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Research Update:

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

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Overview

- We now believe the Greater London Authority (GLA)'s budgetary performance will remain sound, with positive balances after capital accounts at least until 2020, while the authority's management fulfils the mayor's objectives related to transport and housing policies.
- At the same time, we think the GLA will continue to benefit from an exceptional liquidity position and from London's strong economy, despite uncertainty related to Brexit.
- We are affirming our 'AA/A-1+' ratings on GLA.
- The outlook remains negative, reflecting that on the U.K.

Rating Action

On Sept. 29, 2017, 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 United Kingdom (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. Also, we now consider a downgrade of GLA, based on its intrinsic characteristics, to be unlikely, since we expect GLA will receive timely extraordinary support from the U.K. government if needed.

Upside Scenario

We could revise the outlook on GLA to stable if we revised the outlook on the U.K. to stable, while the GLA performed in line with our base-case expectations.

Rationale

The affirmation primarily reflects our expectation that GLA will step up investments over 2018-2020 to fulfill the mayor's objectives for transport and housing, while

maintaining strong budgetary performance. GLA's operating revenues will increase by about 50% in 2017-2018 due to higher business rates. This will help the authority maintain a very strong liquidity position and alleviate currently high debt stemming from funding major infrastructure projects, such as Crossrail 1 and the Northern Line Extension (NLE). In our view, GLA will continue to benefit from a strong economic base, despite the projected slowdown of GDP growth in the U.K. GLA operates under a supportive institutional framework with good predictability and generally adequate expenditure coverage. Nevertheless, its budgetary flexibility remains limited. We now assess GLA's stand-alone credit profile (SACP) at the same level as our 'AA' long-term rating on GLA.

The ratings also continue to reflect our belief that 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 GLA to service the debt it has raised to fund Crossrail 1 and the NLE, and has agreed that the authority can refinance up to £750 million of future NLE debt over a 50-year period with the treasury, if required.

Strong management and London's resilient economy should help GLA maintain sound budgetary performance until 2020

GLA's reported surplus reduced in 2016-2017, with our operating margin figure at about 1% of adjusted operating revenues, compared with 9.4% in 2015. The decline was mainly due to the continuous reduction of government grants, illustrating--in our view--pressure on the revenue-expenditure balance, which weighs on the U.K.'s LRGs. That said, we see the institutional framework as very predictable and well balanced, especially because we view the strict control on local government borrowing and balanced budget requirements as a key strength, as demonstrated by GLA's positive operating balances in recent years.

We view GLA's management as strong. We believe that the authority will stick to a detailed, well-documented, and prudent long-term financial plan covering the next four years (2018-2021). The volatility from business rates, which now accounts for about 70% of GLA's adjusted operating revenues in our base case through 2020, has made financial planning more difficult. Nevertheless, we believe GLA's planning is based on realistic and appropriate assumptions, given uncertainties surrounding the U.K. economy and risk of appeals on the business rates. Also, we now have more clarity about the schedule for the affordable housing program over the mayor's term, which will likely account for 50% of GLA's investment spending in 2020. We view as positive that GLA will likely receive grants related to housing in advance, which supports our projections of surpluses after capital accounts in our current 2018-2020 base case. On the operating expenditure side, we expect GLA will keep a tight rein on its corporate expenditure alongside the moderate interest burden we project over that period. We also acknowledge GLA's cautious debt and liquidity management, as demonstrated by its willingness to hold a high level of liquidity and secure all funding needed during the mayor's term well in advance.

We continue to assess London's economy as very strong in a national and international comparison. London's gross value-added (GVA) per capita is close to £45,000. We forecast that GVA growth will remain steady and above the national average over 2018-2020, at 1.9% per year, in line with Consensus' forecast for London. Nevertheless, this growth rate is lower than in previous years, due to the U.K. economy's likely slowdown in the context of Brexit. Our view of London's solid socio-economic and demographic profiles supports our anticipation of continuous growth of council tax revenue, translating into total operating revenue growth, which we forecast will average about 2.5% annually through 2020. We also anticipate controlled growth of operating expenditure at about 1.5% over that period, leading to positive operating margins of about 2% per year on average, close to our previous base-case forecast. This is also underpinned by our belief that allocations of business rates for GLA's functional bodies will likely remain inferior to revenue collected. We continue to exclude from our calculation about £3 billion of non-legally-owned operating revenue that GLA is required to transfer to its functional bodies. On the capital side, we expect capital income will match investment efforts, in particular to deliver the mayor's affordable housing program; this explains our revised base-case projection of surpluses after capital accounts of about 2% per year over 2018-2020. We expect investments will increase by the end of the mayor's term in line with our former base case, with close to £1 billion of capital expenditure in 2020 compared with about £500 million reported at year-end 2017.

Given the substantial investment effort anticipated, and GLA's very limited ability to reduce transfers to the functional bodies (chiefly, the Mayor's Office for Policing and Crime, and Transport for London), we continue to view GLA's budgetary flexibility as weak. This assessment also takes into consideration the authority's limited autonomy over its revenue base, as is the case for other U.K. LRGs, whose operating revenue came mainly from state grants in 2016-2017 (close to 60% and set to decrease in the next few years). We continue to see GLA's modifiable revenue as currently limited to council tax, which will account for less than 30% of its operating revenue in our revised 2018-2020 base case.

Debt will likely remain high, but liquidity is exceptional and contingent liabilities very low

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 debt.

GLA's debt totaled £3.7 billion as of March 31, 2017, after increasing primarily to fulfil GLA's commitment to partly finance Crossrail 1. Although GLA has started to reduce its Crossrail 1-related debt, we expect that its debt will increase to £4.2 billion in 2020 as a result of its commitment to finance the NLE and housing transactions. The latter differ from the affordable housing program, which is meant to be funded by capital grants from the U.K. central government. We foresee debt to operating revenues staying below 130% through 2020, up from 123% in 2017, in line with our former base case.

We consider GLA's contingent liabilities to be very low. The U.K. central government ultimately bears the risks on Crossrail 1, and Transport for London bears the risks

directly associated with cost overruns on the NLE. Also, we would expect Transport for London will receive financial support from the U.K. central government in case of financial distress.

We view the GLA's overall liquidity position as exceptional, based on what we view as its very strong debt-service coverage; although we recognize that future funding needs remain 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 6x.

We also view 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 GLA within 48 hours of an application.

Key Statistics

Table 1

Greater London Authority Key Statistics

(Mil. £)	--Fiscal year end March 31--				
	2015	2016	2017bc	2018bc	2019bc
Operating revenues	2,282	2,205	3,148	3,218	3,311
Operating expenditures	2,066	2,186	3,119	3,159	3,220
Operating balance	216	19	29	59	91
Operating balance (% of operating revenues)	9.4	0.9	0.9	1.8	2.8
Capital income	1,007	695	569	689	945
Capital expenditures	569	512	588	597	982
Balance after capital accounts	654	202	10	150	54
Balance after capital accounts (% of total revenues)	19.9	7.0	0.3	3.8	1.3
Debt repaid	220	287	174	117	97
Gross borrowings	278	315	344	324	215
Balance after borrowings	611	121	40	340	(76)
Modifiable revenues (% of operating revenues)	36.4	36.6	26.1	26.1	26.3
Capital expenditures (% of total expenditures)	21.6	19.0	15.9	15.9	23.4
Direct debt (outstanding at year-end)	3,707	3,736	3,883	4,045	4,245
Direct debt (% of operating revenues)	162.5	169.4	123.4	125.7	128.2
Tax-supported debt (outstanding at year-end)	3,707	3,736	3,883	4,045	4,245
Tax-supported debt (% of consolidated operating revenues)	162.5	169.4	123.4	125.7	128.2
Interest (% of operating revenues)	5.5	5.7	4.1	4.1	3.9
Local GDP per capita (£)	43,690	44,739	45,480	46,344	46,901
National GDP per capita (£)	28,762	29,546	30,255	30,839	31,628

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.

Ratings Score Snapshot

Table 2

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	Average
Liquidity	Exceptional
Debt burden	High
Contingent liabilities	Very low

*The ratings of S&P Global Ratings on local and regional governments (LRGs) are based 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," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on an LRG.

Key Sovereign Statistics

Sovereign Risk Indicators, July 06, 2017. An interactive version is available at www.spratings.com/sri

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- 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

- Research Update: Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 28, 2017

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

- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions - April 03, 2017
- Public Finance System Overview: U.K. Local And Regional Governments, September 23, 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 agreed that budgetary performance had improved. All other key rating factors were unchanged.

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.capitaliq.com. All ratings affected by this rating action can be found on S&P

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