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Research Update:

Greater Wellington Regional Council Outlook Revised To Positive After Similar Action On New Zealand; Ratings Affirmed

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Overview

- On Jan. 31, 2019, we revised the rating outlook on New Zealand to positive from stable.
- Consequently, we are revising our rating outlook on Greater Wellington Regional Council to positive from stable because the ratings on the council are constrained by the long-term foreign-currency rating on New Zealand.
- At the same time, we are affirming our 'AA/A-1+' ratings on the council.
- Although Greater Wellington's stand-alone credit profile is currently higher than New Zealand's, we believe the council could not withstand a default scenario better than the sovereign could, and that the council's credit metrics would deteriorate in line with those of the sovereign in the event of a distress scenario.

Rating Action

On Feb. 1, 2019, S&P Global Ratings revised its outlook on the long-term ratings on New Zealand's Greater Wellington Regional Council to positive from stable. At the same time, we affirmed our 'AA/A-1+' long- and short-term issuer credit ratings on Greater Wellington Regional Council.

Outlook

The positive outlook on Greater Wellington reflects that on the sovereign because the ratings on the council are constrained by the long-term foreign-currency rating on New Zealand. We could raise the ratings on Greater Wellington within the next two years should the same occur for New Zealand.

Downside scenario

We could revise the outlook on Greater Wellington to stable if we take a similar action on New Zealand, or if Greater Wellington's own creditworthiness deteriorates substantially from our current expectations. This could occur if the council were to change its policy direction in such a way that it weakened its financial position substantially and weakened our view of its financial management.

Rationale

The outlook revision reflects a similar action on the New Zealand sovereign (see "New Zealand Outlook Revised To Positive On Improving Fiscal Position; 'AA+' LC And 'AA' FC Ratings Affirmed," published Jan. 31, 2019). Although Greater Wellington has a standalone credit profile higher than the sovereign's, we cap our rating on Greater Wellington to that of the sovereign's because it does not meet the conditions to be rated above the sovereign in accordance with our criteria. We do not believe any New Zealand local council, including Greater Wellington, could maintain stronger credit characteristics than the sovereign in a stress scenario.

We expect Greater Wellington's budgetary performance to improve, with after-capital account surpluses during the next two years because of higher rates and user charges, and large post-earthquake insurance receipts. We expect the council to then incur a large deficit as it spends these insurance receipts on new infrastructure. This will result in the debt–to-revenue ratio temporarily falling during the next two years compared with historical levels. Our ratings reflect the country's supportive institutional settings and the council's wealthy economy, and strong financial management and liquidity coverage.

A supportive institutional framework, strong financial management, and wealthy economy support Greater Wellington's creditworthiness

We continue to cap our ratings on Greater Wellington at the level of our long-term foreign currency rating on New Zealand (AA/Positive/A-1+) because we believe the council could not withstand a default scenario better than the sovereign could, and that the council's credit metrics would deteriorate in line with those of the sovereign in the event of a distress scenario.

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

Greater Wellington's key credit strength is its experienced and stable financial management. Greater Wellington's finance team has demonstrated strong management capacity, including its execution and management of major infrastructure projects. Like all New Zealand councils, Greater Wellington published a triennial long-term plan in 2018, setting out its priorities for the years ending June 30, 2018 to 2028. The plan sets out four key strategic priorities: improving the quality of water, water supply infrastructure, building regional resilience, and improving public transport. The council is able to adopt budgets and long-term plans without delay, and it remains focused on being financially disciplined with its approach to borrowing and insurance policies.

We consider the council's debt and liquidity policies to be prudent. The council does not borrow in foreign currency, and interest exposure is mostly hedged. In managing liquidity, Greater Wellington undertakes long-term, monthly, and daily cash-flow forecasts.

We believe governance and oversight of its council-controlled trading organization are well managed. Greater Wellington's commercial assets are held under WRC Holdings Ltd., which is wholly owned by the council. WRC Holdings' main operating companies in the group are CentrePort Ltd. and Greater Wellington Rail Ltd. Each year, WRC Holdings Ltd. provides to Greater Wellington, as 100% shareholder, a Statement of Intent for the WRC Holdings Group.

Following on from the Kaikoura earthquakes in November 2016, CentrePort continues to receive insurance progress payments for the significant damage to infrastructure and commercial properties. The repair program is being funded through these insurance payments. CentrePort's short- to medium-term strategy will focus on restoring its pre-earthquake operational capacity and building resilience.

The region's wealthy and diversified economy supports our ratings on Greater Wellington. Greater Wellington has the second-largest economy in New Zealand, with economic activities ranging from public services, screen, digital and information and communication technologies, to food and tourism. Greater Wellington contributes about 14% of New Zealand's GDP and has more than 10% of New Zealand's population. The region's economic structure and performance are significantly stronger than the broader New Zealand economy.

We estimate Wellington's GDP per capita to average about US$48,500 from 2015 to 2017, with the region experiencing stable economic growth. Population growth of around 1.6% per annum continues to drive housing and construction demand. As the capital of New Zealand, Wellington is home to the nation's central government.

The region benefits from high household incomes and low unemployment. A significant proportion of the population works in the public sector, resulting in constituents who are highly educated and among the wealthiest in New Zealand.

Higher revenues leading to temporary improvement in budgetary performance and debt-to-revenue ratio before receding; liquidity remains strong

We expect Greater Wellington's budgetary performance and debt burden to improve during the next two years as a result of higher property rates and user charges as well as the insurance receipts following the 2016 earthquake.

Following this period, we expect the council to incur a large deficit as it spends these insurance proceeds on new infrastructure. Timing issues for insurance and grant receipts, and earthquake recovery capital works make the budgetary performance somewhat volatile.

Alongside increased property rates, fees, and charges, the 2018 implementation of the Public Transport Operating Model will result in user charges collected almost doubling in the 2019 fiscal year from the previous year, increasing the council's operating revenues. Greater Wellington now receives all public transport fare revenue. In addition to user charges and rates, operating revenue growth in 2018 has also benefited from other revenues like insurance. Based on these developments, we expect average operating surplus of 9% of operating revenues between 2017 and 2021.

In addition to higher operating revenues, insurance receipts and capital grants will result in after-capital surpluses of about 5% of total revenues during 2019 and 2020. We consider the improvement in these ratios will see a temporary reduction in forecast borrowing needs compared with the past until 2020 because Greater Wellington will incur a large after-capital account deficit in 2021 of about 26% of total revenues as it spends its insurance receipts on new infrastructure. We forecast average after-capital account deficit of 3% of total revenue between 2017 and 2021, slightly higher than our previous forecast of 1%.

Our assessment of Greater Wellington's debt burden captures the debt and revenues of its council-controlled trading organization, WRC Holdings Ltd., and its subsidiaries. Its after-capital account surpluses, lower WRC Holdings borrowings, and strong increases in operating revenues will reduce the council's total tax-supported debt-to-operating revenues to about 80% in 2019 from 104% in 2018. However, this improvement will be temporary, with the large 2021 deficits forecast to result in total tax-supported debt to operating revenues returning to levels similar to those achieved in 2018. We forecast interest expenses to remain above 5% of operating revenue between 2018 and 2020.

Greater Wellington's liquidity position remains strong. During fiscal 2019, at the consolidated group level, the council will have NZ$144 million of debt maturing and interest expenses of NZ$20 million, which will be more than covered by its cash holdings and available committed undrawn credit facilities of NZ$274 million. The facilities plus forecast unrestricted cash holdings during fiscal 2019 would give Greater Wellington a comfortable debt-servicing coverage ratio of 200%.

Supporting Greater Wellington's revenue flexibility is the council's unrestricted ability to set property rates, fees, and charges. Modifiable revenues remain stable at just about 57% of the council's consolidated revenues, which is lower than the majority of domestic peers' around New Zealand. This is a result of Greater Wellington's high dependence on government transfers and grants, and commercial revenues. Receipts from trading subsidiaries, which are a significant contributor to the council's annual budget, are not as certain and do not offer the flexibility that rates provide.

On the expenditure side, Greater Wellington's responsibilities are highlighted in its recently published long-term plan, which focuses on resilience and growth-related infrastructure projects. With the council's large infrastructure projects in the pipeline, we do not foresee any added budgetary flexibility. Key projects include the rebuild and strengthening of the CentrePort infrastructure, a cross-harbor water supply, flooding-prevention measures, and transport transformation program, "Let's Get Wellington Moving".

We forecast the council, including WRC Holdings, will spend about NZ$200 million per year, on average, on capital projects over the next three years. This is equivalent to about 30% of total expenditure between 2019 and 2021. In the past, Greater Wellington's capital expenditure was about NZ$60 million per year.

Similar to other rated New Zealand local governments, the council's contingent liabilities are small, and support its credit quality. While Greater Wellington's quantifiable contingent liabilities represent less than 2% of the council's operating revenues, the area is prone to natural disasters such as the 2016 earthquake. We consider that the impact of natural disasters on the council's credit profile is limited due to its comprehensive insurance policies, and that the Crown would likely provide extraordinary support to the region in the event of a natural disaster.

Key Statistics

Table 1

Key Statistics

	--Year ended June 30--					
(mil. NZ$)	**2016**	**2017**	**2018E**	**2019BC**	**2020BC**	**2021BC**
Selected Indicators						
Operating revenues	292	386	431	496	495	506
Operating expenditures	287	363	406	441	440	457
Operating balance	5	23	25	55	55	49
Operating balance (% of operating revenues)	1.7	5.8	5.8	11.1	11.1	9.6
Capital revenues	14	83	18	191	128	35
Capital expenditures	29	49	79	189	179	224
Balance after capital accounts	-10	56	-37	57	5	-140
Balance after capital accounts (% of total revenues)	-3.3	12.0	-8.2	8.3	0.8	-25.9
Debt repaid	2	66	18	101	5	(0)
Gross borrowings	109	13	52	44	0	140
Balance after borrowings	97	4	-3	0	0	0

Table 1

Key Statistics (cont.)						
	--Year ended June 30--					
(mil. NZ$)	2016	2017	2018E	2019BC	2020BC	2021BC
Modifiable revenues (% of operating revenues)	57.6	54.6	51.3	57.3	60.1	60.7
Capital expenditures (% of total expenditures)	9.2	11.9	16.4	30.1	28.9	32.9
Direct debt (outstanding at year-end)	470	413	450	393	396	538
Direct debt (% of operating revenues)	161.0	107.1	104.4	79.2	79.9	106.5
Tax-supported debt (outstanding at year-end)	470	413	450	393	396	538
Tax-supported debt (% of consolidated operating revenues)	161.0	107.1	104.4	79.2	79.9	106.5
Interest (% of operating revenues)	6.9	7.0	7.3	4.3	4.3	5.7
Local GDP per capita (single units)	67,394	69,280	0	0	0	0
National GDP per capita (single units)	55,201	57,419	59,396	61,623	63,821	66,757

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. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc—Upside case represents some but not all aspects of S&P Global Ratings’ scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful. E--Estimate. BC--Base case.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Average
Liquidity	Strong
Debt burden	High
Contingent liabilities	Low

S&P Global Ratings bases its ratings on local and regional governments on the 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 foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators. Interactive version available at http://www.spratings.com/sri
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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

- New Zealand Outlook Revised To Positive On Improving Fiscal Position; 'AA+' LC And 'AA' FC Ratings Affirmed, Jan. 31, 2019
- Public Finance System Overview: Australian States And Territories' Institutional Framework One Of The Strongest In The World, Nov. 12, 2018

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; CreditWatch/Outlook Action

	To	From
Greater Wellington Regional Council		
Issuer Credit Rating	AA/Positive/A-1+	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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.