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Research Update:

Ratings On Australian State Of New South Wales Affirmed At 'AAA/A-1+'; Outlook Remains Negative

Primary Credit Analyst:
Craig R Michaels, Melbourne (613) 9631 2082; craig.michaels@spgglobal.com

Secondary Contact:
Anthony Walker, Melbourne (61) 3 9631 2019; anthony.walker@spglobal.com

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Overview

- The ratings on New South Wales (NSW) reflect our view of Australia's extremely predictable and supportive institutional framework, as well as the state's very strong financial management and economy, and its exceptional liquidity.
- As a result, we are affirming our 'AAA/A-1+' long- and short-term ratings on NSW.
- The negative outlook reflects that on the Commonwealth of Australia and represents at least a one-in-three chance of a downgrade within the next 12-24 months.
- A lowering of the long-term rating on the sovereign would result in the same action on NSW because we consider the state is unlikely to withstand a stress scenario better than the Australian sovereign.

Rating Action

On Sept. 26, 2016, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term ratings on the Australian State of New South Wales (NSW). The outlook on the long-term rating remains negative.

Rationale

The negative outlook reflects that on the Commonwealth of Australia (see research update titled, "Australia Outlook Revised To Negative On Growing Fiscal Vulnerabilities; 'AAA/A-1+' Ratings Affirmed", published to RatingsDirect, July 7, 2016).

We view NSW's stand-alone credit profile as 'aaa'.

We do not consider that any state or territory in Australia, including NSW, can maintain stronger credit characteristics than the sovereign in a stress scenario. This reflects the financial reliance that states have on grants from the central government to fund core public services, as well as the likelihood that states' own revenue sources would be severely hampered in a sovereign default scenario.

NSW's credit profile reflects the extremely predictable and supportive institutional framework underpinning intergovernmental relations in Australia, NSW's wealthy and diversified economy, and the state's exceptional liquidity. The ratings also reflect NSW's very strong financial management and very low contingent liabilities. NSW's average budgetary flexibility and budgetary performance, and moderate debt burden partly offset these strengths.

The NSW government is undergoing a major revamp of its balance sheet, which is aimed at ameliorating the state's infrastructure backlog, while constraining its debt levels. This process has some time still to run as the state continues to partially lease major electricity assets mostly to help fund big-ticket transport projects. Overall, we view the state's strategy of boosting infrastructure through this "asset recycling" as supportive of its underlying credit profile. Along with a strong focus on expense control, it contributes to our view that the state continues to demonstrate very strong financial management.

Tight expense control, and a robust local economy and property market, underpin the state's strong cash operating surpluses. The state's operating performance in 2015 and 2016 was stronger than our expectations, largely due to surging property transaction tax revenue. But we expect operating performance will be weaker in following years, mainly due to a likely declining share of nationally collected revenues from the goods and services tax. Still, we expect the state would post strong cash operating surpluses and, overall, we project cash operating surpluses to average 9% of operating revenues over 2015 to 2019.

We expect cash after-capital deficits to average 4% of total revenues over the same period, driven by the state's very large capital spending program. (We incorporate asset transaction proceeds as capital revenue in this calculation.) After-capital deficits are likely to be somewhat higher in coming years than we previously assumed, given that the government has enlarged its capital spending program to help address the state's infrastructure shortcomings. But this has little impact on the outlook for the state's debt, because the state achieved a larger surplus than our forecasts in the year ended June 30, 2015. In addition, the state has also now received the proceeds of the long-term lease of the electricity network operator TransGrid.

We do not incorporate prospective asset transactions in our forecast. Further transactions could improve our current deficit and debt projections for the next few years, until the state spends the proceeds on additional infrastructure. In August 2016, the Australian government blocked the long-term lease of a majority share of Ausgrid to a consortium of bidders on national interest grounds. The NSW government plans to relaunch the lease process shortly. Given that we had not factored this lease into our earlier financial assessment, this delay does not have an immediate bearing on our assessment of NSW. We think that the lease will likely proceed over time, and the state would use this to further boost its capital expenditure.

The economy remains buoyant. NSW's economy is wealthy, with GDP per capita of US$62,000 on average over fiscal years 2013 to 2015. In addition, the outlook for the NSW economy is robust. Over the past few years, the NSW economy has strengthened sharply to become the strongest nationally, with the state's highly diversified economy benefitting the most among the states from low interest rates, a lower currency, and also stronger population growth. With NSW's economy accounting for about one-third of the national economy, and growth prospects being solid, we expect economic expansion to be broadly similar to that of the sovereign in coming years, if not actually outperforming it. Low interest rates and strong population growth also continue to drive a buoyant property market, boosting the state's property transaction tax revenue—an important, although volatile, source of revenue.

NSW's budgetary flexibility is average in our view. Revenues from modifiable sources represent a little more than 50% of total revenue. This share has gradually increased over recent years with the leasing of assets in the regulated utilities sector; hence, diminishing the state's reliance on nonmodifiable revenue. But while capital expenditure is in excess of 15% of total expenditure, we do not consider that this relatively high level of capital spending currently offers much expenditure flexibility, given the state's strained transport infrastructure and the government's intent to address these infrastructure shortcomings.

Liquidity

We consider NSW's liquidity to be exceptional. NSW holds free cash and liquid assets sufficient to fully cover its upcoming 12 months' debt maturities and interest payments. We expect NSW's liquidity, after we apply haircuts to noncash liquid assets, to average over 210% of debt-servicing needs over the year to June 30, 2017. We also consider NSW has strong market access, reflecting its demonstrated ability to access deep and liquid capital markets, even in times of stress. And, if market access did become stressed, we expect the Commonwealth of Australia would provide support.

NSW maintains a large portfolio of cash and high-quality liquid assets, which we expect would have an average value of A$33.4 billion (after we apply haircuts) over fiscal year 2017. This is significantly above its debt-servicing costs of A$15.8 billion in that year.

New South Wales Treasury Corp. (TCorp) manages the state's liquidity and debt issuance. We consider TCorp's management to be prudent. NSW is typically less reliant on short-term funding than some domestic peers (with short-term funding representing around 8.5% of total funding in fiscal year 2015, for example). For 2016, short-term funding was higher, at around 12.2% of total borrowings, given that TCorp is seeking to manage its funding profile in anticipation of large proceeds from further asset transactions. We expect TCorp's reliance on short-term debt to reduce significantly after these transactions are completed.

Outlook

The negative outlook on NSW reflects that on the sovereign, the Commonwealth of Australia. A deterioration in NSW's own credit metrics, which we view as unlikely over the next two years, could also lead to a downgrade of the state.

We would revise the outlook on NSW to stable if we take a similar action on Australia, and NSW's credit metrics remain consistent with a stand-alone credit profile of 'aaa'.

Key Statistics

Table 1

State of New South Wales Key Statistics					
Non Financial Public Sector	**2015 A**	**2016 A (E)**	**2017 A (BC)**	**2018 A (BC)**	**2019 A (BC)**
Adjusted Cash Figures					
Operating Revenue					
Tax Receipts	25,491	28,331	29,002	30,489	31,736
Sales of Goods and Services Non-Modifiable	11,870	9,230	8,431	8,817	8,800
Sales of Goods and Services Modifiable	6,585	8,903	8,776	8,896	9,217
GST	17,065	17,647	17,663	17,679	17,808
Current grants	9,935	10,664	10,516	11,276	10,076
Mining royalties	1,254	1,161	1,257	1,339	1,407
Other revenue	10,067	9,033	8,862	8,601	8,505
Total Operating Revenue	82,267	84,970	84,506	87,097	87,549
Operating Expenditure					
Staff costs	34,065	36,482	36,379	39,379	40,632
Payments for goods and services	21,087	22,293	25,407	25,497	25,032
Interest costs	3,455	3,321	3,166	3,361	3,459
Grants	6,076	7,294	8,059	8,007	6,753
Other	5,847	5,646	5,822	5,563	5,633
Total Operating Expenditure	70,530	75,037	78,834	81,806	81,509
Cash Operating Balance	11,737	9,933	5,673	5,291	6,041
Purchases of non-financial assets	(13,292)	(16,420)	(19,934)	(20,060)	(14,937)
Capital Grants	1,739	1,676	3,831	1,831	1,832
Sales of non-financial assets	2,770	11,497	1,520	942	1,013
Net Cash from Investing	(8,783)	(3,246)	(14,583)	(17,287)	(12,093)
After-capital account balance (cash surplus/deficit)	2,954	6,687	(8,910)	(11,996)	(6,052)
Balance sheet					
Total tax-supported debt	64,995	64,888	70,350	76,700	83,471
Unfunded Superannuation Liability	32,937	34,800	34,400	33,800	33,000
RATIOS					
Modifiable Revenues/Adjusted Operating Revenues (%)	51.85	54.82	55.62	55.64	57.19
Capital Expenditure/Total Expenditure (%)	15.86	17.95	20.18	19.69	15.49
Operating Balance/Adjusted Operating Revenues (%)	14.27	11.69	6.71	6.07	6.90
After-Capital Account Balance/Total Revenues (%)	3.40	6.81	(9.92)	(13.35)	(6.70)
Interest Expense/Adjusted Operating Revenue (%)	4.20	3.91	3.75	3.86	3.95

Table 1

State of New South Wales Key Statistics (cont.)					
Non Financial Public Sector	**2015 A**	**2016 A (E)**	**2017 A (BC)**	**2018 A (BC)**	**2019 A (BC)**
Total Tax-Supported Debt/Consolidated Operating Revenues (%)	79.01	76.37	83.25	88.06	95.34
Unfunded Superannuation Liability/Adjusted Operating Revenues (%)	38.54	40.96	40.71	38.81	37.69

A--Actual. BC--Base case. E--Estimate.

Table 2

Economic Statistics			
	2013 (A)	**2014 (A)**	**2015 (A)**
Economic Statistics			
Population (mil)	7.41	7.51	7.62
Population growth (%)	1.37	1.44	1.41
GSP per capita (local currency)	65,326	66,389	67,825
Real GSP Growth (%)	2	2.3	2.4
Unemployment rate (%)	5.22	5.67	5.93

A--Actual. GSP--Gross state product.

Ratings Score Snapshot

Table 3

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Average
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Very low

Key Sovereign Statistics

Sovereign Risk Indicators, July 6, 2016. Interactive version available at http://www.spratings.com/sri

Related Criteria And Research

Related Criteria

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- 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
- 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

Related Research

- Australia Outlook Revised To Negative On Growing Fiscal Vulnerabilities; 'AAA/A-1+' Ratings Affirmed, July 7 , 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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

New South Wales (State of)	
Issuer Credit Rating	AAA/Negative/A-1+

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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.