MOODY'S INVESTORS SERVICE

CREDIT ANALYSIS

Victoria (State of) Australia

Australia

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Victoria (State of) Australia and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

Ratings

Victoria (State of)

Category	Moody's Rating
Outlook	Stable
Issuer/Debt Ratings	Aaa
Treasury Corporation of Victoria	

Summary Rating Rationale

Moody's assigns long-term debt and issuer ratings of Aaa to the Treasury Corporation of Victoria (TCV), the entity that issues debt on behalf of the State of Victoria and its government owned corporations. TCV's debt is guaranteed by the State of Victoria and the rating reflects the state's credit quality.

Victoria's credit quality reflects a long-term historical record of sound financial performance, ample financial flexibility and a diverse economic base that supports its operations. The state's financial performance weakened in 2008/09, when it moved into a deficit position (net borrowing result). In the interim period, deficits have persisted due to less robust revenue growth, while current and capital spending remained elevated. As a result, the state's debt burden, while remaining manageable, has risen sharply. The government has implemented a budgetary redress program to narrow the deficit and stabilize the debt burden and its continued commitment to achieve these targets is important to the state's credit outlook.

National Peers

Victoria's Aaa rating is well placed when compared to most Australian states and territories, whose ratings range from Aa1 to Aaa, reflecting their better financial and debt metrics, and disciplined fiscal management.

Rating Outlook

The outlook is stable.

What Could Change the Rating - Down

A loosening in the government's resolve to constrain expenditure growth to the degree necessary to bring the budget back into balance as planned and the associated constraint in debt accumulation could result in downward pressure on the rating.

Baseline Credit Assessment

Victoria's Baseline Credit Assessment, which is a measure of the entity's standalone credit strength and excludes extraordinary support considerations, is aaa. The BCA reflects the following factors:

Financial Performance and Debt Profile

Deficits widen as expenditures outpace revenues

Budget gaps have widened since the state moved into a deficit position in 2008/09 as spending remained elevated and capital investments reached record levels, while the pace of revenue growth slowed. This followed many years of solid financial performance underpinned by prudent fiscal practices and robust revenue growth. Subsequently, lower increases in revenues, including Goods and Services Tax-backed (GST) Commonwealth grants, which comprise 23% of revenues, and fluctuations in conveyancing duties, amounting to 8% of revenues, were not offset by commensurate reductions in expenditures. As a result, over the three years through 2011/12, deficits (net borrowing result) in the general government sector averaged 4.5% of revenues.

In 2012/13, the state's deficit widened to 4.9% of revenues compared to the 2.6% of revenues budgeted, and the 3.6% deficit recorded in 2011/12. The deterioration was due to a large rise in capital spending and lower levels of asset sales. But we estimate that the deficit would have been larger -- at around 6% of revenues -- if one-time effects such as a large dividend from the State Electricity Commission of Victoria, a non-cash reduction in superannuation interest costs, and non-cash transfer of land were excluded, as well as adjusting for the negative impact of the timing of Commonwealth capital grants advanced to 2011/12. This weakening reflects lower conveyancing duties, gambling and payroll taxes, and higher than anticipated employee costs due to new hiring and wage outcomes.

Budget balance postponed to 2015/16

The state's 2013/14 budget projects a small improvement with the deficit forecast at 3.8% of revenues, but this is higher than the 1.0% of revenues that had been forecast last year. The bigger deficit reflects increased capital spending, higher employee costs -- in addition to the increases associated with the change in the accounting for superannuation payments -- as well as slower than anticipated growth in taxes and GST grants. The state responded by introducing new revenue measures, including an increase in the congestion tax and restructuring of the fire services levy, and implementing additional savings such as efficiency targets and modifying the first home owners grant.

Deficits are set to average -2.3% over the next four years -- higher than the 0.1% forecast for the same period last year -- with budget balance to be postponed one year from 2014/15 to 2015/16. In part this reflects an additional AUD2.5 billion in capital spending over the four years through 2015/16 (including bringing forward spending on the East-West Link road project) and less optimistic forecasts for tax revenues and GST grants. The forecast, however, also includes lower contingency provisions.

Meeting these targets requires reducing the rate of current spending to 3.0% on average over the next four years, with revenues projected to grow at a faster 4.1% rate. While realizing this lower rate of expenditure growth will be challenging, the state's achievement of a low 2.1% rise in 2012/13, indicates a positive trend. Furthermore, the completion of most major wage agreements, including police, nurses and doctors, provides greater certainty to spending projections.

Results could also be tested by slower than anticipated revenues, particularly given the state's fairly robust revenue growth assumptions -- with taxes and GST grants forecast to rise at a solid 5.5% on average. A more sluggish revenue performance would require further downward adjustments to current expenditures in order to meet fiscal targets. While further budgetary adjustments would be difficult we believe that the government will maintain its strong resolve to take necessary budgetary measures if required.

Gap in consolidated sector estimated to have peaked in 2012/13

The state's consolidated sector's deficits averaged a high 12.2% annually over the four years through 2012/13 reflecting the aforementioned deficit trends in the general government sector, but more importantly a large ramp-up in infrastructure investments by government-owned corporations. These investments included major upgrades to infrastructure to combat drought conditions—including a water desalination plant, pipelines and upgrades to the irrigation system – and an expansion of the regional rail network.

The deficit peaked at 19.6% of revenues in 2012/13, up from 9.1% in 2011/12 to reflect the cost of the desalination plant and also a deterioration in the operating performance of public corporations. In particular, Melbourne Water's operations were negatively affected by a price freeze and refunds to customers for the previous year's rise in water tariffs that had been implemented to cover the cost of the desalination plant before the plant's completion.

Over the medium term, deficits are budgeted to decline steadily over the next four years to average -2.8% and to move into surplus, equaling 2.5%, by 2016/17 as public corporations complete their building programs. Weaker operating results of the public transit company (Victrack), housing corporation (Director of Housing), and the urban renewal company (Places Victoria) are expected to slow the pace of improvement in the corporations sector. There is also a risk that Melbourne Water's financial performance will deteriorate further as approved rate increases were below those proposed. The State's move to play a more active role in managing its public corporations will be important to their future performance.

Debt burden to rise but projected to remain moderate

Victoria's debt burden has risen in recent years, and is projected to continue to grow, reflecting the larger cash deficits that have emerged as the state undertook a sizeable capital improvement program, while maintaining current spending at high levels in a less supportive revenue environment. Nevertheless its debt burden remains moderate when compared to its peers.

Following a decade in which the state's net direct and indirect debt was maintained at very moderate levels – averaging a low 41% of revenues and 5.7% of GSP from 2002 through 2011 -- the debt burden rose to 61.8% of revenues and 8.9% of GSP in 2012/13, up from 37.2% of revenues and 5.1% of GSP in 2007/08.

Over the medium term, the debt burden is programmed to continue to rise reflecting the state's AUD28.4 billion four-year capital improvement plan. Total direct and indirect debt is estimated by Moody's to peak at AUD51.6 billion in 2014/15, and on a net basis debt is projected to amount to 70.6% of revenues and 10.2% of GSP.

We view these figures as manageable, but to the extent that the state is unsuccessful in reducing its cash requirements, leading to even higher levels of indebtedness, then credit quality would consequently weaken.

In line with Moody's internationally comparable debt ratios, "net direct and indirect debt" subtracts the debt of self-supporting public corporations. The positive performance of the state's water corporations eases its debt burden as these companies' debt is self-supporting through tariffs.

All debt is issued through the State's Treasury Corporation, TCV, and on-lent to the general government and public corporations. In addition, TCV borrows to pre-finance large upcoming maturities and to maintain a presence in diverse capital markets. Debt issued for these purposes is offset by substantial financial assets held in liquid investments, providing an ample cushion for these debt obligations (these amounts are not netted off Moody's debt ratios).

The state's liquidity position is strong with financial assets, of AUD5.2 billion (beginning of 2013/14), which is sufficient to cover a large portion of total annual new money requirements; including debt maturities of AUD1.5 billion and budgetary requirements of AUD4.0 billion. If additional internal liquidity were required, however, the state has ample budgetary flexibility as well as other funds that could be accessed in an emergency.

Victoria's unfunded superannuation liability registered 52.7% of revenues and 7.5% of GSP in 2012/13, which is in the mid-range compared to other Australian states/territories and is down from 71.2% of revenues and 10.0% of GSP in 2011/12 due to an increase in the discount rate used to calculate the liability. The state's defined benefit schemes were closed in 1993 and full funding is targeted by 2035.

Governance and Management

Strong governance and management factors include multi-year budget projections, prudent forecasts and contingency provisions that have contributed to a strong record of meeting or exceeding targets over many consecutive years. Substantial financial assets held by the TCV are conservatively invested in strongly rated, liquid securities. Informative and comprehensive annual financial statements, as well as periodic interim statements, offer a significant degree of transparency.

Economic Fundamentals

Victoria's sizable and diversified economic base amply supports its financial obligations. The state is the second largest by economic size -- contributing to nearly 22% of Australia's output -- and by population -- with 5.7 million inhabitants. Its economy has grown at 2.6% on a compound annual basis over the past decade below the national rate of 3.0%. Population gains spurred by international migration have been an important contributor to growth. Victoria's larger manufacturing sector, however, continues to be challenged by a still relatively high Australian dollar and restructuring among older industrial sectors.

Victoria's economic growth slowed in 2012/3 to 1.6%, below the 2.8% rate of expansion in 2011/12 and lower than the national rate of 2.6%, reflecting weaker trends in household spending, housing construction, and business investment, as well as sharp declines in public capital investments[1]. The latter reflects an end to Commonwealth stimulus funding. As a result, domestic demand remained stagnant in 2012/13, while a rise in exports and a decline in imports drove economic growth.

The state anticipates that economic growth will increase by a stronger 2.3% in 2013/14 , supported by lower interest rates and exchange rates. The state's diverse economic profile is likely to be a positive element as mining activities ease nationally.

Institutional Framework

The institutional framework — the arrangements determining intergovernmental relations and jurisdictional powers and responsibilities for Australian states — is well-established and stable. It provides Australian states with policy flexibility over own-source revenues and discretion over expenditure decisions, thereby providing them the tools to respond to adverse budgetary developments.

The strong financial support provided by the Commonwealth government through fiscal transfers to all states is also a key factor in Victoria's ratings with grants contributing to 45% of Victoria's budget. A significant portion of grants are distributed according to a formula that seeks to reduce revenue-raising and cost disparities between jurisdictions. In addition, conditional grants are provided to the states under periodic agreements. Victoria also benefited significantly from Commonwealth stimulus funding provided under the Nation Building – Economic Stimulus Plan.

While grants provide a secure and predictable revenue source to states/territories, the gradual increase in their importance over many years effectively reduces budget flexibility of the states.

Extraordinary Support Considerations

Victoria's Aaa rating takes into account the high likelihood that the Commonwealth Government of Australia (Aaa, stable) would act to prevent a default by the state. The high support reflects Moody's assessment of the risk to Australia's reputation if Victoria was allowed to default, as well as indications of a moderately positive federal government policy stance, illustrated by the flexibility inherent in the system of federal-state transfers.

About Moody's Sub-Sovereign Ratings

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale

[1] Excluding the impact of the transfer of the desalination plant to the public sector, business investment would have remained stagnant.

ratings, please refer to Moody's Rating Methodology published in October 2012 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Annual Statistics

Victoria (State of), Australia

	2009	2010	2011	2012	2013	Budget 2014
Debt Statement (A$ millions) (Fiscal Year ending June 30)						
Moody's Internationally Comparable Ratios[1]						
Total Direct and Indirect Debt	**23,011**	**26,520**	**30,548**	**35,771**	**43,270**	**48,190**
Self-Supporting Debt	4,946	6,233	7,295	8,043	13,217	14,044
Net Direct and Indirect Debt	18,065	20,287	23,253	27,728	30,053	34,146
as % Total Revenue	46.0	45.5	50.5	57.9	61.8	67.8
as % Gross State Product	6.4	6.9	7.4	8.4	8.9	10.0

	2009	2010	2011	2012	2013	Budget 2014
General Government						
Gross Debt	**10,957**	**14,092**	**18,162**	**22,760**	**31,794**	**35,202**
as % of GSP	3.9	4.8	5.8	6.9	9.4	10.3
as % of Revenues	27.9	31.6	39.5	47.5	65.4	69.9
per capita (A$)	2,031	2,577	3,282	4,047	5,559	6,052
Net Debt	**5,292**	**7,964**	**11,837**	**15,237**	**19,822**	**22,983**
as % of GSP	1.9	2.7	3.8	4.6	5.9	6.7
as % of Revenues	13.5	17.9	25.7	31.8	40.8	45.7
Non-Financial Public Sector						
Gross Debt	**18,444**	**23,145**	**28,351**	**33,767**	**43,856**	**48,289**
as % of GSP	6.5	7.8	9.1	10.3	13.0	14.2
as % of Revenues	43.8	48.6	57.2	66.5	86.5	89.7
per capita (A$)	3,419	4,233	5,123	6,005	7,669	8,302
Net Debt	**10,696**	**14,811**	**19,733**	**24,621**	**34,585**	**39,202**
as % of GSP	3.8	5.0	6.3	7.5	10.2	11.5
as % of Revenues	25.4	31.1	39.8	48.5	68.2	72.8

[1] Figures do include debt issued by the Treasury Corporation for debt management purposes.

Victoria (State of), Australia

	2009	2010	2011	2012	Budget 2013	2013	Budget 2014
Financial Statements - General Government (A$ millions) (Fiscal Year ending June 30)							
Revenue							
Taxation revenue	12,627	13,741	14,858	15,027	15,783	15,531	16,454
Grants and subsidies	18,970	22,718	22,426	22,600	22,220	21,902	23,311
Sales of goods and services	4,941	5,290	5,944	6,267	6,753	6,869	6,950
Interest income	378	334	420	413	710	701	867
Other	2,369	2,504	2,380	3,576	2,891	3,610	2,746
Total Revenue	**39,285**	**44,585**	**46,027**	**47,882**	**48,357**	**48,613**	**50,327**
Expenditure [1]							
Gross operating expense	30,415	33,057	34,947	37,026	37,368	38,061	38,800
Nominal superannuation interest	610	867	932	809	729	446	1,129
Other interest expenses	642	843	986	1,243	1,726	1,775	2,177
Current transfers	6,245	7,831	7,589	7,490	8,230	7,600	7,997
Capital transfers	1,122	1,344	958	744	150	414	-
Total Expenditure	**39,034**	**43,942**	**45,510**	**47,311**	**48,202**	**48,297**	**50,103**
Net Operating Balance	**251**	**644**	**517**	**571**	**155**	**316**	**225**
Net acquisition of non-financial assets							
Purchases of non-financial assets	3,147	4,661	4,886	3,565	3,530	4,133	4,869
Sales of non-financial assets	(268)	(187)	(184)	(167)	(553)	(248)	(420)
Gross fixed capital formation	2,879	4,474	4,702	3,398	2,977	3,885	4,449
less Depreciation	1,516	1,870	2,010	2,127	2,386	2,254	2,378
plus Change in inventories	28	-	-	-	-	-	-
plus Other movements in non-financial assets	45	233	79	1,010	845	1,053	49
Total net acquisition of non-financial assets	1,436	2,837	2,771	2,282	1,436	2,684	2,120
Net Lending / (Borrowing) [2]	**-1,184**	**-2,194**	**-2,254**	**-1,711**	**-1,281**	**-2,368**	**-1,896**
Acquisitions Under Finance Leases	-453	-75	-195	-916	-845	-1,065	0
Adjusted for Accruals	287	923	448	1,071	310	175	178
Cash Surplus / (Deficit) [3]	**-1,351**	**-1,345**	**-2,001**	**-1,556**	**-1,816**	**-3,258**	**-1,717**

[1] In Australia, the accrual term is Expenses.

[2] Financing surplus (requirement).

[3] Cash Surplus / (Deficit) includes Acquisitions Under Finance Leases.

Victoria (State of), Australia

	2009	2010	2011	2012	Budget 2013	2013	Budget 2014
Financial Trends - General Government (Fiscal Year ending June 30)							
% Change in Revenue	5.2	13.5	3.2	4.0	3.2	1.5	4.6
% Change in Expenditure	9.4	12.6	3.6	4.0	3.1	2.1	4.5
Expenditure per capita (A$)	7,235	8,036	8,223	8,413	8,572	8,445	8,614
As % of GSP							
Net Lending / (Borrowing)	(0.4)	(0.7)	(0.7)	(0.5)	(0.4)	(0.7)	(0.6)
Cash Surplus / (Deficit)	(0.5)	(0.5)	(0.6)	(0.5)	(0.6)	(1.0)	(0.5)
Expenditure	13.8	14.9	14.5	14.4	15.1	14.3	14.7
As % of Revenues							
Net Lending / (Borrowing)	(3.0)	(4.9)	(4.9)	(3.6)	(2.6)	(4.9)	(3.8)
Cash Surplus / (Deficit)	(3.4)	(3.0)	(4.3)	(3.3)	(3.8)	(6.7)	(3.4)
Gross Operating Balance [4]	4.5	5.6	5.5	5.6	5.3	5.3	5.2
Interest Expense	1.6	1.9	2.1	2.6	3.6	3.7	4.3
Intergovernmental Transfers	48.3	51.0	48.7	47.2	46.0	45.1	46.3

[4] Net Operating Balance add back Depreciation.

Victoria (State of), Australia

	2009	2010	2011	2012	Budget 2013	2013	Budget 2014
Financial Statements - Non-Financial Public Sector (A$ millions) (Fiscal Year ending June 30)							
Revenue							
Taxation revenue	12,457	13,548	14,661	14,790	15,461	15,199	16,050
Grants and subsidies	18,850	22,713	22,419	22,559	22,211	21,879	23,291
Sales of goods and services	7,768	8,324	9,164	9,627	10,202	9,826	11,227
Interest income	474	382	536	528	467	435	388
Other	2,517	2,669	2,776	3,245	2,873	3,338	2,885
Total Revenue	**42,065**	**47,634**	**49,556**	**50,749**	**51,213**	**50,678**	**53,841**
Expenditure [1]							
Gross operating expense	34,693	38,003	40,256	42,246	43,006	43,468	44,809
Nominal superannuation interest	610	868	932	808	729	444	1,129
Other interest expense	1,128	1,362	1,630	1,928	2,524	2,434	2,940
Transfers	5,419	6,634	6,427	5,721	5,793	5,399	5,269
Total Expenditure	**41,851**	**46,867**	**49,143**	**50,703**	**52,052**	**51,745**	**54,147**
Net Operating Balance	**214**	**767**	**413**	**46**	**-839**	**-1,067**	**-306**
Net acquisition of non-financial assets							
Purchases of non-financial assets	7,373	8,924	9,289	7,455	8,518	7,817	8,551
Sales of non-financial assets	(344)	(317)	(342)	(289)	(615)	(404)	(526)
Gross fixed capital formation	7,029	8,607	8,947	7,166	7,904	7,412	8,025
less Depreciation	2,520	3,366	3,576	3,843	4,245	4,092	4,397
plus Change in inventories	128	-	-	-	-	-	-
plus Other movements in non-financial assets	371	501	346	1,322	5,220	5,526	142
Total net acquisition of non-financial assets	5,008	5,743	5,717	4,646	8,878	8,846	3,770
Net Lending / (Borrowing) [2]	**-4,794**	**-4,976**	**-5,304**	**-4,600**	**-9,717**	**-9,913**	**-4,076**
Acquisitions Under Finance Leases	-582	-75	-196	-917	-4,966	-5,434	0
Adjusted for Accruals	618	1,028	615	1,276	4,739	4,999	31
Cash Surplus / (Deficit) [3]	**-4,757**	**-4,023**	**-4,885**	**-4,241**	**-9,945**	**-10,349**	**-4,046**

[1] In Australia, the accrual term is Expenses.

[2] Financing surplus (requirement).

[3] Cash Surplus / (Deficit) includes Acquisitions Under Finance Leases.

Victoria (State of), Australia

	2009	2010	2011	2012	Budget 2013	2013	Budget 2014
Financial Trends - Non-Financial Public Sector (Fiscal Year ending June 30)							
% Change in Revenue	4.3	13.2	4.0	2.4	2.8	(0.1)	7.1
% Change in Expenditure	8.9	12.0	4.9	3.2	3.2	2.1	4.7
Expenditure per capita (A$)	7,757	8,571	8,879	9,016	9,257	9,048	9,310
As % of GSP							
Net Lending / (Borrowing)	(1.7)	(1.7)	(1.7)	(1.4)	(3.1)	(2.9)	(1.2)
Cash Surplus / (Deficit)	(1.7)	(1.4)	(1.6)	(1.3)	(3.1)	(3.1)	(1.2)
Expenditure	14.8	15.8	15.7	15.4	16.4	15.3	15.9
As % of Revenues							
Net Lending / (Borrowing)	(11.4)	(10.4)	(10.7)	(9.1)	(19.0)	(19.6)	(7.6)
Cash Surplus / (Deficit)	(11.3)	(8.4)	(9.9)	(8.4)	(19.4)	(20.4)	(7.5)
Gross Operating Balance [4]	6.5	8.7	8.0	7.7	6.7	6.0	7.6
Interest Expense	2.7	2.9	3.3	3.8	4.9	4.8	5.5
Intergovernmental Transfers	44.8	47.7	45.2	44.5	43.4	43.2	43.3

[4] Net Operating Balance add back Depreciation.

Victoria (State of), Australia

	2009	2010	2011	2012	2013
Economic Trends					
Population (mil.) [1]	5.395	5.468	5.535	5.623	5.719
Nominal GSP (A$ mil.) [2]	281,985	295,803	312,834	328,285	337,493
Real GSP growth rate (%) [3]	1.1	1.6	2.2	2.8	1.6
Inflation (CPI) [4]	2.8	2.1	3.3	2.3	2.3
Employment growth rate (%) [5]	0.8	2.8	3.5	0.4	0.5
Unemployment rate (%) [5]	5.1	5.5	5.1	5.4	5.8

[1] Estimated Resident Population, ABS 3101.0 and Budget

[2] ABS 5220.0, Estimate and Budget figures use previous yr's ABS stat x Real GSP Gwth Rate

[3] ABS 5220.0 and Budget

[4] ABS 6401.0 and Budget

[5] ABS 6202.0

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