

CREDIT OPINION

10 February 2023

Update



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RATINGS

Aberdeen City Council

Domicile	Aberdeen, United Kingdom
Long Term Rating	A1
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

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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Aberdeen City Council (UK)

Update to credit analysis

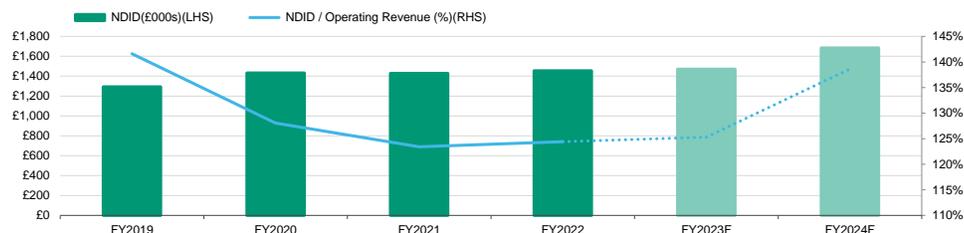
Summary

The credit profile of [Aberdeen City Council](#) (Aberdeen, A1 negative) reflects a strong institutional framework, a strong track record of operating performance, a wealthy local economy balanced by a high debt burden to finance their capital programme and project risk from The Event Complex Aberdeen (TECA) development. The credit profile also reflects a high likelihood that the government of the [United Kingdom](#) (UK, Aa3 negative) would intervene in the event of acute liquidity stress.

Exhibit 1

Aberdeen's debt level was stable in fiscal year ended 31 March 2022 but is expected to increase, though at a modest rate as borrowing increases

Net Direct and Indirect Debt (£000s), Net Direct and Indirect Debt as % of operating revenues



F denotes a projection based on Aberdeen's medium term financial plan.

Source: Issuer, Moody's Investor Service

Credit strengths

- » Strong institutional framework for Scottish local authorities
- » Wealthy local economy, with some concentration in oil and gas industries
- » Track record of balanced financial performance but significant medium term pressures

Credit challenges

- » Debt has increased in level and complexity in recent years
- » Exposure to key project risks associated with the development of The Event Complex Aberdeen (TECA)

Rating outlook

The negative outlook reflects the close institutional, economic and financial linkages between the UK government and local authorities. It also reflects the weakening economic and fiscal

environment in the UK which will lead to lower revenues, higher demand for services and therefore rising cost pressures for local authorities.

Factors that could lead to an upgrade

An upgrade in the near term is unlikely given the negative outlook. However, upward pressure on Aberdeen's rating could be driven by material reductions in projected debt levels, material improvement in operating performance, reduction in risk levels in capital programmes and material improvements in reserves levels.

Factors that could lead to a downgrade

One or a combination of the following could result in downward pressure on Aberdeen's rating: a material increase in debt levels beyond that currently anticipated; an inability to achieve balanced budgets without material depletion of usable reserves; increasing risk exposure or weak performance of commercial investments; a downgrade of the UK sovereign rating or a weakening of the UK's strong institutional framework for local authorities.

Key indicators

Exhibit 2

Aberdeen City Council						
	FY2019	FY2020	FY2021	FY2022	FY2023F	FY2024F
Net Direct and Indirect Debt / Operating Revenue (%)	141.6	128.0	123.4	124.4	125.3	139.1
Interest Payments / Operating Revenue (%)	5.5	4.8	3.9	4.2	3.5	3.5
Gross Operating Balance / Operating Revenue (%)	(0.9)	(0.1)	3.1	0.7	0.1	0.5
Capital Financial Surplus (Requirement) / Total Revenue (%)	(13.3)	(14.4)	0.2	(8.4)	(7.0)	(6.1)
Intergovernmental Transfers / Operating Revenue (%)	48.9	50.1	49.5	43.1	42.5	40.7
Short-Term Direct Debt / Direct Debt (%)	18.0	16.9	18.8	17.6	16.9	15.8
GDP per capita as % of National Average	146.0	146.3	145.7	145.5	145.7	145.7
Usable Reserves / Operating Revenue (%)	6.4	5.4	8.6	9.3	9.0	8.3

F = Forecasts

[1] Gross value-added figures for Aberdeen and Aberdeenshire as a percentage of the UK average (source: Office for National Statistics).

Source: Issuer, Moody's Investors Service

Detailed credit considerations

Aberdeen's credit profile reflects (1) a Baseline Credit Assessment (BCA) of a3, and (2) a high likelihood of extraordinary support from the UK government in the event that the entity faced acute liquidity stress.

Baseline credit assessment

Strong institutional framework for Scottish local authorities

In Scotland, the responsibility for local government funding is devolved, with the Scottish government allocated a block grant from the UK sovereign, which currently amounts to some 85% of the total budget. The Scottish government then allocates a block grant to Scottish LAs in the form of a general revenue grant, non-domestic rates income (business rates) and a general capital grant; this represents around 50% of Aberdeen's gross expenditure. This also means that Aberdeen is less exposed to business closures than LAs in England - as non-domestic rates income acts as a balancing figure within its grant calculation and will scale up and down depending on its grant allocation. This insulates Aberdeen to some extent from an economic downturn. As in England, Scottish LAs' main sources of non-block grant revenue are council taxes, fees, charges, trading and investment income. Similar to English LAs, Scottish LAs have to prepare an annual balanced budget and any failure to meet this requirement means the government must be notified by the designated financial officer (Section 95 officer) at the council.

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Aberdeen's internal governance and scrutiny is strong, supported by recent assessments from the Accounts Commission. The financial planning process includes a strategic review, underpinned by a medium-term financial plan, a corporate risk register and monitoring of the financial position (which is reported quarterly to the City Growth and Resources Committee). Similar to other LAs, Aberdeen manages a number of partnerships with other public bodies to deliver its social mandate. In addition to this, Aberdeen holds shares in a number of entities and subsidiaries to support the delivery of its objectives. All are financed by Aberdeen, so their funding and savings plans are considered in Aberdeen's medium-term financial plan. None have any debt on their balance sheets.

Wealthy local economy, with high concentration in oil and gas industries

Aberdeen is located in the north east of Scotland, with a population of over 212,000. Aberdeen is wealthy compared with the rest of the UK and Scotland. Gross value added per capita in Aberdeen City was £45,834 in 2020, or 146% of the UK average. The city has a highly skilled labour force, with approximately 54% of working age people having qualifications at NVQ4 and above compared with the Scottish and UK averages of 47% and 40% respectively.

The oil and gas sector remains the primary driver of employment in Aberdeen's economy through direct employment on offshore rigs and indirectly through the supply chain. An analysis by Scottish government estimates that the energy sector as a whole represents around 44% of the city's employment. The energy sector also plays an outsized role in the GVA generated by Aberdeen, with GVA/per head (employment) in this sector almost four times that in life sciences and financial and business services.

The oil and gas sector is expected to remain robust over the next two years, following on from the cyclical highs of 2022. This is a credit positive for Aberdeen, given its concentration in the sector. However, significant concentration to this sector introduces volatility to the city's economic performance. Aberdeen's climate change plan, which aims to meet a net carbon zero target by 2045, includes extensive investment in clean energy infrastructure. Development of renewable energy infrastructure such as wind farms and hydrogen buses will require significant investment but will help steer the city towards its carbon transition goals target and introduce some diversification to the city's energy sector. In addition, as an export-led economy, it is exposed to geographical tensions. For instance, the Russia-Ukraine conflict has led to increased export volumes to the bloc as the EU aims to diversify its energy supplies away from Russia. Despite the recent positive performance in one of Aberdeen's key sectors, we expect the challenges looming from Brexit to weigh on trade in the longer term.

While the results of the Brexit referendum initially brought renewed impetus to the arguments for a second Scottish Independence referendum, we view this as currently having little bearing on the strong ties between the UK government, the Scottish government and in turn the Scottish LA sector.

Track record of balanced financial performance, but significant pressures over the medium term

Aberdeen generated a £8.4 million surplus on its General Fund and Housing Revenue Account (HRA) balance in FY2022, resulting in a gross operating balance (GOB) of 0.1%, down from 3.3% in FY2021. In line with other local authorities, the fall in the operating performance in FY2022 was largely driven by the continued impact of the pandemic on the Council's income, due to changes in consumer behaviour and restrictions across the city during the fiscal year. In general, its budgetary performance and budgetary control is strong, however, Aberdeen faces pressures from elevated inflation over the near term and from increasing demand for services over the medium term, which will push up Aberdeen's spending. Aberdeen has forecasted a £2.1 million general fund deficit; £0.5 million HRA surplus. This leaves a net deficit of £1.6 million for FY2023, which will be matched by earmarked reserves to arrive at a balanced budget.

In FY2022, the level of useable reserves to operating revenue increased marginally to 9.3% from 8.6% in FY2021. However, non-earmarked General Fund reserves still remain relatively low at £12 million, equivalent to 1.0% of operating revenue, though is viewed to be reasonable given the Council's size and the significant funding from the Scottish Government. However, reserve balances are expected to reduce over the medium term, to reflect usage of the capital fund, with government grants and contributions expected to return to historic levels whilst earmarked reserves are used to offset budget gaps.

The HRA, similar to that in England, is ring fenced and primarily funded through rental income. Aberdeen currently has around 22,500 council houses, which are covered by a 30-year HRA business plan. As is the case in England, in Scotland, the HRA cannot subsidise the general fund (Housing (Scotland) Act 1987).

Debt has increased in level and complexity in recent years

Aberdeen issued a £370 million index-linked bond in November 2016, maturing in 2054. The bond was intended to support the development of its ambitious capital programme, in particular, financing TECA. The bond is index-linked on the capital repayments - this increases the council's inflation-related risk as a limited proportion of Aberdeen's revenue is index-linked and raises the risk of a potential mismatch between revenue and indexation on the capital.

Aberdeen's debt burden rose slightly to 124% of gross operating revenues at fiscal year ended 31 March 2022. This was due to additional long-term borrowing, as some capital spending plans reconvened following COVID restrictions. Aberdeen's debt includes direct debt of £1 billion, £126 million in PPP liabilities and £56 million of finance leases. Its direct debt is predominantly split between borrowing from the Public Works Loan Board (PWLB, a statutory body of the UK government) (41%), the bond issuance and premium (36%) and the remainder in market debt and temporary loans. There is no use of derivatives, although it continues to have some legacy Lender Option Borrower Option (LOBO) loans, however these are all at fixed rates. As capital spending resumes, borrowing is expected to increase, pushing up the debt level at a modest rate over the medium term.

Aberdeen's treasury policy is straightforward, reflecting the uncomplicated debt and treasury arrangements. The investment policy is risk averse, with an approved counterparty list with the highest-rated entities maintained and adhered to, investments are currently held and planned to be held in highly rated money market funds. [Clydesdale Bank plc \(LT Bank Deposits, A3 stable\)](#) is responsible for day-to-day banking facilities and offers an overdraft facility of £1.5 million.

Aberdeen also has a number of other existing indirect obligations, the largest of these being the pensions fund, which shows an actuarial deficit of £118.4 million. A recovery plan has been agreed with the trustee to address the unfunded position. Aberdeen is involved in two Public Private Partnerships (PPP). These include a 30-year PPP contract for the construction, maintenance and operation of 10 schools. The scheme came into operation between May 2009 and April 2011. The other PPP is for another school, Lochside, which came into operation in August 2018 and is for 28 years. The liability value of the PPPs at FY2022 was £126 million. Aberdeen also has a finance lease for the commercial development at Marischal Square in Aberdeen City Centre which completed in November 2017, for a duration of 35 years. This consists of a hotel, retail and office premises. The discounted present value of the minimum lease payments is £56 million, and this has been consolidated into Aberdeen's net debt and indirect debt. Aberdeen City Council will be liable for the annual rental stream from the asset and carries the revenue risk should the project not be successful. Contingency amounts from the deal are available in the first few years of the development, to protect the council against a shortfall in rental income as rental agreements are signed with tenants.

Key project risk associated with TECA

TECA is the cornerstone of Aberdeen's capital programme. The project comprises a 12,500 capacity seated/standing arena, exhibition and conference centre, two hotels, car parking facilities and an anaerobic digestion plant. Construction started in July 2016 and is now operational as of summer 2019. The total gross construction cost was £425 million.

The project is intended to bolster Aberdeen's ability to compete globally with other cities in the energy sector, as well as support the diversification of Aberdeen's economy through leisure and business tourism. We view the TECA development and Aberdeen's borrowing to finance it as demonstrating the council's higher risk appetite than a typical local authority, although the project is intended to boost Aberdeen's long-term economic performance.

TECA is operated by ASM Global, which has considerable experience running other major event and conference venues in the UK and globally, and hotel franchise agreements with RBH Hospitality Management, under Hilton Hotels and [Marriott International, Inc \(Baa2 stable\)](#) brands. Construction risk is now materially lower, as the majority of the programme is now complete, including the anaerobic digestion plant.

However, Aberdeen remains exposed to revenue risk in the operations phase. The Council's cashflow is expected to be affected by the capital programme in FY2023, due to the higher operating costs resulting from the energy crisis. Though activity was interrupted by COVID restrictions over the last two fiscal years, 120 large events are expected to have taken place in 2022. The ambition is to have an additional 4.5 million visitors, resulting in a £63 million net GVA to the Scottish economy. Over the medium to long term (2023-2028), the lingering

impacts of the pandemic on the events and conference industry may result in a shift in demand for TECA's services, resulting in the local authority having to reconsider the focus of the site.

Extraordinary support considerations

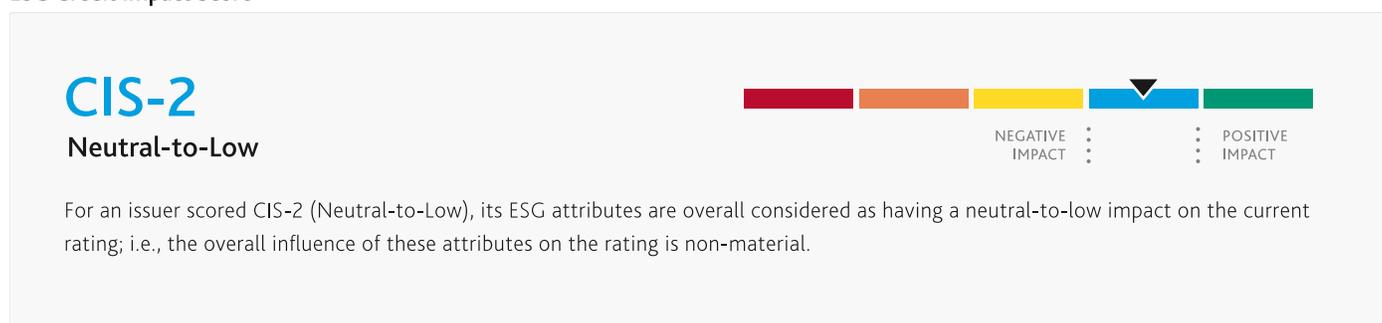
We consider Aberdeen to have a high likelihood of extraordinary support from the UK government, reflecting our assessment of the reputation risk to the state were a local government's financing to fail within such a tightly designed and monitored system, in addition to the Public Works Loan Board's position as a lender of last resort.

ESG considerations

Aberdeen City Council's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3

ESG Credit Impact Score



Source: Moody's Investors Service

Aberdeen's ESG Credit Impact Score is neutral to low (**CIS-2**), reflecting neutral to low exposure to environmental, social and governance risks.

Exhibit 4

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Its overall E issuer profile score is neutral to low (**E-2**), reflecting low exposure to environmental risks across all categories, except for moderately negative exposure to carbon transition risks given the significant dependence of the city on the oil and gas sector and Scotland's net zero targets, which will require the city to invest and adapt to the transition over time. Apart from carbon transition, the other main environmental risk relates to physical climate risks, however adaptation is generally the responsibility of regional and/or national bodies.

Social

We assess its S issuer profile score as neutral to low (**S-2**) reflecting low exposure to social risks across most categories. One exception is in relation to housing where we assess Aberdeen to have a moderately negative exposure to risk due to housing shortages and affordability pressures in the city. A shortfall in affordable housing directly affects local authorities due to their statutory responsibility to provide housing for residents – this leads to additional expenditure pressures.

Governance

We assess its G issuer profile score as neutral to low (**G-2**) reflecting the positive rating impacts of its strong track record of budgetary management, high levels of transparency and a strong institutional structure. Aberdeen has increased its debt levels and revenue risk in recent years due to investments in key projects including a new conference and exhibition centre development (TECA) and town centre mixed use development, both of which have been predominantly closed through the coronavirus pandemic and will likely take an extended period for revenues to recover. Aberdeen – as the owner of both sites – is ultimately liable for all revenue losses on these projects, although they represent a relatively small proportion of their net 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 a3 is the same as the scorecard-indicated BCA. The scorecard-indicated BCA of a3 reflects (1) an idiosyncratic risk score of 4 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a systemic risk score of Aa3, as reflected in the sovereign bond rating for the United Kingdom.

For details about our rating approach, please refer to [Rating Methodology: Regional and Local Governments](#), 16 January 2018.

Exhibit 5

Fiscal 2022

Aberdeen City Council						
Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				2.20	20%	0.44
Economic Strength	1	145.67%	70%			
Economic Volatility	5		30%			
Factor 2: Institutional Framework				3	20%	0.60
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				4	30%	1.20
Operating Margin	5	1.29%	12.5%			
Interest Burden	5	4.23%	12.5%			
Liquidity	1		25%			
Debt Burden	7	124.37%	25%			
Debt Structure	3	17.64%	25%			
Factor 4: Governance and Management				5	30%	1.50
Risk Controls and Financial Management	1					
Investment and Debt Management	5					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						3.74 (4)
Systemic Risk Assessment						Aa3
Scorecard-Indicated BCA Outcome						a3
Assigned BCA						a3

Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
ABERDEEN CITY COUNCIL	
Outlook	Negative
Baseline Credit Assessment	a3
Issuer Rating -Dom Curr	A1
Senior Unsecured -Dom Curr	A1

Source: Moody's Investors Service

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