S&P Global Ratings

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Research Update:

Kapiti Coast District Council Ratings Affirmed At 'AA/A-1+'; Outlook Negative

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Overview

- Kapiti Coast District Council's financial position will remain weak over the next few years as the council borrows to finance a large infrastructure program.
- The council's large after capital account deficits will narrow to an average of 12% over fiscal years 2026 and 2027 (year ending June 30) as it implements large increases in property rates and defers capital expenditure (capex).
- We affirmed our 'AA' long-term and 'A-1+' short-term ratings on Kapiti.
- The negative outlook on the long-term ratings reflects our view of the weakening institutional settings in New Zealand's local government sector and Kapiti's weak financial position. These could put downward pressure on our ratings.

Rating Action

On July 30, 2024, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on Kapiti, a New Zealand local government. The outlook on the long-term rating is negative.

Outlook

The negative rating outlook reflects downward pressure on the institutional settings for New Zealand's local government sector and the council's weak financial position.

Downside scenario

We could lower our ratings on Kapiti if the local government sector's overall 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 capex, or changes in central government policy that undermine the financial outcomes of the sector.

We could also lower our ratings if Kapiti's budgetary forecasts perform below our base case. This could occur if the council backed away from planned increases in rates or continues to increase capex.

Upside scenario

We could revise the outlook to stable if the overall commitment of the New Zealand local government sector to strong finances improves and Kapiti's after capital account deficits continue to narrow. This could lead to a structurally lower ratio of debt to operating revenue and strong liquidity coverage.

Rationale

Kapiti's budgetary metrics have been very weak in the last two years as the council contends with rising costs of delivering core services. At the same time, we expect capital delivery to reach a record NZ$74 million in fiscal 2024 and remain elevated over the next few years.

We have updated our forecasts following Kapiti's adoption of its 2024-2034 long-term plan in June 2024. The plan outlines a revamped financial strategy which aims to consolidate fiscal deficits and repay debt over the next decade. The council will scale back or delay operating and capital spending over the next few years and raise revenue through higher property rates to rein in deficits.

Kapiti's debt as a proportion of operating revenues remains higher than that for most New Zealand councils and much higher than that for all other 'AA'-rated peers internationally. We expect tax-supported debt to be 261% by fiscal 2027.

Our base case assumes Kapiti will continue to deliver all water-related activities. In May 2024, the New Zealand central government (the Crown) introduced the first of two planned pieces of legislation to implement its Local Water Done Well reforms. The reform could take responsibility for drinking water, wastewater, and stormwater assets away from councils and amalgamate these activities into new regional water utilities. The second piece of legislation is due by mid-2025. The reforms could change the composition of Kapiti's revenues, expenses, and debt, depending on their final form.

Record capex delivery and elevated operating costs will keep after capital account deficits high and continue to weigh on liquidity coverage.

We estimate Kapiti will run after capital account deficits averaging 14% over fiscal years 2025-2027, compared with the 30% average over the prior two years. Operating revenues will increase by an average of 11% per year between fiscal years 2023 and 2027, underpinned by large, planned increases in property rates.

We expect capex to average NZ$76 million over fiscal years 2024-2027. This is more than double the NZ$37 million average the council delivered over the preceding five years. Drivers of the increase will be higher prices, waning material and labor constraints, and Kapiti's continuing priority on delivering essential infrastructure for the district.

Despite weak fiscal outcomes, we believe Kapiti has more budgetary flexibility than international peers. The council is able to freely adjust its own-source revenues to meet its spending needs. General property rates, fees, and user charges typically make up 80%-90% of its annual operating revenues.

Kapiti increased general rates by 17.2% in fiscal 2025 to combat rising expenses and fund an operating cost shortfall for its water services. The council also plans to raise rates by 7% per year over the following nine years to aid debt repayment.

Kapiti's large capital program and prefunding strategy continue to add to its debt. Solid growth in operating revenues will contribute to a gradual decline in the ratio of total tax-supported debt to operating revenue to 261% in fiscal 2027 from 283% in fiscal 2023. We forecast interest costs will average 11% of operating revenues over fiscal years 2024-2026.

Kapiti's policy of prefunding upcoming debt maturities up to 18 months in advance supports its internal liquidity. Rising interest rates and large after capital account deficits continue to weigh on our measure of debt coverage. We estimate cash and liquid assets after budgetary needs will be sufficient to cover 112% of upcoming debt maturities, and interest costs over the next 12 months. Liquidity remains a key credit strength compared to peers due to the council's consistent prefunding strategy.

Additionally, Kapiti had NZ$10 million in undrawn bank lines. Upcoming debt service requirements for the next 12 months include NZ$60 million of term debt maturities and NZ$15 million of interest costs. The council has prefunded all upcoming maturities for the next 12 months.

Access to the New Zealand Local Government Funding Agency (LGFA) provides Kapiti and other local New Zealand 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 Kapiti lengthen its maturity profile and reduce its interest costs.

We consider Kapiti's contingent liabilities to be small, mainly reflecting its exposure to natural disasters such as floods and earthquakes. The council is part of the Outer Wellington shared services syndicate with four other councils in the region and is jointly insured for above- and below-ground assets.

New Zealand's institutional framework could be weakening; robust local economy and strong financial management support creditworthiness.

The institutional framework within which New Zealand councils operate is a key factor supporting Kapiti'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 New Zealand local governments. Furthermore, the sector has elevated policy uncertainty. The Crown has tabled the first bill of its water reforms after repealing the previous government's reforms. Parliament could pass this bill soon and a second bill is due later this year.

If these trends continue, we could lower the institutional framework settings for local councils in New Zealand (see "New Zealand Councils' Extremely Predictable And Supportive Institutional Settings Are At Risk," published Feb. 18, 2024).

Higher interest rates have restricted spending and weighed on growth in New Zealand. We forecast real GDP growth will rise to 1.1% in 2024, after two consecutive quarters of contraction in the second half of 2023 (see "Economic Outlook Asia-Pacific Q3 2024: Exporters And EMs Are Outperforming," published June 24, 2024). Strong population growth will keep the economy growing, with record net migration. New Zealand's population grew 2.8% in 2023, the largest annual increase since 1946.

Kapiti's local economy supports its credit profile. The economy is benefiting from widespread hybrid working arrangements across New Zealand, and improved access to the Wellington central business district. The opening of the Transmission Gully Motorway in early 2022 and more affordable housing than Wellington make Kapiti an attractive location for Wellington-based workers. Average house prices in the district were NZ$830,000, according to Infometrics (a New Zealand economic consultancy), compared to NZ$1.05 million in Wellington city.

Kapiti's economy shrank by 1.0% in the year to March 31, 2024. This was as growing cost of living and higher interest rates weighed on economic activities. Meanwhile, total employment grew by 1.9%. The district had an unemployment rate of 2.9%, well below the national average.

The district had about 58,500 residents as of June 30, 2023. Prior to the pandemic, more than 10,000 of the residents commuted to Wellington for work each day. The district also has an older population than the nationwide average. About 26.9% of its residents are aged over 65, compared to the national average of 16.5%. Average household income in Kapiti was about 11% lower than the national average, according to Infometrics.

We consider Kapiti's management to be strong. 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 national requirements. This forward-looking approach to prudent financial management sets an important baseline for the council's operating and capex requirements, and funding strategy.

In our view, Kapiti has prudent liquidity policies. Preparing its prefunding strategy up to 18 months in advance of debt maturities minimizes refinancing risks. The council does not use debt to fund operating expenses, does not issue foreign-currency debt, and mostly hedges its interest exposure.

Key Statistics

Kapiti Coast District Council

(mil. NZ$)	Year ended June 30				
Selected Indicators	**2023**	**2024e**	**2025bc**	**2026bc**	**2027bc**
Operating revenues	98	117	128	138	148
Operating expenditures	84	99	96	100	104
Operating balance	14	18	32	38	44
Operating balance (% of operating revenues)	14.6	15.4	25.1	27.3	29.9
Capital revenues	19	11	14	17	17
Capital expenditures	64	74	75	76	78
Balance after capital accounts	(30)	(44)	(29)	(21)	(16)
Balance after capital accounts (% of total revenues)	(26.0)	(34.4)	(20.4)	(13.5)	(9.6)
Debt repaid	45	55	60	60	60
Gross borrowings	65	100	90	80	75
Balance after borrowings	(10)	1	1	(1)	(1)
Tax-supported debt (outstanding at year-end)	276	321	351	371	386

Kapiti Coast District Council (cont.)

(mil. NZ$)	Year ended June 30				
Selected Indicators	2023	2024e	2025bc	2026bc	2027bc
Tax-supported debt (% of consolidated operating revenues)	282.9	273.8	274.9	268.7	260.9
Interest (% of operating revenues)	9.4	11.1	11.7	11.4	11.1
National GDP per capita (single units)	76,370	77,578	80,116	82,945	85,949

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

Kapiti Coast District Council--Ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	2
Financial management	2
Budgetary performance	3
Liquidity	2
Debt burden	5
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 Q3 2024: Exporters And EMs Are Outperforming, June 24, 2024
- New Zealand Councils Will Lean Into Rising Credit Risk, May 6, 2024
- New Zealand Local Government Funding Agency Ltd. Ratings Affirmed; Outlook Stable, Feb. 27, 2024
- New Zealand Councils' 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
- 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	
Kapiti Coast District Council	
Issuer Credit Rating	AA/Negative/A-1+