New Zealand
Full Rating Report

Hamilton City Council

Ratings

Local Currency	
Long-Term Rating	AA-
Short-Term Rating	F1+

Outlook

Local-Currency Long-Term Rating	Stable

Financial Data

Hamilton City Council

	30 Jun 09	30 Jun 08
Operating revenue (NZDm)	159.5	148.0
Debt (NZDm)	236.8	193.4
Operating balance/ operating revenue (%)	27.59	29.59
Debt service/current revenue (%)	14.83	15.18
Debt/current balance (yrs)	8.11	6.14
Operating balance/interest paid (%)	2.9	3.5
Capital expenditure/total expenditure (%)	37.49	41.18
Surplus (deficit) before debt variation/total rev. (exc. new debt) (%)	-25.87	-29.51
Current balance/capital expenditure (%)	34.97	35.51

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Related Research

Applicable Criteria
- *Tax Supported Rating Criteria* (December 2009)
- *International Local and Regional Governments Ratings Criteria - Outside the United States* (March 2010)

Other Research
- *Institutional Framework For New Zealand Subnationals* (April 2010)

Amendment

This report, which was originally published on 9 June 2010, is being republished with the following amendments: in Appendix A new borrowing has been grossed up and some additional minor expenditure items included. Financial ratios in Appendix B and in the Financial Data table on the front page have been amended. The Debt and Payback chart on page 6 has been revised.

Rating Rationale

- The ratings assigned to Hamilton City Council (Hamilton) reflect its solid socio-economic profile and adequate financial position considering the weakened operating environment in 2008/2009. The ratings also consider the strong institutional framework under which all councils operate in New Zealand. Like all councils, Hamilton has to publish a long-term council community plan (LTCCP) that outlines its financial and strategic development for 10 years, providing investors with clear guidance on its strategic development plans.
- Hamilton's economy benefits from a strong focus on agricultural, dairy-farming and manufacturing businesses with no significant reliance on one employer. Hamilton also hosts a large university in New Zealand, attracting a young population.
- In the fiscal year ended 30 June 2009 (FY09), Hamilton's operating balance remained stable despite the recessionary environment and reduced property values. The Council continues to report strong operating margins. Although these dipped to 27.6% in FY09, compared to a five year average of 31%, they still remain strong and higher than its rated peers'. The LTCCP forecast operating margins increasing to 41% by FY13 although Fitch Ratings' base case scenario projects this to be around 25% in light of smaller central government grants and continuing moderate growth in staff expenses.
- Hamilton benefits from its ability to modify rates, keeping the revenue base stable. However, funding costs increased due to the global financial crisis. Large capex reflecting infrastructure needs exceeded the council's operating balance, leading to a deficit. According to Hamilton's LTCCP, capex should remain significant until 2015, reflecting the need for further infrastructure investment due to population growth and ongoing community improvements.
- Capex is mainly financed by the council's operating balance, asset sales and existing reserves. As these income sources are forecasted to be smaller than capex, the council expects to raise additional debt. Although Hamilton's outstanding debt will nearly double, Fitch takes some comfort as these projections are carefully considered in the council's LTCCP and any changes have to be approved by the community.
- Although liquidity appears tight, Hamilton benefits from banking facilities and cash held for special funds. The latter is mainly used to reduce external borrowing needs.

Key Rating Drivers

- Hamilton's ratings have a Stable Outlook. Negative rating pressure could arise from a structural change in Hamilton's fiscal management leading to a debt payback ratio (debt to current balance) beyond 15 years in the long-term.
- Potential for positive rating actions is relatively limited due to the large capex and borrowing needs in the next four years. However, if Hamilton's operating balance is sufficient to fully fund capex the agency may consider an upgrade of the current Local Currency Long-term rating.

Profile

Hamilton has a population of around 140,700. Its main responsibilities include water distribution, wastewater treatment, solid waste management and public safety.

- Hamilton is the fourth largest urban area in New Zealand
- Healthy population growth supporting tax base
- Local economy dominated by agriculture and food manufacturing industry
- Next election in September 2010

Political Context and Administration

Hamilton is the fourth-largest urban area in New Zealand by population, located on the North Island, about 130km south of Auckland. As a council, Hamilton operates under a strict institutional framework (see *"Institutional Framework For New Zealand Subnationals"* under *Related Research* on the first page). The council is a territorial local authority governed by the Local Government Act 2002.

The council's elected officials include a mayor and 12 city councillors, all of whom are "independent" members without any party affiliation. The most recent local election was held in 2007, after which the number of councillors was reduced from 13 to 12 and the number of wards was reduced from three to two (East Ward and West Ward). The next council election is scheduled for September 2010. Key administrative officials include the chief executive (CEO) and five general managers; the latter manage standard municipal service areas. The mayor appoints the CEO, who has a contract for five years and acts as a principal advisor. The CEO employs the five general managers.

With the planned amalgamation of eight councils in the Auckland area, there have also been discussions among smaller councils about improving efficiency. Hamilton has close working relationships with two neighbouring councils (Waikato District Council and Waipa District Council) Although there have been no official discussions about an amalgamation of these councils, the working relationship has enabled a focus on shared concerns such as transportation and effects of land-use planning policies.

Socio-Economic Profile

Hamilton has a population of around 140,700. This is far smaller than that of New Zealand's largest city, Auckland, which after the amalgamation of eight different councils in its area later in 2010 will have 1.5 million inhabitants. Hamilton is closer in size to Wellington, the country's political capital, with 195,000 inhabitants. Hamilton expects to double its population by 2050, requiring significant infrastructure development.

The city serves as a service centre for the Region of Waikato, a large agricultural and food manufacturing area that accounts for about 9% of New Zealand's population and generated about 8% of New Zealand's GDP in 2009. Hamilton's economy has benefited from continued population and tax base growth, mainly due to migration within New Zealand but to some extent to immigration. Hamilton hosts a large university in New Zealand, therefore attracting a younger population.

The city's property base (capital value) per capita is below the median for New Zealand local governments, but this reflects its largely residential and institutional character. Property is re-valued every three years. Although property values increased strongly until 2007, the financial crisis and sluggish economic environment had a significant impact property values. However, city officials report that property prices seem to have bottomed out and real estate activities are slowly improving, although slightly below the national average. The next revaluation of properties will take place in 2012.

Economic Factors

	2006	2007	2008	2009	2010
Population	134,400	136,600	138,500	140,700[a]	n.a.
Capital value (NZDm)	13,013	21,049	21,170	n.a.	n.a.
Average home sales price (NZD; March each year)	289,000	319,500	332,000	320,000	320,000

n.a. - Not available
[a] At June 2009
Source: Hamilton City Council

Regional employment and sales activities are dominated by retail and wholesale trade, dairy farming, education and manufacturing. At end-2009, a fifth of New Zealand's exports were produced in the region around Hamilton. Until end-2008, employment was growing, especially in the city's major industries, supporting its economic growth. However, due to the recession employment has decreased across all sectors, with some sectors such as construction hit harder. Regional unemployment was 5.3% at March 2010 and is expected to decrease through 2010 and 2011.

Hamilton has an airport that serves some domestic and international flights. The council holds a stake in the airport (see *Contingent Liabilities* below).

Presentation of Accounts

Hamilton's fiscal year ends on 30 June. The most recent audited data available refer to end-June 2009. Fitch has used audited figures for the FY09 accounts and the forecast presented in the most recent LTCCP, which was published in 2009.

In 2004, Hamilton established a finance and audit committee, which meets quarterly and is headed by one of the councillors. The committee reviews the council's financial overview (funding summary), funding facilities and liquidity report, as well as investment report and counterparty credit report. The committee also monitors the council's endowment fund properties, which are mainly commercial and should provide financial returns to offset rates income. There is no debt outstanding to finance these properties. Hamilton has clear investment and liability management policies, which form part of the LTCCP. Any changes to these policies must be published and approved by the community.

Hamilton presents income statement, balance sheet and cash flow statements. For the purpose of our financial presentation in Appendix A, Fitch has used Hamilton's cash flow statements. However, there is no marked difference between accruals and cash flows.

Budgetary Performance and Prospects

- Operating revenue dominated by modifiable tax revenue
- Deterioration of operating margins in FY09 but likely to recover in FY10 due to slower operating expenditure growth
- Strong increase in capex due to infrastructure projects resulting from healthy population growth
- Funding costs likely to further affect budgetary performance

Since the onset of the global financial crisis in 2008, the economic environment — and property values, which are the basis for Hamilton's taxation — has sharply deteriorated in New Zealand. However, due to the council's rate and fee-setting powers, the operating balance has improved despite the decline of central government grants and an increase in operating expenditure in FY09. Overall, budgetary performance remained similar to that of previous years as Hamilton recorded a deficit of NZD40m due to greater interest expenses following the general increase in funding costs while capex remained elevated. Hamilton's 10-year LTCCP expects good economic recovery and additional population growth.

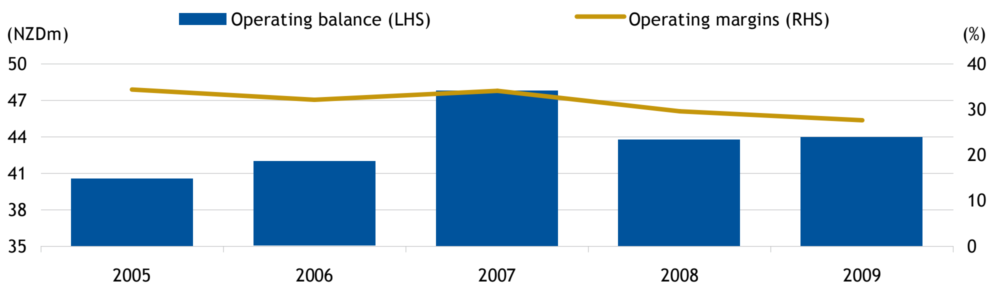
The council expects to report further deficits due to the planned additional infrastructure projects. These will burden the council's capex in FY10, which should remain larger in the following three years than in FY08.

Operating Revenue

In FY09, Hamilton's revenue increased by 8%, mostly in line with the planned budget. Capital contributions relating to development charges, however, were significantly smaller than budgeted, reflecting the weaker economic environment and slowdown in the construction industry, which led to reduced vested assets. Fitch includes these development charges as operating revenue as the council uses them to meet infrastructure and related reserve requirements. However, these charges are not legally pledged nor restricted to the payment of debt service expenditures or capex.

In FY09, tax-related revenue accounted for nearly two-thirds of operating revenue, while central government transfers slightly reduced to 9%. Compared with most international peers, Hamilton generates a significantly greater proportion of revenue through modifiable taxes (around 61% of operating revenue was rate related), reflecting the council's rate-setting power and its ability to react quickly to changes in other income streams in order to absorb any kind of negative impact from unexpected events. According to Hamilton's LTCCP operating revenue will increase, largely due to population growth, improved property values and adjustments in rates.

Budgetary Performance



Source: Hamilton City Council

Operating Expenditure

Operating expenditure, which includes staff expenses and payments for supplies and services, grew by 11% in FY09. As operating expenditure increased faster than operating revenue, Hamilton's operating margin declined slightly to 27.6%, compared with a five-year average of 31%, but is forecast to recover in FY10 by the council's LTCCP. Most of the expenditure growth reflects increased payments for supplies and services. Despite reduced staff numbers, personnel-related expenses continued to increase although the actual growth rate declined somewhat. Staff expenditure growth remains a long-term concern, especially in comparison with other councils, which sub-contract some of the services that Hamilton does "in-house". However, staff costs absorb a third of operating revenue, a lower proportion than for local governments in other countries. In its LTCCP, Hamilton forecasts improved margins due to based slower expenditure and greater revenue growth. Slower growth in operating expenditure is expected to be a result of further reduction in staff numbers.

Since the dislocation of the capital markets in 2007 and due to increased levels of indebtedness, funding costs have increased and negatively affected Hamilton's current balance — interest costs represented 9.5% of operating revenue in FY09 compared with 5.9% in FY05. Although interest spreads declined, Hamilton is still challenged by increased interest expenses due to its growing debt burden. The LTCCP suggests that funding costs will increase to more than 15% of operating revenue by 2012, mostly based on the council's debt projections. These projections are well within the council's policy limits.

Capital Expenditure

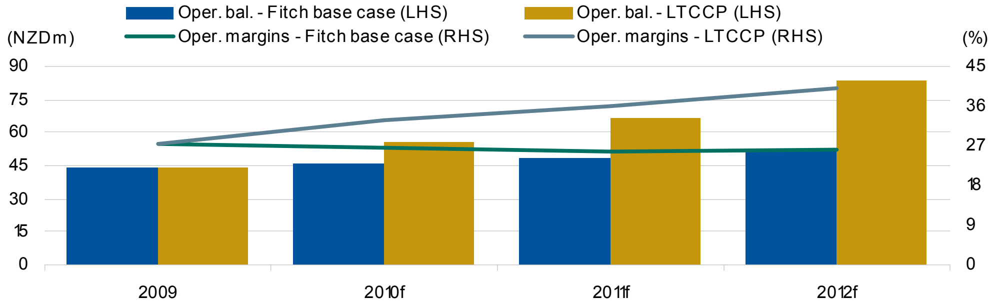
Hamilton's capex grew strongly during FY07-FY09. The current balance covered about a third of Hamilton's capex, reflecting the council's large investments in infrastructure and general improvements in the community. As capex exceeded capital revenue and the current balance, the council needed to raise additional debt. Although projections show Hamilton's continuing need to raise debt, Fitch is comforted that the council can only raise debt within limits set by the LTCCP.

According to Hamilton's LTCCP, the council expects continuing population growth, especially due to the growing importance of Hamilton as an economic hub in the Northern Island of New Zealand. A growing population and improving economic environment along with rising property values should support operating revenue and provide additional sources for the planned infrastructure investments to 2015. Although the LTCCP indicates decreasing new debt and larger repayments, Fitch believes that the council's plans will depend on the economic development of New Zealand and continued population growth. Fitch also takes comfort from the fact that Hamilton has in the past demonstrated an ability to reduce capex to limit its new borrowing and overall indebtedness.

Budgetary Performance Projections

The council's LTCCP forward forecast indicates continued strong operating performance into 2013 due to rises in rates and transfers from the central government. The latter is linked to expenditure on Transportation and Housing. This would result in a doubling in the operating balance by 2013 and substantial improvements in operating margins. However, Fitch has taken a more conservative approach and has reduced the level of transfers (more in line with national GDP growth of 3%) due to austerity measures announced by the New Zealand government. Fitch also projects that expenditure growth, which rose by a compound annual growth rate of 11.7% during 2007-2009, will not be cut back as aggressively as Hamilton forecasts in its LTCCP. In any event, although Fitch's forecast is more conservative, under the agency's base case there will still be a slight improvement in the operating balance creating some buffer against increased debt servicing charges in future. Operating margins are expected to maintain stable at 25%.

Budgetary Projections



f: forecasts
Source: Hamilton City Council and Fitch estimates

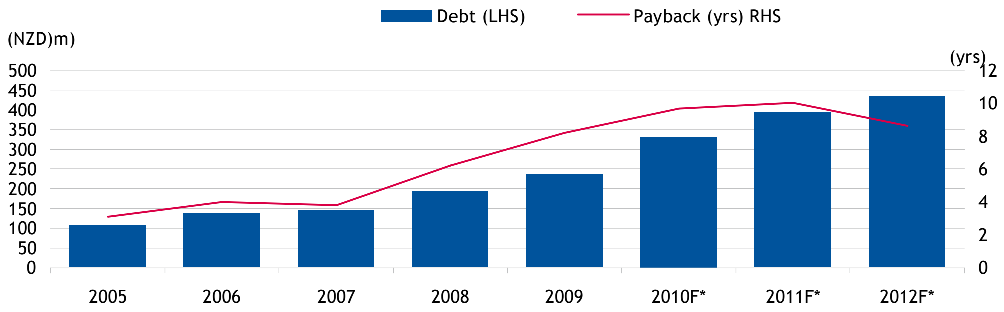
- Expected increase in Hamilton's outstanding debt following large infrastructure investments in the next decade
- All debt secured on rates through an indenture
- Bank facilities providing most of the council's liquidity cushion
- Limited contingent liabilities arising from Hamilton's stakes in different local companies

Debt, Liquidity and Contingent Liabilities

Debt

Due to Hamilton's population growth and increasing importance as an economic centre in the Northern Island of New Zealand, the council has significant infrastructure investments planned up to 2020. These investments will be financed by the council's annual revenue including development contributions, cash reserves and new debt issuances. Due to the increasing debt issuance, Hamilton expects to be a net borrower for the foreseeable future.

Debt and Payback



* forecasts based on Hamilton's current LTCCP
Source: Hamilton City Council's Annual Report and LTCCP

At end-March 2010, Hamilton's outstanding debt totalled NZD282.2m, of which around 16% will mature in the following 12 months. In the past, Hamilton had a historic sinking fund through which it prepared for repayment of outstanding maturing debt. However, following a change in legislation and in line with other councils in New Zealand, Hamilton decided not to proceed with a sinking fund for new borrowing. The previous fund matured in FY09. Fitch views the use of sinking funds as positive as they reduce refinancing risk for the issuer. The agency believes that such a fund would be a conservative measure in light of the council's significant maturing debt in the coming years. Fitch takes some comfort from the council's liability management policy, which sets clear limits on the proportion of debt that can mature within certain periods and from the committed bank funding available.

According to the council's investment policy, Hamilton can establish special funds or reserve funds that are typically used for specific purposes. Liquid assets are not required to be held against these funds. Hamilton has funded these commitments to future specified releases through committed credit facilities. However, the council is reviewing its current liquidity management procedures. In order to be less dependent on committed bank facilities, the council started to increase its cash holding which is mainly invested in bank deposits currently producing a small return. Hamilton has clear liability management policies that limit the amount of debt it can raise. These policies include the overall debt level as a percentage of assets (max 25%) and income (max 180%), and the cost of debt as a percentage of total revenue (max 20%). Fitch views these policy limits as prudent.

Most of Hamilton's debt has fixed interest rates, in line with the council's liability management policy. Hamilton also has some outstanding variable-rate issuances that are hedged back into fixed rates. As the council can only issue local currency debt, foreign exchange risk is very small and arises from goods purchases in foreign currency. Fitch considers Hamilton's foreign exchange risk management policies to be conservative.

Despite the LTCCP's forecast of a 102% increase in debt by FY13, Fitch expects the debt burden to remain manageable for the present rating. Debt will represent 213% of current revenue by FY13, compared with 148% at present, and eight years of the current balance, in line with the payback ratio in FY10.

Hamilton is able to issue secured debt through a master indenture, creating a lien on municipal revenue and accounts. Key provisions include a continuing covenant to pay according to the terms of the debt, a trustee role for the life of the debt, and investor/lender recourse, as long as it does not prevent the provision of services. By end-May 2010, the council had only issued debt supported by a continuing charge on rate revenue (property tax levy). All debentures are secured pari passu, although the council expects one-third of its debt to be supported by development charges.

Liquidity

The council manages its liquidity through short-term working-capital money-market funding lines mainly provided by highly rated banks. The council minimises the holding of cash, which is placed in deposits. At end-March 2010 these liquid assets totalled NZD1m. Hamilton uses internal borrowing to offset its working-capital and debt-funding requirements. In Fitch's view the actual liquidity cushion is small, and the sole reliance on bank facilities is considered less conservative. However, the agency takes comfort from the strong institutional framework in New Zealand, which prevents councils acting outside the set annual plan and LTCCP, which sets out all outgoing cash flows including payments of interest and principal.

Contingent Liabilities

The council has three equity stakes in companies located in its region: 41.38% of Hamilton Riverview Hotel Ltd; 50% of Waikato Regional Airport Limited; and 34.85% of Hamilton Fibre Network Limited. The council made these investments to support the city's infrastructure. Any dividend payments are small. Hamilton has representatives on the boards of all three companies. Should the council decide to exit these investments, the raised cash must be used to repay outstanding debt. At end-March 2010, loans to the companies totalled NZD1.75m which have been repaid on 1 June 2010.

In the LTCCP, Hamilton indicated that it intended to reduce its stakes in Hamilton Riverview Hotel Ltd and Waikato Regional Airport Limited, which would further limit its contingent liabilities. Hamilton had a commitment regarding uncalled share capital in Waikato Regional Airport of NZD4.8m. This figure was NZD10.8m at FY08 but, in order to recapitalise the airport to cover losses, there was a partial call on the shareholders for capital increases. Fitch understands that with the opening of the airport to international traffic it is expected to break-even in the short term.
Hamilton also has some minority stakes in different companies, which it mainly owns with other New Zealand councils. The investments are small but some require funding, which is at an acceptable level. Potential loss absorption is small.

Appendix A

Hamilton City Council

NZDm	June 2005	June 2006	June 2007	June 2008	June 2009
Taxes	73.8	78.1	85.3	91.5	97.4
Transfers received	10	13.5	18.4	15.1	14.3
Fees, Fines and other Operating revenue	34.4	39.4	36.6	41.4	47.8
Operating Revenue	**118.2**	**131**	**140.3**	**148**	**159.5**
Operating expenditure	-77.6	-89	-92.5	-104.2	-115.5
Operating Balance	**40.6**	**42**	**47.8**	**43.8**	**44**
Financial revenue	0.5	0.8	0.4	0.2	0.3
Interest paid	-7	-8.5	-9.8	-12.5	-15.1
Current Balance	**34.1**	**34.3**	**38.4**	**31.5**	**29.2**
Capital revenue	6.2	4.2	13.7	10.4	10.3
Capital expenditure	-50.8	-68.9	-58.5	-88.7	-83.5
Capital Balance	-44.6	-64.7	-44.8	-78.3	-73.2
Surplus (Deficit) before Debt Variation	**-10.5**	**-30.4**	**-6.4**	**-46.8**	**-44**
New borrowing	22.8	39.7	19.1	57.6	51.8
Debt repayment	-12.3	-9.2	-12.4	-10	-8.6
Net Debt Movement	*10.5*	*30.5*	*6.7*	*47.6*	*43.2*
Overall results	**0**	**0.1**	**0.3**	**0.8**	**-0.8**
DEBT					
Short-term	-	34	18.5	54.5	99.2
Long-term	106.7	103.4	127.1	138.9	137.6
Direct debt	**106.7**	**137.4**	**145.6**	**193.4**	**236.8**
+ Other Fitch classified debt - Pre-financing	2	2.1	2.1	2	2.2
Direct risk	**108.7**	**139.5**	**147.7**	**195.4**	**239**
- Cash, Liquid Deposits, Sinking Fund	5.6	6.7	2.3	2.9	0.5
Net direct risk	**103.1**	**132.8**	**145.4**	**192.5**	**238.5**
Guarantees and other Contingent Liabilities	-	-	-	-	-
Net Indirect debt (Public Sector Entities exc. gteed amount)	-	-	-	-	-
Net overall risk	**103.1**	**132.8**	**145.4**	**192.5**	**238.5**
Memo for direct debt:					
% in foreign currency	*0*	*0*	*0*	*0*	*0*
% issued debt	*100*	*100*	*100*	*100*	*100*
% fixed interest rate debt	-	-	-	-	-

Appendix B

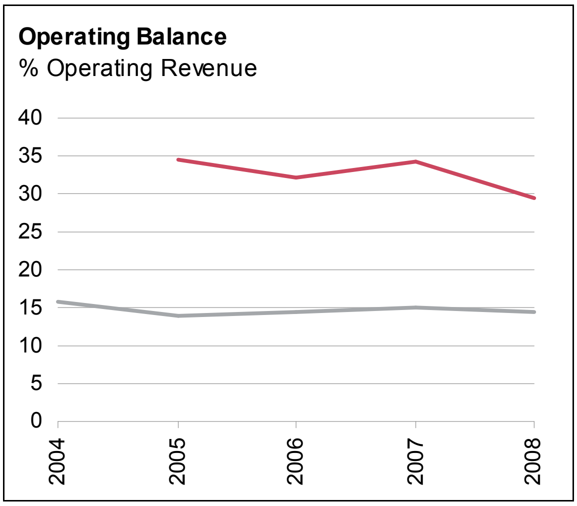
Hamilton City Council

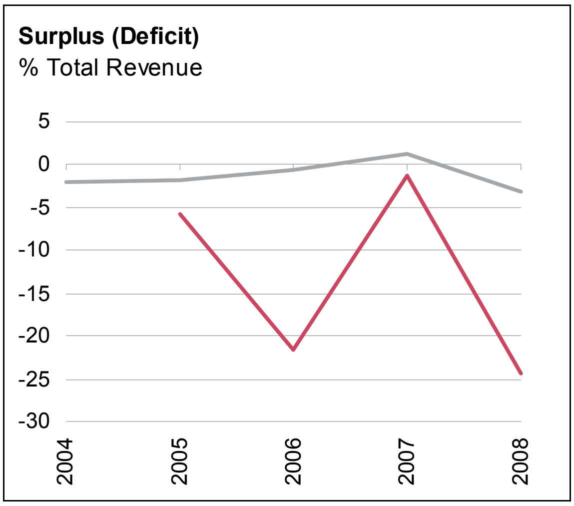
	June 2005	June 2006	June 2007	June 2008	June 2009
Fiscal performance ratios					
Operating balance/operating revenue (%)	34.35	32.06	34.07	29.59	27.59
Current balance/current revenue[a] (%)	28.73	26.02	27.29	21.26	18.27
Surplus (deficit) before debt variation/total revenue[b] (%)	-8.41	-22.35	-4.15	-29.51	-25.87
Overall results/total revenue (%)	0	0.07	0.19	0.5	-0.47
Operating revenue growth (annual % change)	n.a.	10.83	7.1	5.49	7.77
Operating expenditure growth (annual % change)	n.a.	14.69	3.93	12.65	10.84
Current balance growth (annual % change)	n.a.	0.59	11.95	-17.97	-7.3
Debt ratios					
Direct debt growth (annual % change)	n.a.	28.77	5.97	32.83	22.44
Interest paid/operating revenue (%)	5.92	6.49	6.99	8.45	9.47
Operating balance/interest paid (x)	5.8	4.94	4.88	3.5	2.91
Direct debt servicing/current revenue (%)	16.26	13.43	15.78	15.18	14.83
Direct debt servicing/operating balance (%)	47.54	42.14	46.44	51.37	53.86
Direct debt/current revenue (%)	89.89	104.25	103.48	130.5	148.19
Direct risk/current revenue (%)	91.58	105.84	104.98	131.85	149.56
Direct debt/current balance (yrs)	3.13	4.01	3.79	6.14	8.11
Net overall risk/current revenue (%)	86.86	100.76	103.34	129.89	149.25
Direct risk/current balance (yrs)	3.19	4.07	3.85	6.2	8.18
Direct debt/GDP (%)	-	-	-	-	-
Direct debt per capita (local currency)	821	1,057	1,063	1,391	1,691
Revenue ratios					
Operating revenue/budget operating revenue (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Tax revenue/operating revenue (%)	62.44	59.62	60.8	61.82	61.07
Modifiable tax revenue/total tax revenue (%)	100	100	100	100	100
Current transfers received/operating revenue (%)	8.46	10.31	13.11	10.2	8.97
Operating revenue/total revenue[b] (%)	94.64	96.32	90.87	93.32	93.77
Total revenue[b] per capita (local currency)	961	1,046	1,127	1,141	1,215
Expenditure Ratios					
Operating expenditure/Budget operating expenditure (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Staff expenditure/Operating expenditure (%)	43.69	42.36	46.05	46.16	44.59
Current transfer made/Operating expenditure (%)	-	-	1.95	-	-
Capital expenditure/Budget capital expenditure (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Capital expenditure/Total expenditure (%)	34.39	39.24	33.78	41.18	37.49
Capital expenditure/Local GDP (%)	-	-	-	-	-
Total expenditure per capita (local currency)	1,136	1,351	1,264	1,550	1,591
Capital expenditure financing					
Current balance/Capital expenditure (%)	67.13	49.78	65.64	35.51	34.97
Capital revenue/Capital expenditure (%)	12.2	6.1	23.42	11.72	12.34
Net debt movement/Capital expenditure (%)	20.67	44.27	11.45	53.66	51.74

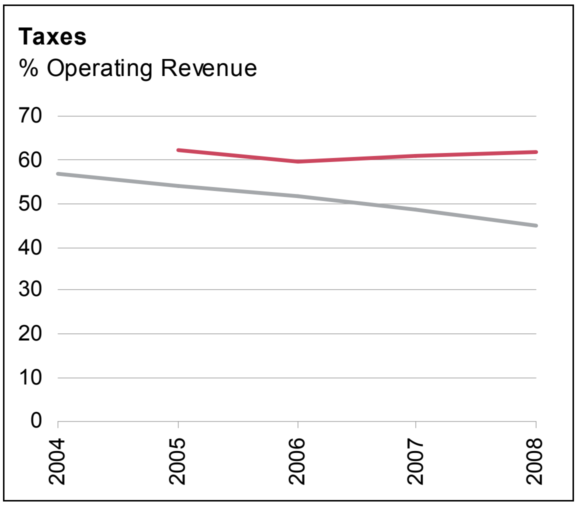
[a] Includes financial revenue
[b] Excluding new borrowing
n.a. - Not available
Source: Fitch

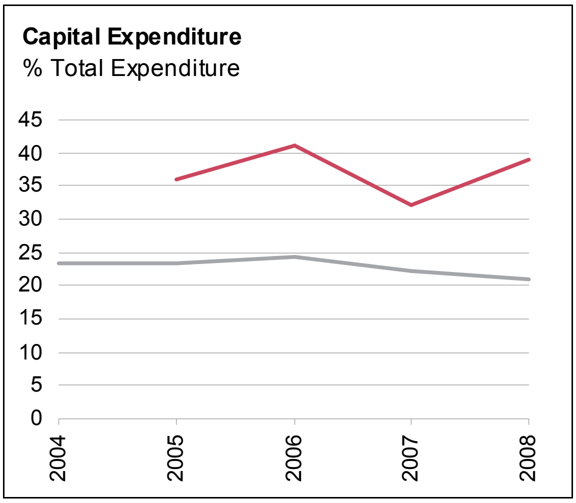
Appendix C

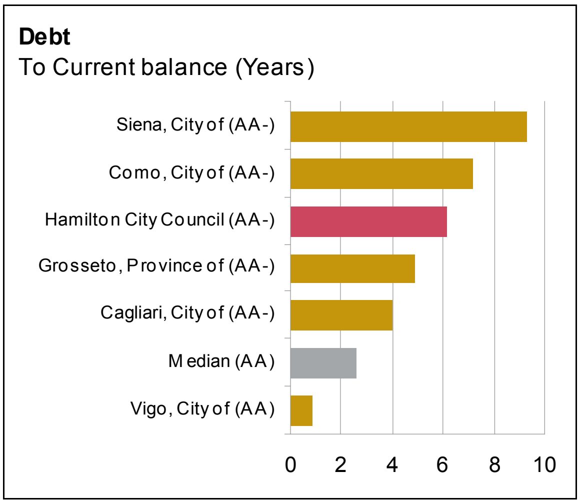
Peer Comparison

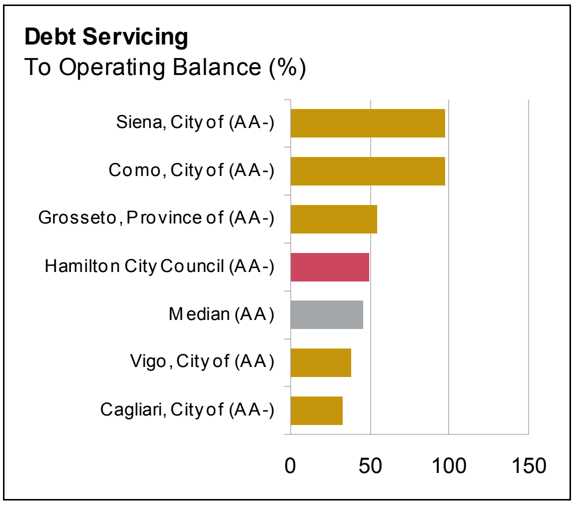












Hamilton City Council — AA- Peer Group Median