S&P Global
Ratings

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Research Update:

Greater Wellington Regional Council Outlook Revised To Negative As Financial Metrics Weaken And Sectorwide Debt Rises

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PRIMARY CREDIT ANALYST

Deriek Pijls
Melbourne
+61 396312066
deriek.pijls
@spglobal.com

SECONDARY CONTACT

Anthony Walker
Melbourne
+ 61 3 9631 2019
anthony.walker
@spglobal.com

ADDITIONAL CONTACT

Frank Dunne
Melbourne
+61 396312041
frank.dunne
@spglobal.com

Overview

- Greater Wellington Regional Council's operating margins will weaken to less than 3% of operating revenues over the next three years. Large property rate increases will not fully cover inflationary pressures, and rising interest expenses and capital expenditure (capex).
- The weakening institutional settings of the sector are also putting downward pressure on our ratings on Greater Wellington.
- Consequently, we revised our long-term rating outlook on Greater Wellington to negative from stable. At the same time, we affirmed our 'AA+/A-1+' long-and short-term issuer credit ratings on the council.
- Excellent financial management and strong liquidity coverage continue to underpin our ratings on Greater Wellington.

Rating Action

On Feb. 19, 2024, S&P Global Ratings revised its long-term rating outlook on Greater Wellington Regional Council, a New Zealand local government, to negative from stable. At the same time, we affirmed our 'AA+/A-1+' long- and short-term issuer credit ratings on the council.

Outlook

The negative outlook reflects downward pressure on the institutional settings for New Zealand's local government sector. It also reflects our view that Greater Wellington's budgetary metrics may underperform our expectations over the next two years.

Downside scenario

We could lower our ratings on Greater Wellington if the New Zealand 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 capital expenditure, or changes in central government policy that undermine the financial outcomes of the sector.

We could also lower our ratings on Greater Wellington if we see a further weakening in the council's budgetary metrics. This could occur if the council backed away from planned increases in rates revenue, or increased its expenditures more than we forecast. This may also lead us to reassess our view of the council's financial management.

Upside scenario

We could revise our rating outlook on Greater Wellington to stable if the New Zealand local government sector's overall commitment to strong finances improves.

We could also revise our outlook on Greater Wellington to stable if the council's budgetary outcomes significantly improve. Higher operating margins and smaller after-capital account deficits could indicate this.

Rationale

Greater Wellington will incur sizable after capital account deficits as it rolls out its record large capital program. We expect capex to average about NZ$250 million over the next three years. This is about NZ$100 million higher than the preceding period. The weakening of Greater Wellington's fiscal metrics mirrors that of New Zealand's local council sector more broadly. Capital budgets are growing and budgetary metrics are weakening, driving up debt levels in a system that is already more highly leveraged than international peers.

Greater Wellington's operating expenses are growing rapidly, weakening its operating position despite large, proposed property rate increases. Operating expenses grew about 23% in fiscal 2023 (year ended June 30), reflecting inflationary pressures and higher interest expenses. While large increases in revenues derived from property rates may help ease pressures on budgetary metrics, we believe revenue will struggle to keep pace with cost escalations. We now forecast operating margins to average about 2.3% of operating revenues during fiscals 2022-2026, about half of our previous forecasts.

Liquidity remains exceptional and provides a buffer to cover potential short-term financial shocks. Greater Wellington's wealthy economic profile and strong financial management support the ratings. We have updated our analysis for the council following the release of its 2023-2024 annual plan and 2022-2023 annual report.

Our base case includes the council continuing to deliver all water-related activities. The Crown has promised to repeal the existing "Affordable Water Reform" legislation by Feb. 23, 2024 and introduce new legislation by mid-2025. We are awaiting further information on the new government's policies, which will likely involve restoring council control and ownership of water assets, coupled with other reforms of its own.

Weaker operating margins and higher capex drive large after capital account deficits; prefunding and large bank facilities support liquidity.

Greater Wellington's operating margins are weaker than we previously forecast. We project operating surpluses will average about 1.8% during fiscals 2024-2026; down from our previous forecasts of about 4.9% for fiscals 2023-2025. Greater Wellington's operating margins are generally lower than those of domestic peers, reflecting the council's activities as a regional council, and they generally carry lower operating margins than the activities of territorial authority peers. Nevertheless, operating margins have historically been greater than 5% of operating revenues under our metrics, on a five-year rolling average basis.

Rapid growth in operating expenses is outstripping growth in operating revenues. The main drivers of operating expenses relate to rising costs of delivering council services, higher interest costs, rising insurance premiums, and a lift in bus driver wages. To counter some of this, Greater Wellington has been increasing general property rates and user charges. In fiscal 2024, the council raised regional rates by 16.9% and the water supply levy by 26.3%; these increases are at the higher end of domestic peers. These rates account for nearly 40% of the Greater Wellington operating revenues.

Furthermore, Greater Wellington has benefited from additional funding from Waka Kotahi (New Zealand Transport Agency), and Crown government subsidies to support decreased farebox revenue from lower public transport patronage in recent years. The cessation of this support poses a downside risk to budgetary metrics.

Greater Wellington and its wholly owned subsidiary, WRC Holdings Ltd., are ramping up capital spending, which will lead to larger after capital account deficits, in our assessment. WRC Holdings is the holding company for all of the council's controlled trading organizations. We expect deficits for the group to average about 20% of total revenues over the next three years. Our forecasts incorporate a 20%-30% haircut compared with the council's forecasts, reflecting historical underspending and continued capacity constraints. The core council delivered NZ$129 million of capex, compared with NZ$159 million budgeted, during fiscal 2023.

Major projects include improvements to the bulk water supply network, flood resilience, and urban development works along the Hutt River as part of the Riverlink project. The council is also aiming to decarbonize the bus fleet and deliver new hybrid trains and rail upgrades as part of the Lower North Island Rail Integrated Mobility (LNIRIM) project. LNIRIM accounts for nearly 30% of Greater Wellington's capex for fiscals 2025 and 2026 and we assumed 90% of funding for the project will come from the Crown government. The project will be delivered through Greater Wellington Rail Ltd., a wholly owned subsidiary of WRC Holdings.

We believe Greater Wellington has strong flexibility to adjust its budget compared with global peers. Rates revenue increases over the last two years have been higher than most New Zealand councils: 13.0% and 12.3% in fiscals 2022 and 2023, respectively. In dollar terms, Greater Wellington's rates are also lower than those at many local governments in New Zealand. As such, rates increases are not as burdensome on local ratepayers. Greater Wellington could also slow down its large capital program or sell some of its commercial assets to support budgetary outcomes. We expect the council to display its flexibility in the upcoming long-term plan due this year by raising rates to counter growth in its operating and capital budgets.

The large capital program and deteriorating operating margins will increase Greater Wellington's debt. We forecast total tax-supported debt could reach about 176% of operating revenue in 2026, up from 153% in 2022. While we forecast total tax-supported debt will increase to NZ$1.42 billion from NZ$762 million during the same period, growth in operating revenue will likely help stabilize the debt burden. We expect interest expenses to average about 5.5% of operating revenues during fiscals 2023-2025.

Our measure of total tax-supported debt includes our estimate for the net present value of the council's administration building lease, and the borrowings of WRC Holdings and its subsidiaries.

Greater Wellington has low contingent liabilities, including potential out-of-pocket costs of natural disasters. This is because of the council's comprehensive insurance policies and potential support from the central government.

We expect Greater Wellington's liquidity position to remain sound over the next two years. The debt-service coverage ratio, including bank lines and contracted funding, stands at 156% of upcoming debt service. We estimate the council has about NZ$303 million in cash and term deposits, and NZ$120 million of undrawn bank lines to cover NZ$50 million of debt repayments and NZ$41 million in interest costs during fiscal 2024, and NZ$145 million in short-dated commercial paper. The council's liquidity is supported by its prefunding strategy that allows it to prefund long-term debt maturities up to 18 months in advance.

In addition to internal liquidity, New Zealand's Local Government Funding Agency (LGFA) provides Greater Wellington with strong access to a well-established source of external liquidity. In our view, LGFA benefits from an extremely high likelihood of extraordinary Crown government support. The agency has helped councils to both lengthen their maturity profiles and reduce borrowing costs.

New Zealand's institutional framework may be weakening; Wealthy local economy and experienced financial management support rating

The institutional framework within which New Zealand councils operate is a key factor supporting Greater Wellington'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's local governments sector. If the trend continues, we could lower the institutional framework settings for local councils in New Zealand. Further, policy uncertainty is elevated.

Higher interest rates to combat broad-based inflation has restricted spending and weighed on growth in New Zealand. With inflationary pressures easing, we forecast growth will pick up to 1.4% in calendar 2024 (see "Economic Outlook Asia-Pacific Q1 2024: Emerging Markets Lead The Way," published Nov. 26, 2023). In the face of economic headwinds, strong population growth has propelled economic growth. Net migration is at record levels; the New Zealand population grew 2.7% in the year to September 2023, its largest annual increase in over 60 years.

The Greater Wellington economy is service-oriented with a highly educated population. The district is home to the country's capital, Wellington, which has a growing public service as well as a large financial and insurance sector. According to economics consultancy Infometrics, the region had a total population of about 550,000 as of June 30, 2023, with some 40% of residents located in Wellington city. The region accounts for about 13% of New Zealand's GDP.

The region's economic fundamentals are solid. According to Infometrics, Greater Wellington had a GDP per capita of NZ$91,000 in March 2023, well above the national average of NZ$72,000 at the time. Similarly, mean household income was about NZ$141,000, about NZ$14,000 higher than the national average.

We assess Greater Wellington's financial management to be very strong in a global context. The council has a track record of increasing modifiable revenues, such as general rates and other fees and charges, to keep pace with fiscal needs. Strong revenue growth from modifiable revenue sources demonstrates this. Given the inflationary operating environment and the council's hefty capital program, utilizing these levers has cushioned fiscal buffers from further erosion.

Greater Wellington is governed by a chairperson and an elected group of councilors. The council's financial management processes are credible and well-established. It prepares 10-year long-term plans every three years, annual plans in the intervening years, and audited annual reports, in line with sector-wide requirements. Greater Wellington's treasury risk-management policy sets limits on external borrowing, liquidity, and interest-rate risks. The council can borrow only in local currency, in accordance with legislation.

We believe Greater Wellington manages governance and oversight of its council-controlled organizations well. The council holds its commercial assets in WRC Holdings, which it wholly owns. WRC Holdings' main operating companies in the group are CentrePort Ltd. and Greater Wellington Rail Ltd.

Key Statistics

Table 1

Selected indicators

	--Fiscal year ended June 30--				
(NZ$ mil.)	2022	2023	2024bc	2025bc	2026bc
Operating revenues	497	633	681	753	807
Operating expenditures	493	599	667	748	785
Operating balance	4	34	14	6	21
Operating balance (% of operating revenues)	0.9	5.4	2.1	0.7	2.6
Capital revenues	13	24	22	105	96
Capital expenditures	145	195	198	276	277
Balance after capital accounts	(127)	(137)	(162)	(165)	(159)
Balance after capital accounts (% of total revenues)	(24.9)	(20.9)	(23.0)	(19.2)	(17.6)
Debt repaid	25	30	50	96	50
Gross borrowings	135	168	288	166	240
Balance after borrowings	(17)	1	77	(95)	31
Tax-supported debt (outstanding at year-end)	762	923	1,162	1,232	1,421
Tax-supported debt (% of consolidated operating revenues)	153.3	145.8	170.6	163.5	176.2
Interest (% of operating revenues)	4.4	4.9	6.0	5.8	6.3
National GDP per capita (single units)	71,076	76,478	77,402	79,934	83,095

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

Greater Wellington Regional Council--Ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	4
Liquidity	1
Debt burden	4
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

- New Zealand Councils' Extremely Predictable and Supportive Institutional Settings Are At Risk, Feb. 19, 2024
- Various Rating Actions Taken On New Zealand Local Councils On Weakening Institutional Framework Trend, Feb. 19, 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

- Economic Outlook Asia-Pacific Q1 2024: Emerging Markets Lead The Way, Nov. 26, 2023
- New Zealand Local Government Outlook 2024: Bridge Over Troubled Waters, Nov. 19, 2023
- Comparative Statistics: Local And Regional Government Risk Indicators: Asia-Pacific LRGs' Persisting Appetite To Spend Weighs On Creditworthiness, Sept. 20, 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
- Institutional Framework Assessment: New Zealand Local Governments, May 16, 2023
- New Zealand Local Government Funding Agency, March 1, 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; Outlook Action

	To	From
Greater Wellington Regional Council		
Issuer Credit Rating	AA+/Negative/A-1+	AA+/Stable/A-1+