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Research Update:

Transport for London Rating Raised To 'AA+' And Removed From CreditWatch Positive On Criteria Revision; Outlook Stable

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Research Update:

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Overview

- We have applied our revised local and regional government (LRG) criteria to our rating analysis on Transport for London (TFL).
- In our view, TFL will be able to respond positively to the U.K. government's 2010 spending review settlements.
- We are therefore raising the rating on TFL to 'AA+' from 'AA', and removing it from CreditWatch positive where it had been placed on Sept. 20, 2010.
- The outlook is stable and reflects our expectation of TFL's continued sound operating performance, and strong liquidity and financial management performance.

Rating Action

On Dec. 3, 2010, Standard & Poor's Ratings Services raised its long-term issuer credit rating on TFL to 'AA+' from 'AA'. At the same time, we removed the rating from CreditWatch with positive implications, where it was placed on Sept. 20, 2010.

Rationale

The upgrade of TFL reflects the application of our revised local and regional government (LRG) criteria and our expectation of TFL's positive response to the 2010 U.K. government's comprehensive review settlement.

The ratings on TFL reflect the predictable and supportive institutional framework within which it operates, a strong relationship with the central government, its excellent financial and risk management performance, and extremely good access to liquidity. These strengths counterbalance the reductions in grant levels recently announced, which are directly related to the fiscal challenges facing the U.K government (AAA/Stable/A-1+), alongside a rising debt burden and risks associated with TFL's substantial capital plans.

TFL benefits from an institutional framework which is one of the strongest that we have reviewed. It is characterized by a highly centralized system where local authorities are not permitted to run up operating deficits financed by borrowing. Instead, they must absorb any grant reductions either by increasing other revenues, drawing on appropriate reserves if these exist, or reducing expenditures. We believe that ready access to the government-funded Public Works Loan Board (PWLB) will provide systemic support in times of need.

Owing to the critical nature of the service provided in London and its importance to the London economy and the U.K. in general, TFL enjoys a very strong relationship with the central government. In fact, approximately half of its revenues come from government grant, paid via the Department for Transport (DFT). Although this government grant will fall by £2.2 billion over the next four years, as announced in the recent spending review, we believe that the effects will only materially impact TFL in the longer term. Further, due to the combination of increased revenues and delayed capital expenditure, we expect operating and post-capex balances to improve initially, before deteriorating in 2014/2015.

We view TFL's liquidity position as very strong. We expect £600 million cash assets and access to committed facilities of £200 million to be sufficient to cover debt service in the next 12 months. In addition, TFL has excellent access to external liquidity via the PWLB, assuming it remains within its prudential borrowing limits.

In our opinion, the reduced grant will inevitably lead to a higher debt burden in the medium term, and TFL expects to fund this through capital market issuance.

TFL has undertaken the development of Crossrail, a £14.9 billion major rail project for London and southeast England. Development costs have fallen by about £1 billion, and delivery time has been extended by one year, to 2018. However, from a credit perspective, TFL's financial obligations are capped under an agreement with the DFT, thereby protecting TFL's credit standing.

Outlook

The stable outlook reflects our expectation of TFL's continued sound operating performance, and strong liquidity and financial management performance.

A deterioration of TFL's financial management performance, ultimately leading to a significant increase in capital expenditure financed by debt, could lead to a negative rating action. Conversely, the ratings could be raised if a significant reduction in debt--funded by a combination of reduced operating costs and increased grants or contributions from third parties--ultimately improved TFL's budgetary performance. We do not view these scenarios as likely in the medium term.

Related Criteria And Research

- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- Principles Of Corporate And Government Ratings, June 26, 2007

Ratings List

Upgraded; CreditWatch/Outlook Action; Affirmed	To	From
Transport for London		
Issuer Credit Rating	AA+/Stable/A-1+	AA/Watch Pos/A-1+
Senior Unsecured	AA+	AA/Watch Pos
Tube Lines (Finance) PLC*		
Senior Unsecured	AA+	AA/Watch Pos
Ratings Affirmed		
Transport for London		
Commercial Paper	A-1+	A-1+

*Guaranteed by Transport for London.

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