CREDIT OPINION
18 October 2024

Update

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Aberdeen City Council (UK)

Update to credit analysis

RATINGS

Aberdeen City Council

Domicile	Aberdeen, United Kingdom
Long Term Rating	A2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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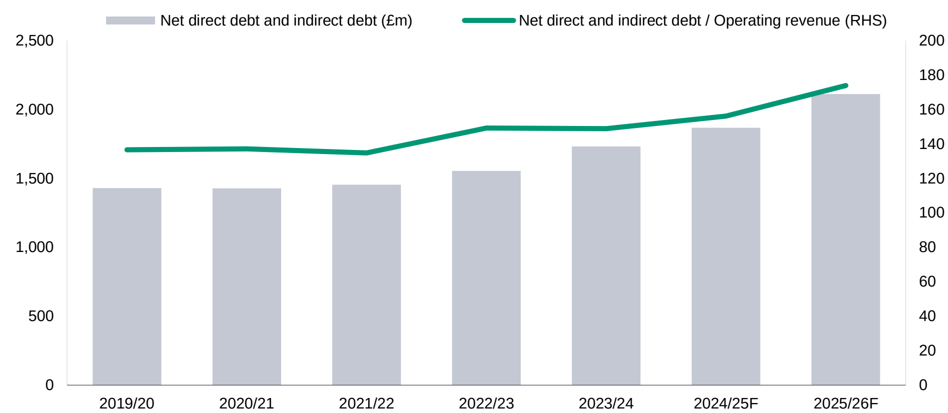
Summary

The credit profile of Aberdeen City Council (Aberdeen, A2 stable) reflects a strong institutional framework, albeit with limited fiscal flexibility, a wealthy local economy and a strong track record of operating performance, balanced by a high and increasing debt burden and some exposure to commercial properties. Aberdeen's credit profile benefits from our assumption of a high likelihood that the government of the UK (Aa3 stable) would act in a timely manner to prevent a default.

Exhibit 1
We expect debt to continue rising over the next two years



Source: Aberdeen City Council and Moody's Ratings

Credit strengths

» Good track record of financial performance despite medium-term pressures

» Strong institutional framework for Scottish local authorities

» Wealthy local economy but highly concentrated in the energy sector

Credit challenges

» High and increasing debt levels weighing on debt affordability

» Increasing exposure to commercial properties

» Low reserves levels compared to peers

Rating outlook

The stable outlook reflects our view that Aberdeen will be able to manage current budgetary pressures without a material deterioration of its reserve buffers thanks to tight expenditure control and its good track record of financial management. It also reflects the stable outlook on the UK sovereign rating.

Factors that could lead to an upgrade

Upward pressure on the ratings could emerge if the sector's funding settlement aligns with service demand and cost inflation, thereby supporting strong operating performance over the medium term. A decline in debt and a material increase in reserve buffers would be positive for the ratings. An upgrade of the UK sovereign rating would also result in upward pressure on the ratings.

Factors that could lead to a downgrade

Downward pressure on the ratings could result from a sustained deterioration in operating performance and a material depletion of usable reserves or a material increase in debt levels. A downgrade of the UK sovereign rating or a sustained weakening of the UK's institutional framework and extraordinary support mechanisms for local authorities could also lead to downward pressure on the rating.

Key indicators

Exhibit 2

Aberdeen City Council	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25F	2025/26F
Net Direct and Indirect Debt / Operating Revenue (%)	136.6	137.2	134.8	149.1	148.8	156.2	173.9
Interest Payments / Operating Revenue (%)	5.1	4.4	4.6	5.8	6.4	6.9	7.3
Primary Operating Balance / Operating Revenue (%)	4.9	10.9	7.8	6.0	6.2	5.0	4.7
Usable Reserves / Operating Revenue (%)	5.7	9.6	12.4	14.9	13.6	11.2	11.1
Regional GDP Per Capita (£)	48,920	43,673	45,815	52,517	50,935	50,624	50,382
Short-Term Direct Debt / Direct Debt (%)	14.8	16.6	15.7	20.1	23.9	22.1	19.5

Source: Aberdeen City Council and Moody's Ratings

Detailed credit considerations

Aberdeen's A2 ratings combine: (1) a Baseline Credit Assessment (BCA) of baa1; and (2) a high likelihood of extraordinary support from the UK government would act in a timely manner to prevent a default.

Baseline credit assessment

Good track record of financial performance despite medium-term pressures

Aberdeen exercises prudent financial planning, for example projecting no council tax increase or additional government grants, which is supported by recent assessments from the Accounts Commission. As a result, it has an established track record of good budgetary performance with an average primary operating surplus of 6.7% over the last three years. Aberdeen has also delivered significant savings over the last decade.

That said, Aberdeen faces pressures from increasing demand for services and we forecast the primary operating balance to deteriorate in the coming years. Spending on homelessness and children social care has seen the largest increase over the last few years. Aberdeen forecasts a budget gap of £44 million over the next three years as staff and service costs will increase faster than revenue. The budget gap does not account for the remediation of Reinforced Autoclaved Aerated Concrete (RAAC) in over 500 council houses given the uncertainty related to the costs of demolishing and rebuilding affected properties. We expect some of these costs will be borne by the council and add to existing budgetary pressures.

Strong institutional framework for Scottish local authorities

The institutional framework for UK local authorities is mature, highly developed and underpinned by a number of key pieces of legislation. The UK local authority system is one of the most centralised in Europe. This results in a close link between the policies and resources of the government and local authorities. Local government is a matter devolved to the Scottish government, resulting in a slightly different funding and regulatory model compared to England.

The sector is supported by a stable institutional framework illustrated by the legal requirement to set a balanced budget; statutory codes of practice for capital spending, investments, treasury management and borrowing; and strong market access in the form of the PWLB, which also acts as the sector's lender of last resort. Similar to their English counterparts, grants, council taxes, business rates and user fees are the primary sources of revenue for Scottish local authorities. However, government grants make up a larger share of funding and can be spent more flexibly. Scottish local authorities are also more insulated from economic cycles as grant funding is adjusted to smooth fluctuations in business rates. However, we consider that fiscal flexibility has deteriorated due to consistently high expenditure pressures and funding levels that do not keep pace with cost inflation and demand.

Wealthy local economy but highly concentrated in the energy sector

Aberdeen has the highest GDP per capita in Scotland after Edinburgh, standing at £52,517 in 2022. This reflects the concentration of high value-added jobs, particularly in the energy sector. Aberdeen is a global centre for the oil and gas industry, which accounts for 24% of employment and generates over 50% of gross value added in the North East of Scotland.

However, this high degree of concentration exposes the local economy to short-term fluctuations in the sector. Over the longer run, Scottish oil and gas production will decline due to the depletion of reserves and global efforts towards carbon transition. That said, Aberdeen's budget is relatively insulated from those economic fluctuations.

Diversification away from oil and gas will be key for Aberdeen's long-term economic prospects. Significant investment is underway in sectors such as green energy, life science and tourism. Aberdeen has been able to form partnerships with the private sector and receives ongoing support from the Scottish and UK governments towards economic diversification.

High and increasing debt levels weighing on debt affordability

Aberdeen's debt burden is high, standing at 149% of gross operating revenue as of FYE2024. It increased significantly in the last five years from 137% in FYE2020 to support its development programme. We expect debt to increase further over the next three years to reach 185% of revenue by FY2027 to fund the council's investment plans. Aberdeen plans to invest £600 million over the period (50% of its operating revenue), of which 78% will be financed through borrowing. The main investment projects are related to town centre regeneration, schools and transport. However, we expect slippages in the delivery of its capital plans, which will likely lead to a slower debt increase than we currently forecast.

The majority of the council's debt is at long-dated maturities including PWLB loans (36% of total), a 38-year bond issued in 2016 (26%) and some LOBOs (6%). We also include in our definition of debt two PPPs contracts related to schools (7%) as well as a long-term lease on Marischal Square (3%).

Aberdeen is more exposed to interest rate movements than peers with 24% of its borrowing being short-term. As a result, interest costs have increased and absorbed 7% of gross operating revenue in FY2024 up from 4.3% in FY2020. We expect debt affordability to deteriorate further in line with the expected increase in debt. In addition, the outstanding bond is linked to inflation, which exposes the council to inflation risks because only a limited proportion of its revenue increases with inflation.

Increasing exposure to commercial properties

Aberdeen has increased its exposure to commercial investments, demonstrating the council's higher risk appetite than a typical local authority. Aberdeen entered a 35-year finance lease in 2017 for the redevelopment of Marischal Square, consisting of a hotel, retail and office premises. The Event Complex Aberdeen (TECA), which comprises a multi-purpose arena, two hotels, car parking facilities and an anaerobic digestion plant, represents its largest risk exposure. The project was completed in 2019 at a cost of £425 million and is intended to support the diversification of Aberdeen's economy through leisure and business tourism. TECA is expected to contribute an additional 4.5 million visitors to the city, resulting in a £63 million gross value added by 2030. Operations were significantly impacted by the pandemic and the recovery has been slower than expected.

Aberdeen is exposed to fluctuations in commercial income from those projects although they remain a relatively minor portion of its budget at around 2% of gross operating revenues in FY2024. The council has also earmarked reserves that can be used to deal with commercial revenue volatility and is not planning any further commercial investments.

Low reserve levels compared to peers

Reserve levels are low compared to rated peers at 13.6% of operating revenue in fiscal 2024. We note that this is in line with the rest of Scotland where reserves tend to be lower given the more generous grant regime. Reserves significantly increased in the last three years reflecting one-off unspent grants received during the pandemic. Most of those reserves are earmarked for specific purposes and the extent to which they can be made available therefore varies. We forecast reserves to reduce over the medium-term to cover some of the budget gap and fund capital expenditures.

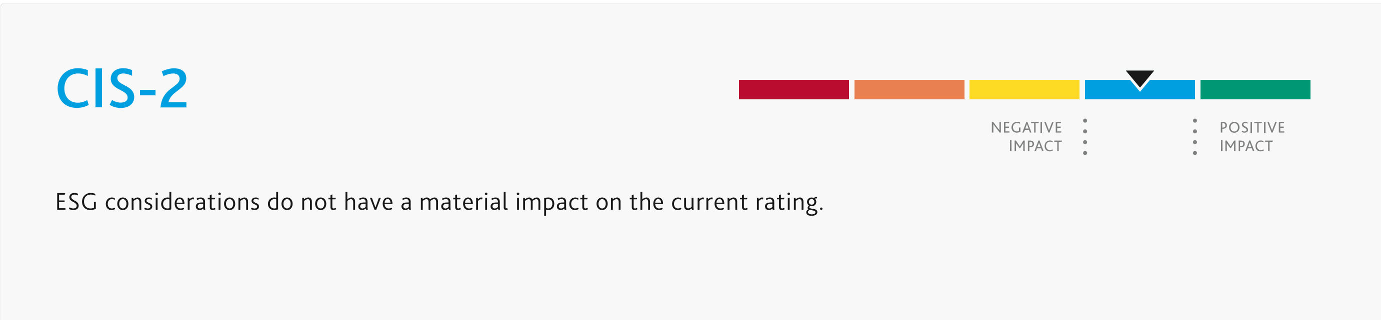
Extraordinary support considerations

We consider that there is a high likelihood that the UK government would intervene in a timely manner to prevent default. The UK government has regularly intervened when councils indicated a failure to balance budgets, providing the ability to fund operating deficits through capital sources, including borrowing. We note that those mechanisms remain untested in Scotland but it is our expectation they would be closely aligned to England. We also expect that PWLB would have the ability to act as lender of last resort in the event of severe liquidity stress in the sector.

ESG considerations

Aberdeen City Council's ESG credit impact score is CIS-2

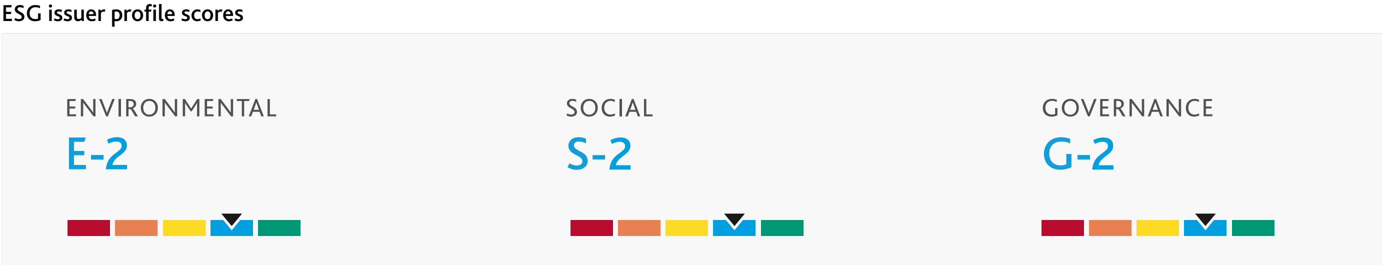
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Aberdeen's **CIS-2** indicates that ESG risks have a limited impact on its ratings. Environmental risks are low although the concentration of its economy in the oil and gas sector poses long-term challenges. Its main exposure to social risks relates to housing risks, due to housing shortages and unaffordability, which increases housing expenditure. However, its strong governance mitigates the impact of these risks on its ratings.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Aberdeen has limited exposure to environmental risks (**E-2**), which reflects a generally low exposure across most categories. However, the city is exposed to carbon transition risks due to its status as a global hub for the oil and gas sector. This high degree of concentration exposes the local economy to short-term fluctuations in the sector and will require significant investments to diversify away from fossil fuels. That said, its operating budget is relatively insulated from economic fluctuations and we expect that the private sector and the central and Scottish governments will fund most of the economic diversification efforts.

Social

Aberdeen has limited exposure to social risks (**S-2**), reflecting a generally low exposure across most categories. The one exception relates to housing, where Aberdeen is assessed to have a material exposure to risks due to the city's housing shortages and unaffordability. The lack of affordable housing directly impacts local authorities because of their statutory responsibility to supply housing for residents, consequently leading to increased expenditure pressures particularly on temporary accommodation.

Governance

Aberdeen has limited governance risks (**G-2**), reflecting its strong track record of budgetary management and high levels of transparency. However, these strengths are offset by a weakened institutional framework, characterised by limited fiscal flexibility, and increased debt and revenue risks due to investments in significant projects, such as a a multi-purpose arena and a mixed-use town centre development. As the owner, Aberdeen bears the responsibility for all revenue losses associated with these projects, although they constitute a relatively minor portion of its budget.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of baa1 is in line with the scorecard-indicated BCA.

For details about our rating approach, please refer to Rating Methodology: Regional and Local Governments, 28 May 2024.

Exhibit 5
Aberdeen City Council
Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Score	Factor Weighting	Total
Factor 1: Economy					**25%**	**1.37**
Regional Income [1]	1.13	74236.60	15%	0.17		
Economic Growth	12.00	ba	5%	0.60		
Economic Diversification	12.00	ba	5%	0.60		
Factor 2: Institutional Framework and Governance					**30%**	**2.25**
Institutional Framework	6.00	a	15%	0.90		
Governance	9.00	baa	15%	1.35		
Factor 3: Financial Performance					**20%**	**1.81**
Operating Margin [2]	9.80	6.16%	10%	0.98		
Liquidity Ratio [3]	13.54	4.97%	5%	0.68		
Ease of Access to Funding	3.00	aa	5%	0.15		
Factor 4: Leverage					**25%**	**2.60**
Debt Burden [4]	9.44	148.83%	15%	1.42		
Interest Burden [5]	11.87	6.37%	10%	1.19		
Preliminary BCA Scorecard-Indicated Outcome (SIO)						**(8.03) baa1**
Idiosyncratic Notching						**0.0**
Preliminary BCA SIO After Idiosyncratic Notching						**(8.03) baa1**
Sovereign Rating Threshold						**Aa3**
Operating Environment Notching						**0.0**
BCA Scorecard-Indicated Outcome						**(8.03) baa1**
Assigned BCA						**baa1**

[1] Regional GDP per capita in terms of purchasing power parity (PPP) terms, in international dollars
[2] Primary Operating Balance / Operating Revenue
[3] Cash and Cash Equivalents / Operating Revenue
[4] Net Direct and Indirect Debt / Operating Revenue
[5] Interest Payments/ Operating Revenue
Source: Moody's Ratings; Fiscal 2023.

Ratings

Exhibit 6

Category	Moody's Rating
ABERDEEN CITY COUNCIL	
Outlook	Stable
Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	A2
Senior Unsecured -Dom Curr	A2

Source: Moody's Ratings

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