

# Research

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## Summary:

# Auckland Council

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## Summary:

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**Credit****Rating:** AA/Stable/A-1+

This report supplements our summary analysis "Auckland Council," published on Nov. 10, 2013. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

## Rationale

The ratings on Auckland Council (Auckland) reflect our view of the predictable and supportive institutional framework available to local and regional councils within New Zealand. The ratings also incorporate Auckland's very strong economy and financial management, its strong budgetary flexibility and liquidity, and low contingent liabilities. Auckland's weak budgetary performance and very high debt burden partially offset these strengths.

We perceive the institutional framework within which New Zealand local governments operate as being one of the strongest and most predictable globally. The New Zealand local government system promotes a strong management culture and fiscal discipline among New Zealand councils. In our view, significant changes to this framework are unlikely over the medium term. This provides a source of credit strength for Auckland, and allows it to support higher debt burdens than some of its international peers can tolerate.

Auckland's economy is very strong and diverse with GDP per capita of about US\$43,700 between 2012 and 2014, compared to the national average of US\$38,600. Auckland is located on the north island of New Zealand and is home to more than 1.5 million residents. It is the financial center of New Zealand and the economy supports the ratings on the council. In our view, Auckland's economy is more diversified than the rest of New Zealand's, and represents the single largest regional economy in the country, accounting for more than one-third of national GDP. The economy has grown by 2.6% per year since 2012. Strong population growth fueling housing construction has largely supported this growth. Over the medium term, we expect population growth as well as the central government's housing supply targets to boost construction in the region.

Auckland's very strong financial management also supports the ratings and is one of the strongest in New Zealand. The size and importance of the council attract high-quality employees that can manage a complicated business and very high debt burden. There have been a number of changes in management with a new Chief Executive and Treasurer appointed this year, and the Chief Financial Officer recently vacating the position. We expect this new management team to successfully manage Auckland's financial position during this transition period and beyond. Auckland's debt and liquidity management policies are the most sophisticated in New Zealand. The council's financial management strength is also reflective of the system in New Zealand, which incorporates a culture of long-term capital and financial planning, transparency, and consultation.

Further supporting Auckland Council's fundamentals are its low level of contingent liabilities and strong budgetary flexibility. Auckland's capital expenditure is about 36.3% of total expenditure from 2013-2017, but we don't consider that Auckland has substantial flexibility to delay capital expenditure projects because it would exacerbate the region's infrastructure backlog. However, the council has a number of revenue measures that can be used to support its budgetary performance, given that about 83% of its revenues are modifiable between 2013 and 2017. The low amount of contingent liabilities also means that shocks to the council's operating position are likely to be limited. This is particularly important as the council's after-capital deficit is likely to remain very high over the medium term.

These very high after-capital deficits result in weak budgetary performance and rising debt levels that constrain the ratings on Auckland. We expect after-capital deficits to average about 19% of total revenues from 2013-2017, down from 29% of total revenues between 2011 and 2015. This improvement reflects the mayor's plan to cut Auckland's capital expenditure from 2016, which should decrease its after-capital account deficits to about 10% in 2016 and 2017. However, there is a risk that the mayor's proposed capital expenditure cuts may not fully materialize following the public consultation process. Addressing the region's significant infrastructure and maintenance backlog as well as strong population growth has fueled the need for additional infrastructure spending. These deficits offset Auckland's operating surpluses of 13.6% of operating revenues from 2013-2017.

This weak budgetary performance is pushing its total tax-supported debt higher. We forecast total tax-supported debt will reach about 260% of operating revenues in 2017, up from 196% in 2012. Auckland's interest expenses are also likely to be very high at about 13% of operating revenues between 2014 and 2016. A sharp improvement in budgetary performance and a significantly lower debt burden are unlikely over the medium term.

### **Liquidity**

Auckland's liquidity is strong. We project its debt-servicing ratio of free cash, liquid assets (after haircuts), and unutilized bank facilities over the next 12 months to be 141% of the council's next 12 month's debt and interest repayments.

We forecast Auckland to hold approximately NZ\$180 million in unrestricted cash, NZ\$654 million in bond and listed equities (after haircuts), and unutilized committed bank facilities totaling NZ\$1 billion over the next 12 months, to cover debt maturing within the next 12 months of NZ\$884 million and interest of NZ\$409 million.

In our view, Auckland's access to external liquidity is satisfactory. New Zealand's capital markets are comparatively liquid, but, given its small size, are not considered by Standard & Poor's as being particularly deep. This was highlighted during the severe market dislocation in 2008 and 2009, during which some New Zealand councils had difficulty issuing unrated commercial paper. Auckland Council's individual characteristics support its access to external liquidity. Given the size and predominance of the council, our expectation is that Auckland will continue to experience satisfactory access to capital markets.

## **Outlook**

The stable outlook reflects our expectation that Auckland's very strong financial management and economy, and its strong liquidity will mitigate weaknesses in its balance sheet and budgetary performance. Given the size of the

council's capital-expenditure program and its need to address an infrastructure and maintenance backlog, upward pressure on the ratings is unlikely over the next 24 months.

Downward rating pressure might arise if Auckland's debt increases to more than 270% of operating revenues as the council borrows to invest in infrastructure or if its operating position weakens because of lower-than-expected revenue. This would reflect further deterioration in Auckland's budgetary performance with sustained after-capital account deficits of about 23% of total revenues.

## **Related Criteria And Research**

### **Related Criteria**

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

### **Related Research**

- Public Finance System Overview: New Zealand's Reforms Are Likely To Strengthen Councils' Governance, Nov. 26, 2013
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

This report supplements our summary analysis "MACROBUTTON ArticleId\_6310080\_4\_0491928S.000\_000004 Auckland Council," published on Nov. 10, 2013. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

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