STANDARD & POOR'S

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Summary:
Transport for London

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Credit Rating: AA/Stable/--

Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' local and foreign currency long-term issuer credit rating on Transport for London (TfL). The outlook is stable.

The rating on TfL continues to reflect its significant fare-generating capacity and its strong links with the U.K. government--through funding by transport grants, and central oversight by the U.K. local authority framework. TfL, an executive body of the Greater London Authority (GLA; AA+/Stable/--), is responsible for most public transport functions in London, including the Underground system, and bus services. TfL's function is to implement the transport strategy for London set by the Mayor, who also chairs TfL.

TfL enjoys an extremely strong business position and a near-monopoly over public transport in the London area, with control over the Underground and bus systems, and the associated fares. Furthermore, it is able to capture additional revenues from private transport through its congestion charge.

The business plan underpinning the growth in debt assumes increases in fares in line with inflation and passenger numbers on both bus and Underground services. Although demand for public transport services in London historically has not been much affected by fare increases, a decline in London's economy could reduce projected passenger numbers. Consequently, as TfL is required to balance its budget, any reduction in revenues would be offset by a decline in operational expenditure. Similarly, any material increase in debt and consequently debt service will be subject to TfL's ability to restore its balance of revenues and operating expenses.

In October 2007, TfL entered into a 10-year funding agreement with the U.K. government, which gives the public transport provider a strong degree of funding certainty for the period, thereby enabling it to manage its longer term commitments and obligations more effectively. The funding package represents an envelope within which TfL is expected to manage its agreed obligations. TfL is in the process of putting together a more detailed business plan that incorporates its significant new responsibilities with respect to the restructuring of the Metronet public-private partnership (PPP) contracts and the delivery of Crossrail. Although the funding package is a positive credit feature, it is fair to say that there is a significant risk of unforeseen costs associated with the Metronet restructuring and the Crossrail project. If such unforeseen costs crystallize to the extent that they cannot be accommodated within the funding envelope, we expect that the government would provide additional support, assuming good relations between TfL and the central government continue.

The £15.9 billion Crossrail project will be funded by a mix of government grant, TfL borrowing, a supplementary business rate in London, and private sector contributions. In the event of significant cost overruns, the government will assume the risks and responsibilities for the project. TfL's commitment to Crossrail's financing will therefore result in a significant stepping up of TfL's debt obligations by some £2.7 billion, which is expected to be repaid by additional fare revenues generated by Crossrail. TfL will borrow the first £1 billion of this before 2010. The construction risk associated with Crossrail, particularly in the deep-tunneling works, is high. TfL's liabilities have been capped, however, under an agreement with the government. A further £3.5 billion of funding will come from the GLA through the introduction of a supplementary business rate in London.

On July 18, 2007, the Metronet companies responsible for delivering the Metronet contracts entered into administration. One consequence of this action was that the put option on Metronet's senior debt became exercisable six months later--on Jan. 18, 2008. The payment of the put option is a London Underground Ltd (LUL) obligation guaranteed by TfL. The put option is estimated to total about £1.7 billion. The U.K. government will meet this funding requirement in the current year, consistent with its Letter of Comfort.

On Oct. 25, 2007, TfL submitted a formal bid to buy the Metronet contracts. No bids were received from potential commercial buyers. TfL is currently in negotiations with Metronet's subcontractors to restructure their contracts. The put option is expected to be exercised in February 2008, and the contracts are expected to transfer to TfL shortly after.

TfL also continues to face the ongoing challenges of managing the relationships and cost pressures associated with its PPP contracts with Tube Lines (Finance) PLC. In addition, TfL has several separate project-specific private finance initiative (PFI) transactions to manage, as well its own program of infrastructure and cost improvements.

TfL's credit standing closely depends on its ongoing strong relationship with the U.K. central government. Any weakening of this situation, due to political or management reasons, could undermine TfL's strong credit rating.

Outlook

The stable outlook reflects TfL's strengthening relationship with the U.K. Government, as shown by the new 10-year funding settlement and its central role in restructuring the Metronet contracts and delivering the Crossrail project. TfL also continues to maintain a strong cash position and enjoys a certain degree of flexibility to delay its investment programs.

That said, any unforeseen costs, particularly in connection with Crossrail and Metronet, that are outside the control of TfL and are not supported by the U.K. government could put pressure on the rating. Furthermore, a major slowdown in the London economy that materially affects fare revenues, or any weakening in the relationship between the government and the Mayor of London, could also negatively affect the rating.

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