STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Research Update:

Greater London Authority Rating Affirmed At 'AA+' On Exceptional Liquidity and Government Support; Outlook Stable

Primary Credit Analyst:
Hugo C Foxwood, London (44) 20-7176-3781; hugo.foxwood@standardandpoors.com

Secondary Contacts:
Robin Froggatt-Smith, London (44) 20-7176-3609; robin.froggatt-smith@standardandpoors.com
Carl Nyrerod, Stockholm (46) 8-440-5919; carl.nyrerod@standardandpoors.com

Table Of Contents

Research Update:

Greater London Authority Rating Affirmed At 'AA+' On Exceptional Liquidity and Government Support; Outlook Stable

Overview

- The Greater London Authority's (GLA's) credit strengths include its exceptional liquidity position, its potential control over the sizable funding it distributes to its functional bodies, and its potential to receive extraordinary support from the U.K. government.
- At the same time, it has very high debt levels stemming from its involvement in co-financing Crossrail and the Northern Line extension (NLE).
- We are therefore affirming our long-term rating on the GLA at 'AA+'.
- The stable outlook reflects our view that the GLA will continue to enjoy strong support from the U.K. government, and that revenues from business rates will prove less volatile than in the financial year ending March 31, 2014 (financial year 2014). We also expect that the GLA will maintain an exceptional liquidity position.

Rating Action

On Nov. 14, 2014, Standard & Poor's Ratings Services affirmed its 'AA+' long-term issuer credit rating on the Greater London Authority (GLA). The outlook is stable.

At the same time, we affirmed the 'AA+' long-term issue rating on the £600 million loan granted to the GLA by the special-purpose vehicle Community Finance 1 PLC.

Rationale

The rating on the GLA reflects our view of London's very strong economy, and its fiscal and political significance for the U.K., which would provide strong incentives for the U.K. government to provide extraordinary support, if required. Other supporting factors are the extremely predictable and supportive U.K. local government institutional framework; the GLA's exceptional liquidity position in international terms; its very strong financial management; its strong budgetary flexibility; and its very low level of contingent liabilities. These strengths are offset by the GLA's very high debt burden; and its very large negative balances after capital accounts, which lead us, based on our criteria definitions, to assess financial performance as very weak. The negative balances after capital accounts reflect the significant funding that the GLA is passing to Transport for London for its capital expenditure (capex) on Crossrail and, starting this year, the Northern Line Extension (NLE).

The risk associated with the GLA's very high debt levels and negative balances after capital accounts are balanced by the credit strengths described above. In a stress scenario, we also note that the GLA could delay or reduce the very large funding that it distributes to its functional bodies (£1.8 billion, comprising £0.9 billion retained business rates, £0.7 billion council tax, and £0.2 billion revenue support grant; or 15x its interest costs in the financial year ending March 30, 2014). We have deducted these funds to the functional bodies from our calculation of the GLA's own revenues, as we consider them more akin to pass-through items (see table 1).

The rating also reflects our belief that the U.K. government would be willing to provide timely extraordinary support to the GLA, if required. The government has already acted supportively in allocating the GLA additional revenues to service the debt raised to fund Crossrail and the NLE, and in guaranteeing that the GLA can refinance up to £750 million of future NLE debt over a 50-year period, if needed. Given the political significance of London, and the major net contribution it makes to the U.K.'s fiscal position, we anticipate that the U.K. government would have a strong incentive to provide any required extraordinary support on a timely basis. For these reasons, our 'AA+' long-term issuer credit rating on the GLA is one notch higher than the GLA's 'aa' stand-alone credit profile.

The GLA has previously raised debt through Community Finance Company 1 PLC (CofCo 1), a special-purpose entity established to issue notes and onlend the proceeds to the GLA. We rate the bonds issued by CofCo 1 at 'AA+'. We understand that if the GLA were to raise further debt through CofCo 1, then it would use a similar structure. As such, we would expect to rate a further bond issuance at 'AA+'--the same level as the issuer credit rating on the GLA.

The GLA's very high debt levels and negative balances after capital accounts are a direct consequence of the implementation of Crossrail (a £14.7 billion infrastructure project to be completed by 2019) and the NLE (a £1 billion project to be completed by 2020). The GLA is contributing £4.1 billion to Crossrail's cost by raising debt and passing the borrowing proceeds, plus any surplus after debt service from a ringfenced revenue stream (supplementary business rates) to TfL. The GLA also plans to contribute £960 million to finance the NLE. It will raise debt to make this contribution, which is capped at £1 billion. It plans to service the debt from developer contributions and business rates within an associated enterprise zone. As with Crossrail, the GLA will transfer a specified level of funding to TfL, and will not directly assume any construction risk.

Because these construction projects are capital-intensive, we expect the GLA's capex to vary significantly from year to year, which will have a corresponding effect on the GLA's balance after capital accounts. In FY2014, for instance, the GLA posted a negative balance after capital accounts of 53% of revenues, as it passed significant Crossrail funding to TfL. In the current financial year, ending March 31, 2015, the contribution to Crossrail is set to be rather less, resulting in a small deficit after capital accounts of 2%, followed by one of 5% in FY2016. From FY2017, however, we expect deficits after capital accounts to increase as the GLA provides funding for the NLE.

On an operating basis, the GLA has generally posted modest surpluses, although in cash terms it did post a temporary operating deficit of 21% in FY2014. This was related to a transition to a new funding system, whereby local authorities receive a significant portion of their revenues based on levels of business rate collection. The London boroughs, which collect business rates, underestimated the revenue that was lost as a result of business rate appeals. Consequently, the GLA experienced a shortfall of about £81 million from what it had budgeted.

In responding to this revenue shortfall, the full details of which became apparent only after the financial year-end, the GLA decided not to claw back funds that had already been paid out to functional bodies, but instead effectively to absorb the revenue shortfall over the following five years. On average, therefore, we anticipate that between FY2014 and FY2017, the GLA's operating position will be in surplus by about 2% of operating revenues. We have based our calculation of the GLA's operating position on movements in the general fund balance (which have been positive throughout this period, and generally give an accurate measure of underlying performance), adjusted for cash movements relating to provision for debt repayment and the shortfall in business rates. This way of calculating operating balances marks a change from our previous practice, which paid closer attention to movements in ringfenced reserves.

Despite the transitional revenue volatility associated with business rate reform, we continue to assess the U.K. institutional framework for local and regional governments as extremely stable and predictable from a credit perspective. Although many local authorities will face continued spending pressures over the coming years, as the U.K. seeks to reduce its fiscal deficit, we anticipate that they will have both the political willingness and the capacity to properly plan and reduce expenditures without threatening their mandatory responsibilities.

In common with many other U.K. local authorities, we consider that the GLA has limited autonomy over its revenue base, although we do factor in what we view as an above-average capability to generate revenues from asset sales, as the GLA has a substantial portfolio of land and assets. As such, we believe its level of financial flexibility is strong.

More generally, we view the GLA's financial management as very strong. Although it failed to accurately forecast its revenues from business rates in FY2014, we view this as a transitional issue--the GLA made its plans based on estimates provided by the local authorities that collected the revenues. More positively, we consider that the GLA has shown good debt and liquidity management, as demonstrated by its prudent approach to the sourcing and planned amortization of Crossrail borrowing; its comprehensive long-term planning; and its decision to hold high levels of liquidity.

Over the longer term, we anticipate that the reform of business rates will prove more positive for the GLA, which should be able to benefit if, as we expect, London business rates rise by more than the national average. We estimate that London's gross value added (GVA) per capita was £38,939 in 2013, and we forecast that growth in GVA will remain steady at about 3% on average over the next three years, supported by rising employment levels.

We expect London will grow faster than the U.K. average of 2.5% in 2015 and 2.2% in 2016, reflecting the more-flexible and service-oriented nature of London's economy, in which financial services play a key role. London is both pivotal to the U.K.'s economic growth and a major net contributor to the U.K.'s fiscal position. The demands of London's growing economy and population have fueled the current phase of investment in transport infrastructure, which led to the GLA's high levels of debt.

The GLA has raised a total of £3.3 billion in debt in the past four years to March 2014, mainly to fulfil its commitment to part-finance Crossrail. This borrowing for Crossrail comprises mainly loans from the Public Works Loan Board (PWLB) and a £600 million loan from Community Finance Company 1 PLC (CoFCo 1), a special-purpose entity established to issue notes and onlend the proceeds to the GLA.

In FY2015, we expect the GLA to incur about £309 million in debt. As a result, the GLA's tax-supported debt will rise to more than 10x consolidated operating revenues. Although these debt levels are extremely high, they should be seen in the context of the GLA's total unadjusted cash operating revenues (that is, before we deduct the amount that it passes to the functional bodies). In 2016, for instance, we forecast GLA's unadjusted cash operating revenues will be £2.2 billion, of which debt will be just 167%.

We consider the GLA's contingent liabilities to be very low. TfL bears the risks directly associated with cost overruns on Crossrail and the NLE and the U.K. government ultimately bears the risks on Crossrail.

Liquidity

We view the GLA's overall liquidity position as exceptional, based on what we view as an exceptional debt service coverage and our expectation of exceptional access (in international terms) to external liquidity. This overall assessment reflects the GLA's very large funding needs.

In October 2014, the GLA had about £1.3 billion in free cash reserves and short-term investments (after allowing for some loss of value in a stress scenario and coverage of part of the GLA's investment program), which will comfortably cover about 622% of the next 12 months' debt service.

We also view the GLA as having exceptional access to external liquidity, compared with international peers. This is primarily due to the U.K. government's PWLB, which can provide funding to the GLA within 48 hours of an application, as long as the GLA is operating according to the Prudential Code.

Outlook

The stable outlook reflects our base-case expectation that the GLA will continue to enjoy strong support from the U.K. central government, and that revenues from business rates will prove less volatile than in FY2014. We also expect that the GLA will maintain an exceptional liquidity position.

We could lower the rating if more volatile business rates, combined with exposure to credit risk incurred from planned onlending activities under the GLA's housing financial transactions, increases pressure on deficits after capital accounts. If deficits after capital accounts look set to exceed about 20%-25% of revenues, and the GLA does not demonstrate its willingness to reduce expenditures in response to shortfalls in its budget, then we may lower the rating. Alternatively, a weakening in the GLA's liquidity position, combined with a weakening in our assessment of financial management, perhaps in relation to the forecasting and control over revenues and expenditures, could also cause us to lower the rating.

We could consider raising the rating over the next two years if the GLA significantly reduced its planned capital expenditure, and looked set to post continued surpluses after capital accounts. We view this scenario as unlikely within the next two years.

Key Statistics

Table 1

Greater London Authority Financial Statistics

	--Year ending March 31--					
(Mil. £)	**2012**	**2013**	**2014bc**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	796	541	315	350	442	395
Operating expenditures	791	505	381	295	405	371
Operating balance	5	37	(66)	55	37	24
Operating balance (% of operating revenues)	0.62	6.81	(20.99)	15.83	8.34	6.13
Capital revenues	102	827	1,015	1,740	910	661
Capital expenditures (capex)	873	1,471	1,651	1,835	1,009	1,090
Balance after capital accounts	(766)	(608)	(702)	(40)	(63)	(405)
Balance after capital accounts (% of total revenues)	(85.38)	(44.42)	(52.75)	(1.91)	(4.63)	(38.37)
Debt repaid	0	0	45	0	169	39
Balance after debt repayment and onlending	(766)	(608)	(747)	(40)	(232)	(444)
Balance after debt repayment and onlending (% of total revenues)	(85.38)	(44.42)	(56.13)	(1.91)	(17.13)	(42.04)
Gross borrowings	684	1,080	800	309	340	395
Balance after borrowings	(82)	472	53	269	108	(49)

Table 1

Greater London Authority Financial Statistics (cont.)						
Operating revenue growth (%)	106.18	(31.96)	(41.84)	11.14	26.27	(10.55)
Operating expenditure growth (%)	105.00	(36.19)	(24.49)	(22.68)	37.49	(8.40)
Modifiable revenues (% of operating revenues)	26.06	38.40	48.96	56.24	31.83	33.58
Capital expenditures (% of total expenditures)	52.47	74.46	81.25	86.17	71.36	74.61
Direct debt (outstanding at year-end)	1,400	2,500	3,255	3,564	3,735	4,091
Direct debt (% of operating revenues)	175.95	461.77	1,033.79	1,018.46	845.29	1,035.11
Tax-supported debt (% of consolidated operating revenues)	175.95	461.77	1,033.79	1,018.46	845.29	1,035.11
Interest (% of operating revenues)	7.58	16.69	36.64	36.69	28.07	33.65
Debt service (% of operating revenues)	7.58	16.69	50.93	36.69	66.32	43.45

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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. Base case reflects Standard & Poor's expectations of the most likely scenario. Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with an upgrade.

Table 2

Greater London Authority Economic Statistics						
	--Year ended Dec. 31--					
	2011	**2012**	**2013**	**2014bc**	**2015bc**	**2016bc**
Population	8,204,484	8,308,417	8,416,427	8,517,424	8,611,116	8,714,449
Population growth (%)	1.77	1.27	1.30	1.20	1.10	1.20
GDP per capita (£)	36,976	37,232	38,939	40,363	41,920	43,453
National GDP (nominal) per capita (US$)	39,480	39,351	39,965	44,019	45,882	47,591
Real GDP growth (%)	4.4	1.5	3.4	3.2	3.0	2.9
Unemployment rate (%)	9.1	10.0	7.6	7.6	7.5	7.5

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices, Eurostat, and Experian Ltd.

Ratings Score Snapshot

Table 3

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Very strong
Budgetary flexibility	Strong
Budgetary performance	Very weak
Liquidity	Exceptional
Debt burden	Very high
Contingent liabilities	Very low

Table 3

Ratings Score Snapshot (cont.)
*Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators, Sept. 22, 2014, (Interactive version also available at http://www.spratings.com/sri)

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

Related Research

- Rating Assigned To U.K. Repack Transaction Community Finance Company 1's Series 01 Notes, July 8, 2011
- Public Finance System Overview: U.K. Local and Regional Governments, April 5, 2011
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Presale: Community Finance Company 1 PLC (Series 1), June 22, 2011

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

Greater London Authority	
Issuer Credit Rating	AA+/Stable/--
Senior Unsecured	AA+

Additional Contact:
International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.