Department for Transport

Great Minster House
76 Marsham Street
London SW1P 4DR

E-Mail: bronwyn.hill@dft.gsi.gov.uk

Web site: www.dft.gov.uk

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Stephen Allen
Managing Director, Finance
Transport for London
Windsor House
42-50 Victoria Street
London SW1H 0TL

Dear Steve,

TfL SR07 settlement

1. This letter sets out the Secretary of State's present intentions in relation to the Department for Transport's funding of Transport for London up to 2017/18, including for TfL's commitments to Crossrail. It represents an agreed position between the parties but should be considered a draft document until the finalisation of the Department's overall SR07 settlement. The detail of Crossrail funding is set out in the separate Heads of Terms document.

2. The grant profile for TfL and London Overground funding is as below, with TfL grant levels for 2008/09 and 2009/10 as agreed at SR04.

£m (cash)	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18
TfL grant	2528	2651	2975	3115	3261	3415	3576	3673	3773	3874
Capital Grant	100	100								
Overground grant	41	42	42	43	44	45	46	47	49	50

3. It is recognised that the Mayor intends to raise resources to allow TfL to raise prudential borrowing towards meeting its needs, and his undertakings to contribute to Crossrail. This is to be contained within the following profile:

£m (cash)	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18
TfL borrowing	1250	1100	300	400	400	300	600	600	600	600

4. The Mayor will be separately entitled to raise £3.5bn for Crossrail from 2010/11, supported by a supplementary business rate, according to the following profile:

£m (cash)	10/11	11/12	12/13	13/14	14/15
GLA borrowing	800	700	700	800	500

5. TfL will manage its estate within the above levels of borrowing (which includes both direct borrowing and borrowing undertaken through new finance leases but excluding operating leases not recognised on the balance sheet of TfL or its subsidiaries) and DfT grant funding, plus TfL's other sources of income. The TfL estate includes, but is not confined to:

   - London Underground, including the Tube Lines PPP contract, the interim body into which Metronet's PPP contracts are transferred, the post-Metronet permanent structure, LU pensions, and other works on the London Underground outside the scope of the PPP contracts;
   - TfL's other transport and corporate activities;
   - TfL's Olympics projects;
   - The balance sheet impact of TfL PFIs under current accounting standards;
   - TfL's Crossrail contribution.

6. It is recognised that had the Metronet companies remained in the private sector into the second review period, public expenditure totals would also have increased to reflect growth in the Finance Lease Creditor amounts on LUL's balance sheet. HMG will forecast equivalent increases in public expenditure totals to reflect "post-Metronet" company borrowing and this level of borrowing cover will continue to be made available. At this stage, the precise form of this spending cannot be predicted as it will depend on the structure, and approach to financing, of the post-Metronet companies, though it is recognised that Metronet were expecting to borrow an additional £1.3bn in the second review period of the PPP.

7. The Government recognises that additional funding is required to cover first period costs for the Metronet contracts. The following sources of funding are offered to TfL to cover these additional costs.

8. With respect to Metronet's existing debt, public expenditure cover worth £1.7bn is offered[1]; this amount, less the value of any debt assumed or taken out by TfL, will be paid as a grant/loan:

   - for existing commercial bank and EIB facilities (including break costs) if existing debt is restructured.
   - for the underpinned amount payable if the put option is exercised.

[1] On the basis that payment from TfL to the lenders is the minimum necessary.

For the avoidance of doubt, should the overall public expenditure impact of Metronet's existing debt be lower than £1.7bn, the savings would be to TfL's benefit.

9. Further public expenditure cover of £630m is offered towards the costs of the funding already in place for the companies in administration and thereafter. In the event of a successful LUL nominee bid, this will be available as a grant/loan to TfL on the following profile:

£m (cash)	07/08	08/09	09/10	10/11
	157.5	157.5	157.5	157.5

10. In lieu of the interest that would otherwise have been payable on these amounts funded through new grants, the level of future TfL Transport Grant will be reduced in each year by an amount equalling 4.76% of the total grants paid (as described in paras 8 & 9 above) up to the end of the preceding year[2]. Otherwise, TfL will retain the benefit of the financing cost savings resulting from grant funding rather than the commercial debt service assumed in the Metronet contracts.

    OR TfL will pay to DfT in each year at a fixed rate of interest of 4.76% on these loans, calculated on the basis of the closing balance at the end of the preceding year. It is intended that these loans will be subordinated to any other borrowing by TfL. Any repayment of the principal is at the discretion of TfL.

11. The TfL Transport Grant is being maintained as agreed at SR04 (subject to adjustments described in para 10). Assuming a successful LUL nominee bid, this realises savings for TfL as the ISC that the grant was based on included Metronet shareholder distributions to the end of the first period, which are assumed now not to be paid. Savings should also be achievable post-first period and these will be attributable to program outputs.

12. £150m will be paid to TfL as capital grant (under Section 31 of the Local Government Act 2003) in 2007/08.

13. In addition, recognising the cash and Capital Budget surpluses in 2008/09 to 2010/11 that would otherwise arise within the Crossrail project, DfT will pay a capital grant (under Section 31 of the Local Government Act 2003) to TfL to meet costs of funding Metronet in administration and the interim body into which Metronet's contracts are transferred. (There will be no rebating of future TfL Transport Grant in respect of these additional grant payments.)

[2] The figure of 4.76% represents the Weighted Average Cost of Capital of borrowing by HM Treasury.

The amounts of additional grants to be paid under this heading are:

£m cash	2008/09	2009/10	2010/11
TfL additional grant	116	49	235

14. The DfT grant to Crossrail is set out in the separate Heads of Terms document.

15. The longer-term shortfall in the Crossrail funding plan created by the use of the £400m early year surpluses outlined in paragraph 13 would need to be closed in later years (to keep Crossrail funding as a whole in balance). This may be achievable by reducing costs, or it may require TfL to provide additional funding; TfL will bear the risk on this. Any cost reduction up to £400m achieved with respect to the Metronet/Crossrail interface risk will be available to TfL alone.

16. TfL would take the risk on meeting the debt servicing costs of their prudential borrowing from all their existing and future revenue sources. During Crossrail's construction, TfL may additionally use any surplus revenues from a business rate supplement not required to service Crossrail borrowing at the GLA level to service Crossrail borrowing at the TfL level.

17. TfL bear the financial risk for PPP administration costs, including the costs arising from the time required to obtain necessary state aid clearances, and the costs that may arise due to delays in setting up the post Metronet permanent structure beyond the end of the first period. DfT will seek State Aid clearances and will support TfL in expediting the post Metronet permanent structure; DfT and TfL will work closely accordingly.

18. The attached Memorandum of Understanding further details the assumptions on the financing and restructuring of the Metronet contracts, though for the avoidance of doubt, in the event of any inconsistency between this letter and the Memorandum of Understanding, the letter shall prevail.

19. It is the Secretary of State's intention that all possible steps will be taken to avoid deviation from this funding plan. To the extent that exceptional pressures on the TfL budget emerge or budgets are significantly affected by public expenditure classifications, DfT will consider these at future Spending Reviews. In any future review of TfL funding, DfT will take all relevant circumstances into account including a full account of TfL's revenues, the extent to which the circumstances giving rise to exceptional pressures were outside of TfL's control, and TfL's capacity to raise further income from fares or asset sales. These pressures will also be weighed against DfT's public expenditure position.

20. This letter is intended to subsume the matters covered in the letter dated 20 July 2004 from Robert Devereux to Jay Walder, which will cease to have effect from today's date save in respect of the provisions in relation to Olympic projects.

BRONWYN HILL