

## CREDIT ANALYSIS

# Transport for London

United Kingdom

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### Summary Rating Rationale

The Aa1 debt rating of Transport for London (TfL), with stable outlook reflects the essential nature of TfL's services as the dominant provider of urban transport in London and the stability that London and central governments have given it within long-term funding plans.

- » TfL has substantial operating risk from its responsibilities for the London Underground and bus services as well as from its rail and congestion charging systems. Although TfL's record of increasing revenue has been good, long-term pressure on government transfers could eventually raise concerns regarding the future robustness of TfL's finances and TfL's ability to deliver a very large and growing investment plan.
- » TfL has significant direct and indirect financing liabilities and contingent liabilities through its agreements on programme management, particularly its investment in Crossrail.
- » The above risks are strongly mitigated by the importance of TfL's services, both to London and to the national economy. These encourage close practical links with the government, which have been manifested in longer-term funding agreements, which match to political cycles; and they have led to a high level of disclosure and accountability on TfL's operations and investments.
- » Whilst the Mayor directs TfL's operations and financial management through policy and board appointments, Moody's expects the central government to help address the worst downsides of any distress case, particularly if the co-operative and self-re-enforcing framework of long-term funding agreements and good service delivery by TfL is maintained.

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

## International Comparisons

TfL's operating and investment risks are similar in profile and scale to those of other major urban providers of public transport; in particular its services are vital for regional and national economic productivity. TfL does not enjoy direct legal integration into sovereign finances, such as the EPIC status RATP in Paris.

## Rating Outlook

The rating outlook is stable.

## What Could Change the Rating – Up

Given the range of operating, investment, and political risk that TfL faces within the political environment of urban public transport, it is unlikely that TfL will achieve the same rating on its debt as the UK government without specific 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 financial burden in its financial projections, were the UK government to signal a clear dilution of its support for TfL or were TfL to under-perform persistently in meeting operational or financial goals.

## Issuer Overview

Established in July 2000<sup>1</sup>, TfL is an essential system in the national economy and a key component of the local government of greater London, as the dominant provider of urban transport. It owns the London Underground (Tube) network and the Docklands Light Railway (DLR), Croydon tram systems, and has full control of the franchising of the Greater London bus network to private operators. TfL has also taken on certain portions of the above-ground rail system within London and is developing Crossrail a major new underground line. Finally, TfL has responsibility for the major roads into London, for a congestion charging system that applies to central London, and for regulating the taxis.

## Key Rating Considerations

### Institutional Framework

#### Necessity of services TfL provides supports the rating

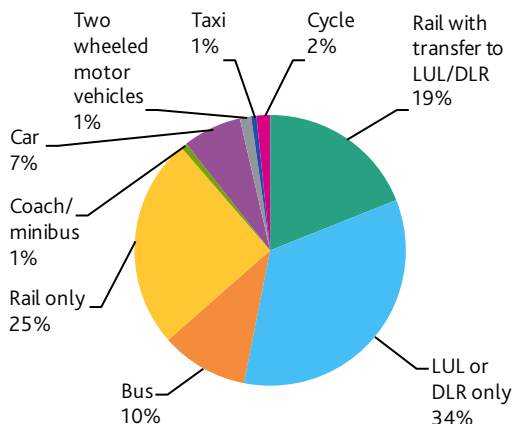
Approximately 70% of trips to the central business district<sup>2</sup> (CBD) of London are provided by TfL's services (figure 1). As all the urban transport systems in London, including those not controlled by TfL, are effectively at-or-close-to capacity, there is little competitive pressure on passenger levels. TfL provides over eight million trips per day<sup>3</sup> and over 500 million kilometres of service per year. Within national and local governmental policies, the continuing expansion of TfL's services are essential to meeting projections of economic growth for the city and the growth of its key industries.

<sup>1</sup> The GLA Act of 1999.

<sup>2</sup> The central business district of London has a particularly high concentration in finance, business, retail, government, and internationally important cultural institutions.

<sup>3</sup> Transport for London website, [www.tfl.gov.uk](http://www.tfl.gov.uk); Table 1.1.1 Daily average number of journey stages.

FIGURE 1  
Share of Trips to the London CBD



Source: Moody's calculations from TfL website (2009)

**Virtuous cycle of service quality supporting long-term funding support, which in turn allows efficient planning and service delivery**

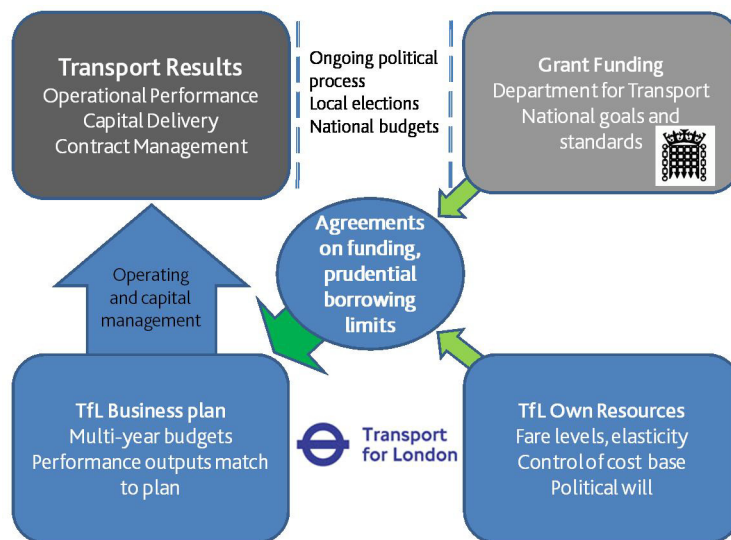
Like all other major urban public transportation entities, TfL's systems rely on significant subsidies for infrastructure and, to a lesser degree, for operations. Total grant to 2014/15 is GBP12.1 billion. Whilst we anticipate that this amount will remain stable for the plan period<sup>4</sup>, grant remains subject to intense political competition within government funding.

TfL's fares and the costs from its service levels, too, depend on broad political support, as both are generally recognised as high by international standards.

Since 2003, TfL has benefited from stable funding agreements with the government, which, as seen in figure 2 below, underpin the long-term operating and investment programmes required for stable and deliverable plans for efficient service. The current agreement on funding and prudential borrowing with the Department for Transport has been shortened from 2017/2018 to 2014/15 (Crossrail continues to extend to 2017/18), which remains a sufficient base for the delivery of core projects. Although the funding agreements reflect current government policy and are published on the TfL website, they are not binding on future governments.

FIGURE 2  
Political, Planning, and Delivery Cycle

Transportation investment in London



<sup>4</sup> On 2 December 2011 the government agreed an additional GBP136 million to lower originally planned increases in fares for 2012.

### TfL has a solid track record of delivering on investments

As a result of the stable funding regime, as seen in table 1, TfL has established a good track record on system improvements. These include:

TABLE 1

#### Key Project Delivery and Operating Achievements

» Improvements to bus services and dramatic increases in passenger levels since 2000; record Underground passenger levels	» Upgrades of the Jubilee and Victoria lines	» Completion of Phase I and start of Phase II of East London Line; establishment of London Overground network with metro frequencies and standards
» Delivery of the transport plan for the 2012 Olympics in London; infrastructure projects are progressing well	» Development of Barclay's Cycle Hire scheme; expansion of Cycle network	» Progressing major construction packages for Crossrail
» DLR extensions and capacity improvements on-time and within budget	» The rollout of the Oyster contact-less smart card system; implementation of Congestion Charging system	» The management of London Underground PPP contracts and takeover of future capital works with few disruptions and substantial potential savings

### Financial Position and Performance

#### Recent results have been strong; plan to 2014/15 depends on continuing cost controls

The demand for TfL's service during fiscal year 2010/11 has continued to strengthen, with passenger journeys increasing 4.0% for London Underground, 1.4% for London Buses and 12.8% for Docklands Light Railway compared to the previous fiscal year. Underground traffic is at an all-time record, whilst bus service is its highest in 50 years. Rising demand, coupled with the effects of the January 2011 fare increase, has contributed to an increase of 9.7% of TfL's 2010/11 income from fares compared to the previous fiscal year, 5.9% ahead of the budgeted revenues.

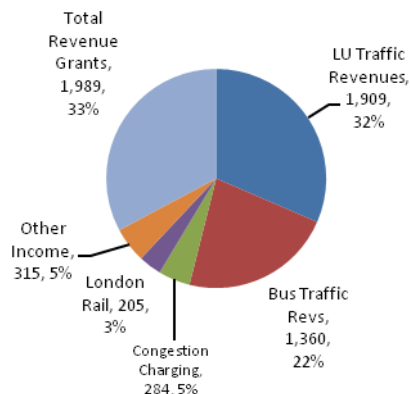
Operating expenditure for the fiscal year 2010/11 has been 8.4% below the previous year expenditure, and 8.0% below budget. The main savings have been from lower staff costs, overhead reductions and cost efficiencies related to the 2010 acquisition of Tube Lines.

In total, TfL completed the 2010/11 budget ahead of projections, making an additional GBP1.0 billion of grant and other sources available for capital spending.

Capital expenditures, including Crossrail, have been 14.5% lower than the previous year, and 9.5% below the budget. While most of the savings from re-phasing the upgrade works of Tube Lines were already included in the budget, the additional under-spend against budget is mainly due to the deferred purchase of the new Piccadilly line rolling stock. Whilst this provides additional margin to help deliver the spending reforms, over the long-term core costs such as rolling stock cannot be eliminated.

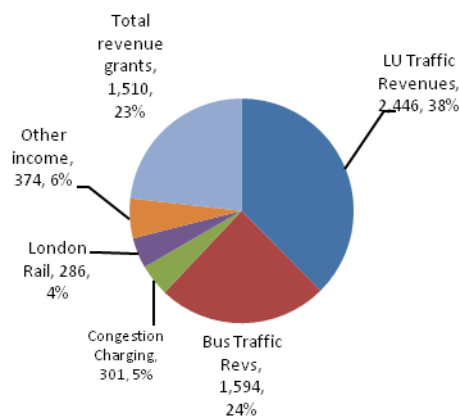
Mid-year results in 2011 show further gains in passenger levels; budgets look to surpass both revenue (3%) and spending targets (3%); and headcount reductions are proceeding ahead of schedule. Capital spending against budget appears in line with targets. Overall, good financial results, stable service and continuing control of the complex capital investments are being delivered within the challenges of a difficult economy and the national austerity programme.

FIGURE 4  
Operating Revenue Budget Results 11/12



Source: Moody's calculations from TfL Plan revenues

FIGURE 5  
Operating Revenue Projections 14/15



Source: Moody's calculations from TfL Plan revenues

#### Future revenues and costs likely to remain stressed

Despite the buoyancy of passenger levels and fare revenues (and recent fare increases being moderated by some increase in grant), the risk of economic downturn in the UK and London and its impact on fares and future government grant remains. For expenditures, TfL's plans to achieve GBP7.6 billion of efficiencies by 2017/2018 have started well, with GBP1.7 achieved to date including structural changes that should recur in future years. Whilst TfL claims its total GBP31.7 billion operating and capital plans to 2014/15 will continue to meet essential maintenance and renewal work, the total level of cuts remains ambitious; and they raise the risk of higher subsequent corrective costs and delays in investments, as occurred in the 1990s. The reduction of grant to 23% of revenues by 2014/15 (see figures 4 and 5, above), low by international standards and with further reductions possible for future plans, may strain political consensus and support for the system. This in turn could weaken the virtuous cycle of political-financial-delivery achieved over the past ten years.

#### Responsibility for large capital expenditures creates financial and programme risk

TfL is currently funding GBP6.9 billion in capital works over the plan period. The plan reduces the pre-CSR expectation of approximately GBP2 billion of capital spend per year to approximately GBP1.7 billion, before taking into account any impact of TfL's responsibilities under the project agreements for Crossrail spending, which by itself is anticipated to run at roughly GBP2 billion per year beginning in 2012/13. The scale of these figures underscores the continuing high demands of political accountability and reputation risk that TfL faces in the delivery of its investment programme.

#### Crossrail offers benefits to London, but adds to substantial investment management risk

With GBP12.7 billion in estimated cash costs, Crossrail is the largest single transport improvement planned in the UK. Costs are to be shared between the national government, London businesses, developers, land sales and TfL. Its scale means that even a small percentage variance in outturn (roughly 1% is equivalent to GBP130 million) can have a major impact on TfL's finances. TfL plans to meet its contribution of GBP2.5 billion largely from direct borrowing and an allocation of GBP590 million from currently held capital reserves. The detailed funding plan for Crossrail is in Appendix 1.

## Debt & Liquidity

### Flexible borrowing alternatives with good access to capital

As a local government entity, TfL must issue debt within the restrictions of Section 13 (3) of the Local Government Act of 2003. TfL may borrow from the government-controlled Public Works Loan Board (PWLB), which effectively acts as a lender of last resort and mitigates the threat of liquidity shocks.

TfL has also raised capital-market debt to introduce market scrutiny into its operations and investment programmes. The European Investment Bank (EIB) has provided funding for the East London Line, the DLR, and for costs associated with Crossrail. TfL is well placed to raise market funds directly through its EMTN programme, which unlike other prudential borrowing programmes in the UK, has established a moderate but significant international presence. TfL may also continue to use PFI or PFI-related financing where applicable.

### Debt levels are high, but are balanced in projections and agreed with Government in funding settlements

Within the funding agreements, the Department for Transport approves and establishes limits for TfL's debt projections, subject to requirements of prudence and affordability required under the Prudential Code.

TfL's debt has risen from GBP3.9 billion as of year-end 2009 to GBP6.4 billion (including GBP1.6 billion of acquired debt from Tube Lines which had been incurred for PPP financing), equal to approximately 72% of total revenue and grant of GBP8.8 billion and 115% of the operating cost base in the revised Q2 forecasts for 2011/12.

As a local government entity, TfL's borrowing ranks *pari passu* with all other existing obligations. This in practice links payment for essential operations, including payroll and other contractual agreements to debt itself. The Department for Transport and the Mayor of London approve and establish limits for TfL's debt projections, subject to TfL meeting requirements of prudence and affordability under the Prudential Code. Despite the strong linkage of credit quality on TfL's debt to its provision of essential services and to strong oversight by both the Mayor and government, TfL's debt is not guaranteed by government.

TfL also guarantees PFI or PPP contracts for some of its subsidiary companies, which may relate to significant debts, which TfL funds via service charges. Counting the impact of these contracts, Moody's assesses TfL's current total financing burden at approximately GBP7.5 billion, or 134% of the operating cost base, rising to approximately GBP9.3 billion, or 146% of operating costs by 2014.

Whilst this exposure is high, it is not extraordinary by UK local government standards, and TfL's control over a broader range of revenues on a relatively robust passenger base partially offsets the substantial risks of exposure to the economy and management of major project costs. And whilst debt has risen against earlier years' projections, largely the result of capital expenditures for Crossrail, interest costs have come in below projections and remain affordable within the rating range.

TfL's total retirement benefit obligations are GBP1.6 billion, and has varied between GBP1.2 and GBP2.2 billion since 2009. The current balance is provided for by TfL contributions through 2020.

TfL has approximately GBP2.1 billion of liquid investments as of 30 September 2011, which are held as funding for capital expenditures in the business plan, and which include a modest level of operating and capital reserves. The reserves are not ring-fenced and may be used for debt service payments or other costs of TfL and its operating subsidiaries. Internal liquidity has historically been strong, particularly as capital funds are generally secured in advance of major project approvals. Over the medium term, reserves are expected to remain under pressure to meet post-period completion costs of the 2011/12-14/15 projects and for spending on new 'post-plan' projects. These pressures could become more acute in what is likely to remain an austere funding environment for UK governments and related entities.

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## Governance and Management Factors

### Sound governance is critical to the success of TfL's future performance

The Jubilee Line Extension – completed in 2000, with substantial budget overruns, reputational damage to LUL and significant political friction – underscores TfL's need to deliver investment efficiently and preserve the confidence of its funding partners. TfL has established an internal capital programme oversight group and an Investment Programme Advisory Group made up of senior executives in external engineering companies. These groups provide review and oversight to all maintenance, renewal, upgrades and major projects.

### TfL's controls are detailed and pervasive

The links between the Mayor and TfL have been very strong and are well co-ordinated on key matters of operations and funding. The Mayor provides the Transport Strategy, which is the guiding document within which TfL's specifies programmes of operation and investment. The Mayor also appoints the Board and sets fare levels. The Board approves the Commissioner for Transport, the executive head of TfL. The Board also oversees the creation and delivery of the multi-year business plan and annual budgets through various committees, including operations, the Finance & Policy Committee and a separate audit committee.

Under the Prudential Code, TfL may borrow for capital purposes up to a level agreed with the Mayor, subject to reserve powers retained by the government. Borrowing limits are also agreed within the multi-year funding agreements with the national government. TfL's borrowing profile has been conservative, with 93% of debt at fixed rates. Current guidelines allow up to 50% of debt to be floating and a new commercial paper programme has been established, in part to take advantage of short-term rates. TfL engages in forward swaps to fix longer term financing costs, which it plans to complete against future financing under hedge accounting rules, with GBP500 million of notional value outstanding. TfL does not have to post collateral under these contracts, but could be subject to substantial termination payments were they to be cancelled.

TfL's accounts are subject to external audit, and Local finance law imposes statutory obligations upon officers and permits government intervention in cases of mismanagement or financial failure.

Accounting standards are high. Audited financials are produced under IFRS accrual formats, but, as with UK local authorities also using this system, are difficult to reconcile to the more cash-based systems used for budgets and long-term planning, which more clearly tie to the cash resources of near- and medium-term government budgets.

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### Application of Joint-Default Analysis

Transport for London's Aa1 rating is composed of three principal inputs: a baseline credit assessment (BCA) of 10 (on a scale of 1 to 21, in which 1 represents the lowest credit risk), very high support, and very high dependence.

The very 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 multi-year funding settlement and the agreement to proceed with Crossrail and the tube upgrades. Very high support also reflects the continuing high profile of transport for the Olympics in 2012.

Moody's rating committee also assigns a very high default dependence level reflecting the high portion of central government funding to TfL and its historical co-ordination with national investment policies.



## Company Annual Statistics

### Transport for London

GBP Million

FYE - Fiscal Year End 31 March

	FYE 2007	FYE 2008	FYE 2009	FYE 2010	FYE 2011
<b>Income and Expenditure Account</b>					
Revenues	2,965.6	3,278.8	3,451.5	3,595.0	3,884.2
Fares	2,296.4	2,445.8	2,577.5	2,662.8	2,942.3
Other	669.2	833.0	874.0	932.2	941.9
Exceptional items	0.0	(258.7)	0.0	0.0	0.0
Operating costs	5,235.7	5,739.7	6,020.0	6,108.0	6,066.6
Personnel costs	880.4	1,005.5	1,308.7	1,298.0	1,455.6
Depreciation	601.0	607.6	707.5	813.8	849.7
Other	3,754.3	4,126.6	4,003.8	3,996.2	3,761.3
Operating surplus/(deficit) before interest	(2,270.1)	(2,719.6)	(2,568.5)	(2,513.0)	(2,182.4)
Surplus/(deficit) on disposal of assets	(23.6)	(29.5)	(85.8)	(105.2)	(321.8)
Net finance cost	129.0	175.4	217.5	407.3	404.2
Finance income	70.4	114.0	104.6	13.9	9.4
Finance cost	199.4	289.4	322.1	421.2	413.6
Pensions interest cost and expected return	23.9	16.6	(41.7)	(107.6)	(37.6)
Other	(47.5)	0.0	0.0	39.2	38.1
Financing surplus/(deficit)	(2,446.3)	(2,907.9)	(2,913.5)	(3,093.9)	(2,907.9)
Transport Grant	2,390.3	2,682.4	3,033.5	2,887.4	3,184.0
Council tax precepts	12.0	12.0	12.0	12.0	12.0
Other grants, excluding CRL	44.2	179.2	63.4	266.4	254.6
Surplus/(deficit) for the year	0.2	(34.3)	195.4	71.9	542.7
Revenue by type:					
Transport grants	2,390.3	4,382.4	3,033.5	3,034.5	3,035.5
Other grants	44.2	179.2	63.4	266.4	254.6
Own-source	3,036.0	3,392.8	3,556.1	3,608.9	3,893.6
Council tax precepts	12.0	12.0	12.0	12.0	12.0
Total revenue	5,470.5	7,954.4	6,653.0	6,909.8	7,183.7

Please note that due to changes in accounting policy, FYE 2010 and FYE 2011 are fully compliant with IFRS, whilst FYE 2009 is partially restated. It is standard accounting practice not to restate previous years and so FYE 2007 and FYE 2008 are not compliant. Changes include several PFI schemes being brought on balance sheet and all grant income shown on the I&E account whereas previously only revenue grants were included previously.

## Appendix 1. TfL Business Plan 2011/12 – 2014/15

<b>Operating</b>					
<b>(£m)</b>	<b>2011/2012 Budget</b>	<b>2012/2013</b>	<b>2013/2014</b>	<b>2014/2015</b>	<b>4 year total</b>
Fares income	3,468	3,747	4,018	4,319	15,552
Congestion Charge, LEZ and enforcement income	284	307	307	301	1,198
Other operating income	310	320	346	359	1,335
Interest income	5	6	20	15	46
<b>Total income</b>	<b>4,067</b>	<b>4,379</b>	<b>4,691</b>	<b>4,994</b>	<b>18,132</b>
Operating costs (incl. third-party contributions)	-5,693	-5,793	-5,914	-6,036	-23,437
Debt interest	-304	-332	-350	-369	-1,355
Group items	-71	-44	19	53	-44
<b>Total operating expenditure</b>	<b>-6,068</b>	<b>-6,170</b>	<b>-6,244</b>	<b>-6,353</b>	<b>-24,835</b>
<b>Net operating expenditure</b>	<b>-2,001</b>	<b>-1,790</b>	<b>-1,553</b>	<b>-1,359</b>	<b>-6,704</b>
General grant	1,943	1,922*	1,795*	1,476*	7,136
Overground grant	26	26	28	28	109
GLA precept	6	6	6	6	24
Other revenue grants	14	84	0	0	97
Total revenue grants	1,989	2,038	1,829	1,510	7,366
<b>Surplus/(deficit) to fund capital plan</b>	<b>-12</b>	<b>248</b>	<b>276</b>	<b>151</b>	<b>663</b>

\* The amount of general grant for these years was increased by a total of £136m following the Chancellor's announcement on 29 November in relation to rail fares.

**Capital**

(£m)	2011/2012 Budget	2012/2013	2013/2014	2014/2015	4 year total
Capital expenditure	-2,023	-1,714	-1,698	-1,513	-6,947
Third-party contributions - capital	74	36	43	7	160
<b>Net capital expenditure</b>	<b>-1,949</b>	<b>-1,677</b>	<b>-1,655</b>	<b>-1,506</b>	<b>-6,788</b>
Crossrail sponsors' funding commitment	-1,205	-1,904	-2,247	-2,002	-7,359
Crossrail funding sources	1,390	2,059	2,068	1,693	7,210
<b>Net Crossrail contribution</b>	<b>185</b>	<b>155</b>	<b>-179</b>	<b>-309</b>	<b>-149</b>
<b>Net capital expenditure (incl. Crossrail contribution)</b>	<b>-1,764</b>	<b>-1,522</b>	<b>-1,834</b>	<b>-1,816</b>	<b>-6,937</b>
<b>Funded by:</b>					
Operating surplus/(deficit) from above	-12	248	276	151	663
Investment grant	861	881	904	928	3,574
Metronet grant	424	352	184	0	960
Other capital grants	25	31	2	0	58
Sales of property and other assets	44	95	95	71	305
Working capital released/(created)	-124	-56	9	-49	-221
Net borrowing, other financing and reserve movements*	546	-28	365	714	1,597
<b>Total</b>	<b>1,764</b>	<b>1,522</b>	<b>1,834</b>	<b>1,816</b>	<b>6,937</b>

\* Excluding Crossrail Sponsor Funding Account.

**Funding Projections for Crossrail****Crossrail Funding Plan**

	Prior Years	2011/12 Budget	2012/13	2013/14	2014/15	2015/16- 2018/19	TOTAL
Cash required (incl. Crossrail train operations)	2,246	1,205	1,905	2,248	2,013	3,109	12,727
<b>Funded by:</b>							
DfT committed funding	392	517	1,205	1,123	1,082	800	5,119
GLA funding (incl. Crossrail Business Rate Supplement)	1,002	868	829	886	518	0	4,103
Developer contributions	0	5	25	59	93	394	576
Sale of surplus land	0	0	0	0	0	444	444
Cash funding from TfL Group	852	-185	-154	180	320	1,471	2,485
<b>Total funding</b>	<b>2,246</b>	<b>1,205</b>	<b>1,905</b>	<b>2,248</b>	<b>2,013</b>	<b>3,109</b>	<b>12,727</b>

## Moody's Related Research

### Special Comment:

- » [UK General Election: Hung Parliament No Direct Threat to UK's Aaa Rating, May 2010 \(125007\)](#)

### Rating Methodology:

- » [Government-Related Issuers: Methodology Update, July 2010 \(126031\)](#)

### Analyses:

- » [United Kingdom, Government of, December 2011 \(138072\)](#)
- » [Regie Autonome des Transports Parisiens, July 2010 \(126545\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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