STANDARD & POOR'S
RATINGS SERVICES

Press Release

Long-Term Rating On New Zealand's Christchurch City Council Lowered To 'AA-', Short-Term Rating Affirmed, Outlook Negative

MELBOURNE (Standard & Poor's) Dec. 19, 2012--Standard & Poor's Ratings Services said today that it had lowered its long-term credit ratings on New Zealand's Christchurch City Council (CCC) and the council's wholly owned subsidiary Christchurch City Holdings to 'AA-' from 'AA'. The short-term ratings on both entities were affirmed at 'A-1+' and the outlooks remain negative.

"The downgrades reflect our view that the council's financial management--while still positive--is increasingly being affected by a difficult environment stemming from a prolonged recovery period following the earthquakes in 2010 and 2011. Although we consider CCC's financial strategy to be prudent, the degree of control over the reconstruction held by the Crown, rather than by CCC, in our view reduces the council's political and managerial strength," Standard & Poor's credit analyst Claire Curtin said.

Significant repair and reconstruction costs have affected the council financially. It has significant capital expenditure responsibilities from earthquake repairs and infrastructure reconstruction, which is affecting budgetary flexibility and performance, and increasing the debt burden. We expect capital expenditure to rise to about 40% of total expenses as the reconstruction gains pace, and will remain elevated in the medium term. CCC's modifiable revenues are around 35% of total consolidated revenues.

In addition, earthquake-related impacts have dampened revenues and weakened the council's budgetary performance. These impacts have reduced the rateable base while increasing expenses. CCC's operating balance was weak in fiscal years ended June 30, 2011 and 2012, but performance is expected to improve as elevated earthquake-related operating expenditure eases. We expect CCC's operating balance to average in excess of 5% for 2011-2015. Primarily funded through debt and deferrals, CCC's large capital program and its currently weak operating performance result in a large deficit after capital expenditure, of about 15%. We anticipate that CCC's operating performance will improve as revenues increase and recovery costs ease. However, we forecast that CCC's deficit after capital expenditure will remain high over the medium term given the duration of the reconstruction program, which is anticipated to take more than five years.

CCC has implemented some special rates levies to raise council revenues and fund the reconstruction over time; in the interim, a significant amount of capital expenditure is being debt-funded, increasing CCC's debt burden to more than 180% of revenues. We anticipate that debt will remain below this level, however. Our base case anticipates that CCC will not fully achieve its capital-expenditure program as scheduled--given its large size--of around NZ$1 billion per year over the coming four years. We expect that interest costs will rise to be in excess of 5% of revenues as CCC's debt levels rise, but that interest will remain less than 9% in the medium term.

Contingent liabilities continue to weigh on the CCC rating. Insurance cover remains difficult to source, and further damaging seismic activity could have a significant financial impact on CCC. Litigation risk has also heightened, although we do not currently consider it likely that litigation will result in significant financial impact on CCC within the rating horizon.

Ms. Curtin added: "The negative outlook reflects our view that there is at least a one-in-three chance of a further downgrade for CCC in the coming two years. We consider that the most likely rating driver for negative rating action is from a rising debt burden--such as if total tax-supported debt was expected to exceed 180% of revenues and/or interest to exceed 9% of revenues. CCC's debt levels could increase more than anticipated due to an escalation in CCC's share of reconstruction costs above our expectations. This could occur from a shortfall in insurance recoveries, project cost escalation that CCC was required to fund, or further earthquake activity causing greater damage to council infrastructure."

The outlook could be revised to stable when we consider there is greater certainty concerning the likely peak of CCC's debt levels. This would likely stem from greater clarity on the anticipated total cost of the reconstruction to CCC. Greater confidence that seismic risk had eased would also provide certainty on potential costs.

Due to the strength of the institutional framework, we do not currently consider that there is a high probability of the long-term rating falling to lower than 'A+'.

RELATED CRITERIA AND RESEARCH

- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec 9, 2010

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