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Subject: Final response - LGOIMA 427844 - [REDACTED] - Recent Credit Rating
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[image002.jpg](#)
[image003.jpg](#)
[RatingsDirect_ResearchUpdateHamiltonCityCouncilDowngradedToAA1OnWeakeningFinancialManagementAndLargeDeficitsOutlookNegative_59309745_Sep-06-2024.PDF](#)

Kia ora,

We refer to your information request below. Hamilton City Council provides the following response.

Your request:

Please provide the full credit rating or the link to this document.

Our response:

Please see the attached report from S&P Global.

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

Ngaa mihi

Keeley Faulkner

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From: [REDACTED]
Sent: Friday, September 20, 2024 3:39 PM
To: Official Information <officialinformation@hcc.govt.nz>
Subject: HCC/ Standards & Poor/ Recent Credit Rating

Good afternoon, Please provide the full credit rating or the link to this document. Thanks

Kind Regards

[REDACTED]
AREINZ

Director

[REDACTED]
PO Box 22 Hamilton NZ

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Research Update:

Hamilton City Council Downgraded To 'A+/A-1' On Weakening Financial Management And Large Deficits; Outlook Negative

September 5, 2024

Overview

- Hamilton City Council's financial outcomes are very weak. Its large capital expenditure (capex) pipeline means after capital account deficits will be much weaker than that of 'AA-' rated peers, at more than 25% of total revenue. This will push up debt to more than 300% of operating revenue for the New Zealand council.
- We believe Hamilton's financial management has weakened, as seen in the fiscal outlook and recent outcomes. Its after capital account deficit for fiscal 2024 was one of the largest in the world, and the council's debt and interest costs are rising rapidly.
- We lowered our long-term issuer credit rating on Hamilton to 'A+' from 'AA-', and the short-term issuer credit rating to 'A-1' from 'A-1+'.
- The negative outlook on the long-term rating reflects the weakening institutional settings in New Zealand's local government sector.

Rating Action

On Sept. 6, 2024, S&P Global Ratings lowered its long-term issuer credit rating on Hamilton City Council, a New Zealand local government, to 'A+' from 'AA-', and the short-term issuer credit rating to 'A-1' from 'A-1+'. The outlook on the long-term rating is negative.

Outlook

The negative outlook reflects the downward pressure on the institutional settings for New Zealand's local government sector.

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Downside scenario

We could lower our ratings on Hamilton if the 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 emerge due to 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 Hamilton to stable if the New Zealand local government sector's overall commitment to strong finances improves.

Alternatively, we could revise the outlook to stable if we believe Hamilton's financial management is strengthening, which would result in materially lower after capital account deficits and an easing debt and interest burden.

Rationale

We have lowered our ratings on Hamilton because the financial outlook is--and recent outcomes have been--much weaker than we previously expected. We believe this reflects a deterioration in financial management. We estimate the council's after capital account deficit will be much higher than peers', at about 36% of total revenue, over fiscals 2023-2027. Further adding to credit risk is the more than tripling of interest costs over the past three years.

We estimate Hamilton will deliver one of the largest deficits in the world in fiscal 2025, at 44% of total revenue. This is after accounting for historically large general property rate increases, savings initiatives, and deferrals of capex. This follows an exceptionally large deficit of more than 50% of total revenue in fiscal 2024. The deficit in fiscal 2024 was one of the highest in the New Zealand council sector, which has lagged all other local government systems that S&P Global Ratings rates across the world.

Hamilton adopted its 2024-2034 Long-Term Plan in July 2024, continuing its focus on investing in key infrastructure to address the needs of its fast-growing population.

The institutional framework within which New Zealand councils operate and Hamilton's economic profile are key factors supporting the rating. Hamilton was the fastest growing area in New Zealand in fiscal 2023. It has seen rapid growth for the past decade. Further, we expect the council's liquidity coverage to remain robust during a period of elevated spending.

Our base case assumes Hamilton will continue to deliver all water-related activities. In August 2024, the New Zealand central government (the Crown) passed the first of two planned pieces of legislation to implement its "Local Water Done Well" reforms. These reforms could give councils the option to shift water assets into new regional water utilities. The second piece of legislation is due by December 2024.

Hamilton's financial management has weakened, as could New Zealand's institutional framework; the council's very strong economic growth prospects support the rating.

We believe Hamilton's financial management has weakened. The council has delivered exceptionally weak financial outcomes over the past two years as it seeks to address growth pressures and some infrastructure backlogs. This will see debt triple between fiscals 2021 and 2027 despite the announcement of historically large rate increases, savings targets, and capex deferrals. We believe the low rate increase in fiscal 2024 undermined financial outcomes during a period of high inflation and major capex pressures.

Moreover, the council's savings targets, while positive in a financial sense, may bring additional challenges. Savings measures include a reduction in headcount, just a year after the council reduced its headcount by about 100 or about 12.5%. Any reduction could lead to increased turnover, loss of corporate knowledge in key areas, and potentially create capacity pressures within the council.

We consider Hamilton's budgets to be credible and processes to be well established. The council prepares 10-year long-term plans every three years, and annual plans in the intervening years, in line with New Zealand requirements.

The council's treasury management policy sets limits on borrowing, liquidity, and interest-rate risk. That said, Hamilton's modest level of interest rate hedging and rapid increase in borrowing has seen its interest costs spike as global interest rates rose rapidly over the past two years. The council only borrows in local currency, in accordance with legislation.

The institutional framework within which New Zealand councils operate is a key factor supporting Hamilton's credit profile. We believe this framework is 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 local governments. Furthermore, the sector has elevated policy uncertainty. The Crown has passed the first bill of its water reforms after repealing the previous government's reforms. A second bill is due in December 2024. 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 on RatingsDirect on Feb. 18, 2024).

We believe Hamilton's long-term economic and growth prospects are very strong. Hamilton's economic profile is a key factor supporting the rating because it should drive revenue generation to fund the council's high debt burden.

The commencement of rate cuts by the Reserve Bank of New Zealand in August 2024, should support the economy over the next year. High interest rates this year have restricted spending and weighed on growth across New Zealand. According to provisional estimates by economic consultancy Infometrics, the local Hamilton economy contracted by 0.1% in fiscal 2024. Hamilton's labor market indicators remained subdued, with a high unemployment rate of 6.3% during the period (compared with 4.2% nationally). Meanwhile, employment growth remained robust at 2.8% during the same period.

Hamilton's economy is supported by a diverse range of industries. It is also one of New Zealand's fastest growing urban areas. The council's population growth peaked at more than 3% in fiscal 2023. It has recorded average yearly population growth of 2.1% per year over the past 10 years, compared with 1.6% nationally. Strong population growth will add to the knowledge-intensive labor force and benefit the local economy. The population is among the youngest of New Zealand's territorial authorities--79% of the population is below 55 years, compared with 71% nationally. Further, we believe large ongoing greenfield projects such as Peacocke and Rotokauri will contribute to the city's economic growth and help meet residential housing demand.

Significant growth-related capex will ensure deficits remain very large; liquidity should cover rapidly rising interest costs and debt.

Hamilton's financial position is very weak compared to that of its peers. We estimate the council will deliver some of the largest after capital account deficits in the world in fiscals 2024 and 2025. As a high-growth council, Hamilton is borrowing heavily to invest in critical infrastructure to address growth pressures, particularly greenfield projects for private housing development.

We estimate Hamilton's after capital account deficits will average 36% of total revenue between fiscals 2023 and 2027. We expect capex of about NZ\$340 million per year across fiscals 2025 to 2027. Nearly one-third of the capital program in fiscal 2025 is related to the Peacocke and Rotokauri greenfield developments. This includes building wastewater capacity, water treatment plant upgrades, and transport and road projects (such as the Waikato River Bridge), connecting Peacocke to the rest of the city. Once complete, Peacocke will provide housing for up to 20,000 residents.

The council almost fully delivered its NZ\$348 million capital budget outlined in the 2023-2024 annual plan. This, combined with a small rate increase, rising interest costs, and general inflationary pressures resulted in a hefty after capital account deficit of 50% of total revenue in fiscal 2024.

Crown grants and subsidies only partially fund Hamilton's large capex. The council received NZ\$150 million in grant funding from the Crown's Infrastructure Acceleration Fund to support brownfield developments within the city center.

We forecast Hamilton will deliver operating surpluses of about 20% of operating revenue in fiscals 2026 and 2027. This is better than the 11% we estimate in fiscals 2024 and 2025 as the council promises to contain operating expenses (by implementing savings) and maintain large general property rate increases over the next four to five years.

Given our expectations of large deficits, we forecast Hamilton's total tax-supported debt will be about 320% of operating revenue in fiscal 2027, up from 195% in fiscal 2021. Debt will roughly triple to NZ\$1.6 billion in fiscal 2027 from NZ\$530 million in fiscal 2021. Included in tax-supported debt are borrowings from the New Zealand Local Government Funding Agency (LGFA), commercial papers, and borrowings from the Crown's Housing Infrastructure Fund. Hamilton has fully drawn NZ\$180 million from this facility to support the Peacocke development. Drawdowns are interest-free for 10 years. The council has negotiated with the Ministry of Business Innovation and Employment to defer NZ\$16.4 million of loan payments originally scheduled for June 2023 to July 2027. Given the intergovernmental and concessional nature of the loan we do not consider this a restructuring or default under our methodology.

Hamilton's interest expenses have risen rapidly and are very high as a proportion of operating revenues. We estimate interest expenses will average about 14% of operating revenue between 2024 and 2026, up from less than 5% in 2021.

Hamilton's debt-service coverage ratio, which includes interest costs and principal payments, has remained stable, supported by its cash holdings, funding undertaken this fiscal year, and undrawn facilities. The council has total free cash and undrawn facilities after budget needs sufficient to cover about 107% of debt service needs during the next 12 months.

Further, we consider that access to the LGFA provides Hamilton and most of its New Zealand peers with strong access to a well-established source of external liquidity. In our view, the LGFA benefits from an extremely high likelihood of extraordinary central government support and has

helped Hamilton lengthen its maturity profile and reduce interest expenses.

We consider Hamilton's contingent liabilities to be very small, with little uninsured exposure to natural disasters or to off-balance sheet council-controlled organizations. The council is part of the Waikato Local Authority Shared Services syndicate with 11 other councils in the region and is jointly insured for above- and below-ground assets.

Key Statistics

Hamilton City Council--Selected Indicators

(Mil. NZ\$)	2023	2024e	2025bc	2026bc	2027bc
Operating revenues	327	359	382	440	504
Operating expenditures	278	317	341	360	393
Operating balance	49	43	41	80	111
Operating balance (% of operating revenues)	15.0	11.8	10.8	18.1	22.0
Capital revenues	106	85	86	99	108
Capital expenditures	309	353	334	317	371
Balance after capital accounts	(154)	(225)	(208)	(138)	(152)
Balance after capital accounts (% of total revenues)	(35.7)	(50.5)	(44.4)	(25.6)	(24.8)
Debt repaid	70	95	85	115	140
Gross borrowings	314	300	296	256	290
Balance after borrowings	89	(20)	3	3	(2)
Tax-supported debt (outstanding at year-end)	925	1,108	1,319	1,460	1,610
Tax-supported debt (% of consolidated operating revenues)	282.7	308.2	345.6	332.1	319.7
Interest (% of operating revenues)	10.5	14.7	13.9	12.8	12.4
National GDP per capita (single units)	76,370	77,578	80,116	82,945	85,949

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

Hamilton City Council--Key rating factors

	To
Institutional framework	1
Economy	1
Financial management	3
Budgetary performance	4
Liquidity	2

Hamilton City Council--Key rating factors

	To
Debt burden	5
Stand-alone credit profile	a+
ssuer credit rating	A+

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 <http://www.spratings.com/sri>

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Other governance factors

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

- 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
- Economic Outlook Asia-Pacific Q3 2024: Exporters And EMs Are Outperforming, June 24, 2024
- Global LRGs Rating History List, June 18, 2024
- New Zealand Councils Will Lean Into Rising Credit Risk, May 6, 2024
- New Zealand Local Government Funding Agency Ltd. Ratings Affirmed; Outlook Stable, Feb. 27, 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 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

Downgraded

	To	From
Hamilton City Council		
ssuer Credit Rating	A+/Negative/A-1	AA-/Negative/A-1+

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