

Research Update:

# Tasman District Council 'AA/A-1+' Ratings Affirmed; Outlook Remains Negative

October 28, 2021

## Overview

- Tasman District Council's capital expenditure program, which includes its participation in the large Waimea Community Dam joint venture, will lead to moderate after-capital-account deficits and a gradually rising debt burden during the next few years.
- The council's solid financial management, strong liquidity, and New Zealand's excellent institutional settings continue to support its ratings.
- We affirmed our 'AA/A-1+' issuer credit ratings on Tasman.
- The negative outlook reflects downside risks arising from Tasman's exposure to the dam project.

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## Rating Action

On Oct. 29, 2021, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on Tasman District Council, a New Zealand local government. The outlook on the long-term rating is negative.

## Outlook

The negative outlook reflects risks arising from Tasman's exposure to the Waimea Community Dam project, which is experiencing cost overruns, and the council's elevated capital expenditure (capex) program.

## Downside scenario

We could lower our ratings on Tasman during the next two years if its after-capital-account deficits are larger or more prolonged than we presently expect, and/or if liquidity coverage worsens. Downward pressure on the ratings could also emerge if off-balance sheet risks grow, affecting our view of financial management.

## **Upside scenario**

We could revise our outlook on Tasman to stable during the next two years if its budgetary performance were to progress broadly in line with, or better than, our forecasts and as risks associated with the Waimea Community Dam recede. This could also ease pressure on liquidity metrics.

## **Rationale**

We expect Tasman to post moderate after-capital-account deficits during the next few years. The council has expanded its infrastructure program, though this will be partly offset by above-average increases in property rates, which are its largest source of revenue. We have updated and extended our forecasts through fiscal year 2024 (the year ending June 30, 2024) following the release of the council's triennial 10-year long-term plan in June 2021.

Cost escalations and delays associated with the Waimea Community Dam present some risks, in our view, to Tasman's credit profile. Our 'AA/A-1+' ratings on Tasman continue to be supported by its solid financial management, strong liquidity, and New Zealand's excellent institutional settings.

Our base-case scenario excludes the potential effect of the "three waters" reforms proposed by the central government (the Crown). The reform program, as currently envisaged, could see responsibility for drinking water, wastewater, and stormwater assets taken away from councils and amalgamated into four new regional water service entities from mid-2024. The reforms are still under development.

## **Elevated capital investment and Waimea Community Dam costs lead to moderate deficits; liquidity still very strong**

We expect Tasman to incur moderate after-capital-account deficits, averaging about 9% of total revenues, during the five-year period between fiscals 2020 and 2024. Tasman's share of the activities of Waimea Water Ltd. (WWL), a majority-owned company that is responsible for constructing the Waimea Community Dam, is included in its cash flow statements using the accounting principle of proportional consolidation. Similarly, we factor WWL's activities into our base-case financial metrics, too. The total projected construction cost of the dam has risen to about NZ\$164 million, up from NZ\$129 million a year ago. Cost overruns will be shared between Tasman and its joint venture partner, Waimea Irrigators Ltd. (WIL). We see some risk of further cost escalations given current inflationary pressures and the project's complexity.

Tasman's annual capex should decline to NZ\$55 million-NZ\$60 million after the dam reaches completion around the second half of 2022. Meanwhile, the council's operating surpluses will remain very strong, averaging about 17% of operating revenues. The council has lifted its annual rate increases to 4%-4.4%, excluding growth in the ratepayer base, during the next three years. This follows a temporary freeze in rates during fiscal 2021, enacted in response to the COVID-19 pandemic.

We believe Tasman, like many of its domestic peers, has a high degree of fiscal flexibility. The council's largest single source of revenue is property rates, which can be easily adjusted and are relatively stable through economic cycles. Unlike international peers, New Zealand councils generally receive little by way of intergovernmental transfers.

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Tasman's gross debt has declined in the past year as it drew down on cash and term deposits to make repayments. We forecast the council's total tax-supported debt will gradually rise to about 160% of operating revenues by fiscal 2024. We expect interest expenses to average about 5.8% of operating revenues during fiscal years 2021-2023.

In our view, contingent liabilities present some risk to Tasman's credit metrics. The council has provided a guarantee of up to NZ\$29 million over a loan from Crown Irrigation Investments Ltd. (CIIL) to WIL; this loan will be gradually paid down by WIL over a term of 15 years. In addition, WWL itself is accruing debt and has received loans of about NZ\$18.2 million from CIIL and shareholder advances of NZ\$8.9 million from the council as of June 30, 2021. WWL has a facility arrangement in place to borrow up to a further NZ\$39 million from the council.

Tasman owns 50% stakes in two council-controlled trading organizations--Nelson Airport Ltd. and Port Nelson Ltd.--with Nelson City Council controlling the other 50% of each. We treat Tasman's share of the debts of these entities as contingent liabilities, though we believe the risk of materialization is small. The two councils are currently developing a plan to transfer their equity stakes into a new, jointly controlled holding company. Tasman is also one of 30 local authority shareholders and 65 guarantors of the New Zealand Local Government Funding Agency (LGFA). We consider the likelihood of this guarantee being activated to be remote.

Tasman's liquidity is very strong, though on our metrics this may decline if the council reduces its prefunding or posts larger deficits. We estimate that total free cash--inclusive of access to NZ\$31 million in undrawn committed facilities with ASB Bank Ltd. and Westpac Banking Corp.--is sufficient to cover about 121% of debt maturities and interest payments during the next 12 months. We expect Tasman's debt-servicing needs to comprise NZ\$15 million in LGFA loans maturing in April 2022, NZ\$27 million-NZ\$36 million in short-dated LGFA commercial paper, and about NZ\$8 million in annual interest expenses.

In addition to its internal liquidity, LGFA provides Tasman 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, and the agency has helped Tasman to both lengthen its maturity profile and reduce borrowing costs.

## **Economy recovering strongly from COVID-19 downturn; supportive institutional framework and solid management underpin creditworthiness**

The Tasman district, like most of New Zealand, emerged from a brief lockdown in August 2021. Since mid-2020, New Zealand has been relatively successful in suppressing COVID-19 across most parts of the country, allowing its economy to reopen sooner than many other advanced nations. We recently revised up our GDP growth projections for New Zealand to 5.4% for calendar-2021 (see "Economic Outlook Asia-Pacific Q4 2021: Growth Slows On COVID-19 And Rising China Uncertainty," published Sept. 27, 2021). In October 2021, the Reserve Bank of New Zealand lifted its policy rate for the first time in seven years, signaling the start of a tightening cycle.

Tasman's GDP per capita is about 25% lower than the national average of about US\$46,200. The largest industry by employment share (19.2%) is agriculture, forestry, and fishing. The district is somewhat susceptible to droughts and other climatic events, though the Waimea Community Dam should help to secure long-term water supply. Tasman has a population of about 56,400 as of end-June 2020. The local populace is aging, in part due to the region being an attractive retirement destination. While the Crown government is responsible for pensions and healthcare, an aging population could constrain the council's rate-setting decisions in the future.

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The institutional framework within which New Zealand councils operate is a key strength supporting Tasman's credit profile. The framework promotes a strong management culture, fiscal discipline, and high levels of disclosure among local councils. We note that because of a shortage of auditors, the Crown has passed legislation extending statutory reporting deadlines for fiscal years 2021 and 2022 to six months from year-end, instead of four months.

We consider Tasman's fiscal processes to be credible and well established, with the council preparing long-term plans every three years, annual plans in the intervening years, and audited annual reports, in line with New Zealand requirements. Internal policies set prudent limits on external borrowing, liquidity, and interest-rate risk. Tasman borrows only in local currency, in accordance with legislation. Like all New Zealand councils, Tasman is governed by an elected group of councilors, led by a mayor. Councilors delegate day-to-day management to a full-time chief executive. The next local elections are scheduled for October 2022.

## Key Statistics

Table 1

### Key Statistics

(mil. NZ\$)	--Year ended June 30--				
	2020	2021e	2022bc	2023bc	2024bc
<b>Selected indicators</b>					
Operating revenues	132	131	136	146	151
Operating expenditures	100	109	110	128	132
Operating balance	32	22	26	19	19
Operating balance (% of operating revenues)	24.2	16.5	19.1	12.9	12.8
Capital revenues	17	36	28	27	17
Capital expenditures	54	74	72	60	55
Balance after capital accounts	(5)	(17)	(18)	(14)	(19)
Balance after capital accounts (% of total revenues)	(3.3)	(10.3)	(11.1)	(7.8)	(11.3)
Debt repaid	35	66	15	25	20
Gross borrowings	86	28	38	39	39
Balance after borrowings	46	(55)	5	0	0
Tax-supported debt (outstanding at year-end)	224	186	209	223	242
Tax-supported debt (% of consolidated operating revenues)	169.5	142.1	153.4	152.2	159.8
Interest (% of operating revenues)	6.3	6.5	5.6	5.5	6.1
National GDP per capita (single units)	62,711	66,472	69,155	72,556	75,518

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 performance	3
Liquidity	1
Debt burden	5
Standalone credit profile	aa
Issuer credit rating	AA

Note: 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. An interactive version is available at <https://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

- Global Ratings List: International Public Finance Entities 2021, Oct. 13, 2021
- Institutional Framework Assessments For International Local And Regional Governments, Oct. 7, 2021
- Economic Outlook Asia-Pacific Q4 2021: Growth Slows On COVID-19 And Rising China Uncertainty, Sept. 27, 2021
- Default, Transition, and Recovery: 2020 Annual International Public Finance Default And Rating Transition Study, Sept. 15, 2021

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- Comparative Statistics: Asia-Pacific Local And Regional Government Risk Indicators, Sept. 1, 2021
- Non-U.S. Local Governments: To What Extent Did Sovereign Support Offset The Pandemic Dwindraft? July 19, 2021
- Local And Regional Governments Midyear Outlook 2021: Sovereign Support And Market Access Anchor Credit Quality, July 15, 2021
- New Zealand Councils' Infrastructure Spending Could Erode Rating Headroom, April 12, 2021
- Local Government Debt 2021: Infrastructure Needs Will Boost Borrowing In Developed Markets, March 25, 2021
- Local Government Debt 2021: Global Borrowing To Hit \$2.25 Trillion, March 25, 2021
- Public Finance System Overview: New Zealand's Institutional Framework For Local And Regional Governments, Oct. 28, 2020
- Ratings History List: Asia-Pacific Local And Regional Government Ratings Since 1975, May 29, 2020

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

#### Tasman District Council

Issuer Credit Rating AA/Negative/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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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