S&P Global
Ratings

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Research Update:

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

September 20, 2019

Overview

- We continue to expect the Greater London Authority (GLA) to post a large deficit after capital accounts in the current financial year. Additional funding required to complete Crossrail will see GLA's debt increase sharply.
- We also think GLA would likely step in if Transport for London (TfL) needed further financial assistance, so we include TfL's debt and own-source revenue in our assessment of GLA's tax-supported debt.
- We expect that GLA will continue to benefit from its exceptional liquidity position and London's strong economy, despite Brexit-related uncertainty.
- We are therefore affirming our 'AA/A-1+' ratings on GLA.
- The outlook remains negative, reflecting that on the U.K.

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Rating Action

On Sept. 20, 2019, 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 GLA's £800 million loans (issued through the special-purpose vehicle Community Finance 1 PLC).

Outlook

The rating on GLA is capped by the ratings on the U.K. (unsolicited, AA/Negative/A-1+); therefore the negative outlook on GLA reflects that on the U.K.

Downside scenario

We would lower the long-term rating on 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 (LRGs) to be rated above the sovereign. We would also lower the long-term rating on GLA over the next 24 months if we saw GLA posting a much higher debt burden compared with our base case expectation. This could primarily result from higher borrowings needed for Transport for London (TfL), in our view.

Upside scenario

We could revise the outlook on GLA to stable over the next 24 months if we revised the outlook on the U.K. to stable, and if GLA's financial position did not deteriorate further than we anticipate in our updated base case.

Rationale

Our base case is that GLA's deficits after capital accounts and its significant Crossrail-related debt increase will be temporary, and that it will continue posting operating surpluses over the next two-to-three years.

GLA benefits from a very predictable and well-balanced institutional framework. Unlike other English local authorities, GLA does not rely on state grants (which the government has reduced nationally) and does not have to support the sort of services--such as social care--that other local authorities cover and which carry associated demand-driven cost increases.

Despite Brexit, we continue to assess London's economy as very strong when compared with international peers and we anticipate London's gross value-added (GVA) will increase above the national average over the next few years. London's robust demography, increasing housing supply, and sound business environment will support GLA's tax revenue base and its ability to deliver operating surpluses over our forecast horizon. GLA also exhibits prudent financial management and an exceptional liquidity position, which will allow it to absorb high deficits after capital accounts and potential volatility in its credit ratios.

Despite prudent financial management and London's resilient economy, we expect GLA's budgetary performance to remain constrained due to increased Crossrail funding

London's economy is very strong in a national and international comparison. We estimate its GVA per capita at close to £50,000 for 2019 and we forecast that this will grow by 1.8% over 2019-2021--above the national average of 1.3% for the same period (S&P Global Ratings' forecast). We also expect that London's robust population growth, increasing housing supply, and diversified economy will support GLA's tax revenue growth via council tax and retained business rates.

In 2019, GLA posted a higher operating surplus (4%) than we had anticipated in our previous base case on stronger business rates collection. We anticipate GLA's operating revenue will increase by a further 12% in 2020. This will mainly stem from new revenue sources--Adult Education Budget grants from the U.K. government and the second iteration of the Mayoral Community Infrastructure Levy (MCIL2), under which London boroughs will continue to levy developers. This should help the GLA maintain operating surpluses over the forecast period despite a likely drop in business rates, from the existing level, if the central government decides to reset the business rates retention scheme. Under the scheme, GLA retains 75% of rates in 2019-2020 but the government could decide to reduce this thereafter. Business rates account for more than two-thirds of GLA's operating revenue. GLA would likely reduce its one-off operating spending if its business rates revenue decreased. We view positively management's initiative to hold a business rates reserve of £188 million at March 31, 2019 (about 5% of GLA's operating revenue) to manage business rates income risk.

GLA's creditworthiness is supported by strong financial management and prudent budgeting. It has a clear budgetary strategy and high financial transparency, as well as detailed financial planning that typically incorporates prudent assumptions. However, GLA's executive management does not have full control over the operations of Crossrail. We saw this with the additional £1.4 billion funding package agreed with the U.K. government and TfL to address Crossrail delays and cost overruns. The additional funding led us to forecast deficits after capital accounts of 8% of total revenue over the next two-to-three years (still our base case). We view the high deficits as temporary, however, because they are Crossrail-specific. This also explains the £1.4 billion of additional spending forecast for 2019-2021.

GLA's debt will increase significantly, but its exceptional liquidity position will remain a support

In December 2018, GLA agreed to provide a grant of £1.4 billion to TfL to complete Crossrail--£1.3 billion in additional borrowing from the Department for Transport (DfT) and a £100 million cash contribution from the Business Rates Supplement. This materially affects GLA's debt levels, which were already high compared with peers.

In line with our previous base case, we forecast a steep increase in debt, to £5.7 billion in 2021 from £3.8 billion in 2018. Direct debt will be 143% of operating revenue at the end of our updated forecast horizon to the fiscal year ending March 2022. Although housing and the Northern Line Extension remain an important portion of new debt, the spike stems from additional Crossrail funding.

GLA may not be fully insulated from potential further funding pressures at TfL and may have to provide additional support to honor TfL's financial and operational obligations. As such we now include TfL's debt and own-source revenue (for example fares) in our assessment of GLA's tax-supported debt, which stands at a high 188% of consolidated operating revenue in 2022.

However, we understand that the DfT could loan TfL up to £750 million if Crossrail requires further financing. This ultimately supports our ratings affirmation because we expect that any further expenses would be at least partly borne by the U.K. government. We also continue to forecast a moderate interest burden at 4% of operating revenue in 2020-2022.

We assess GLA's overall liquidity position as exceptional based on its very strong debt-service coverage, noting that future funding needs are large.

Over the next 12 months, we estimate that 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 investment program) to comfortably cover the next 12 months' debt service by about 5.3x. This is higher than in our previous base case due to stronger cash levels at GLA.

We also view GLA as having exceptional access to external liquidity, compared with international peers. This is primarily due to its access to the U.K. government's Public Works Loan Board, which can provide funding to GLA within 48 hours of an application. We also factor in GLA's unquestioned access to capital markets as well as banks as proven over the past years to fund the capital transport projects.

Key Statistics

Table 1

Greater London Authority Selected Indicators

	Fiscal year end March 31				
£	2018	2019	2020bc	2021bc	2022bc
Operating revenues	3,170	3,544	3,984	3,849	3,827
Operating expenditures	3,165	3,398	3,962	3,842	3,803
Operating balance	5	146	22	7	23
Operating balance (% of operating revenues)	0.2	4.1	0.6	0.2	0.6
Capital revenues	739	897	1,071	1,180	1,466
Capital expenditures	1,028	1,423	2,063	1,479	1,480
Balance after capital accounts	(284)	(381)	(969)	(292)	9
Balance after capital accounts (% of total revenues)	(7.3)	(8.6)	(19.2)	(5.8)	0.2
Debt repaid	109	128	145	95	341
Gross borrowings	216	736	1,173	444	54
Balance after borrowings	(237)	129	(135)	(103)	(327)
Direct debt (outstanding at year-end)	3,844	4,364	5,393	5,741	5,455
Direct debt (% of operating revenues)	121.2	123.2	135.4	149.2	142.5
Tax-supported debt (outstanding at year-end)	15,855	17,690	19,358	20,169	20,263
Tax-supported debt (% of consolidated operating revenues)	179	191	208	204	188
Interest (% of operating revenues)	4.1	3.7	3.7	4.1	4.1
Local GDP per capita (single units)	48,857	49,736	50,482	51,290	52,419
National GDP per capita (single units)	31,036	31,876	32,469	33,172	34,086

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc—Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Greater London Authority Ratings Score Snapshot

Key rating factors	
Institutional framework	2
Economy	1
Financial management	2

Table 2

Greater London Authority Ratings Score Snapshot (cont.)

Budgetary performance	4
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa
Issuer credit rating	AA

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 11, 2019. An interactive version is available at www.spratings.com/sri

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Transport for London 'AA-/A-1+' Ratings Affirmed; Off Watch; Outlook Negative, Dec. 20, 2018
- Bulletin: GLA Has Capacity To Absorb Additional Debt For Crossrail; TfL Still On CreditWatch Negative, Dec. 13, 2018
- United Kingdom Ratings Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 26, 2019
- Public Finance System Overview: English Local Authorities; Sep. 27, 2018

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/Negative/A-1+
Senior Unsecured	AA