S&P Global
Ratings

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Research Update:

Marlborough District Council 'AA/A-1+' Ratings Affirmed; Outlook Positive

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Overview

- Marlborough District Council's robust financial management and relatively low debt burden continue to support its ratings.
- The COVID-19 economic shock has had only a minor effect on Marlborough's finances, though we expect elevated capital spending to lead to modest after-capital-account deficits during the next few years.
- We are affirming our 'AA' long-term and 'A-1+' short-term issuer credit ratings on Marlborough.
- The outlook remains positive, reflecting that on the New Zealand sovereign.

Rating Action

On Nov. 30, 2020, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on Marlborough District Council, a New Zealand local government. The outlook on the long-term ratings remains positive.

Outlook

The positive outlook reflects that on the New Zealand sovereign. This is because our ratings on Marlborough are constrained by our long-term foreign-currency rating on the sovereign.

Upside scenario

We could raise our ratings on Marlborough within the next two years if we were to do the same for New Zealand, all other factors being equal.

Downside scenario

We would revise our outlook on Marlborough to stable if we were to take similar action on New

Zealand or if Marlborough's own creditworthiness were to deteriorate relative to our current expectations.

The latter could occur if Marlborough's after-capital-account deficits widen significantly or are more prolonged than we forecast, resulting in a sharp rise in debt, or if debt-service coverage weakens. Such developments might also cause us to reassess our view of Marlborough's financial management.

Rationale

New Zealand has been successful in containing the spread of the coronavirus, allowing normal economic activity to resume sooner than in other advanced countries. We have updated and extended our forecasts for Marlborough through fiscal 2023 (i.e., the year ending June 30, 2023). We expect the council to post modest after-capital-account deficits during the next few years, though its debt burden will remain low relative to its peers. Marlborough's robust financial management and the country's excellent institutional settings underpin the ratings.

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

Robust financial management and New Zealand's institutional framework support Marlborough's creditworthiness; economy recuperating from COVID-19 shock

New Zealand's economy is recovering from a COVID-19-induced recession. The country has reverted to "Alert Level 1," under which social distancing restrictions have been removed and councils have resumed normal services. This follows its success in eliminating community transmission of the coronavirus. National GDP contracted 12.2% quarter on quarter in June 2020, which is large in a historical context but comparable to the average for Organization for Economic Cooperation and Development (OECD) advanced economies. We believe the recovery will be supported by substantial Crown government stimulus and highly accommodative monetary policy. However, the continued closure of international borders will weigh on tourism.

We expect Marlborough's local economy to continue to perform soundly. The district's GDP per capita is a little higher than the national average of US$38,800. Marlborough produces about 80% of New Zealand's total wine output, and its economy is somewhat concentrated in agriculture, viticulture, and associated manufacturing industries. This exposes the district to some risk of economic volatility, in our view. Marlborough's population stands at about 50,200. The district has the highest proportion of elderly people in New Zealand, with about 23% of the local population aged over 65. We believe these demographics could put pressure on the council's ability to raise revenues over the longer term.

Marlborough's fiscal processes are credible and well established, with the council preparing 10-year long-term plans every three years, annual plans in the intervening years, and audited annual reports, in line with New Zealand requirements. The council's treasury management policies set prudent limits on external borrowing and interest rate risk, and all borrowing is in local currency. Like all New Zealand councils, Marlborough is governed by an elected group of councilors, led by a mayor. Councilors delegate day-to-day management to a full-time chief executive.

The council owns 100% of Marlborough District Council Holdings Ltd. (MDCHL), which in turn is the sole owner of Port Marlborough New Zealand Ltd. and Marlborough Airport Ltd. The council also provides NZ$70 million of uncalled capital to MDCHL. Our analysis is based on the consolidated financials of the entire group.

The institutional framework within which New Zealand local governments operate is a key factor supporting Marlborough's credit profile. We believe this framework to be one of the strongest and most predictable globally. It promotes a robust management culture, fiscal discipline, and high levels of transparency and disclosure.

Modest deficits and debt burden underpin strong credit profile; access to New Zealand Local Government Funding Agency enhances liquidity

We expect Marlborough to post modest after-capital-account deficits during the next few years. The council has plans to ramp up its infrastructure spending, with a large volume of projects having recently gone to tender or contract. There is higher capital investment budgeted at subsidiary level, too, as Port Marlborough continues a NZ$28 million extension of its Waikawa Marina. Our base-case forecasts assume the Marlborough group will deliver about NZ$54 million to NZ$58 million of capital expenditure per annum. The council will benefit from NZ$11 million of grants from the Crown government toward construction of its new library and art gallery.

Operating surpluses are likely to remain strong, averaging about 22% of operating revenues during fiscal years 2019 to 2023. Despite the onset of the pandemic, the outturn for fiscal 2020 was stronger than we previously anticipated, largely because of delays in rolling out capital spending.

We believe that Marlborough has a high degree of short-run fiscal flexibility compared with its domestic and international peers. The council's largest single source of revenue is property rates, which can be readily adjusted from year to year and are relatively stable through economic cycles. Unlike international peers, New Zealand councils ordinarily receive little by way of intergovernmental transfers. Marlborough's ability to delay or reschedule nonessential capital spending is further evidence of its flexibility.

We forecast that the council's tax-supported debt burden, as a proportion of operating revenues, will rise to 83% by the end of fiscal 2023, up from 68% at the end of fiscal 2020. This debt ratio remains among the lowest of all rated New Zealand councils. Marlborough's borrowings stood at NZ$101 million as of June 30, 2020, just 3.3x its cash operating surplus. Our financial metrics incorporate all the group's revenues and expenses, and our debt metrics include all its debt, including funds that are borrowed by the council and advanced to MDCHL and its subsidiaries.

We believe there may be some deterioration in the council's finances as new projects are added to the pipeline. Marlborough and Port Marlborough are among the partners in the proposed Waitohi/Picton Ferry Precinct Redevelopment Project. The potential costs of this project are not yet fully captured in our base-case forecasts. The next long-term plan, due in the second quarter of 2021, may provide further clarity on medium-term fiscal direction.

Marlborough's liquidity remains strong. We estimate that total free cash--inclusive of term deposits, and access to a NZ$20 million undrawn standby facility with Westpac New Zealand Ltd.--is sufficient to cover about 94% of debt maturities and interest payments during the next 12 months. We expect Marlborough's debt-servicing needs to comprise NZ$16 million and NZ$21 million of term debt maturing in the next two years; NZ$27 million in short-dated commercial paper, which is regularly rolled over; and about NZ$5 million in annual interest expenses.

We consider that the New Zealand Local Government Funding Agency (LGFA) provides

Marlborough 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 it has helped councils to lengthen their maturity profiles and reduce borrowing costs.

Marlborough's quantifiable contingent liabilities are small. Although the council lies within the highest earthquake risk zone in New Zealand and the district sits on a series of fault lines, its insurance coverage is adequate. Most above-ground assets are insured commercially, and underground assets are insured through a cost-sharing arrangement between the Local Authority Protection Programme and the Crown government. Marlborough is one of approximately 60 local authorities that are joint-and-several guarantors of the LGFA's borrowings. We consider it very unlikely that this guarantee will be activated in the near future.

Key Statistics

Table 1

Key Statistics

	--Year ended June 30--				
(mil. NZ$)	**2019**	**2020**	**2021bc**	**2022bc**	**2023bc**
Selected indicators					
Operating revenues	155	147	142	150	157
Operating expenditures	116	117	115	116	119
Operating balance	38	31	27	34	38
Operating balance (% of operating revenues)	24.8	20.8	18.7	22.5	24.4
Capital revenues	21	7	24	7	10
Capital expenditures	40	34	57	54	58
Balance after capital accounts	19	4	(6)	(14)	(9)
Balance after capital accounts (% of total revenues)	10.9	2.6	(3.9)	(8.6)	(5.5)
Debt repaid	21	1	16	21	18
Gross borrowings	29	2	22	34	27
Balance after borrowings	27	5	0	0	0
Tax-supported debt (outstanding at year-end)	101	101	108	121	130
Tax-supported debt (% of consolidated operating revenues)	65.1	68.4	75.9	81.0	82.9
Interest (% of operating revenues)	2.6	2.6	2.8	3.0	3.1
National GDP per capita (single units)	61,317	61,002	60,849	64,606	67,051

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

Ratings Score Snapshot

Key rating factors	
Institutional framework	1
Economy	3
Financial management	1
Budgetary performance	2
Liquidity	2
Debt burden	2
Standalone 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 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 https://www.spratings.com/sri.

Related Criteria

- 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
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Public Finance System Overview: New Zealand's Institutional Framework For Local And Regional Governments, Oct. 28, 2020
- Credit Conditions Asia-Pacific: Recovery Roads Diverge, Sept. 29, 2020
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 25, 2020
- Comparative Statistics: Asia-Pacific Local And Regional Government Risk Indicators, July 29, 2020
- COVID-19: Fiscal Response Will Lift Local And Regional Government Borrowing To Record High, June 9, 2020

- Ratings History List: Asia-Pacific Local And Regional Government Ratings Since 1975, May 29, 2020
- COVID-19's Effects Will Pressure New Zealand Council Ratings, May 24, 2020
- New Zealand 'AA/A-1+' FC And 'AA+/A-1+' LC Ratings Affirmed; Outlook Positive, May 3, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019

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	
Marlborough District Council	
Issuer Credit Rating	AA/Positive/A-1+