

HD *S&P Affirms Queensland Rtgs At 'AA+/A-1+'; Otlk Stable

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The following is a press release from
Standard & Poor's:

OVERVIEW

-- We are affirming our 'AA+/A-1+' long- and short-term ratings on the Australian State of Queensland.

-- The affirmation reflects our view of Queensland's extremely predictable and supportive institutional framework, exceptional liquidity, wealthy economy, strong financial management, and low contingent liabilities.

-- Constraining the ratings are Queensland's weak budgetary performance, average budgetary flexibility, and high debt burden.

-- The stable outlook reflects our view that the state will largely adhere to its fiscal strategy and that in its forecast years, operating surpluses will sustain its budgetary performance while its debt burden levels are expected to stabilize and gradually decline.

RATING ACTION

On Oct. 10, 2014, Standard & Poor's Ratings Services affirmed its 'AA+/A-1+' ratings on the State of Queensland. The outlook remains stable.

RATIONALE

The ratings affirmation on the state reflects our view of the extremely predictable and supportive institutional framework benefiting state and territory governments in Australia. Also underpinning the ratings are: the state's wealthy economy, exceptional liquidity, strong financial management, and low contingent liabilities. Constraining the ratings are Queensland's average budgetary flexibility and performance, and high debt burden.

Australia's institutional framework governs the relationship between the Commonwealth government and the states and territories. We consider it to be extremely predictable and supportive, and one of the strongest in the world. Nevertheless, Australia adopts a system of fiscal equalization that results in a degree of structural imbalance between revenue powers and expenditure responsibilities. The bulk of revenues raised in Australia are by the Commonwealth government, while the states and territories have significant expenditure responsibilities including health and education. The fiscal

equalization system is administered by an independent commission. This system results in our assessment of Queensland-along with most Australian states and territories-as having average budgetary flexibility. Specifically, around 40% of Queensland's consolidated operating revenues come from the Commonwealth.

Queensland's economy is very strong compared to its global peers', and supports the ratings on the state. Its nominal Gross State Product (GSP) per capita of about A\$62,000 (US\$61,000) at June 2013 is high by international standards, and reflects the state's wealthy and relatively diverse economy. Its economic wealth is usually around the national per capita average. However, Queensland does have an industry concentration in the **mining** sector,

at 11% of the state's GSP, exposing its economy to external factors such as commodity prices and exchange rate movements for the currently strong Australian dollar. The state's **mining** industry currently is reliant on **coal** production, but the commencement of liquefied natural gas (LNG) exports in fiscal 2015 would diversify the sector. Demand for Queensland's **coal** export volumes has been driven by **China**, and as such, future growth in **coal** royalty income will be reliant on **China's** pace of economic growth. Growth has been above the national average for the past couple of years, with real GSP growth

of 3.6% in fiscal 2013 and 3.0% estimated for fiscal 2014. The state expects GSP to strengthen to 3.0%-6.0% for each of the forecast years to fiscal 2018,

which underlies its employment growth forecasts of 2.0%-2.5%. Population growth remains buoyant at 2% in the forecast years.

We consider Queensland's financial management to be strong, supporting the state's creditworthiness. Its financial management strength is partly reflective of the system in Australia, which incorporates a high degree of transparency, including full consolidation of government businesses in budgeting and accrual accounting. In our view, the state's prudent approach to

debt management, as well as the development of medium- and long-term fiscal and economic strategies, demonstrates its financial strength. We view the state's revenue and expenditure management to be strong, demonstrated by the reduction of government full-time equivalent (FTE) employees by 14,000 in fiscal 2013. The government also continues to implement its departmental savings requirements of A\$100 **million** per annum from fiscal 2014 onward.

Budgetary flexibility is average for most states and territories in Australia, due to the country's fiscal equalization system which dictates the size of grants Queensland receives from the Commonwealth. Under this system, Queensland is a recipient state, meaning that it receives more than its average per-capita share of the goods and services tax (GST) pool. Enhancing the state's budgetary performance is its average capital expenditure as a percentage of total expenditure, which is generally around 15%. In our view, there are limited projects the government could cancel but it may be able to delay some projects, such as those relating to natural disaster reconstruction, if required. A capital expenditure program of greater than 15% of total expenditures can often provide additional flexibility as it may mean that several projects can be delayed or cancelled.

We evaluate Queensland's budgetary performance as weak. Over fiscal 2013 to fiscal 2017, our base case expects a non-financial public sector cash operating surplus of 2% of operating revenues (after Standard & Poor's adjustments) for the state. GST revenues are expected to rise due to a favorable movement in GST relativities, as well as growth in **mining** royalty revenues driven by the commencement of LNG exports in fiscal 2015. We also forecast an after-capital account deficit of around 11% of total revenues,

reflecting the state's continued elevated levels of capital expenditure. Natural disaster reconstruction activity is continuing following damage caused by Tropical Cyclone Ita and other events in 2014.

We forecast Queensland's high debt burden to peak at 156% of operating revenues in fiscal 2015, before gradually declining as a result of improved operating balances and slower capital expenditure growth. In line with the government, we have not factored in the proceeds from the potential A\$33.6 billion of asset sales announced in June 2014, as the government will seek a mandate on this proposal after the 2015 elections, and even if approved, it will take some time to arrange these sales. Interest expenses continue to remain more than 5% of adjusted operating expenses.

The Queensland government continues to maintain a fully funded superannuation liability position, as evidenced by its QSuper fund assets plus employer fund exceeding its QSuper accrued liabilities.

Further, Queensland's low level of contingent liabilities supports the ratings. Quantifiable material contingent liabilities comprised 21% of operating revenues at fiscal 2013, although we believe contingent liabilities

of only 2%-10% of operating revenues will require support in an event of financial stress. Contingent liabilities include borrowings by local government entities; contingent liabilities relating to some insurance policies issued by Suncorp at the time it was privatized; guarantee provided relating to Ergon Energy's trading activities in the National Electricity Market; an operating sub-lease relating to 1 William Street, Brisbane; and the net impact of natural disasters.

Liquidity

We consider Queensland's liquidity to be exceptional, reflecting its coverage of its upcoming debt maturities and interest expense of 103% at fiscal 2014. Similar to other Australian states and territories, Queensland also has strong access to external liquidity, as shown in: a) the state's own strong market access due to the state's proven track record of sufficient access to deep and liquid capital markets, and b) likely support of the Commonwealth government in time of need, demonstrated by its offer to guarantee state government debt in 2009.

Queensland's debt maturity profile is reasonably balanced despite a large maturity in 2018, with Queensland Treasury Corp. (QTC), its central borrowing agency, issuing bonds in most maturity years, thereby reducing funding concentration risk. We also consider Queensland's liquid assets to be highly marketable, providing ample flexibility if required.

OUTLOOK

The stable outlook reflects our expectation that the state's financial management will remain strong, in particular its expense management, which we expect to lead to operating surpluses in its forecast years. Elevated capital expenditure levels, driven in part by natural disaster reconstruction activity, will continue to contribute to after-capital account deficits, but continued expenditure management is expected to lead to a stabilization of its high debt burden through the end of the forecast period.

Upside rating potential is unlikely within the next two years, in our view. An upgrade may occur with a significant and sustained improvement in Queensland's budgetary performance. This would be evident through a sustained improvement in the after-capital account balance, combined with a significant reduction in its debt burden. While proceeds from asset sales would make a sizable reduction to Queensland's high debt burden, we do not expect it to progress sufficiently during the outlook period to alter our view of the state's debt burden as being weak. However, we do recognize that a sizable reduction in debt burden would, over time, assist in improving the state's operating performance through lower interest expenses.

Downward ratings pressure would occur if the state allowed operating expenditures to grow faster than its operating revenues, resulting in operating deficits and larger after-capital account deficits further

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increasing its debt burden. We consider this unlikely over the outlook period.

KEY STATISTICS

RATINGS SCORE SNAPSHOT

KEY SOVEREIGN STATISTICS

-- Sovereign Risk Indicators, Sept. 22, 2014. Interactive version available at "

<http://www.spratings.com/sri>"

RELATED CRITERIA AND RESEARCH

Related Criteria

-- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

-- 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

Related Research

-- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

-- Public Finance System Overview: Australian States And Victorian Municipalities, Feb. 20, 2013

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.

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