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Research Update:

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

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Overview

- The Greater London Authority's (GLA's) credit strengths include London's very strong economy, the GLA's exceptional liquidity position, 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 cofinancing Crossrail and the Northern Line Extension.
- We are therefore affirming our 'AA+' long-term rating on the GLA.
- 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 (FY2014). We also expect that the GLA will maintain an exceptional liquidity position.

Rating Action

On May 15, 2015, 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 loans issued by the GLA to the special-purpose vehicle Community Finance 1 PLC.

Rationale

The affirmation 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 strong financial management; and its very low level of contingent liabilities. These strengths are offset by the GLA's weak budgetary flexibility; its very high debt burden; and its large negative balances after capital accounts, which lead us to describe financial performance as weak, according to our criteria. The negative balances after capital accounts reflect the significant funding that the GLA is passing to Transport for London (TfL) for its capital expenditure (capex) on Crossrail and, more recently, the Northern Line Extension (NLE).

In an important change from previous years, we now include in the GLA's revenues and expenditures the council tax precepts, revenue support grants, and business rates that it collects and then distributes to its functional bodies. These represent about £1.9 billion annually. Previously, we had excluded these from our calculation of the GLA's revenues and expenditures, viewing them as pass-through items. We have changed our approach to better reflect the flexibility that GLA would have,

particularly in a stress scenario, to use these revenues for debt service. (We continue to exclude from our calculation the ringfenced grants that the GLA is legally required to pass through to its functional bodies.)

At the same time, we have reviewed the scope of our assessment of financial management in light of this more consolidated approach. Previously, we factored in the GLA's high and rapidly rising debt levels by adjusting the rating by one notch from what our scoring would suggest. We have now decided to factor in this rising debt in a different way, namely by revising down our assessment of GLA's debt management to reflect its appetite for borrowing. This has led us to revise down our overall assessment of its financial management to strong from very strong.

Another effect of our more consolidated approach to financial analysis is that we now assess the GLA's budgetary flexibility in relation to a much larger revenue and expenditure base. We are therefore revising our assessment of its flexibility to weak from strong. For similar reasons, we have revised our assessment of budgetary performance upward to weak from very weak, as the deficit after capital accounts as a percentage of total revenues is smaller when we include in the denominator all the revenues that are potentially available for debt service.

The rating also reflects our belief that the U.K. government would be willing to provide timely extraordinary support to the GLA, if required, given London's political significance and contribution to the U.K.'s economic and fiscal position. The government has already allocated additional revenues to the GLA to service the debt it has raised to fund Crossrail and the NLE, and has guaranteed that the GLA can refinance up to £750 million of future NLE debt over a 50-year period, if needed. 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's very high debt levels and negative balances after capital accounts are a direct consequence 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 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 (capped at £1 billion) to finance the NLE. It plans to service this 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 levels will vary significantly from year to year, correspondingly affecting the GLA's balance after capital accounts. In FY2014, for instance, the GLA posted a negative balance after capital accounts of 28.5% of total revenues as it passed significant Crossrail funding to TfL. In the current financial year ending March 31, 2016, its contribution to Crossrail looks likely to be significantly smaller, resulting in a small deficit after capital accounts of 1.9%. This will then increase in the following two years as the GLA provides funding to TfL for the NLE. On an operating basis we see less variability, with the GLA typically posting modest

operating surpluses. Operating revenues are slightly lower than initially forecast due to higher-than-expected provisions for businesses successfully appealing against the level of their business rates.

Despite the revenue volatility associated with changes to business rates, we continue to assess the U.K.'s 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 undermining their mandatory responsibilities.

In common with many other U.K. local authorities, we consider that the GLA's flexibility lies more on the expenditure side; its autonomy over its revenue base is limited. That said, our assessment also recognizes the GLA's limited flexibility to reduce transfers to the functional bodies, based on potential political sensitivities. We do recognize some capacity to generate revenues from asset sales, as the GLA has a substantial portfolio of land and assets, although we do not formally reflect this in our scoring.

Generally, we view the GLA's financial management as strong. The increased volatility from business rates has made the context more challenging, but we view the GLA's long-term planning as comprehensive and detailed, and its liquidity management as cautious, as demonstrated by its decision to hold high levels of liquidity. Notwithstanding the GLA's appetite for borrowing, which is high for the rating level, we see its debt management as a strength, as demonstrated by its prudent approach to the sourcing and planned amortization of its borrowings.

Over the longer term, we anticipate that business-rate reforms will prove more positive for the GLA. It stands 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 £42,222 in 2014, and we forecast that GVA growth will remain steady at about 3% on average over the next three years, supported by rising employment levels.

We expect London will continue to grow faster than the U.K. average, reflecting the more-flexible and service-oriented nature of its 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 has led to the GLA's high levels of debt.

The GLA held a total of £3.6 billion in debt as of March 2015, primarily raised to fulfil its commitment to part-finance Crossrail. Over the next three years to March 31, 2018, we expect that its debt will rise to £4.3 billion, or 181% of operating revenues, mostly to finance the NLE. In our calculation of debt, we also include £355 million of grant that will be repayable to the U.K. government, but which

incurs no interest charge. We understand that this grant will be onlent by the GLA to various entities to build housing.

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 its exceptional debt service coverage, although we recognize that future funding needs are large. Our assessment also reflects our expectation of exceptional access (in international terms) to external liquidity.

Over the next 12 months, we estimate that the GLA will have sufficient 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) to comfortably cover, by about 4x, 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 Public Works Loan Board, which can provide funding to the GLA within 48 hours of an application.

Outlook

The stable outlook reflects our base-case expectation 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 FY2014. We also expect that the GLA will maintain an exceptional liquidity position.

We could lower the rating if more volatile business rates and higher-than-expected levels of capex cause deficits after capital accounts to increase. If deficits after capital accounts look set to exceed about 20%-25% of revenues, then in the absence of mitigating factors, we may lower the rating.

We could consider raising the rating over the next two years if the GLA significantly reduced its planned capex and appeared likely 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					
	--Fiscal Year End March 31--				
(Mil. £)	2014	2015	2016	2017	2018
Operating revenues	2,319	2,419	2,392	2,353	2,355
Operating expenditures	2,254	2,293	2,265	2,262	2,226
Operating balance	64	127	127	91	129
Operating balance (% of operating revenues)	2.8	5.2	5.3	3.9	5.5
Capital revenues	531	990	1,030	491	391
Capital expenditures	1,408	1,437	1,223	865	907
Balance after capital accounts	(813)	(321)	(66)	(284)	(387)
Balance after capital accounts (% of total revenues)	(28.5)	(9.4)	(1.9)	(10.0)	(14.1)
Debt repaid	45	0	169	74	68
Balance after debt repayment and onlending	(767)	(359)	(410)	(517)	(595)
Balance after debt repayment and onlending (% of total revenues)	(26.9)	(10.5)	(12.0)	(18.2)	(21.6)
Gross borrowings	799	344	263	355	361
Balance after borrowings	32	(15)	(147)	(162)	(234)
Operating revenue growth (%)	N/A	4.3	(1.1)	(1.6)	0.1
Operating expenditure growth (%)	N/A	1.7	(1.2)	(0.1)	(1.6)
Modifiable revenues (% of operating revenues)	34.0	32.4	33.4	31.7	31.7
Capital expenditures (% of total expenditures)	38.4	38.5	35.1	27.7	29.0
Direct debt (outstanding at year-end)	3,254	3,598	3,692	3,974	4,267
Direct debt (% of operating revenues)	140.4	148.7	154.4	168.9	181.2
Tax-supported debt (% of consolidated operating revenues)*	140.4	148.7	154.4	168.9	181.2
Interest (% of operating revenues)	4.9	5.2	5.4	5.5	5.6
Debt service (% of operating revenues)	6.9	5.2	12.5	8.7	8.5

*Equivalent to direct debt. 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.

Table 2

Greater London Authority Economic Statistics				
	--Fiscal Year End Dec. 31--			
	2013	2014bc	2015bc	2016bc
Population growth (%)	1.3	1.2	1.1	1.2
GDP per capita (local currency) (single units)	40,215	42,222	43,729	45,060
Real GDP growth (%)	3.3	3.7	3.1	2.8
Unemployment rate (%)	8.2	6.4	6.2	6.0

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 and Eurostat. bc--Base case.

Ratings Score Snapshot

Table 3

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

*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, March 31, 2015 (Interactive version also available at <http://www.spratings.com/sri>)

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014

Related Research

- Public Finance System Overview: U.K. Local and Regional Governments, April 5, 2011
- Default, Transition, and Recovery: International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

- Report Card: U.K. Local Authorities Absorb Major Cuts, But What Flexibility Remains?, March 31, 2015
- Presale: Community Finance Company 1 PLC (Series 2), May 11, 2015

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	
	To	From
Greater London Authority		
Issuer credit rating		
Foreign and Local Currency	AA+/Stable/--	AA+/Stable/--
Senior Unsecured		
Local Currency	AA+	AA+

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