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Research Update:

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

Primary Credit Analyst:
Robin Froggatt-Smith, London (44) 20-7176-3609; robin.froggatt-smith@standardandpoors.com

Secondary Contact:
Ines Olondriz, Madrid (34) 91-788-7202; ines.olondriz@standardandpoors.com

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Overview

- The Greater London Authority (GLA) benefits from London's very strong economy, its own 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 financing Crossrail and the Northern Line Extension of the London Underground.
- We are therefore affirming our 'AA+' long-term rating on the GLA. We are also assigning a ‘A-1+’ short-term credit rating to the GLA.
- The stable outlook reflects our view that the GLA will continue to enjoy strong support from the U.K. government, and an exceptional liquidity position.

Rating Action

On Nov. 13, 2015, Standard & Poor's Ratings Services affirmed its 'AA+' long-term issuer credit rating on the Greater London Authority (GLA). The outlook is stable.

We are also assigning an ‘A-1+’ short-term credit rating to the GLA.

At the same time, we affirmed the 'AA+' long-term issue rating on the loans issued to the GLA by 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, with some volatility related to business rate appeals in London, which now causes us to describe financial performance as very 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) of the London Underground.

We include in the GLA's revenues and expenditures the council tax precept, revenue support grant, and business rates that it collects and then distributes to its functional bodies. These represent about £1.9 billion annually. We include these revenues and expenditures to better reflect the flexibility that GLA has, 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.)

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 the 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 will vary significantly from year to year, correspondingly affecting the GLA's balance after capital accounts. In financial year 2013/14, for instance, the GLA posted a negative balance after capital accounts of 30.5% 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, and, taking into account the retiming of other capex,, we anticipate a small surplus after capital accounts of 1.1%. Negative balances after capex will then return 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. However, the GLA is affected by appeals to business rates, of which a share are collected by boroughs and passed on to the GLA. The GLA has absorbed this volatility resulting from appeals in different ways, in part by passing on less funding to its functional bodies. Nonetheless, we believe the GLA’s exposure to this funding source and higher-than-anticipated appeals from businesses will result in some volatility in its operating balance, which we forecast will move from nearly 8.7% in the current financial year ending March 31, 2016, to negative 0.2% in the following year when the GLA receives less in business rates income from the boroughs.

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, 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 about £42,000 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 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 £3.7 billion, or 167% of operating revenues, mostly to finance the NLE. In our calculation of debt, we also include funding related to housing transactions (expected to rise to £400 million beyond our base case forecast) that will be repayable to the U.K. government. We understand that this 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 3.3x, 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 the GLA will maintain an exceptional liquidity position.

We could lower the rating if 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 and ceased increasing its debt as a percentage of operating revenues. We view this scenario as unlikely within the next two years.

Key Statistics

Table 1

Greater London Authority Financial Statistics

	--Fiscal year beginning April 1--				
(Mil. £)	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	2,172	2,229	2,264	2,130	2,268
Operating expenditures	2,122	2,196	2,067	2,134	2,107
Operating balance	50	33	196	(4)	161
Operating balance (% of operating revenues)	2.3	1.5	8.7	(0.2)	7.1
Capital revenues	531	990	835	469	511
Capital expenditures	1,406	1,366	998	856	775
Balance after capital accounts	(825)	(343)	33	(390)	(102)
Balance after capital accounts (% of total revenues)	(30.5)	(10.7)	1.1	(15.0)	(3.7)

Table 1

Greater London Authority Financial Statistics (cont.)

	--Fiscal year beginning April 1--				
(Mil. £)	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Debt repaid	45	10	255	209	108
Net budget loans	0	(171)	(117)	2	25
Balance after debt repayment and onlending	(870)	(524)	(339)	(597)	(184)
Balance after debt repayment and onlending (% of total revenues)	(32.2)	(16.3)	(10.9)	(23.0)	(6.6)
Gross borrowings	799	405	325	245	139
Balance after borrowings	(71)	(119)	(14)	(352)	(46)
Operating revenue growth (%)	N.M.	2.6	1.5	(5.9)	6.5
Operating expenditure growth (%)	N.M.	3.5	(5.9)	3.2	(1.3)
Modifiable revenues (% of operating revenues)	35.9	36.0	36.7	35.8	33.9
Capital expenditures (% of total expenditures)	39.9	38.3	32.6	28.6	26.9
Direct debt (outstanding at year-end)	3,254	3,649	3,719	3,756	3,786
Direct debt (% of operating revenues)	149.8	163.7	164.3	176.3	167.0
Tax-supported debt (% of consolidated operating revenues)	149.8	163.7	164.3	176.3	167.0
Interest (% of operating revenues)	5.1	5.6	5.7	6.0	5.9
Debt service (% of operating revenues)	7.1	6.1	17.0	15.8	10.6

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. N.M.--Not Meaningful

Table 2

Greater London Authority Economic Statistics

	--Fiscal year beginning April 1--				
	2013	**2014**	**2015bc**	**2016bc**	**2017bc**
Population	8,416,636	8,517,635	8,611,329	8,714,665	8,810,526
Population growth (%)	1.3	1.2	1.1	1.2	1.1
GDP per capita (local currency) (single units)	40,215	42,142	43,730	45,105	46,626
Real GDP growth (%)	3.3	3.5	3.3	2.9	2.8
Unemployment rate (%)	8.2	6.4	6.2	6.0	5.8

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 Limited.

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	Very 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, Oct. 12, 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
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009

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

	Rating	
	To	From
Greater London Authority		
Issuer credit rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/--
Senior Unsecured		
Local Currency	AA+	AA+

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.