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Research Update:

Greater London Authority Ratings Affirmed At 'AA+/A-1+' On Exceptional Liquidity, Despite High Debt; 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 1 and the Northern Line Extension.
- We are therefore affirming our 'AA+' long-term and 'A-1+' short-term credit ratings on the GLA.
- The stable outlook reflects our view that the GLA will continue to enjoy strong support from the U.K. government and maintain exceptional liquidity.

Rating Action

On April 22, 2016, Standard & Poor's Ratings Services affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings 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 to the GLA by the special-purpose vehicle Community Finance 1 PLC.

Rationale

The rating on GLA reflects our view of London's very strong economy and its fiscal and political significance for the U.K., giving the U.K. government a strong incentive to provide the GLA with 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. Additionally, the GLA has now fulfilled its committed funding for Crossrail 1. We anticipate that this might have a positive impact on the GLA's financial performance in the upcoming years. These strengths are offset by the GLA's weak budgetary flexibility and performance; its very high debt burden; and its volatile balance after capital accounts, related to the GLA's contributions to fund major infrastructure projects, and more recently also from appeals against business rates in London.

We include in the GLA's revenues the council tax precepts, revenue support grants, and business rates that it collects and then distributes to its functional bodies. These represent about £2 billion annually. We include these revenues (and corresponding 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 (mainly to the Mayor's Office for Policing and Crime, and to Transport for London [TfL]).

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 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 Northern Line Extension (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 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 significant capital expenditure (capex) are a direct consequence of Crossrail 1 (a £14.8 billion infrastructure project to be completed by 2019) and the NLE (a £1 billion project to be completed by 2020). The GLA has already contributed £4.1 billion to Crossrail 1 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 £1 billion to finance the NLE; which it plans to service from ringfenced funding sources, such as developer contributions and business rates within an associated enterprise zone, over 25 years. We understand that the Treasury has granted GLA the option to extend the NLE funding source (business rates from the associated enterprise zone) by five years as a contingency measure. As with Crossrail 1, the GLA will transfer a specified level of funding to TfL and will not directly assume any construction risk.

Due to the capital-intensive nature of the construction projects, the GLA's capex levels have varied significantly from year to year, causing its balance after capital accounts to be volatile. In the past, the GLA has posted large deficits after capital accounts, owing to its role in cofinancing Crossrail 1. The GLA's contribution for Crossrail 1 is now complete. Consequently, we forecast a slight improvement in the balance after capital accounts and project a smaller deficit of 3.2% for the current year.

The operating balance, on the other hand, tends to be more stable, although appeals against business rates continue to affect operating revenues. The GLA has absorbed this instability from appeals in different ways, in part by passing on less funding to its functional bodies. 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. The one-off drop expected in operating balance (as a percentage of adjusted operating revenues) to 1% in the current year 2016/2017, from 8.6% in 2015/2016, is partly due to losses from business rates appeals passed on to the GLA from London 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 plan appropriately 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. On May 5, 2016, London will elect a new Mayor, who will also be the head of the GLA. The mayoral priorities and policies will determine the evolution of the GLA's budgetary flexibilities.

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.

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 rate volumes rise by more than the national average. We estimate that London's gross value added (GVA) per capita was about £42,690 in 2015, 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 propelled 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 £3.7 billion in debt as of March 31, 2016, primarily raised to fulfil its commitment to part-finance Crossrail 1. Although it is starting to pay down its Crossrail 1-related debt, we expect that the GLA's debt will have risen to £4.1 billion, or 178% of operating revenues, by March 31, 2019. This increase in debt reflects the GLA's commitment to finance the NLE. In calculating debt, we include funding related to housing transactions (expected to rise to £320 million in our base case) that will be repayable to the U.K. government. We anticipate that the GLA will lend this funding on 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 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 (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 5.8x, 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. Alternatively, we could lower the rating on the GLA if we reassessed the likelihood of it receiving extraordinary support from the central government.

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.

Key Statistics

Table 1

Greater London Authority Financial Statistics

	--Fiscal year beginning April 1--					
(Mil. £)	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Operating revenues	2,172	2,220	2,256	2,178	2,286	2,329
Operating expenditures	2,122	2,195	2,062	2,158	2,143	2,159
Operating balance	50	24	194	20	144	170
Operating balance (% of operating revenues)	2.3	1.1	8.6	0.9	6.3	7.3
Capital revenues	531	841	843	548	902	410

Table 1

Greater London Authority Financial Statistics (cont.)

	--Fiscal year beginning April 1--					
(Mil. £)	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Capital expenditures	1,406	1,421	607	655	963	474
Balance after capital accounts	(825)	(556)	429	(86)	83	105
Balance after capital accounts (% of total revenues)	(30.5)	(18.2)	13.8	(3.2)	2.6	3.8
Debt repaid	45	10	220	115	104	140
Net budget loans	0	(171)	(123)	(73)	(85)	(334)
Balance after debt repayment and onlending	(870)	(737)	86	(274)	(106)	(368)
Balance after debt repayment and onlending (% of total revenues)	(32.2)	(24.1)	2.8	(10.1)	(3.3)	(13.4)
Gross borrowings	799	405	277	140	260	400
Balance after borrowings	(71)	(332)	363	(134)	154	32
Operating revenue growth (%)	N.M.	2.2	1.6	(3.5)	5.0	1.9
Operating expenditure growth (%)	N.M.	3.5	(6.1)	4.6	(0.7)	0.8
Modifiable revenues (% of operating revenues)	35.9	36.1	36.9	37.0	34.5	34.2
Capital expenditures (% of total expenditures)	39.9	39.3	22.8	23.3	31.0	18.0
Direct debt (outstanding at year-end)	3,254	3,649	3,706	3,732	3,888	4,148
Direct debt (% of operating revenues)	149.8	164.4	164.3	171.3	170.0	178.0
Tax-supported debt (% of consolidated operating revenues)	149.8	164.4	164.3	171.3	170.0	178.0
Interest (% of operating revenues)	5.1	5.6	5.6	5.8	5.7	5.7
Debt service (% of operating revenues)	7.1	6.1	15.3	11.0	10.2	11.7

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. bc--Base case reflects Standard & Poor's expectations of the most likely scenario. N.M.--Not meaningful.

Table 2

Greater London Authority Economic Statistics

	--Fiscal year end Dec. 31--					
	2013	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Population	8,416,636	8,528,813	8,639,691	8,757,268	8,868,846	8,980,224
Population growth (%)	1.3	1.3	1.3	1.4	1.3	1.3
GDP per capita (£)	40,215	41,912	42,690	43,755	45,132	46,622
Real GDP growth (%)	3.3	4.1	3.1	2.8	2.8	2.8
Unemployment rate (%)	8.2	6.4	6.3	6.2	6.1	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, Eurostat, and Experian Ltd. bc--Base case reflects Standard & Poor's expectations of the most likely scenario.
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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, April 12, 2016. An interactive version is 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

- Default, Transition, and Recovery: 2014 Annual International Public Finance Default Study And Rating Transitions - June 08, 2015
- Presale: Community Finance Company 1 PLC (Series 2) - May 11, 2015
- Report Card: U.K. Local Authorities Absorb Major Cuts, But What Flexibility Remains? - March 31, 2015
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - February 05, 2015
- Public Finance System Overview: U.K. Local and Regional Governments - April 5, 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

	Rating	
	To	From
Greater London Authority		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/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.

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