MBIE. This figure is the latest available and was lower than New Zealand's national average of NZ$63,556 during the period. Some 22.4% of Western Bay's residents were aged 65 and above as of June 2021, compared with the national average of 16%.

Higher infrastructure spending will result in after-capital account deficits and higher debt; liquidity is exceptional despite this.

We expect Western Bay's after-capital account deficit to widen to 12.9% from 2024 to 2026, averaging 9% from 2022 to 2026. The wider deficit reflects the council's push to increase investments in water and transport infrastructure to support the district's fast-growing population. While currently manageable within the current rating level, it marks a shift from the council's previous after-capital account surpluses of about 9% of total revenue on average from 2013 to 2021.

We expect Western Bay to spend NZ$64 million on capex a year between 2024 and 2026. The council could materially underdeliver its capital budget for 2024, which is roughly twice the amount spent in 2023. It spent NZ$54 million on infrastructure in 2023, 27% higher than the previous year. Like many domestic peers, planning and approval delays, and capacity constraints (including labor shortages) could hamper the infrastructure rollout.

Western Bay has a strong operating balance, although the balance narrowed to 16% of operating margins in 2023. We forecast margins will improve to about 20% from 2025 following a pickup in property rates and grants, and lower inflation. The council's operating margins averaged 27% of operating revenue over 2015-2022. This helped to drive exceptional strong fiscal outcomes during the period.

Western Bay has been demonstrating stronger budgetary flexibility than its domestic and global peers, in our view. The council raised property rates for 2024 by more than 7% over its 4% self-imposed limit. It derives about 85% of its revenues from rates, fees, and user charges and can delay some capex to aid financial outcomes.

Western Bay maintains lower debt than domestic peers, although the debt is moderate in a global context. Because of softer operating margins and higher infrastructure spending, we expect the total tax-supported debt of the council to increase to about 116% of operating revenue in 2026, from 68% in 2022.

Rising interest expenses have increased the debt burden of Western Bay. In our estimation, interest expense could exceed 5% of operating revenue in 2025. This reflects rising debt and the council's hedging policy. Still, the council has very low contingent liabilities, with little exposure to council-controlled organizations and adequate insurance coverage.

Western Bay maintains a strong liquidity position, with a debt-service coverage ratio of 172% for the next 12 months. The council also maintains access to the New Zealand Local Government Funding Agency (LGFA). It had about NZ$15 million in cash at end-2023 to cover NZ$15 million of term debt maturities and about NZ$5.6 million of interest. Western Bay currently has no commercial paper outstanding and has unutilized bank facilities of NZ$30.6 million.

Access to LGFA provides Western Bay and the other New Zealand local councils with additional sources of external liquidity, particularly during periods of stress in financial markets. In our view, LGFA benefits from an extremely high likelihood of central government support and has helped Western Bay lengthen its maturity profile and reduce interest costs.

Key Statistics

Table 1

Key Statistics

	Year ended June 30				
(mil. NZ$)	2022	2023e	2024bc	2025bc	2026bc
Selected Indicators					
Operating revenues	120	110	120	127	130
Operating expenditures	87	92	99	101	104
Operating balance	33	18	21	26	26
Operating balance (% of operating revenues)	27.2	16.2	17.3	20.5	20.4
Capital revenues	20	18	28	18	16
Capital expenditures	42	54	62	65	64
Balance after capital accounts	10	(18)	(14)	(21)	(22)
Balance after capital accounts (% of total revenues)	7.1	(14.1)	(9.2)	(14.3)	(15.1)
Debt repaid	10	15	15	25	25
Gross borrowings	0	27	30	48	48
Balance after borrowings	(0)	(6)	1	3	0
Tax-supported debt (outstanding at year-end)	81	91	106	129	151
Tax-supported debt (% of consolidated operating revenues)	67.6	82.5	88.2	101.3	116.5
Interest (% of operating revenues)	3.5	3.6	4.7	5.4	6.2
National GDP per capita (single units)	71,005	75,854	76,952	79,841	83,112

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

Ratings Score Snapshot

Key rating factors	
Institutional framework	**1**
Economy	**3**
Financial management	**2**
Budgetary perfomance	**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 the "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, July 10, 2023. 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

- Comparative Statistics: Local And Regional Government Risk Indicators: Asia-Pacific LRGs' Persisting Appetite To Spend Weighs On Creditworthiness, Sept. 20, 2023
- Economic Outlook Asia-Pacific Q3 2023: Domestic Demand, Inflation Relief Support Asia's Outlook, June 26, 2023
- Default, Transition, and Recovery: 2022 Annual International Public Finance Default And Rating Transition Study, May 24, 2023
- Institutional Framework Assessment: New Zealand Local Governments, May 17, 2023
- New Zealand Local Government Funding Agency, March 1, 2023

- Pipedream Or Panacea: New Zealand's "Three Waters" Reforms Pt.1, Feb. 27, 2023
- Pipedream Or Panacea: New Zealand's "Three Waters" Reforms Pt.2, Feb. 27, 2023
- Global Ratings List: International Public Finance Entities 2023, Jan. 9, 2023
- Local And Regional Governments Outlook 2023: Rougher Seas Ahead, Nov. 29, 2022
- Credit FAQ: Lifting The Lid On New Zealand's "Three Waters" Reforms, Oct. 12, 2022

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are7 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	
Western Bay of Plenty District Council	
Issuer Credit Rating	AA/Stable/A-1+