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## Research Update:

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


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## Overview

- We believe the Greater London Authority (GLA) will maintain a sound budgetary performance, 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.
- Given the deterioration in Transport for London's financial position, we believe the GLA's contingent liabilities have increased, although we consider that this this does not have material credit impact.
- We are affirming our 'AA/A-1+' ratings on the GLA.
- The outlook remains negative, reflecting that on the U.K.

## Rating Action

On March 23, 2018, 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. We 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 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 fulfil the mayor's objectives for transport and housing, while maintaining strong budgetary performance. GLA's operating revenues increased by about 50% in 2017-2018 due to higher business rates. This helps the authority to 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 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 reported a very small deficit in 2016-2017, with our operating margin figure at about -0.3% of adjusted operating revenues, compared with a 9.5% surplus in 2015-2016. The decline was mainly due to the continuous reduction of government grants, which in our view illustrates the pressure on the revenue-expenditure balance that 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 five years (2018-2022). 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 the risk of appeals on business rates. Also, we now have more clarity about the schedule for the affordable housing program over the mayor's term, which will account for more than 50% of GLA's investment spending in our 2018-2020 base case. 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 2% per year. 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 socioeconomic 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 5% annually through 2020. We also anticipate controlled growth of operating expenditure at about 3% over that period, leading to positive operating margins of about 2% per year on average, fully in line with our previous base-case forecast. We continue to exclude from our calculation about £3 billion to £3.5 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 base-case projection of surpluses after capital accounts of about 3% per year over 2018-2020, slightly higher than our previous base case forecast (2%). 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 (MOPAC), and Transport for London (TfL)--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.

### GLA's contingent liabilities have increased, in our view, but debt is controlled and liquidity remains exceptional

Due to deterioration in TfL's financial position, we now believe that GLA contingent liabilities have increased (see "Transport for London Rating Lowered To 'AA-' On Weakening Financial Strength; Outlook Stable," published on March 13, 2018). This does not have any material impact on the ratings on GLA, as we would expect TfL to ultimately receive extraordinary support from the U.K. central government in case of financial distress. Nevertheless, we consider that GLA may not be fully immune from potential further pressure at TfL given its significance at all levels for London. In fact, the mayor allocates a very large portion of retained business rates to TfL (close to 80% in 2017-2018). Most of the rest of the operating revenues are passported to MOPAC and the London Fire Commissioner (LFC), which manage core services for London that could not be squeezed, in our opinion.

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 its 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 at just above 120% in 2020, lower than our former base case (128%) as a result of reduced debt intake and slightly higher projected revenue.

We continue to view 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 7x.

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**

| | --Fiscal year end March 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. £)** | **2015** | **2016** | **2017bc** | **2018bc** | **2019bc** |
| Operating revenues | 2,282 | 2,217 | 3,165 | 3,451 | 3,464 |
| Operating expenditures | 2,066 | 2,223 | 3,146 | 3,376 | 3,348 |
| Operating balance | 216 | (6) | 19 | 75 | 116 |
| Operating balance (% of operating revenues) | 9.4 | (0.3) | 0.6 | 2.2 | 3.4 |
| Capital revenues | 1,007 | 695 | 1,100 | 1,099 | 1,021 |
| Capital expenditures | 569 | 512 | 986 | 1,003 | 1,029 |
| Balance after capital accounts | 654 | 177 | 133 | 171 | 109 |
| Balance after capital accounts (% of total revenues) | 19.9 | 6.1 | 3.1 | 3.8 | 2.4 |
| Debt repaid | 220 | 217 | 133 | 140 | 120 |
| Gross borrowings | 278 | 246 | 270 | 360 | 261 |
| Balance after borrowings | 611 | 67 | 130 | 374 | 1 |
| Modifiable revenues (% of operating revenues) | 36.4 | 36.7 | 26.2 | 24.7 | 26.1 |
| Capital expenditures (% of total expenditures) | 21.6 | 18.7 | 23.9 | 22.9 | 23.5 |
| Direct debt (outstanding at year-end) | 3,707 | 3,736 | 3,873 | 4,060 | 4,196 |
| Direct debt (% of operating revenues) | 162.5 | 168.5 | 122.4 | 117.6 | 121.1 |
| Tax-supported debt (outstanding at year-end) | 3,707 | 3,736 | 3,873 | 4,060 | 4,196 |
| Tax-supported debt (% of consolidated operating revenues) | 162.5 | 168.5 | 122.4 | 117.6 | 121.1 |
| Interest (% of operating revenues) | 5.5 | 5.7 | 4.1 | 3.8 | 3.8 |
| Local GDP per capita (single units) | 43,690 | 44,739 | 45,570 | 46,390 | 47,271 |
| National GDP per capita (single units) | 29,008 | 29,873 | 30,603 | 31,244 | 32,045 |

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.

## 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 |

**Table 2**

| Greater London Authority Ratings Score Snapshot (cont.) | |
|---|---|
| **Key Rating Factors** | |
| Contingent Liabilities | 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, Dec. 14, 2017. An interactive version is available at www.spratings.com/sri

## Related Criteria

- 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
- 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, Nov. 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, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Transport for London Rating Lowered To 'AA-' On Weakening Financial Strength; Outlook Stable, March 13, 2018
- Research Update: Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, Oct. 27, 2017

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 GLA's contingent liabilities had deteriorated. 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

Ratings Affirmed

| | |
|---|---|
| Greater London Authority | |
| Issuer Credit Rating | AA/Negative/A-1+ |
| Senior Unsecured | AA |

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