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May 17, 2012

Research Update:

Transport for London 'AA+/A-1+' Ratings Affirmed On Improved Budgetary Performance; Outlook Stable

Primary Credit Analyst:
Gianluca Minella, London (44) 20-7176-3548;gianluca_minella@standardandpoors.com

Secondary Contact:
Liesl Saldanha, London (44) 20-7176-3571;liesl_saldanha@standardandpoors.com

Research Contributor:
Carlos Carpizo, London (44) 20-7176-3483;Carlos_Carpizo@standardandpoors.com

Table Of Contents

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Overview

- In our view, Transport for London (TfL) has demonstrated an improving budgetary performance, supported by a strong funding framework and growing demand levels.
- We are affirming the 'AA+/A-1+' issuer credit ratings on TfL.
- The stable outlook reflects our expectations that TfL will maintain a good budgetary performance and marginally increase its tax-supported debt levels as a percentage of consolidated operating revenues. We also expect TfL to maintain a very positive liquidity position throughout the rating horizon.

Rating Action

On May 17, 2012, Standard & Poor's Ratings Services affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on Transport for London (TfL). The outlook is stable.

Rationale

The ratings on TfL reflect the predictable and supportive institutional framework within which it operates and our view of the significant, ongoing central government support that it receives, as well as the likelihood of further extraordinary support if required.

We consider that TfL benefits from a dominant position in the provision of urban transport services in the Greater London area. This supports its very strong demand profile, which demonstrates a long-term growth trend and resilience to economic downturns.

TfL's liquidity position is very positive for the rating, and is supported by its strong cash reserves and its access to the Public Works Loan Board (PWLB), which would provide timely liquidity support if needed. We also consider that TfL's financial management is very positive for the rating.

Constraining rating factors include TfL's high tax-supported debt levels, which we expect to reach about 150% of consolidated operating revenues by 2015. We consider that TfL is exposed to risks associated with its investment in large projects, especially its investment in Crossrail, a major new railway link being built in London.

TfL is a functional body of the Greater London Authority (GLA; AA+/Stable/--) and is responsible for implementing the mayor's transport strategy in London. The authority operates through a regulated multiyear funding agreement with the central government and the Department for Transport. Within this framework however, TfL enjoys a good degree of operational and financial flexibility.

TfL is funded by revenues generated via fare and fees and by government grants (both operational and capital). In our opinion, the central government has demonstrated its commitment to ensuring that TfL has stable funding, as outlined in the funding agreement that expires at the end of financial year 2015. The government grant has reduced in line with the U.K. government's austerity drive. TFL has made strategic cost reductions on the operational side and has rephased some of its capital expenditure to maintain its financial strength.

TfL provides a complex portfolio of transport services, through a large number of subsidiaries that together comprise the TfL Group. For the purposes of our analysis, we focus on the group as a whole.

In our opinion, TfL has demonstrated a strong budgetary performance over several years, posting operating balances above 15% of consolidated operating revenues in the period 2009-2011. Over the 2012-2015 period, we expect TfL's operating performance to remain strong, supported by regulated fare increases and structural cost saving. A strong operating performance is essential to fund ongoing capital investments.

TfL has an extensive investment plan for 2013-2015--amounting to about £11.6 billion. This should lead to average forecasted deficit after capital accounts of about 10% by 2015.

One of the key priorities of TfL's investment plan is Crossrail, a £14.7 billion investment, expected to be in operation in 2018. The project is primarily funded by the U.K. Department for Transport (DfT), the Greater London Authority (GLA; AA+/Stable/--), and TfL itself. So far, construction has proven to be on track and well within budget.

We forecast that TfL's tax-supported debt profile will reach about 150% of consolidated operating revenues by 2015, as a result of its considerable investment plan. Although direct debt is likely to increase significantly, we expect the ratio of tax-supported debt as a percentage of consolidated operating revenues to remain relatively stable because of the forecasted growth in consolidated operating revenues.

During the London 2012 Olympics, TfL will be responsible for managing the extended operations of the public transport and road system. We understand that all related infrastructure projects have been completed on time and to budget.

Liquidity

We consider that TfL's liquidity position is very positive for the rating; cash and short-term investments amount to about £0.8 billion (after Standard & Poor's haircuts). This is equivalent to about 43% of estimated annual debt service, including financial leases and commercial paper, for financial year 2012-2013. Excluding commercial paper and financial leases, this would be equivalent to about 181% of estimated annual debt service. TfL also has access to about £200 million in committed liquidity facilities, if required.

Because TfL is a local government entity, it has access to the government-funded PWLB, subject to the guidelines in the U.K. Prudential Borrowing Code of 2004. We consider that TfL's access to PWLB provides a valuable source of external liquidity.

TfL's treasury policy is conservative, and designed to mitigate risk. For this reason, it invests its cash mainly in U.K. Treasury bills and gilts, as well as money market funds rated at the 'AAA' level.

We exclude from TfL's liquidity analysis an additional £1.4 billion of liquidity, which is only available to Crossrail. TfL cannot use these funds to service its debt.

Outlook

The stable outlook reflects our expectations that TfL will maintain a good budgetary performance and marginally increase its tax-supported debt levels as a percentage of consolidated operating revenues. We also expect TfL to maintain a very positive liquidity position throughout the rating horizon.

We could consider upgrading TfL following a reduction of its debt burden and increasing regulatory flexibility on fares increases. We might also consider upgrading TfL if stronger support from the central government or the DfT were to mitigate risks and contingent liabilities associated with its capital-intensive business profile.

Although unlikely, we could downgrade TfL if its budgetary performance were to deteriorate significantly to below 10% of adjusted operating revenues, following a considerable worsening of its multiyear funding agreement with the central government. In our downside case, we would expect TfL to commit to its current investment plan, despite the weaker operating performance, leading to tax-supported debt levels rising to well above 170% of consolidated operating revenues within the rating horizon.

Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

Ratings Affirmed

Transport for London	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+
Commercial Paper	A-1+
Tube Lines (Finance) PLC	
Senior Unsecured*	AA+

*Guaranteed by Transport for London.

Additional Contact:
International Public Finance Ratings Europe;PublicFinanceEurope@standardandpoors.com

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