

Research Update:

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

October 29, 2024

## Overview

- Tasman District Council's deficits are wider than our previous expectations, amid rising costs of delivering council services and improved capital delivery. We expect after capital account deficits to average about 13.7% of total revenue over fiscal 2023-2027 (year-end June 30).
- Cost overruns for the Waimea Community Dam contributed to weaker budgetary outcomes and a steady rise in debt. Total tax-supported debt rose to 221% of operating revenues in fiscal 2024, from 117% in fiscal 2021. Moderating capital expenditure (capex) and increases in general rates should reduce after capital account deficits and stabilize the debt burden from fiscal 2025.
- We affirmed our 'AA' long-term and 'A-1+' short-term issuer credit ratings on Tasman.
- The negative outlook on the long-term rating reflects our view that liquidity coverage could weaken and debt could rise beyond our forecasts. It also reflects downward pressure on the institutional settings of New Zealand's local government sector.

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## Rating Action

On Oct. 30, 2024, 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 our view that Tasman's liquidity coverage could weaken and debt burden rise. It also reflects weakening institutional settings for New Zealand's local government sector.

## Downside scenario

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We could lower our ratings on Tasman if its financial outcomes are weaker than we forecast. This could lead to larger borrowing requirements, driving up the debt burden and weakening liquidity coverage.

We could also lower our ratings on Tasman if the New Zealand local government sector's overall commitment to strong finances continues to deteriorate, as indicated by large sector-wide 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.

### **Upside scenario**

We could revise our outlook on Tasman to stable if the council reduces its after capital account deficits, leading to a declining debt burden while liquidity coverage remains strong. At the same time, the overall commitment of the New Zealand local government sector to strong finances would need to improve.

### **Rationale**

Tasman's financial outcomes are weaker and its debt burden higher than our previous forecasts. Construction of the Waimea Community Dam is over. The total cost of construction was NZ\$208 million. This was NZ\$45 million higher than the council's estimates three years ago and more than double its original budget.

The cost escalations and a large land purchase contributed to the large deficits and are the key reasons fiscal outcomes have performed below our previous expectations. The dam project and improving capital delivery resulted in total tax supported debt nearly doubling over the past three years. Total tax supported debt was 221% of operating revenue in fiscal 2024.

Tasman will likely begin to rein in deficits and stabilize its debt burden from fiscal 2025. The council increased general rates by 11.1% in fiscal 2025, a deviation from its previous low increases. It will also reduce its capex somewhat after completing the dam.

We believe the risk of further cost escalation has receded, given that the dam has moved from the construction phase to the operational phase. While Tasman has some exposure to legal action for costs from the dam contractor, we do not believe the outcome of this action will materially weigh on the council's financial outcomes.

Robust liquidity supports the ratings and provides a buffer for potential short-term financial shocks. Meanwhile, strong financial management continues to support Tasman's credit profile. The district's economic profile tempers these strengths due to its aging population.

### **New Zealand local government's institutional settings are weakening; solid financial management underpin Tasman's creditworthiness.**

Our base case assumes Tasman will continue to deliver all water-related activities. In September 2024, the Crown passed the first of two planned pieces of legislation to implement its "Local Water Done Well" reforms. The reforms could give councils the option to shift drinking water, wastewater, and stormwater assets into new water utilities, which may be owned by one or more councils or consumer trusts. The second bill is to be introduced in December. The reforms could change the composition of Tasman's revenues, expenses, and debt, depending on their final form.

The institutional framework within which New Zealand councils operate is a key factor supporting

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Tasman's credit profile. We believe this framework is currently one of the strongest and most predictable globally. It promotes a robust management culture and high levels of transparency and disclosure.

However, rising infrastructure budgets and responsibilities are exerting pressure on the finances of New Zealand's local governments. Furthermore, the sector has elevated policy uncertainties.

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).

Economic conditions in New Zealand are soft. Real GDP fell 0.2% over the 12 months to June 2024 and contracted in four of the last eight quarters. The Reserve Bank of New Zealand recently began to loosen policy, for the first time in more than four years. It cut its policy rate by 25 basis points (bps) in August 2024 and a further 50 bps in October 2024. This should boost domestic spending power.

We forecast growth will pick up to 2.3% in 2025 (see "Economic Outlook Asia-Pacific Q4 2024: Central Banks To Remain Cautious Despite U.S. Rate Relief," published Sept. 23, 2024). The local economy is not immune to softer economic conditions. According to economics consultancy Infometrics, it contracted by 1.3% in the year to June 2024. The Tasman district is susceptible to droughts and other climate events, although the Waimea Community Dam should help it secure long-term water supply, in our view. The district's largest industries by employment share are agriculture, forestry, and fishing.

The local populace is aging, in part because the region is an attractive retirement destination. According to Infometrics, Tasman had a population of about 59,400 as of end-June 2023. Some 24% was aged 65 and over, higher than the national average of 15.7%. This could increase to 28% by 2034, according to economics consultancy Sense Partners.

While the Crown government is responsible for pensions and healthcare, an aging population could negatively influence Tasman's future rate-setting decisions. We consider Tasman's fiscal processes to be credible and well-established. Tasman prepares 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 most New Zealand councils, Tasman is governed by an elected group of councilors, led by a mayor. The council delegates day-to-day management to a full-time chief executive. A new chief executive, Ms. Leonie Rae, began in February 2024. She was previously chief operating officer and served as interim chief executive in 2023.

We believe Tasman prudently manages its strategic assets. Waimea Water Ltd. (WWL) manages the construction, operations, and maintenance of the Waimea Community Dam. As of June 30, 2024, the council controls 72% of WWL. The council includes its shares of WWL activities in its financial statements, using the accounting principle of proportional consolidation. We similarly factor WWL's activities into our base case.

Tasman also owns 50% of Infrastructure Holdings Ltd. (IHL). This is a council-controlled holding company for Nelson Airport Ltd. and Port Nelson Ltd. Nelson City Council controls the other 50%.

### **Large deficits are driving debt higher; liquidity remains strong.**

We believe Tasman will strengthen its cash operating margins. Larger increases in general property rates than in the past should buttress operating margins, beginning with an 11.1%

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increase in fiscal 2025.

We forecast operating surpluses will average about 16% of operating revenue over the next three years. General inflationary pressures, rising interest costs, and the mounting cost of insurance weighed on operating margins in fiscal 2023-2024.

Tasman has a large capex program. This drives up the council's after capital account deficits. A weaker operating position coupled with improved capital delivery underpinned a considerable deficit of about 24% of total revenue in fiscal 2024.

We expect Tasman's after capital account deficits to narrow to an average of about 9% of total revenue over the next three years. This is as operating margins strengthen and capex decreases following the completion of the Waimea Community Dam.

Our capex forecasts assume Tasman will deliver 90% of its capex budgets over fiscals 2025-2027. Greater capital execution is a focus for Tasman. In fiscal 2024, the council delivered NZ\$99 million, compared with NZ\$90 million outlined in the 2023-2024 annual plan. This included one-off land purchases totaling NZ\$17 million.

We believe the council's decision to hire additional project managers as well as easing material and labor shortages across the country will spur capital delivery. We consider Tasman, like many of its domestic peers, to have a high degree of fiscal flexibility. The council's largest single source of revenue is property tax, which the council can easily adjust. This revenue source is also quite stable through economic cycles. Unlike international peers, New Zealand councils generally receive little by way of intergovernmental transfers. The council can also defer non-essential capex to support budgetary outcomes.

Tasman's gross debt rose significantly over the past fiscal year. Tasman provided additional funding for the Waimea Community Dam, delivered record capex, and prefunded debt maturing in fiscal 2025. Total tax-supported debt jumped to 221% of operating revenues in fiscal 2024 from 170% in fiscal 2023.

However, with revenue increases and our expectation that capex will be less than fiscal 2024, we forecast total tax-supported debt will stabilize at around 197% of operating revenue by fiscal 2027. We estimate interest expenses will average about 7.8% of operating revenues over fiscal 2024-2026.

Contingent liabilities are receding with the completion of the Waimea Community Dam, in our view. Tasman has some potential exposure to a dispute brought by the dam contractor for additional costs. However, we believe any additional costs incurred will not materially weigh on the council's credit profile. The council would equally split any cost with the other shareholder, Waimea Irrigators Ltd.

Tasman has provided a guarantee of up to NZ\$29 million for a loan from Crown Irrigation Investments Ltd. (CIIL) to WWL. WWL will gradually pay down this loan over 15 years. We also treat Tasman's share of the debts in IHL as contingent liabilities, although we believe the risk of materialization is low. This is because of the shared ownership with Nelson City Council and because the airport and port are profitable and self-supporting.

Tasman has strong liquidity. We estimate the council has sufficient total free cash (including access to NZ\$50 million in undrawn committed facilities from ASB Bank Ltd. and Westpac Banking Corp.) less budget needs to cover about 102% of debt maturities and interest payments over the next 12 months. We believe liquidity coverage will improve as deficits and annual debt maturities decline from fiscal 2026 onward.

We expect Tasman's debt-servicing needs to comprise NZ\$64 million in Local Government

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Funding Agency (LGFA) loans due in April 2025, NZ\$15 million in short-dated LGFA commercial paper, and about NZ\$15 million in annual interest expenses. WWL will service about NZ\$33 million of the LGFA loans due in April 2025 through the council.

In addition to internal liquidity, LGFA in New Zealand 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 Crown support. The agency has helped councils to both lengthen their maturity profiles and reduce borrowing costs.

## Key Statistics

### Tasman District Council--Key statistics

(mil. NZ)	Year ended June 30				
	2023	2024e	2025bc	2026bc	2027bc
<b>Selected Indicators</b>					
Operating revenues	170	165	183	189	193
Operating expenditures	158	155	155	158	161
Operating balance	12	11	27	31	33
Operating balance (% of operating revenues)	7.3	6.4	14.9	16.3	16.8
Capital revenues	30	39	27	30	27
Capital expenditures	75	99	81	72	80
Balance after capital accounts	(33)	(50)	(28)	(11)	(20)
Balance after capital accounts (% of total revenues)	(16.7)	(24.4)	(13.2)	(5.2)	(9.0)
Debt repaid	49	89	84	41	52
Gross borrowings	97	165	70	51	70
Balance after borrowings	15	26	(42)	(1)	(2)
Tax-supported debt (outstanding at year-end)	289	366	351	362	380
Tax-supported debt (% of consolidated operating revenues)	169.6	221.3	192.3	191.2	196.7
Interest (% of operating revenues)	5.6	8.5	7.4	7.4	7.6
National GDP per capita (single units)	76,142	77,759	80,229	83,364	86,605

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

<b>Institutional Framework</b>	1
Economy	3
Financial management	2
Budgetary performance	3

<b>Institutional Framework</b>	1
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa
Issuer credit rating	AA

## 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 Q4 2024: Central Banks To Remain Cautious Despite U.S. Rate Relief, Sept. 24, 2024
- Comparative Statistics: Local And Regional Government Risk Indicators: Asia-Pacific Spending Appetite Erodes Creditworthiness, Sept. 19, 2024
- New Zealand Local Government Funding Agency Ltd. Ratings Affirmed; Outlook Stable, Sept. 9, 2024
- Default, Transition, and Recovery: 2023 Annual International Public Finance Default And Rating Transition Study, Aug. 21, 2024
- New Zealand's Water Infrastructure Reshuffle Could Alter Local Government Funding Agency's Lending Mix, Aug. 12, 2024
- Global LRGs Rating History List, June 18, 2024
- New Zealand Councils Will Lean Into Rising Credit Risk, May 6, 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

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

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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

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#### Tasman District Council

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Issuer Credit Rating AA/Negative/A-1+

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