Transport for London

United Kingdom

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured -Dom Curr	Aa1

Contacts

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Key Indicators

Transport for London	2004/05	2005/06	2006/07	2007/08	2008/09
Transport Grant / Total Revenues (%)	**46.8**	**44.2**	**44.6**	**57.4**	**46.6**
Own Source Revenues / Total Revenues (%)	**53.2**	**55.8**	**55.4**	**42.6**	**53.4**
Surplus / (Deficit) for the year / Total Revenues (%)	**0.5**	**-0.1**	**-0.8**	**0.2**	**4.2**
Current Assets / Current Liabilities (%)	**116.2**	**117.3**	**133.1**	**128.0**	**131.9**
Long-Term Borrowings / Fixed Assets (%)	**1.5**	**5.3**	**8.8**	**11.7**	**16.4**
General Fund & Earmarked Reserves / LT Borrowings (x)	**5.7**	**1.8**	**1.1**	**0.8**	**0.4**
General Fund & Earmarked Reserves/Interest Payable (x)	**109.0**	**24.0**	**11.2**	**9.1**	**7.8**

Opinion

Credit Strengths

Credit strengths of Transport for London:

The strategic importance of TfL to national transport plans, as the major provider of transport within the capital; its importance has been reinforced by the recent ten-year funding settlement to 2018 from government, which will cover the 2012 Olympic Games, the completion of major upgrades of the London Underground, and the Crossrail project.

The relatively high level of oversight and control exercised by the UK government. TfL's legal status as a local authority requires it to follow the Chartered Institute of Public Finance and Accountancy (CIPFA) code in establishing that its borrowing is prudent and affordable. TfL is legally obligated to set a balanced budget on an annual basis, and it has kept to the borrowing limits it has agreed with the government.

TfL's near monopoly on public transport provision in London, via its ownership of London Underground Ltd, its control of the Greater London bus network, and its significant participation in above-ground rail services.

TfL's record of meeting goals and keeping to the financial projections laid out in its published business plan. Some of its notable successes are the Congestion Charge, improvements to the quantity and quality of bus services, extensions of the Docklands Light Railway (DLR), the addition of a seventh carriage to Jubilee Line trains, the establishment of the London Overground rail services and the approval and progressing of Crossrail.

The stable and experienced management team of TfL, which can draw on expertise in the fields of transport administration, public policy, risk management and corporate finance.

Credit Challenges

Credit challenges of Transport for London are:

A projection of GBP8.1 billion of borrowing on its balance sheet by 2018; this includes GBP4.3 billion of direct borrowing in addition to GBP3.3 billion previously agreed. The financing of the Tubelines PPP and other PFI contracts provide further debt-like burden as finance leases. There is the potential for up to GBP500 million of existing and fully budgeted PFI contracts coming on balance sheet, which Moody's has already taken into account as a debt-like burden.

Uncertainty regarding longer-term financial outturns of the refurbishment and upgrade of the London Underground and the delivery of Crossrail. TfL's control of the farebox and its capacity to manage - and if need be reduce - other transport investments should mitigate these impacts in the medium term.

Whilst fares and congestion charges are fully under the control of the Mayor of London, the need to provide services at politically acceptable prices limits how much can be raised.

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

Closer alignment of TfL to the UK government could provide upward pressure on the rating; nevertheless, it is unlikely that TfL will achieve the same rating on its debt as the UK government without the support of provisions which approach an effective guarantee on its obligations.

What Could Change the Rating - Down

TfL's rating could be lowered were it to take on a substantially higher, unsupported financial burden in its financial projections, were the UK government to signal a clear dilution of its support for TfL, or were it to persistently under-perform in meeting operational or financial goals.

Rating Rationale

The Aa1 debt rating of Transport for London (TfL), with stable outlook, reflects the application of Moody's rating methodology for government-related issuers. In accordance with this methodology, the rating reflects a combination of the following inputs: (1) a Baseline Credit Assessment of 10 (on a scale of 1 to 21, where 1 represents the lowest credit risk); (2) the Aaa rating of the UK government; (3) a high probability of support from the national government; and (4) high default dependence.

The BCA of 10 can be attributed to TfL's exposures to expensive and complex projects and as well as the burden of existing debt, PFI and PPP agreements. It also takes into account its effectiveness in managing within a highly political environment, which may influence fares, subsidies, and project selection.

The decision to go forward with Crossrail and the transfer of the Metronet projects and staff make TfL directly responsible for a far larger share of capital construction, refurbishment and maintenance costs than was contemplated when TfL was established in 2000. Keeping outturns of the Underground and Crossrail projects within the GBP72 billion spending plan to 2018 will remain a significant challenge, even with TfL's costs on Crossrail being capped as per agreement with the government. TfL's delivery of these projects in good time and within budget should support the view of the national government, which has agreed to provide roughly GBP38 billion in grant to 2018 including funding for Crossrail, of TfL as a reliable operating and funding partner. This would in turn enhance the stability of both the current funding package and future levels of funding.

TfL continues to have a significant level of contingent liabilities related to the financing of the Tube Lines PPP and other PFI contracts. The Metronet administration showed that TfL and the government could manage the orderly termination of these contracts without draining TfL's resources to deliver its key services and improvements. The unwinding of the Metronet contract also proved, however, that such adjustments can take years to play out between the contractual parties, can result in unbudgeted costs and may reduce near-term flexibility.

TfL has approximately GBP2.0 billion of liquid investments, which are held for as funding for future capital expenditures and a modest level of reserves. They are not ring-fenced and may be used at any time for debt service payments or other near-term costs. Whilst such funds are projected to be drawn to GBP250 million by next year - with some later recovery to around GBP400 million - it is likely that substantial amounts will remain to help absorb the impacts in the near-term for economic variance. Were these amounts to be depleted below roughly 5% of total annual spending for the longer term, TfL may lose some of the flexibility it now enjoys in adjusting its budgets gradually, so as to maintain operating efficiency.

The high support assessment for TfL reflects the importance of the transport system and infrastructure improvement in London by the UK government as reflected in the ten-year funding settlement and the agreement to proceed with Crossrail. High support also reflects the continuing high profile of transport for the Olympics in 2012 and the comfort letter for the Tubelines PPP.

High default dependence reflects TfL's necessary reliance upon UK government funding and its lack of economic viability as a standalone entity.

Recent Developments

The recession in London has reduced traffic growth and fare revenue against earlier projections. This has forced TfL to seek further GBP2.5 billion in additional efficiencies to 2018, rising to over GBP700 million per year against a baseline budget in the range of GBP8 billion per year. TfL is also instituting certain programme cuts in addition to savings noted above, which will result in the delay of some projects with less impact on the core underground, bus, and surface rail systems, with likely little impact to the central service improvements which have been part of TfL's plans since 2002.

To close the funding gap, on 15 October the Mayor of London instituted fare increases of 12.7 percent on buses and 3.9 percent on tube passengers, to take effect in January 2010. Whilst the Mayor has announced that he remains minded to undo the western extension of the congestion charging zone, the central zone will remain intact; and baseline charges will rise to GBP10 per day. The combined spending cuts and fare increases preserves the balance of the long-term financial and delivery plans, which are important for allowing the planning and delivery of long-term infrastructure.

The scale of the cost cutting may raise financial risk to the business plan to the extent that savings particularly in future years may be more uncertain. Over the past seven years, TfL's record of achieving savings has generally been good; but the savings of this round are substantially higher and may offer fewer quickly realizable targets.

Also, some revenues, such as property sales may remain variable in timing and amount, should the current difficulties in the property markets persist. TfL's substantial liquid resources, held for other programme costs, allow for some flexibility to maintain an ordered process for further revisions in plans, if necessary.

Moody's expects that sound financial management and continued co-operation between the Government, the Mayor, and TfL will preserve stable finances for TfL. The Mayor's actions to raise fares and to cut spending, whilst politically difficult, are consistent within the broader policy and funding framework established to allow TfL longer-term funding certainty and substantial autonomy in maintaining its systems.

Moody's views central government support for the company as high. The resolution of the Metronet Put Option, the agreement for the funding of Crossrail, the length of the current funding settlement and its specific discussion of borrowing plans of TfL are all evidence of the continuing congruence of TfL's plans and overall transport funding strategy by the Government.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings. Country Ceilings for Foreign Currency Obligations.

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases, the close economic links and/or close intergovernmental fiscal arrangements between a GRI and its associated government result in a medium to high degree of default dependence.

Default dependence is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%)