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Victoria (State of)

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Victoria (State of)

Major Rating Factors

Strengths:

- Strong balance sheet compared with international and domestic peers
- Strong management and ongoing fiscal discipline
- Strong system support
- Diversified economy

Issuer Credit Rating

AAA/Stable/A-1+

Weaknesses:

- Like all Australian states, a degree of structural imbalance between revenue powers and expenditure responsibilities

Rationale

The ratings on Victoria are supported by the state's strong balance sheet, diversified economy, ongoing fiscal discipline and strong system support. These strengths are offset, as with all Australian states, by an institutional framework that contains a degree of vertical fiscal imbalance.

Victoria's balance sheet is strong.

This provides the state with the flexibility to increase debt without jeopardizing its rating. While Victoria's current policy favors partial debt-funding of its capital program, Victoria's debt levels are expected to remain consistent with the rating. Even after factoring in the state's increased debt, Victoria's balance sheet, including its unfunded superannuation liabilities, is expected to remain strong.

The government's strong financial management provides ongoing financial stability.

Victoria's good governance—including its strong fiscal strategy and good financial transparency—is a credit strength. In recognition of the more aggressive capital spending profile, the government has introduced a more stringent operating surplus target of at least 1% of operating revenue compared with the previous target of A\$100 million.

The state governs in a supportive financial environment.

Australia's system support and the predictability of Commonwealth-state relations are among the strongest in the world, and are expected to remain so. In particular, Australia adopts a system of fiscal equalization, which is administered by an independent commission, and which provides a buffer for the state against specific fiscal shocks. Under this system Victoria receives less than its average per capita share of the goods and services tax (GST) pool.

The state has a well diversified economy, which means it is more resilient to any downturn in a particular sector.

While the economy has not seen the large growth rates experienced by the resource states of Queensland (AAA/Stable/A-1+) and Western Australia (AAA/Stable/A-1+), its performance has been the best of the non-resource states. It is also less exposed to a downturn in mining activity. The state is likely to continue to benefit from stronger population growth than in other states, allowing it to avoid a deeper slowing in its property markets.

Limited fiscal flexibility is a credit weakness of the Australian states, including Victoria, but this has not impeded strong fiscal outcomes.

Under the current institutional environment, the Commonwealth of Australia has control over most taxes, whereas

the states assume most of the responsibilities for delivering services. Victoria relies on about 43% of its operating revenues from the Commonwealth.

Short-term credit factors.

Victoria's short-term rating is 'A-1+' and is supported by the state's strong liquidity. Victoria's short-term debt is more than offset by its liquid assets. At Oct. 31, 2008, liquid assets were A\$6.0 billion and short-term liabilities were A\$4.8 billion.

Outlook

The stable outlook reflects the government's commitment to fiscal prudence.

This includes a fiscal strategy that seeks to maintain an adequate operating performance and strong balance sheet.

Absent of any deterioration in other credit metrics, the ratings on the state are likely to come under pressure if the ratio of net financial liabilities (net debt and unfunded superannuation) to operating revenue exceeds 130%.

The state's net financial liabilities as a proportion of operating revenue, including the core government and public trading enterprises, are forecast to increase to about 80% by fiscal 2012. Victoria's history of conservative forecasts, additional Commonwealth government funding through the proposed infrastructure fund, and possible revisions to capital expenditure because of changing market conditions will also influence the state's debt levels.

Comparative Analysis

Victoria is more closely comparable to the states of New South Wales and South Australia than the resource-rich states of Western Australia and Queensland.

Victoria's accrual operating performance has compared well against its non-resource 'AAA' peers. The state's general government accrual operating balances as a proportion of operating revenue have averaged 3.7% for the five years to fiscal 2007. This compares well against 2.9% in South Australia but is weaker than New South Wales' 7.2%. Victoria's after-capital expenditure performance remains stronger than New South Wales', largely reflecting New South Wales' challenging capital program.

Victoria's balance sheet compares well against its domestic peers.

Victoria's nonfinancial public sector (general government and public trading enterprises) debt levels as a proportion of operating revenue are stronger than New South Wales', South Australia's, and the lower-rated state of Tasmania's. While its balance sheet is expected to weaken over the medium term, it will remain stronger than its main peers. Unlike New South Wales and Tasmania, Victoria's debt is concentrated in the general government and not in the riskier nonfinancial public sector.

Victoria's economy is stronger than that of its main peer, New South Wales.

Victoria's diversified economy means its economic growth tends to track the national average, unlike New South Wales, whose economic performance has been subdued compared with the national average. Victoria also enjoys better fiscal flexibility, as there is less pressure to spend on its infrastructure. Further, Victoria does not have risks associated with an energy sector, unlike New South Wales.

Victoria's debt and financial performance compares well to its 'AAA' rated international peers.

In general, the Australian system factors in a lower level of support from higher levels of government than in Germany and a higher level of support than in Canada and Switzerland. In relation to its international peers, only general government comparisons are possible.

Victoria's cash operating performance is weaker than some of its international peers', but its operating performance remains solid.

The state's balance sheet compares well against international peers, with the levels of debt for each entity reflecting the level of system support enjoyed by the regional government (see table 1).

Table 1**Perr Comparison, Victoria, 2007**

	Victoria (State Of)	Basel-Country (Canton Of)	Bavaria (State Of)	British Columbia (Province Of)	New South Wales (State Of)	Queensland (State Of)	South Australia (State Of)	Tasman (State Of)
Issuer credit rating (LC)	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Negative/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AA+/Stable
Population	5.2	0.3	12.5*	4.4	6.9	4.2	1.5	
Unemployment rate (%)	4.8	N.A	6.2*	4.2	5	4.1	5	
GDP (real) growth (%)	2.7	N.A	2.8	3.1	1.8	4.9	0.8	
Three-year averages, using actual results only								
Operating balance (% of operating revenues)	8.1	6.4	9	12.3	5	22.7	6.2	
Balance after capital expenditures (% of total revenues)	1.5	1.3	1.4	3.6	(2.4)	12.6	1.1	
Capital expenditures (% of total expenditures)	7.2	8.2	10.9	9.1	8.2	12.6	6.2	
2007 (mil. AUD)								
Total revenues	35,169.00	3,114.50	69,850.60	44,555.20	46,389.00	33,625.00	12,090.00	
Direct debt (at year-end)	7,789.00	1,116.60	44,460.20	29,823.90	13,689.00	2,771.00	3,384.00	
Direct debt (% of operating revenues)	22.3	37.2	65.9	66.9	29.9	8.4	28.3	
Net financial liabilities (% of tot rev) [§]	36.4	28.3	286.7	57.9	39.8	(16.7)	41.8	
Interest (% of operating revenues)	1.2	1.4	2.7	5.9	1.9	0.5	1.6	

N.A.--Not available. §Calculated using Standard & Poor's estimates of unfunded pension liabilities for German states.

Economy

Victoria's economy remains a moderate supporting factor of the rating.

Victoria is located in the southeast of Australia and is the second largest economy in Australia. The state accounts for nearly 25% of Australia's output and, with about 5.2 million people, represents 25% of Australia's total population.

Victoria's economy is more diversified than other states', which will provide resilience to easing economic conditions in Australia and in key export markets.

While the state has some concentration in the higher-end manufacturing sector, this dependence is easing, and the weaker Australian dollar should support the sector's competitiveness. The potentially volatile sectors of agriculture, mining, and construction account for around 17% of state output, which is similar to the national average of 16%. The state is also likely to continue to benefit from stronger population growth than in other states, allowing it to avoid a deeper slowing in its property markets.

Victoria's economic growth has been solid.

Victoria's long-term economic growth is largely in line with the national average. Although the state's economic growth has not been as strong as Queensland's and Western Australia's, the state did achieve the strongest growth of the 'AAA' non-resource states in fiscal 2007. Given the uncertain international and domestic economic environment, forward yearly estimates are likely to soften.

Table 2

Victoria's Economic Indicators					
Year ended June 30	2010f	2009f	2008e	2007	2006
Gross State Product	3	3	3.25	2.7	2.7
Employment (% change)	1.5	1.5	2.75	2.7	1.7
Unemployment	4.75	4.75	4.5	4.8	5.3

System Structure and Management

Australia's system support and the predictability of Commonwealth-state relations is one of the strongest in the world, and is expected to remain so (see "System Support and Predictability for Australian State Governments", published on RatingsDirect on March 16, 2006).

Management

Victoria's commitment to fiscal discipline is likely to lead to ongoing financial stability.

The government's fiscal strategy is adequate, and includes general long-term targets and more specific short-term targets. In the fiscal 2009 budget, the government announced a revision of its short-term operating surplus target. The target changed from at least A\$100 million to at least 1% of revenue each year, ensuring the surplus target grows in line with revenue. The other key element of the state's fiscal strategy is maintaining state government net financial liabilities at prudent levels.

Victoria enjoys ongoing political stability.

The current government is in its fourth term in office, with the November 2006 election increasing its majority position in the lower house. While the government does not have a majority in the Upper House, this is not uncommon in Australian politics and has not affected the business of government in Victoria.

Fiscal Flexibility

Victoria has moderate fiscal flexibility.

This is primarily the result of the Australian institutional environment, in which the Commonwealth holds most of the taxation powers, whereas the states have most of the responsibilities for delivering services (see "Fiscal Flexibility Index for International Local and Regional Governments", published on RatingsDirect, Dec. 17, 2007).

The state expects to receive around 43% of its revenues in 2009 from the Commonwealth, a factor that limits the state's fiscal flexibility.

The state's total Commonwealth grant as a proportion of revenue is expected to remain relatively stable.

Victoria's financial liabilities are skewed to the lower-risk general government.

Victoria has fewer public trading enterprises than some of its peers such as Queensland, New South Wales, and Western Australia. In particular, Victoria's business ownership is primarily in lower-risk water and housing, whereas Queensland, New South Wales, and Western Australia are more dependent on the higher-risk energy sector.

Budgetary Performance

The state's budgetary performance remains strong but is likely to weaken, reflecting the slowdown in the broader economy.

The state's operating balance as a proportion of operating revenue is expected to average 2.4% over the four years to fiscal 2012. This compares with average operating balances as a proportion of operating revenue of 4.1% for the four years to fiscal 2008. Given the uncertainty in the national and international economies, there is more downside pressure to Victoria's operating position than upside. In particular, a slowing economy will impact GST revenues as well as land-transfer duty. However, the strength of its balance sheet, the diversity of the Victorian economy, and ongoing population growth means Victoria is well positioned to manage the downturn.

Wages continue to pose a risk to the state's operating position despite the finalization of a number enterprise bargaining agreements (EBA) negotiations in fiscal 2009.

This risk is particularly relevant in those sectors in which there is an ongoing shortage of specialists, e.g. doctors. The government has sought to mitigate the risk by cost offsets or productivity improvements. However, given that the upcoming EBA negotiations are in the politically sensitive health and education services, there can be practical difficulties in controlling the volume of these services and the cost at which they are provided. Ongoing demand driven by population growth and an ageing population adds further pressure.

Net lending deficits are being driven by capital spending, not operating spending.

This remains consistent with the rating on the state given the strength of the state's balance sheet. The state's capital program will keep Victoria's net fiscal position in deficit, meaning that part of the capital program is being funded by debt rather than operating funds. The state is anticipating nonfinancial public sector net lending as a proportion of operating revenue to average 9.4% over the four years to 2012. Liquidity and Debt Management

Victoria has a strong liquidity position.

Victoria's short-term debt is more than offset by its liquid assets. At Oct. 31, 2008, liquid assets were A\$6.0 billion and short-term liabilities were A\$4.8 billion.

Treasury Corp. of Victoria's (TCV) financial obligations are guaranteed by the state of Victoria, and the rating on TCV reflects the ratings on the state.

TCV performs the state's treasury and debt management function and funds Victoria's public sector borrowings (see separate report on TCV, published on RatingsDirect, on Nov. 21, 2007).

Table 3

TCV's Gross Debt Maturity Profile in Face Value Terms at June 30		
(Mil. A\$, actuals)	2008	2007
0-3 Months*	3,124	2,004
3-12 Months	38	94

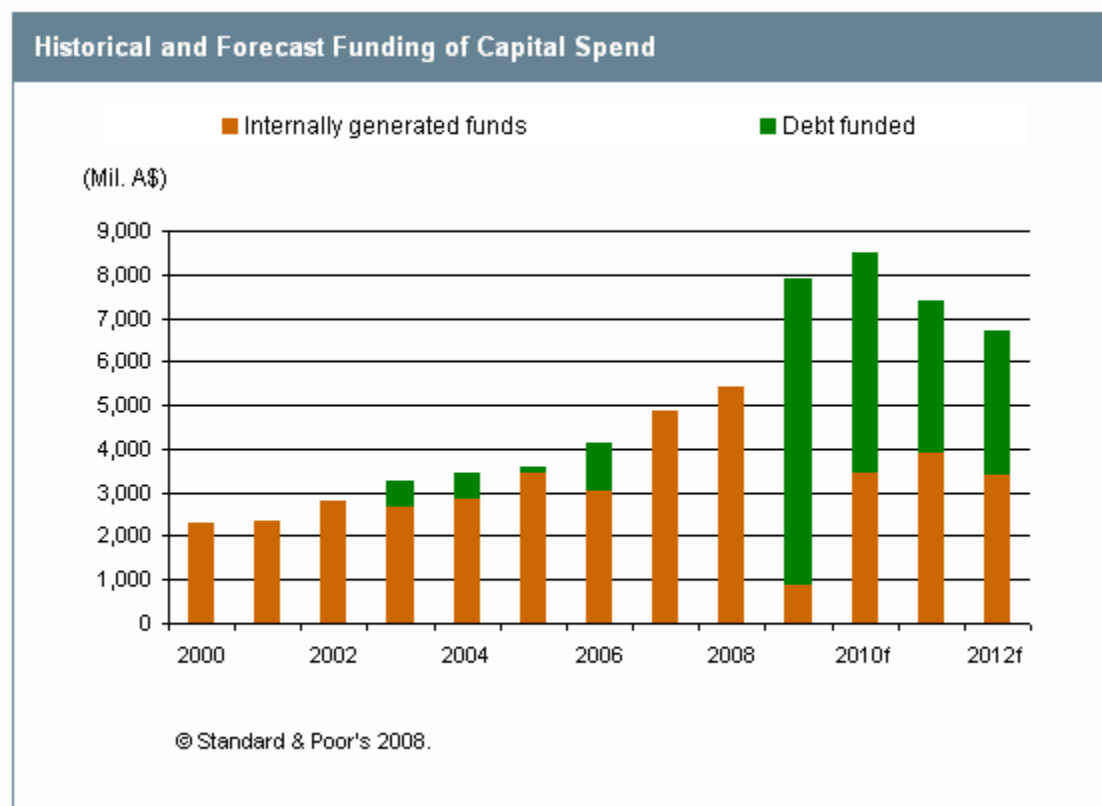
Table 3

TCV's Gross Debt Maturity Profile in Face Value Terms at June 30 (cont.)		
1-5 years	4,802	4,455
> 5 years	5,394	6,092
Total	13,358	12,645

Debt

The government's policy to partially debt-fund its capital program does not affect the state's credit quality.

The state's increased capital-infrastructure plan to fiscal 2012 will increase debt in both the general government and the government trading enterprises. However, debt increases at the levels forecast remain consistent with the rating, particularly given the strength of the state's balance sheet and the state's expected surplus operating position. If there is a weakening in the operating surplus, the level of debt needed to fund the capital program may increase. However, given Victoria's history of conservative forecasts, it is unlikely that any increase would be material.

Chart 1

Even after using a wider measure of debt obligations and net financial liabilities, the state's balance sheet is expected to remain strong.

Victoria's nonfinancial public sector net financial liabilities as a proportion of operating revenue are projected to grow to 79% in fiscal 2012 from about 44% in fiscal 2008. At this level, the state's net financial liabilities as a proportion of revenue are expected to be lower than many of its 'AAA' rated peers, including New South Wales and

Queensland. Whether the state's net financial liabilities reach the forecast levels will depend on the state's capacity to deliver the partially debt-funded capital program, given Victoria's tight labor market and competition between the states for input supply.

Victoria is expected to respond to the Eddington Report into Melbourne's transport system in late 2008.

While some additional capital expenditure is expected to be announced prior to the 2010, budget any debt increase associated with these projects is unlikely to put pressure on the rating.

Other Liabilities

The state's other liabilities are manageable.

The state has guarantees and other contingent liabilities estimated at A\$1.5 billion at June 30, 2008, or around 4% of revenue. It also has other liabilities that include the state's fully funded statutory insurance companies and its involvement in public-private partnerships (PPP)h.

The asset allocation of the public sector assets is moderately aggressive relative to private sector peers.

About 49% of investments were held in Australian and international equities and property at March 30, 2008.

Given the long-tailed nature of the schemes and over-funding, a degree of volatility from higher-risk assets can be absorbed. Investment assets are managed centrally by the Victorian Funds Management Commission.

The Victorian WorkCover Authority (VWA) is the state monopoly workers' compensation insurer.

At June 30, 2008, the scheme was fully funded, with the A\$7.8 billion actuarial estimate of liabilities met by A\$9.7 billion financial assets. The fiscal 2009 budget announced a 5% cut in WorkCover premiums--the fifth consecutive reduction.

The Transport Accident Commission (TAC) is the state monopoly compulsory third-party motor vehicle insurer.

At June 30, 2008, the TAC's A\$7.6 billion financial assets more than fully funded its A\$6.9 billion liability estimate.

The Victorian Managed Insurance Authority (VMIA) is the state's self-insurer for the public sector.

At June 30, 2006, VMIA's A\$1.2 billion financial assets more than fully funded its A\$0.9 billion liabilities estimate.

Victoria's active participation in the PPP market flows through to the state's debt balance.

It is a credit strength that the state takes the conservative approach of treating the projects as finance leases, which increase debt on its balance sheet.

Table 4

Victoria Non-Financial Public Sector					
(Mil. A\$)	2009b	2008	2007	2006	2005
Year ended June 30					
Accrual					
Taxation revenue	12,706	12,709	11,565	10,762	10,291
Current grants and subsidies	17,676	16,014	14,634	13,911	12,870
Interest income	509	564	506	466	415
Other revenue	9,823	11,059	10,754	9,366	8,950
Operating revenue	40,714	40,346	37,459	34,505	32,526
Interest expenses	1,075	802	780	749	690
Depreciation	2,603	2,335	2,202	2,121	1,897

Table 4

Victoria Non-Financial Public Sector (cont.)					
Other expenses	35,572	35,470	32,650	30,657	28,508
Operating expenditure	39,249	38,607	35,632	33,527	31,095
Net operating balance	1,464	1,739	1,827	978	1,431
Net lending	(5,217)	(1,283)	(1,054)	(1,184)	(39)
Cash					
Operating revenue	41,243	40,613	37,152	35,428	32,816
Operating expenditure	38,591	36,011	33,202	31,890	29,381
Operatng balance	2,652	4,602	3,950	3,538	3,435
Capital spending	7,814	5,428	4,865	4,125	3,599
Net capital receipts	326	(12)	(77)	(275)	115
Cash surplus (deficit)	(4,835)	(838)	(992)	(862)	(49)
KEY FINANCIAL RATIOS					
Operating revenue growth	0.9	7.7	8.6	6.1	4.7
Operating expenditure growth	1.7	8.3	6.3	7.8	6.8
Cash operating balance/cash receipts	6.4	11.3	10.6	10	10.5
Accrual operating balance/op. revenue	3.6	4.3	4.9	2.8	4.4
Net interest expense/ operating revenue	1.4	0.6	0.7	0.8	0.8
Net lending/operating revenue	(12.8)	(3.2)	(2.8)	(3.4)	(0.1)
Cash Surplus (Deficit)/receipts	(11.7)	(2.1)	(2.7)	(2.4)	(0.1)
Capital expenditure/total payments	16.8	13.1	12.8	11.5	10.9
Financial assets	8,772	9,222	7,984	6,462	6,058
Gross debt	18,891	13,935	12,751	11,414	9,932
Unfunded superannuation	17,040	12,959	9,915	12,934	10,540
Other financial liabilities	4,349	6,254	6,249	5,176	5,253
Net debt	10,119	4,713	4,767	4,952	3,874
Net financial liabilities	27,159	17,672	14,682	17,886	14,414
KEY LIABILITY RATIOS					
Gross debt/operating revenue	46.4	34.5	34	33.1	30.5
Net debt/operating revenue	24.9	11.7	12.7	14.4	11.9
Net financial liabilities/operating revenue	66.7	43.8	39.2	51.8	44.3

Table 5

Victoria General Government Sector					
(Mil. A\$)	2009b	2008	2007	2006	2005
Year ended June 30					
Accrual					
Taxation revenue	12,880	12,863	11,702	10,885	10,415
Current grants and subsidies	17,718	16,021	14,646	13,920	12,879
Interest income	436	452	423	390	340
Other revenue	6,936	8,004	8,115	6,776	6,193
Operating revenue	37,970	37,340	34,886	31,971	29,827

Table 5

Victoria General Government Sector (cont.)					
Interest expenses	565	438	459	452	426
Depreciation	1,596	1,416	1,335	1,279	1,139
Other expenses	34,061	34,004	31,757	29,417	27,466
Operating expenditure	36,222	35,858	33,551	31,148	29,031
Net operating balance	1,598	1,482	1,335	823	796
Net lending	(1,057)	413	(227)	(398)	337
Cash					
Operating revenue	38,317	37,966	34,943	32,867	30,341
Operating expenditure	36,025	34,088	32,103	30,231	27,858
Operating balance	2,292	3,878	2,840	2,636	2,483
Capital spending	3,033	2,768	2,812	2,297	1,966
Net capital receipts	152	(77)	(135)	(208)	47
Cash surplus (deficit)	(589)	1,033	(107)	131	564
KEY FINANCIAL RATIOS					
Operating revenue growth	1.7	7	9.1	7.2	4.7
Operating expenditure growth	1	6.9	7.7	7.3	5.5
Cash operating balance/cash receipts	6	10.2	8.1	8	8.2
Accrual operating balance/op. revenue	4.2	4	3.8	2.6	2.7
Net interest expense/ operating revenue	0.3	0	0.1	0.2	0.3
Net lending/operating revenue	(2.8)	1.1	(0.7)	(1.2)	1.1
Cash Surplus (Deficit)/receipts	(1.5)	2.7	(0.3)	0.4	1.9
Capital expenditure/total payments	7.8	7.5	8.1	7.1	6.6
Financial assets	5,420	5,297	5,076	4,860	4,428
Gross debt	10,608	8,206	7,789	6,699	5,972
Unfunded superannuation	17,018	12,927	9,900	12,896	10,493
Other financial liabilities	4,128	4,639	4,379	4,170	3,958
Net debt	5,188	2,909	2,713	1,839	1,544
Net financial liabilities	22,206	15,836	12,613	14,735	12,037
KEY LIABILITY RATIOS					
Gross debt/operating revenue	27.9	22	22.3	21	20
Net debt/operating revenue	13.7	7.8	7.8	5.8	5.2
Net financial liabilities/operating revenue	58.5	42.4	36.2	46.1	40.4

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Ratings Detail (As Of December 8, 2008)*

Victoria (State of)

Issuer Credit Rating

AAA/Stable/A-1+

Ratings Detail (As Of December 8, 2008)***(cont.)**

Commercial Paper

Local Currency

A-1+

Senior Unsecured (8 Issues)

AAA

Issuer Credit Ratings History

16-Feb-2003

Foreign Currency

AAA/Stable/A-1+

18-May-1999

AA+/Stable/A-1+

21-Aug-1996

AA/Positive/A-1+

22-Apr-1998

Local Currency

AAA/Stable/A-1+

27-Mar-1998

AA+/Watch Pos/A-1+

17-Sep-1996

AA+/Stable/A-1+

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