

COMMITTEE	Finance, Policy & Resources
DATE	1 December 2017
REPORT TITLE	Credit Rating Annual Review
REPORT NUMBER	CG/17/132
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1. PURPOSE OF REPORT:-

- 1.1 To provide an overview of the recent credit rating annual review and report the outcome of the review.

2. RECOMMENDATION(S)

- 2.1 It is recommended that Committee note the following:

- a) The process undertaken for the annual review; and
- b) The outcome of the annual review.

3. BACKGROUND/MAIN ISSUES

Background

- 3.1 During 2016/17, Aberdeen City Council became the first local authority in Scotland to be awarded a credit rating and subsequently secure funding towards its capital investment programme, by issuing bonds of £370 million on the London Stock Exchange (LSE).
- 3.2 The credit rating must be maintained over the term of the bonds with the credit rating agency conducting a review at least once every twelve months. The first annual review of the Council's credit rating was undertaken in October 2017.
- 3.3 At its meeting on 14 December 2016, Council considered a report "Bond Financing Strategy – Implications for the Council" which provided details on the implications of the award of a credit rating by Moody's Investor Services. The report can be viewed using the following link (item 15):

<http://councilcommittees/ieListDocuments.aspx?CId=122&MId=3897&Ver=4>

- 3.4 A credit rating, from a recognised credit rating agency, had to be secured to enable the Council to issue bonds. In determining a credit rating, the agency considered the strength of the institutional framework within which a Scottish local authority operates as well as considering the performance of the economy within which the local authority operates.
- 3.5 In addition, the Council was required to submit detailed financial information to the ratings agency in order to demonstrate its stewardship, including annual accounts; past, present and future budgetary information and analysis including the main income streams; capital programmes and major projects; analysis of past and projected future reserves and balances; treasury management policy and strategy; credit metrics; and 35 year projected income statement, cashflow statement and balance sheet.
- 3.6 In early October 2016, Aberdeen City Council received a credit rating from Moody's Investor Services ("Moody's") of Aa2, and was placed on negative outlook. The rating was one notch below the UK sovereign rating with the negative outlook mirroring that of the UK sovereign rating, following the vote to leave the European Union. This is third highest rating Moody's award and is a high-grade investment rating

UK Rating Downgrade and Impact on Aberdeen City Council

- 3.7 On 22 September 2017, Moody's downgraded the UK Sovereign Rating from Aa1 to Aa2, whilst also moving from a negative outlook to a stable. The key drivers for this change were:
- The outlook for the UK's public finances has weakened significantly since the negative outlook on the Aa1 rating was assigned, with the government's fiscal consolidation plans increasingly in question and the debt burden expected to continue to rise;
 - Fiscal pressures will be exacerbated by the erosion of the UK's medium-term economic strength that is likely to result from the manner of its departure from the European Union (EU), and by the increasingly apparent challenges to policy-making given the complexity of Brexit negotiations and associated domestic political dynamics.
- 3.8 The rationale for the stable outlook was:
- 3.8.1 The fiscal deterioration that Moody's expects is balanced by the UK's continued economic and institutional strengths, that compare well to peers at the Aa2 rating level. While the ongoing Brexit negotiations introduce a high level of uncertainty over the economic outlook for the UK, Moody's base case remains that some form of a free trade agreement is in the interest of both sides and will ultimately be agreed. Such a scenario would mitigate the negative economic implications of the UK's departure from the EU to some extent.

- 3.8.2 In that context, Moody's notes that the UK government may be softening its negotiating stance in a number of areas, including on the European Court of Justice, on continuing budget contributions in the transition phase and most importantly on the need for a transitional agreement beyond March 2019 to limit the disruption to trade following the UK's exit.
- 3.9 On the back of the UK rating downgrade, Moody's reviewed sub-sovereign ratings including Aberdeen City Council and on 26 September 2017 published a rating action which downgraded the Council's credit rating from Aa2 to Aa3, again moving from a negative to a stable outlook.
- 3.10 It is worth noting that Moody's did not take the same action on all sub-sovereign bodies with the outlook for a number of bodies retained at negative whilst the rating of one body went down two notches to A1.
- 3.11 The downgrade of the Council's credit rating was an expected consequence of the change to the UK sovereign rating and therefore should not be seen as a direct reflection on the Council.

Annual Review Process

- 3.12 In February 2017, Moody's indicated that the annual review should take place after the publication of the Council's 2016/17 audited annual accounts which were due to be considered by the Audit, Risk & Scrutiny committee on 26 September 2017.
- 3.13 They further advised that the review would be in the form of a face to face meeting and indicated they would be keen to have the meeting in Aberdeen. The date for this meeting was subsequently set for 13 October 2017, with Moody's providing an agenda of the areas they would wish to cover in the meeting.
- 3.14 As the format for the original credit meeting assessment included a Management Presentation by the Chief Executive, Head of Finance and Head of Economic Development, it was concluded that a similar format for the day would be appropriate and this was agreed with Moody's. In addition and reflecting the importance of governance around the bond and credit rating, the Head of Legal & Democratic Services was also included for this meeting.
- 3.15 The updated Management Presentation focussed on "telling the story" since the original assessment covering the 2016/17 reported financial position, current estimated 2017/18 financial position, projected medium term financial position, treasury and debt management position and the local economy.
- 3.16 As part of the day, the Moody's Analysts were on a site visit to the AECC development where they met a representative from SMG (the AECC operator). As the biggest project the Council is undertaking and given the size and complexity of the development, the analysts were particularly keen to enhance their understanding of the project including how the project is being

run, the robustness of future revenue stream assumptions and the overall risk to the Council arising from the project.

- 3.17 By way of supporting the assessment of the economy, a further visit was also undertaken to the Oil & Gas Technology Centre (OGTC) where they met the CEO of OTGC and the Head of Communications & External Affairs of Oil & Gas UK.
- 3.18 Whilst the review meeting itself allowed question and answer sessions throughout, further follow up information was requested by Moody's in the week commencing 17 October 2017, with the majority of the information provided that week. More detailed information on the AECC development project was also requested and this was provided through documentation and discussion with the analysts during the period to 6 November 2017.

Annual Review Outcome

- 3.19 On 20 November 2017, Moody's issued their credit opinion, Aa3 with a stable outlook, no change from that issued in September 2017. The full published credit opinion is included in Appendix 1 and can be summarised as follows:
 - 3.19.1 The credit profile reflects a strong institutional framework, a strong track record of operating performance and a wealthy local economy whilst also reflecting challenges around the increase in ACC's debt levels from 2016/17 to finance their capital programme and key project risk from the development of the Aberdeen Exhibition and Conference Centre (AECC).
 - 3.19.2 The credit profile also reflects our assessment of support from the UK government (Aa2 stable) and the high likelihood it would intervene in the event that ACC were to face acute liquidity stress.
 - 3.19.3 The credit opinion highlights those factors which could lead to a future upgrade or downgrade, with these including changes in financial performance, significant changes in the size and/or complexity of debt and changes in the risks associated with ambitious capital projects both in terms of delivery and future revenue streams.

Future Annual Reviews

- 3.20 As previously mentioned, the credit rating must be maintained over the period of the bonds. This means a formal review of this nature will take place annually. While we expect each review will have a strong focus on the current and projected financial position of the Council it is noted that credit rating agencies value independent analysis and reporting of local economies.
- 3.21 At its meeting on 15 March 2017, Council approved plans to establish an Economic Policy Panel to advise on and inform the Council's annual credit rating reassessment and to inform the Regional Economic Strategy and other economic matters relevant to the Council.

- 3.22 At its meeting on 23 August 2017, Council approved the appointment of three members to the Aberdeen Economic Policy Panel (the Panel) and noted the immediate working priorities of the Panel.
- 3.23 It was further noted that, with the Panel only just established, it would not be possible for the Panel to produce an economic report in advance of the first annual credit rating review in October 2017.
- 3.24 The annual work plan of the Panel will revolve around the production of its annual economic report around September/October each year which, as independent validation of economic policy and performance will provide a robust check on the economic analysis provided to Moody's from 2018 onwards.

4. FINANCIAL IMPLICATIONS

- 4.1 Whilst there are no direct financial implications arising from the recommendations of this report, it is important to note that the bond issuance places a financial commitment on the Council until 2054.
- 4.2 In addition, financial stability and strong financial management are key elements to maintaining a credit rating throughout the period of the bonds.

5. LEGAL IMPLICATIONS

- 5.1 There is a specific requirement within the bond documentation that a credit rating be maintained throughout the period of the bonds.
- 5.2 While the Council's bonds are trading on the LSE, the Council is required to comply with the Market Abuse Regulations, the Disclosure and Transparency Rules, the Listing Rules and ongoing obligations as set out in the LSE Admission and Disclosure Standards.
- 5.3 A Bond Governance Project Board has been established to deliver a programme of work aimed at ensuring all governance requirements in relation to the bond issuance are put in place.

6. MANAGEMENT OF RISK

Financial

- 6.1 The Council must endeavour to maintain a suitable credit rating. Should the credit rating fall the liquidity of the bonds in the secondary market will drop. If concerned, bondholders may call a meeting which would analyse the Council's financial position and the Council are obliged to respond honestly to all questions. Further if the credit rating falls such that it is three notches below the UK sovereign rating, the bondholders have the ability to request repayment of the bonds.

6.2 In addition if the credit rating falls then the Council's ability to obtain other financial products in market place may become more expensive and/or difficult to access. This is due to the perceived risk in investing in a lower credit rated body.

6.3 These risks are partially mitigated by putting in place and maintaining robust governance, to ensure the Council is able to react and take action promptly to address issues arising. The Bond Governance Project Board incorporates the key work programmes identified to ensure these risks are mitigated as far as possible.

Employee

6.4 Council employees and councillors have access to an array of information which may be confidential and/or inside information in terms of the relevant legislation, rules and regulations that come with being an LSE listed organisation.

6.5 It is important that all employees and councillors understand the implications of being a listed organisation and having a credit rating and the specific requirements this puts on them.

6.6 These risks are mitigated by the programme of training which has been undertaken through the Bond Governance Project Board.

Other

6.7 Consideration has also been given to Customer / Citizen, Environmental and Technological, and no risks were identified.

Legal & Reputational

6.8 Failure to adhere to the relevant legislation, rules and regulations may result in the Financial Conduct Authority (FCA) seeking to investigate the governance arrangements in place to comply with the LSE requirements. This could be on a corporate and/or individual basis and represents both a legal and reputational risk.

6.9 These risks are mitigated by the programme of work being delivered through the Bond Governance Project Board.

7. IMPACT SECTION

Economy

7.1 The bond issuance has provided a source of financing which allows investment in the city through the projects identified within the Council's capital programmes.

People & Place

7.2 Investment in the city enhances the lives of its citizens and those of the wider region through the provision of better facilities.

Technology

- 7.3 There are no direct implications on technology arising from the recommendations of this report

8. BACKGROUND PAPERS

Bond Financing Strategy – Implications for the Council (Council 14/12/16)
Bond Financial Strategy – Economic Policy Panel (Council 15/03/17)
Recruitment to Aberdeen Economic Policy Panel (Council 23/08/17)
Moody's Credit Rating Opinion (20 November 2017)

9. APPENDICES

Appendix 1 – Moody's Credit Rating Opinion

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