SUPPLEMENTARY

AGENDA

WHAKATĀNE
District Council
Kia Whakatāne au i ahau

Risk and Assurance Committee
Te Komiti Whakahaere Tūraru

Friday, 1 March 2024
Rāmere, 1 Poutūterangi 2024

Totara Room, Whakatāne District Council
14 Commerce Street, Whakatāne
Commencing at: 9:00 am

Chief Executive: Steph O'Sullivan
Publication Date: 27 February 2024

Live Streaming the Meeting - *Ka whakapāho mataora te hui*

PLEASE NOTE
The **public section** of this meeting will be Live Streamed via YouTube in real time. The live stream link will be available via Council's website.
All care will be taken to maintain your privacy however, as a visitor in the public gallery, your presence may be recorded. By remaining in the public gallery, it is understood your consent is given if your image is inadvertently broadcast.
The opinions or statements expressed during a meeting by individuals are their own, and they do not necessarily reflect the views of the Whakatāne District Council. Council thus disclaims any liability with regard to said opinions or statements.

A Membership - *Mematanga*

Mayor Dr V Luca

Independent Chairperson - Stuart Henderson

Deputy Mayor L N Immink - Deputy Chairperson

Councillor W B James

Councillor T O'Brien

Councillor J Pullar

Independent Member - P Lucioli

B Delegations to the Risk and Assurance Committee - *Tuku Mahi ki te Komiti*

The purpose of the Risk and Assurance Committee is to oversee the effectiveness of Council's risk management, internal control environment, legal responsibilities, statutory compliance, and external auditing process.

The Committee has the authority to appoint up to two independent persons who are not elected members, who can assist the Committee to meet its obligations and responsibilities.

The quorum for this Committee is 4 members.

Responsibilities and Functions

a. Oversee the effectiveness and appropriateness of the Enterprise Risk Management framework, including but not limited to Council’s Risk Policy and Corporate Risk Register.
b. Advise the Council on matters of risk and risk appetite.
c. Ensure that the Organisation has internal control systems in place.
d. Monitor Council’s compliance with applicable laws, regulations, standards and best practice guidelines for public entities.
e. To monitor performance of the Council’s treasury function.
f. Maintain oversight of legal proceedings involving Council.
g. Oversee the effectiveness and appropriateness of the internal control environment.
h. Review the policies, systems, processes and controls to ensure that fraud is detected and effectively investigated.
i. Ensure the adequacy, integrity and reliability of the external financial reporting of Council.
j. Review the integrity and appropriateness of external reporting, and accountability arrangements.
k. Review, and monitor progress against, the external auditors’ recommendations.
l. Recommend to the Office of the Auditor General the decision either to publicly tender the external audit or to continue with the existing provider for a further three-year term.
m. Where required, request expert advice through the chief executive where necessary.

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1 Reports - *Ngā Pūrongo*

1.1 Treasury – Proposal to seek Credit Rating

To:	**Risk and Assurance Committee**
Date:	**Friday, 1 March 2024**
Author:	**G Connolly / CFO & GM Business Partnering**
Authoriser:	**S O'Sullivan / Chief Executive**
Reference:	**A2621959**

1. Reason for the report - *Te Take mō tēnei rīpoata*

The purpose of this report is present the committee with a proposal to seek a credit rating for Whakatāne District Council, for the committees' feedback prior to submission of final report to Council for approval.

2. Recommendations - *Tohutohu akiaki*

1. **THAT** the Proposal to seek Credit Rating report, and the supporting information in the PWC "Whakatāne District Council - Credit rating assessment report [Draft]" be received; and
2. **THAT** that it be recommended to the Council to approve the Proposal to seek Credit Rating.

3. Subject - *Kaupapa*

The current draft LTP2034 indicates the need to secure additional borrowings to enable delivery of the required level of investment in assets, to achieve the outcomes identified in LTP2034. The growth in debt over the life of the 10-year plan LTP2034 is projected to be from $180M in 2024 to $350M in 2034.

Debt required to support the LTP is expected to range between the current projected 2024 limit of net debt to total revenue of 160%, up to approximately 230% by 2031.

At present WDC would be constrained in securing debt at the levels required to support the LTP due to the LGFA Lending Covenant of <175% Net Debt to Total Revenue for unrated Councils.

By securing a credit rating WDC would be able to secure debt within LGFAs Foundation Policy Covenant of <290% Net Debt to Total Revenue for Council rated "A" or higher.

This paper and the supporting report provides additional background to the issue and the process to become credit rated. We are seeking the committees, feedback in advance of and, endorsement to submit to Council for approval.

4. Background - *He tirohanga whakamuri*

4.1. The need to borrow for capital expenditure and impact on debt

Borrowings are a key component of recognising the intergenerational equity principle and recognising that the cost of long-term assets should be met by ratepayers over the life of those assets. It is important that we prudently manage the amount of borrowings, while enabling continued investment in infrastructure and community assets.

In light of the significant capital expenditure plans reflected in the draft LTP2034, particularly as a response to the demands for improving water infrastructure and the Rex Morpeth Park Project, we are projecting we will need to increase our debt to fund what is not provided for by way of capital subsidies, development contributions income and depreciation.

Council is able to externally borrow through a variety of market mechanisms including direct bank borrowing, the LGFA, accessing the short and long-term wholesale/retail debt capital markets directly or internal borrowing of reserve and special funds.

Council’s ability to readily attract cost effective borrowing is largely driven by its ability to rate, maintain a strong financial standing and manage its relationships with its investors, LGFA, and financial institutions/brokers.

The growth in debt over the life of the 10-year plan LTP2034 is from $180M to $350M in 2033/34. And this is expected to range between the current project 2023/24 limit of debt to total revenue of 160% to approximately 230% by 2031.

Investment in capital expenditure is the major driver of the projected increase in borrowings, with $365M in capital expenditure to meet demand and essential investment in infrastructure to improve levels of service.

4.2. Limits on levels of borrowings

There are two major limit setting control on the ability of Council to borrow:

1. Councils’ Debt affordability benchmark – borrowing amount quantifies limit:

   This limit which is required by legislation is set within Councils’ Treasury Management Policy (Liability Management). As present the policy sets the limit at 150%, but this was superseded in LTP2031 to 175%.

   In Council briefings on LTP2034, having indicated the likely performance range over the 10 years we have identified 250% as the anticipated proposed limit for the Treasury Management Policy to be adopted in May/June 2024.

2. LGFA financial covenants:

   As part of its risk management in supporting borrowings for councils across New Zealand LGFA sets financial covenants that need to be met to secure future borrowings.

   At present LGFAs covenants including policies of:

   - Unrated Councils - <175% Net Debt to Total Revenue

- Rated Councils (Short-term “A” or higher) - <290% (285% 2025)
- Rated Councils (Long-term “A” or higher) – bespoke %

Therefore, in order to secure borrowing to support the delivery of LTP2034 WDC will need to become credit rated, or significantly constraint is capital expenditure investment further.

4.3. Credit Rating

The supporting paper from PWC [currently in draft subject to feedback from WDC] provides significant background on the process of becoming credit rated, including indicative rating agency pricing, although this would be subject to confirmation through an RFP process.

Although there is a material initial and annual costs to secure and maintain a rating, it is anticipated the benefit in better interest rates as a result given the indicative level of borrowings required would more than offset any cost, and may result in further benefit to offset rates in coming years.

From a timing perspective it is anticipated that the process would take 4-6 weeks from commencement. We would ideally like to have this done prior to the finalisation of LTP2034 in June, therefore timing for approval of this proposal to proceed is critical.

5. Options analysis - *Ngā Kōwhiringa*

The report identifies a potential significant constraint in borrowing limits. At the high level the options are to purpose credit rating to enable delivery in line with LTP2034, or revise LTP2034 to maintain compliance as an unrated council.

6. Significance and Engagement Assessment - *Aromatawai Pāhekoheko*

6.1. Assessment of Significance

The recommendations of this report are assessed to be of low significance in accordance with the Council’s Significance and Engagement Policy.

6.2. Engagement and community views

Due to the low significance of the matters of this report, public participation is not required to inform decision-making, as set out in Section 6.1(a) of the Council’s Significance and Engagement Policy.

7. Considerations - *Whai Whakaaro*

7.1. Financial/budget considerations

Financial considerations are identified in the attached report from PWC. As indicated although there is a material initial and annual costs to secure and maintain a rating, it is anticipated the benefit in better interest rates as a result given the indicative level of borrowings required would more than offset any cost, and may result in further benefit to offset rates in coming years.

7.2. Strategic alignment

No inconsistencies with any of the Council's policies or plans have been identified in relation to this report.

7.3. Climate change assessment

Based on this climate change assessment, the decisions and matters of this report are assessed to have low/moderate/high climate change implications and considerations, in accordance with the Council's Climate Change Principles

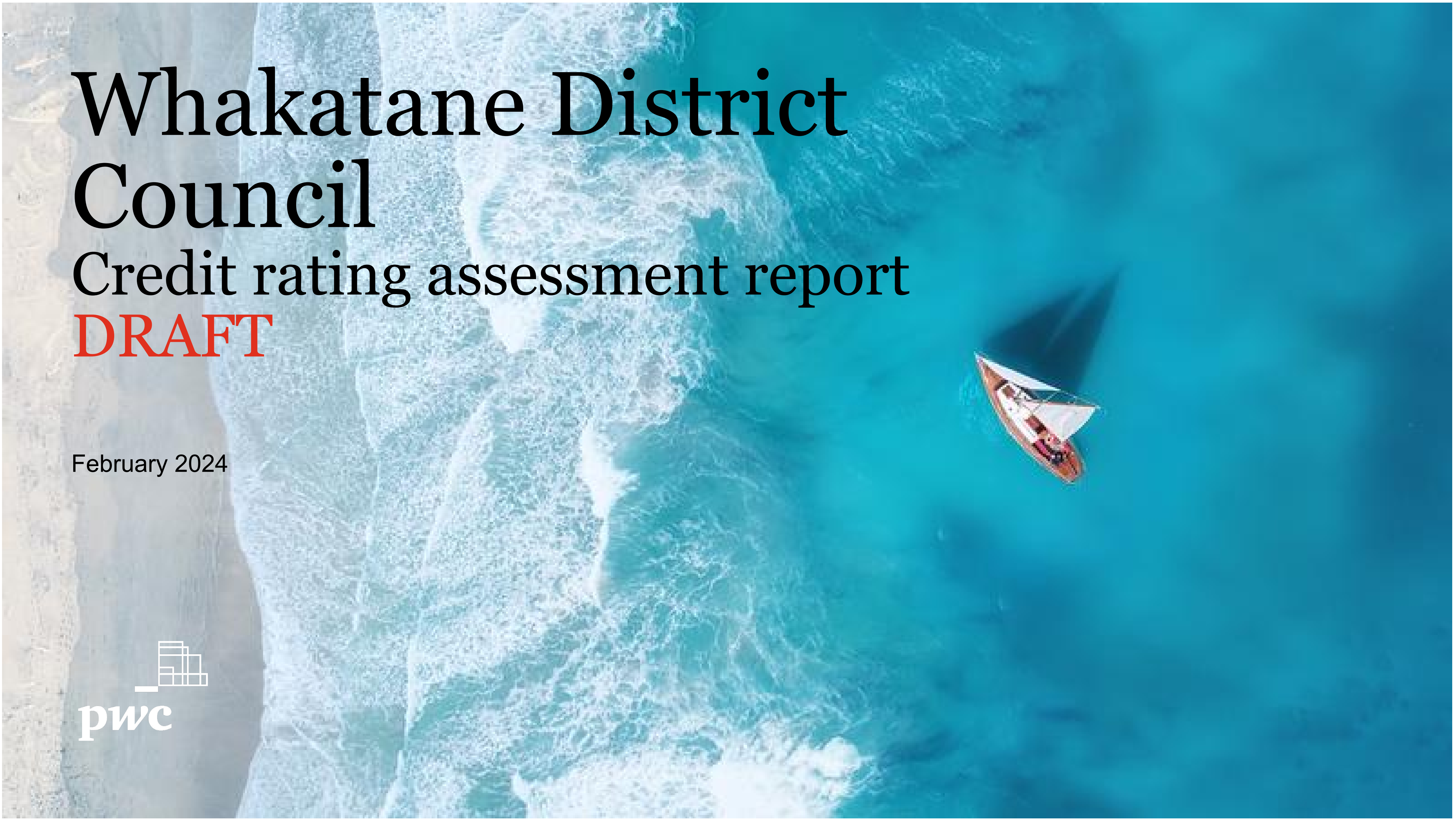
7.4. Risks

There are no known risks associated with the matters of this report.

Attached to this report:

- Appendix 1 – PWC WDC – Credit Rating Assessment Report

1.1.1 Appendix 1 – PWC WDC – Credit Rating Assessment Report


Whakatane District Council
Credit rating assessment report
DRAFT
February 2024
pwc

Disclaimer and restrictions

This Report is issued pursuant to the terms and conditions set out in our engagement letter dated 7 February 2024 and the Terms of Business attached. This Report has been prepared solely for Whakatane District Council ('Council') for the purposes stated herein and should not be relied upon for any other purpose.

This Report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this Report and/or any related information or explanation (together, the "information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the company. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this report are based on information available as at the date of the Report.

We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this Report was not brought to our attention, or subsequently comes to light.

We have relied on forecasts and assumptions prepared by Whakatane District Council about future events which, by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

Alex Wondergem
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Whakatane District Council
Commerce Street
Whakatane 3158

Attention: Gary Connolly, Chief Financial Officer & General Manager Business Partnering

23 February 2024

Credit rating assessment and discussion

Dear Gary,

The following report outlines PwC's treasury advisory services in connection with Whakatane District Council ("Council") seeking a formal credit rating. Our report has been completed as outlined within the scope of our Letter of Engagement, dated 7 February 2024.

Within the report we discuss the key credit rating considerations for Whakatane, with a focus on the credit rating process and the pros and cons of receiving a formal external credit rating. We have also provided a shadow credit rating using S&P 's published methodology and compared key aspects of this with the Fitch methodology equivalent.

This report is strictly confidential. We will not accept any duty of care (whether in contract, tort, including negligence, or otherwise) to any person other than those addressed in connection with this report.

We look forward to discussing this report with you.

Yours sincerely,
PricewaterhouseCoopers

Alex Wondergem
Partner

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1

Credit rating considerations

What is a Formal Credit Rating?

Whakatane District Council will need to assess whether debt pricing benefits alongside the increased amount of administration time that coincides with maintaining a formal credit rating is justifiable relative to the borrowing programme, noting also the increased debt capacity under LGFA borrowing covenants with a formal credit rating.

Overview

A formal credit rating is a forward-looking opinion provided by a certified, external rating agency about the ability and willingness of an organisation to pay back investors and other counterparties in full and on time. In order to assess this, the rating agency considers both quantitative and qualitative information about the organisation, while also incorporating analysis of the wider macro environment in which it operates.

It is important to point out that the purpose of a credit rating is not to ascribe an organisation a precise default probability, as these vary significantly over time, sector, region and by issuer. As such, the cumulative default rates across rating bands capture average historical default rates and are not an estimate of an organisation's specific default probability at any given time.

For example, if the 10-year cumulative default probability for AA- rated organisations is 1.1%, the rating agency is expecting 1 out of 100 organisations with AA- ratings to default over a 10-year period, although it has no idea which of the organisations this may relate to. The agency is therefore assessing the borrower's relative vulnerability to default over time as the organisation progresses, funding and liquidity markets evolve, and regulatory and political expectations change.

Decision considerations

When debating whether to commission a formal credit rating or not, there are two key questions for councils to consider:

- Will the independent assessment / validation of the council's credit profile create a financial benefit (particularly with respect to new debt or debt refinancing) which is large enough to cover the cost of the credit rating?
- Does the scrutiny from an external party create increased discipline around financial management, governance and reporting which translates to improved perception / confidence from key stakeholders? Or is it simply administratively more burdensome?

Pros and Cons of a Formal Credit Rating

In order to justify the cost of obtaining and maintaining a formal credit rating, Whakatane District Council requires either significant amounts of debt refinancing or new debt raising to be occurring in the short-term and/or an expectation or a sizable amount of new debt drawdowns over coming years. Note that only new and refinanced borrowings (and not existing debt), are able to benefit from a credit rating in terms of financial flexibility and pricing.

Pros

- **Reduced cost of funding:** As previously discussed, the LGFA price differentiates between councils which are credit rated and those that are not. The following pricing is the cost savings relative to margins which the LGFA charges.
  - Rated AA 20 basis points p.a.
  - Rated AA- 15 basis points p.a.
  - Rated A+ 10 basis points p.a.
- **Commercial paper:** As a formally rated issuer, Council could issue CP through the LGFA at margins below those of unrated issuers.
  - Rated: <181 days 15 bps p.a. and >181 days 20 bps p.a.
  - Unrated: <181 days 20 bps p.a. and >181 days 25 bps p.a.
- **Risk appetite and financial disciplines:** A credit rating promotes greater financial discipline and awareness of Council's risk appetite with a framework and boundary to risk appetite that can help management assess whether Council's strategic decisions and financial strategy fit within the targeted credit rating band.
- **Increased debt capacity:** Through achieving a formal credit rating, the LGFA will provide Council with additional debt capacity, increasing the net debt/ revenue borrowing covenant from 1.75x to 2.80x.

Cons

- **Financial costs:** The financial cost associated with maintaining a credit rating is the most important and obvious cost for rated Councils. As of January 2024, 25 Councils had a credit rating with S&P and 10 with Fitch. Below is estimated the fees for a credit rating which can differ slightly by provider:
  - Fitch's initial rating fee is NZD 55,000 and has surveillance costs of NZD 52,500 annually for the second and subsequent years.
  - S&P's initial rating fee is AUD 63,000 (NZD ~67,500) and has surveillance costs of AUD 63,000 (NZD ~67,500) annually for the second and subsequent years.
- **Rating agency management:** There is also the time cost on internal personnel, given the need for semi-annual analyst updates and the requirement to keep them abreast of any potentially sensitive information. Any assessment of the costs and benefits associated with a rating should consider this additional cost and whether the internal staff time spent on the rating could be better spent on other tasks. In addition to these considerations, the credit rating surveillance reports and meetings may expose Council to an undesired level of scrutiny if they lack robust internal processes. Once a credit rating is obtained, Councillors and staff have to be mindful of any action which might have the effect of negatively influencing the credit rating and thereby hurting the Council's reputation and financial position.

Rating Provider Comparison

Fitch and S&P both have a specific local government rating framework with councils rated in New Zealand. S&P rates the majority of councils and the majority of the sector's debt (25 rated councils and ~90% of sector debt), but most of these councils became rated over five years ago with the majority of recent credit ratings being provided by Fitch.

Overview of rating agencies

Both S&P and Fitch are highly reputable global organisations, with a specific local government rating framework. Each agency currently views the rating powers of New Zealand councils very favourably and their current ratings are all higher than A+ (with an average rating of AA). S&P rates the most councils at 25, which equates to roughly 90% of local government debt compared to Fitch advising 10 councils.

Considerations for selecting a credit rating agency

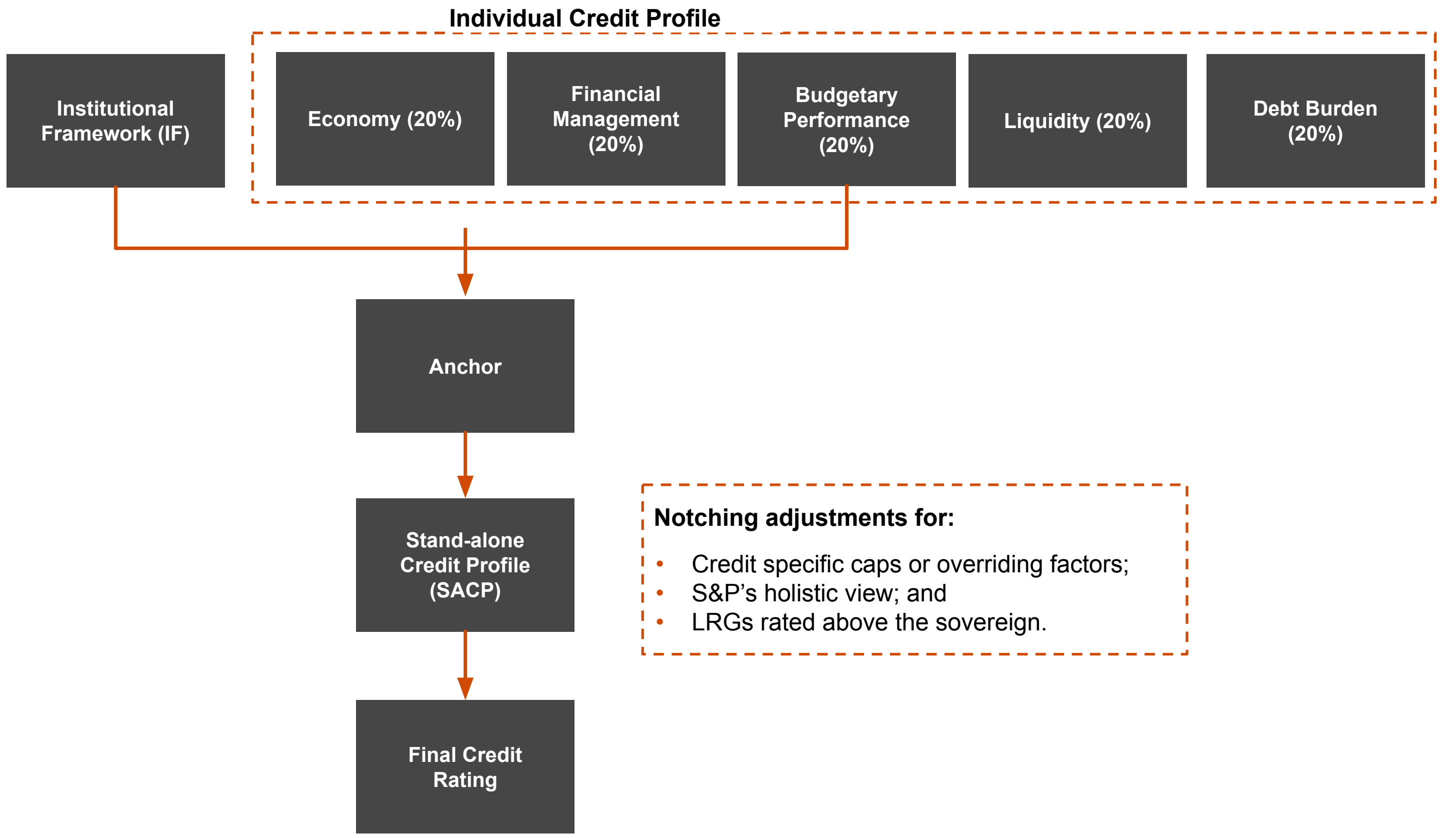
- **Fees:** Fitch has the cheapest annual surveillance costs which are roughly NZD 15,000 lower than S&P each year, which equates to NZD 150,000 over a 10 year period. In order to make the credit rating process beneficial, Council would need to undertake a total of $30 million of new debt and refinancing each year (NZD 60,000 in interest savings).
- **Cost of a one notch difference**: The impact of one notch difference in credit rating (i.e. AA versus AA-) is 5bps with debt issuances through the LGFA. On NZD 100m of debt this would be NZD 50,000 per year and NZD 500,000 over 10 years.
- **Council credit ratings:** S&P has the widest ranging portfolio of New Zealand Councils with a presence in may parts of the country. As a result they are considered the leading player in the sector and have extremely good knowledge of the sector given their wide presence of exiting ratings. Although, of new council credit ratings over the last five years, most councils have chosen to go with Fitch with only one going to S&P.
- **Overview on the sector:** S&P's recent credit rating reviews have been relatively negative with many councils being placed on a negative watch or downgraded. Their recent research publications have also been negative for the sector as a whole given worsening debt metrics and the current status of affordable waters, which could result in a downgrade of the Institutional Framework and lower credit ratings for all councils. Fitch on the other hand has held all credit ratings constant over the last year and maintained stable outlook for all.
- **Methodology**: Both agencies are supportive of New Zealand's legal rating framework for local governments which supports strong credit metrics in their some of their quantitative assessments. One important distinction in the quantitative methodology is Fitch looks at net debt opposed to S&P using gross. Considering the managed funds support Council's net debt capacity with the LGFA this could support the metric calculation. However, without completing full shadow credit ratings using each methodology the difference in credit rating outcomes cannot be fully known.

Overview of S&P's Credit Rating Methodology

We have outlined a high level summary of S&P's approach to credit rating Local and Regional Governments (LRGs) below. There are two key aspects to their approach: (1) the assessment of the institutional framework and (2) the five key credit factors. The other rating agencies have different methodologies but S&P is the most common across the sector and is relatively simple to understand outcomes.

Credit rating process

- The diagram to the right reflects S&P's approach to formally credit rating Local and Regional Governments (LRGs).
- Their ratings process is formulaic, with the credit assessment built up through the evaluation of specific ratings factors.
- S&P begin their assessments through evaluating the Institutional Framework (IF). This is relatively prescriptive and does not typically vary across LRGs in New Zealand because many of the factors assessed relate to items that are set at a national level.
- The IF assessment is combined with S&P's evaluation of an LRG's individual key credit factors. These two items are then combined to produce an anchor rating outcome.
- Where necessary, notching adjustments are then made to the anchor for LRG specific items that otherwise would not have been reflected.
- Following these adjustments, the credit rating outcome is finalised.

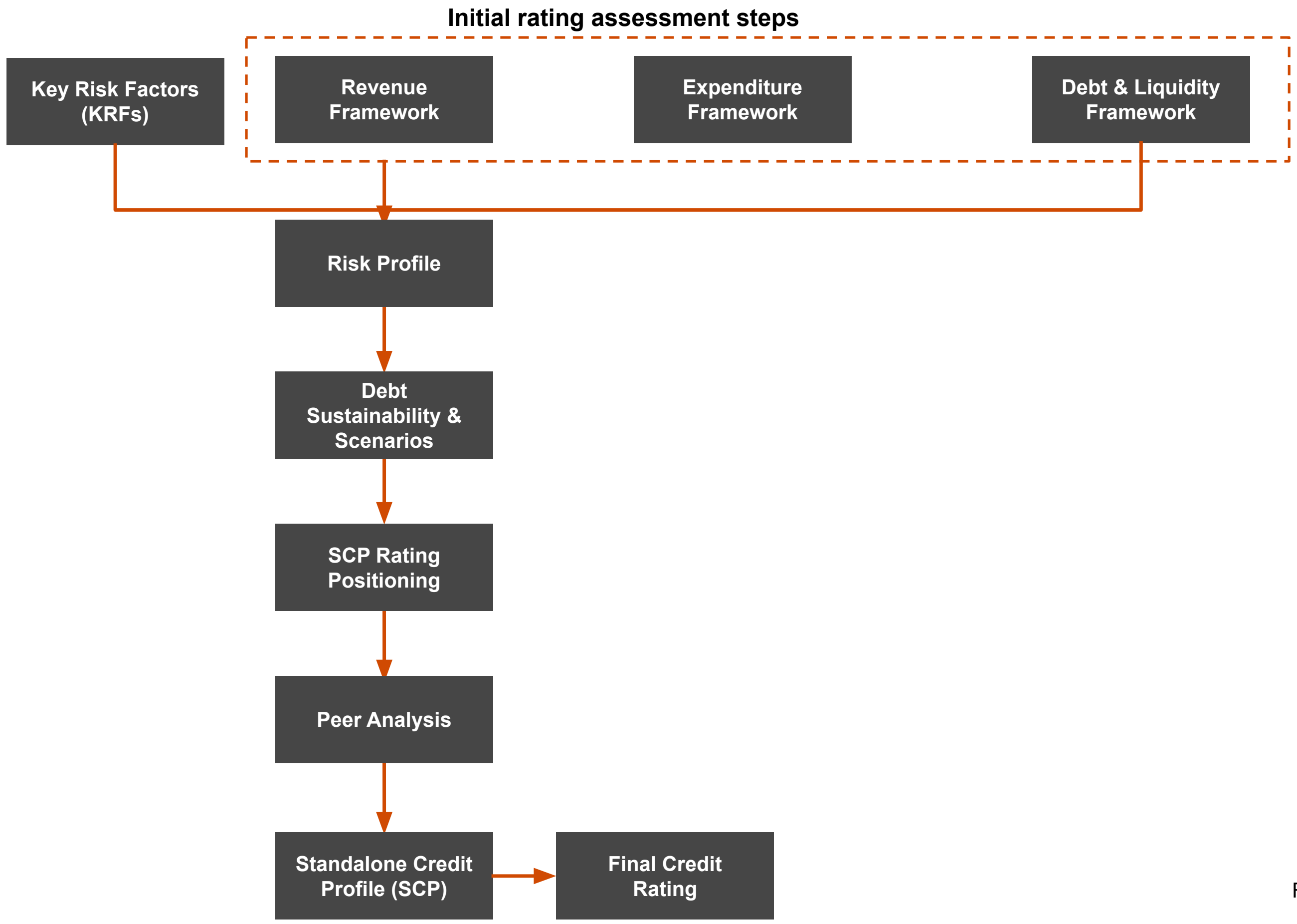


Overview of Fitch Credit Rating Methodology

We have outlined a high level summary of Fitch's approach to credit rating Local and Regional Governments (LRGs) below. Fitch's approach to rating LRG's can be broken down into five steps: (1) Key Risk Factor analysis, (2) risk profile assessment, (3) debt sustainability and scenarios, (4) rating positioning and (5) peer analysis.

Credit rating process

- The diagram to the right depicts Fitch's standardised approach to rating LRG's.
- Fitch begins their assessment by considering six key risk factors (KRFs). Two of these factors relate to revenue, two to expenditure and two to debt and liquidity.
- These six key risk factors are then combined to determine a risk profile.
- LRGs are than assessed against three industry specific financial ratios being (1) payback ratio, (2) Fiscal debt burden and (3) coverage ratio.
- Both the risk profile and debt and sustainability assessment are then combined to reach an initial standalone credit profile (SCP)
- Notching adjustments are than completed based on peer comparables.
- Following these adjustments, where necessary, the SCP will be adjusted according to the sovereign's credit rating to reflect a level of government support.



2 Shadow credit rating

S&P Institutional Framework Assessment

The institutional framework (IF) assessment is the first stage of S&P's credit rating methodology. The IF sets the scene for formal rules and laws, practices, customs and precedents for an LRG with a total of three factors being assessed: (1) predictability, (2) transparency and accountability and (3) revenue and expenditure balance.

Institutional framework assessment

Factor	Weighting	Comments	Estimated score
Predictability	**25%**	• The frequency and extent of reforms affecting the division of responsibilities and revenues • between the levels of governments in a jurisdiction; • The predictability of the outcomes of reforms when they occur, based on their pace of implementation and impact on both short- and long-term finances; • The ability to influence and potentially veto decisions at a higher level, particularly those that may adversely affect an LRG's financing system.	**1 - Extremely Predictable and supportive**
Transparency and Accountability	**25%**	• The national regulation of public-sector accounting systems and standards of financial • reporting and planning; and • The accountability of managers and politicians.	**1 - Extremely Predictable and supportive**
Revenue and Expenditure Balance	**50%**	The overall adequacy of the revenues that an LRG receives or collects to cover its expenditure mandates; • The strength of a fiscal policy framework imposing prudent limits on an LRG's debt and deficit levels; and • The availability of exceptional support provided by a higher government tier.	**1 - Extremely Predictable and supportive**

PwC Assessment: Traditionally, New Zealand has been considered with as a score rank 1 for the IF assessment detailing an extremely predictable and supportive environment. However, this assessment has recently been placed on a weakening outlook given uncertainty around the implementation and potential impact of surrounding water reforms. Therefore, while we would still expect Whakatane to score a 1 in this area we acknowledge the risk of Whakatane being placed on a negative outlook watch with a potential downgrade in the future.

S&P Key Credit Factors (1/3)

The individual credit assessment is made up of five key credit factors and is assessed alongside the institutional framework (IF) assessment. The five key credit factors that are assessed within the S&P methodology are: (1) economy, (2) financial management, (3) budgetary performance, (4) liquidity and (5) debt burden.

Economy

One of the factors that S&P will typically consider when considering the economy factor is GDP per capita. New Zealand on a whole has historically been considered to have a rating of 1 or very strong in this area.

In 2021 the Ministry of Business, Innovation and Employment estimated Whakatane to have a GDP per Capita ~17% less than the national average. Therefore, we consider Whakatane to have a 2 (strong) economy score.

Liquidity

Currently, Council borrows entirely through the Local Government Funding Agency (LGFA) and we expect this to continue moving forward. Borrowing via the LGFA provides Council with a consistent, strong and well-established source of external liquidity.

The second aspect of liquidity assessed by S&P is the LRG's debt service coverage ratio (DCSR). Given Whakatane Council has already pre-funded 100% of all maturing debt within the next 12 months we can consider Whakatane as having a DSCF in excess of 100%. Additionally, upon removing pre-funding we would still expect a DSCF above 100%, suggesting that Council should receive a liquidity assessment of 1 (very strong).

Please note that for the purposes of this analysis we have assumed that current liquidity balances will be maintained consistently over the 12 months.

Financial Management

Financial management covers three factors: (1) political and managerial strength, (2) financial planning and implementation, (3) Liquidity, debt, and contingent liability management. We have assessed Whakatane as having a financial management score of 2 (strong). Reasoning being that there is a relatively prudent level of medium-term financial planning via the LTP which is re-evaluated every three years. Additionally, internal policies set prudent limits on external borrowing, liquidity and interest-rate risk and like all New Zealand councils, Whakatane is governed by an elected group of councillors, led by a mayor. Councillors delegate day-to-day management to a full-time chief executive

Budgetary Performance

Initially, we assessed Whakatane as having a score of 1 (very strong) based off the 2021-31 LTP. However, given discussions with Council about their proposed capex plan we would revise this score down by a couple of notches to reflect underestimated spending. This would result in a score of 3 (average) See below table for potential adjustment factors to budgetary performance.

Positive qualitative adjustments	Negative qualitative adjustments
• Expected structural improvement • High cash reserve levels • Strong flexibility	• Expected structural deterioration • Pronounced volatility in performance • Underestimated spending • Underspending on pensions • Limited flexibility

S&P Key Credit Factors (2/3)

Debt burden is one factor that will be negatively impacted by increasing debt to maximum capacity. The New Zealand local government sector is very highly indebted so scores of 4 and 5 are common, with the stronger credit ratings being supported by other factors under the credit rating methodology. If debt was increased to the maximum capacity then it would score a '5' and would be at risk of a rating downgrade near the 450% level.

Debt burden

Debt burden consists of two factors, interest costs to revenue and debt to revenue. These covenants are similar to the LGFA, however S&P operates off a gross rather than net basis so liquid assets do not provide an offset for additional capacity. The debt burden score combines with the other factors on the previous page to give the overall credit rating, which means a weak debt burden outcome does not directly result in a low credit rating outcome. It also depends on the quality of other components.

The yellow highlighted outcomes indicate Council's outcomes in 2022 and 2023 with a relatively strong score relative to the rest of rated New Zealand councils (displayed on the following page). The grey dotted box is the outcome if Council increased debt to maximum capacity. Within S&P's methodology it directly calls out a debt to revenue ratio of greater than 450% leading to a notching downgrade in credit rating.

S&P's assessment of a local government debt burden

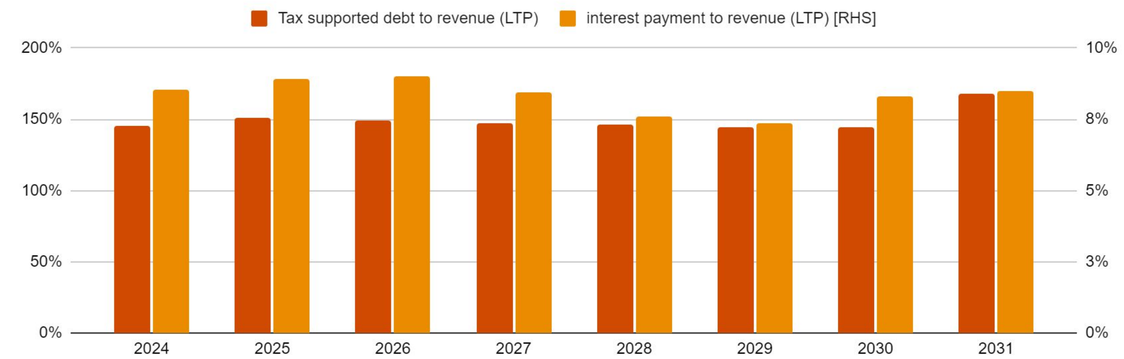
	Tax supported debt as % of revenue				
Interest payment % revenue	**< 30%**	**30% - 60%**	**60% - 120%**	**120% - 240%**	**240% +**
< 5%	1	2	3	4	5
5% - 10%	2	3	4	4	5
> 10%	3	4	5	5	5

Whakatane District Council's debt burden calculation

S&P's two gross metrics are displayed below using 2021-31 Long term plan (LTP) data. The bars show gross debt to revenue (left-hand side) and interest to revenue (right-hand side). Under the the 2023-31 LTP we would expect for Whakatane to receive a score of 4 (weak) for the debt burden assessment.

However, we acknowledge that Council is currently in the process of developing its 2024-34 LTP. Following discussions with Council we would expect for the impact of water reforms to increase debt levels materially and so we have assumed that debt will be increased to maximum capacity. As such, we have assessed Whakatane as having a score of 5 (Very weak) to reflect this.

Tax supported debt and interest payment as % of operating revenue



Source: Whakatane 2021 LTP & 2023 annual plan, IHS Markit

S&P Key Credit Factors (3/3)

Each factor is scored on a scale of between '1' and '5' from '1' (very strong) to '5' (very weak) and equally weighted, with the weighted score used to determine the final scoring outcome. This score is then combined with the IF assessment to determine the anchor credit score (i.e. before any ratings notching). Based of our assessment Whakatane DC should expect to receive either a AA or AA- rating.

Individual key credit factors

Factor	Weighting	Comments	Estimated score
Economy	**20%**	• National GDP per capita • Economic growth prospects • Economic concentration and/or volatility • Socioeconomic profiles	**2 - Strong**
Financial Management	**20%**	• Political and managerial strength; • Financial planning and implementation; • Liquidity, debt, and contingent liabilities management	**2- Strong**
Budgetary Performance	**20%**	• The level and volatility of LRGs expected cash flows (from operations and investment activities) that are available to service debt; • Operating balance as a percentage of adjusted operating revenues; • Balance after capital accounts as a percentage of adjusted revenues	**3. Average**
Liquidity	**20%**	• An initial liquidity assessment based on a debt service coverage ratio (DCSR, adjusted when warranted for qualitative aspects; • An assessment of a LRG's access to external funding	**1 - Very Strong**
Debt Burden	**20%**	A forward looking view of a LRGs debt and interest burden relative to its available resources. It includes an initial assessment based on two measures: 1. Tax-supported debt to consolidated operating revenues; 2. Interest payment to adjusted operating revenues	**5 - Very Weak**
Total	**100%**		**2.6 (AA/AA-)**

Fitch Key Credit Factors

Fitch prescribes each of the six KRFs identified below with one of three attributes. These three attributes are; (1) stronger, (2) midrange and (3) weaker. These attributes are then blended together to determine the risk profile. The risk profile may be determined as: (1) stronger, (2) high midrange, (3) midrange, (4) low midrange, (5) weaker and (6) vulnerable.

Individual key credit factors

Key Risk Factor	Comments
Revenue Robustness	• Stability and predictability of revenue sources • Revenue growth
Revenue Adjustability	• Affordability of taxation • Revenue equalisation
Expenditure Sustainability	• Control over expenditure growth • Control over expenditure during economic turmoil
Expenditure Adjustability	• Budget balance • Cost flexibility •
Debt and Liquidity Robustness	• Debt and liability framework • Off-balance sheet management • Debt profile • Materiality of exposures
Debt and Liquidity Flexibility	• Emergency liquidity support • Availability of liquidity sources

Fitch assessment

To the left are the key credit factors which make up a large portion of fitch's assessment.

Upon assessment, these factors are blended together to create a risk profile. This risk profile is then combined with the debt sustainability and scenario analysis undertaken (see following page for more details).

For an LRG there are typically three credit metrics examined, these are: (1) payback ratio, (2) fiscal debt burden and (3) coverage ratio. The payback ratio is considered a primary metric by Fitch and therefore given higher weighting then the other two metrics.

Following this assessment, the final stage undertaken would likely be a peer analysis. A peer analysis is primarily utilised to verify a level of consistency of ratings amongst LRGs.

Debt sustainability and scenarios assessment

One key difference between the Fitch and S&P methodologies is how LRG's debt burden is considered. For the S&P methodology the debt burden is considered alongside other key credit factors, whereas the Fitch methodology determines debt as a separate assessment to be combined with the risk profile as well as within the KRFs that make up the risk profile. As a result, the Fitch methodology places greater emphasis on debt metrics than S&P.

Debt sustainability ratios

Risk Profile	Payback Ratio (x)	Fiscal Debt Burden	Coverage (x)
aaa	<5	<50	>4
aa	<9	<100	>2
a	<13	<150	>1.5
bbb	<18	<200	>1.2
bb	<25	<250	>1
b	>25	>250	<1

Primary metric

Secondary metrics

PwC Assessment: Given Council's expectations for a significant increase in future debt undertaking, we have highlighted the different ways in which the S&P and Fitch methodologies consider debt levels and repayments. Whakatane scores relatively strong with its payback ratio, achieving an "aa" rating outcome but less strongly in the Fiscal debt burden and Coverage secondary metrics. Therefore, we would expect that these weaker metrics would reduce Whakatane's debt sustainability assessment by one ratings notch to "a".

While we have not provided Whakane with a full credit rating under the Fitch methodology, based off the debt sustainability assessment we would expect that Whakatane would fall somewhere within the "A" ratings band following an assessment by Fitch (see Appendix for further details). We would also note that the peer analysis may provide a ratings uplift with no Fitch-rated local government in NZ achieving a ratings outcome less than aa-.

3 Appendix

S&P Peer Table

Entity	Credit ratings	Institutional framework	Economy	Financial management	Budgetary performance	Liquidity	Debt burden
Auckland Council	AA/Stable	1	1	1	4	1	5
Bay Of Plenty Regional Council	AA/Negative	1	3	1	4	1	5
Christchurch City Council	AA/Stable	1	1	3	3	2	4
Dunedin City Council	AA/Negative	1	2	2	4	2	4
Greater Wellington Regional Council	AA+/Negative	1	1	1	3	1	4
Hamilton City Council	AA-/Negative	1	1	2	4	1	5
Hastings District Council	AA-/Negative	1	2	2	3	2	4
Horowhenua District Council	AA-/Negative	1	3	2	4	1	4
Hutt City Council	AA/Negative	1	2	2	3	2	4
Kapiti Coast District Council	AA/Negative	1	2	2	3	2	5
Marlborough District Council	AA/Negative	1	2	1	4	3	4
Nelson City Council	AA/Negative	1	2	2	4	1	4
New Plymouth District Council	AA+/Negative	1	2	2	2	1	4
Palmerston North City Council	AA/Negative	1	2	2	3	2	4
Porirua City Council	AA/Negative	1	2	2	3	1	4
South Taranaki District Council	AA/Negative	1	3	2	3	1	4
Tasman District Council	AA/Negative	1	3	2	2	1	5
Taupo District Council	AA+/Negative	1	2	1	2	1	4
Tauranga City Council	A+/Stable	1	2	3	4	2	5
Upper Hutt City Council	A+/Negative	1	2	2	4	2	5
Waimakariri District Council	AA/Negative	1	2	2	3	2	4
Wellington City Council	AA+/Negative	1	1	1	3	1	4
Western Bay Of Plenty District Council	AA/Negative	1	3	2	3	1	4
Whanganui District Council	AA/Negative	1	3	2	2	1	4
Whangarei District Council	AA/Stable	1	3	1	3	1	4

Peer data as at 1 February 2024. The list does not include other rating agencies

Fitch Peer Table

Entity	Credit ratings	Risk profile	Debt sustainability (ratings
Ashburton District Council	AA+/Stable	High midrange	aa
Canterbury Regional Council	AA+/Stable	High midrange	aa
Far North District Council	AA/Stable	High midrange	aa
Invercargill City Council	AA+/Stable	High midrange	aa
Queenstown Lakes District Council	AA-/Stable	High midrange	aa
Rotorua Lakes District Council	AA-/Stable	High midrange	aa
Selwyn District Council	AA+/Stable	High midrange	aa
Timaru District Council	AA-/Stable	High midrange	aa
Waikato District Council	AA+/Stable	High midrange	aa
Waipa District Council	AA-/Stable	High midrange	aa

Peer data as at 1 February 2024. The list does not include other rating agencies

Thank you

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