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Research Update:

Greater London Authority Ratings Affirmed At 'AA/A-1+'; Outlook Remains Negative

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Overview

- In our opinion, the Greater London Authority (GLA) continues to benefit from London's very strong economy, an exceptional liquidity position, and its potential to receive extraordinary support from the U.K. government.
- From fiscal year 2017/2018 (starting April 2017; FY 2017/2018) onward, and as part of the ongoing devolution process in the U.K., the GLA will receive 37% of business rates (from 20% currently) or about £1 billion of additional income, which leads us to revise our debt assessment to high from very high in our updated base case.
- We are affirming our 'AA' long-term and 'A-1+' short-term credit ratings on the GLA.
- The outlook remains negative, indicating that we would lower the rating on the GLA if we lowered our long-term rating on the U.K. In addition, it also reflects the likelihood of a downgrade if the U.K.'s exit from the EU resulted in materially adverse economic conditions in London such that the GLA's stand-alone credit profile (SACP) was weakened, or if we believed that the likelihood of the GLA receiving extraordinary support from the central government had diminished.

Rating Action

On Oct. 21, 2016, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on the Greater London Authority (GLA). The outlook remains negative.

At the same time, we affirmed our 'AA' long-term issue rating on the £800 million loan issued to the GLA by the special-purpose vehicle Community Finance 1 PLC.

Rationale

The ratings on the GLA reflect our view of the very predictable and well balanced institutional framework for U.K. local and regional governments, and GLA's very strong economy, exceptional liquidity, strong management, and very low contingent liabilities. These strengths are offset by the GLA's weak budgetary flexibility and performance, as well as its high debt burden stemming from funding major infrastructure projects such as the Northern Line Extension (NLE) and Crossrail.

The ratings also continue to reflect our belief that the GLA would receive timely extraordinary support from the U.K. government if needed, given London's considerable 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 1 and the NLE, and has agreed that the GLA can refinance up to £750 million of future NLE debt over a 50-year period with the Treasury, if required. As such, our 'AA' long-term issuer credit rating on the GLA is one notch higher than the GLA's 'aa-' SACP.

As part of the ongoing devolution process in the U.K., the GLA will be able to control 37% of business rates from FY 2017/2018 onward (from 20% currently) in its areas of operations. Therefore, in our 2017-2019 updated base case, we include about £1 billion of additional revenue. That said, this will not have a material impact on our assessment of the GLA's budgetary performance and flexibility because additional revenue will likely be passported to the GLA's functional bodies, mainly Transport for London (TfL).

From FY 2017/2018 onward, the revenue support grant being rolled up into additional business rates will decrease by about 9% per year over our forecast horizon, which illustrates, in our view, the growing pressure on the revenue-expenditure balance that also led us to revise our assessment of the U.K. local and regional government institutional framework to very predictable and well balanced (from extremely predictable and supportive) in August 2016. However, we continue to view the strict control on local government borrowing and balanced budget requirements as a key strength of the institutional framework, demonstrated by the GLA's positive operating balances in recent years.

Our October 2016 base case now incorporates the GLA’s FY 2015/2016 final accounts, which performed in line with our former base-case forecast on the operating side: a 9% margin was recorded. We now observe a higher surplus after capital accounts for FY 2015/2016 of 20% (versus 14% in our previous base case) because in FY 2015/2016 the front loading of capital revenue due to the GLA, under agreed capital programs, was greater than anticipated.

However, we continue to view the GLA’s overall budgetary performance as weak. As an investment-oriented entity, the GLA will structurally record an annual deficit after capital accounts on average through to 2019, in our view. This will result from investment in transport (the NLE) and in housing areas; the new mayor is strongly committed to these areas.

Due to the capital-intensive nature of the infrastructure projects, which are also subject to some slippages, the GLA’s capital expenditure levels vary significantly from year to year, causing its balance after capital accounts to be volatile. The operating balance, on the other hand, tends to be more stable. Our updated 2016-2019 base-case forecast (2% per year on average) reflects this, although appeals against business rates will likely continue to affect operating revenues. The GLA has absorbed instability from appeals in different ways over the past few years. This has included a temporary £75 million business-rates clawback from TfL. Nonetheless, we consider that the GLA's exposure to this funding source and higher-than-anticipated appeals from businesses could result in its operating balance becoming more volatile. We note that the GLA will retain about £1 billion of additional business rates from FY 2017/2018 onward. We continue to exclude from our calculation about £3 billion of levy and tariff payments to the government and ring-fenced grants to the functional bodies (mainly the Mayor's Office for Policing and Crime), that the GLA is legally required to passport.

We view the GLA’s budgetary flexibility as weak, notably because its autonomy over its revenue base is limited in line with other U.K. local and regional governments.

These entities' operating revenues came mainly from state grants in FY 2015/2016 (62%; set to decrease in the next few years). We continue to view GLA's modifiable revenue as currently limited to the council tax that will account for about 30% of GLA's operating revenue in our 2016-2019 updated base case. Our assessment also recognizes the GLA's limited flexibility to reduce transfers to the functional bodies, based on potential political sensitivities as well as on the mayor’s commitment to developing transport and housing supply in the London area.

Generally, we view the GLA's financial management as strong. The increased volatility from business rates has made financial planning more difficult, 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 borrowing.

We assess the GLA’s economy as very strong, compared globally. We estimate that London's gross value added (GVA) per capita was about £44,913 in 2016, and we forecast that GVA growth will remain steady at about 3% on average over the next three years. 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 pivotal to the U.K.'s economic growth and a major net contributor to its fiscal position. However, the U.K.'s vote to exit the EU has increased uncertainties and placed downward pressure on the economy that we think could negatively affect the GLA’s revenue flows in the short to medium term.

The demands of London's growing economy and population have propelled the current phase of investment in transport infrastructure, which has led to the GLA's high levels of debt.

The GLA had a total of £3.7 billion in debt as of March 31, 2016, primarily raised to fulfil its commitment to part-finance Crossrail 1. Although the GLA is starting to pay down its Crossrail 1 related debt, we expect that its debt will continue to grow to £4.1 billion as a result of its commitment to finance the NLE and housing transactions. We now foresee lower debt to operating revenues of 130% in FY 2018/2019 (compared with 178% in our previous base case, see " Greater London Authority Ratings Affirmed At 'AA/A-1+'; Outlook Negative ") solely due to additional revenue stemming from business rates that GLA will control from FY 2017/2018 onward.

We consider the GLA's contingent liabilities to be very low. TfL bears the risks directly associated with cost overruns on the NLE, and the U.K. government ultimately bears the risks on Crossrail 1.

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 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 7.3x, 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 negative outlook indicates that we would lower the long-term rating on the GLA if we lowered our long-term rating on the U.K. This is because we do not believe that the institutional and financial framework allows U.K. local and regional governments to be rated above the sovereign. Additionally, it represents the likelihood that we could downgrade the GLA if the U.K.'s exit from EU resulted in materially adverse economic consequences for London such that the GLA's SACP was weakened.

We could also lower the rating on the GLA if we believed the likelihood of it receiving extraordinary support from the central government had weakened.

We could revise the outlook on the GLA to stable if we revise the outlook on the U.K. government to stable, and, at the same time, if the GLA performs in line with our base-case expectations.

Key Statistics

Table 1

Greater London Authority Financial Statistics

	--Fiscal year beginning Apr-01--				
(Mil. £)	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**
Operating revenues	2,220	2,282	2,186	3,220	3,204
Operating expenditures	2,195	2,066	2,161	3,120	3,167
Operating balance	24	216	25	99	37
Operating balance (% of operating revenues)	1.1	9.5	1.1	3.1	1.1
Capital revenues	1,061	1,007	535	832	403
Capital expenditures	1,421	569	561	823	643
Balance after capital accounts	(336)	654	0	109	(203)

Table 1

Greater London Authority Financial Statistics (cont.)

	--Fiscal year beginning Apr-01--				
(Mil. £)	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**
Balance after capital accounts (% of total revenues)	(10.2)	19.9	0.0	2.7	(5.6)
Debt repaid	10	220	115	104	140
Net budget loans	(171)	(101)	(73)	(85)	(334)
Balance after debt repayment and onlending	(517)	333	(188)	(80)	(677)
Balance after debt repayment and onlending (% of total revenues)	(15.7)	10.1	(6.9)	(2.0)	(18.8)
Gross borrowings	405	278	140	260	400
Balance after borrowings	(111)	611	(49)	179	(277)
Modifiable revenues (% of operating revenues)	36.1	36.5	36.9	24.5	24.8
Capital expenditures (% of total expenditures)	39.3	21.6	20.6	20.9	16.9
Direct debt (outstanding at year-end)	3,649	3,707	3,733	3,889	4,149
Direct debt (% of operating revenues)	164.4	162.5	170.8	120.8	129.5
Tax-supported debt (% of consolidated operating revenues)	164.4	162.5	170.8	120.8	129.5
Interest (% of operating revenues)	5.6	5.5	5.9	4.1	4.3
Debt service (% of operating revenues)	6.1	15.2	11.1	7.4	8.7

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

Table 2

Greater London Authority Economic Statistics

	--Fiscal year end Dec-31--				
	2014	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Population	8,528,813	8,639,691	8,757,268	8,868,846	8,980,224
Population growth (%)	1.3	1.3	1.4	1.3	1.3
GDP per capita (local currency) (single units)	41,912	42,690	43,755	45,132	46,622
Real GDP growth (%)	4.1	2.6	2.6	2.6	2.6
Unemployment rate (%)	6.4	6.3	6.2	6.1	6.0

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Rating' 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	Very Predictable and well balanced
Economy	Very Strong
Financial Management	Strong
Budgetary Flexibility	Weak
Budgetary Performance	Weak
Liquidity	Exceptional
Debt Burden	High
Contingent Liabilities	Very Low

*S&P Gloabl Ratings bases its ratings on local and regional governments on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

- Sovereign Risk Indicators October 13, 2016

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign - December 15, 2014
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions - November 19, 2013
- 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
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Greater London Authority Ratings Affirmed At 'AA/A-1+'; Outlook Negative, August 12, 2016
- Public Finance System Overview: U.K. Local And Regional Governments, September 23, 2016
- 2015 Annual International Public Finance Default Study And Rating Transitions, June 30, 2016

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/Negative/A-1+	AA/Negative/A-1+
Senior Unsecured		
Local Currency	AA	AA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. 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 S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.