FitchRatings

Fitch Maintains Transport for London's 'AA-' IDR on Rating Watch Negative

Fitch Ratings-Barcelona/London-30 April 2019: Fitch Ratings has maintained Transport for London's (TfL) 'AA-' Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) on Rating Watch Negative (RWN). The Short-Term Foreign-Currency IDR has been affirmed at 'F1+'.

Fitch has also maintained TfL's GBP5 billion MTN programme's 'AA-' long-term foreign- and local-currency ratings on RWN and affirmed the ECP commercial paper programme's short-term foreign and local currency ratings at 'F1+.

TfL's ratings are notched down once from the UK sovereign (AA/RWN/F1+) under Fitch's Government Related Entity (GRE) criteria, reflecting the application of the four key rating factors under the strength of linkage and incentive to support factors. Fitch believes that extraordinary support from the UK government would be forthcoming if needed. The RWN reflects that on the UK.

TfL is a statutory body established under the Greater London Authority Act 1999. Its main activity is the provision of integrated transport facilities and services in Greater London, including buses, London Underground, Docklands Light Railway, London Overground, TfL Rail/Elizabeth line, trams, the management of certain roads in London and the Congestion Charge scheme, cycling, river services, the licensing of taxi and private hire.

KEY RATING DRIVERS
Status, Ownership and Control Assessed as Strong
TfL's legal status is that of a statutory corporation subject to local government finance rules and as such it must produce a balanced budget each year. TfL is a functional body of the Greater London Authority (GLA) and reports to the mayor of London, who is the chair of the board. The mayor appoints the board members and develops and publishes a transport strategy reflecting national and local priorities. Since 2004, a prudential scheme for local authorities has been in place, allowing TfL to borrow up to authorised limits.

Support Track Record and Expectations Assessed as Strong
The UK government has expressed its support for TfL's long-term commitments in the latest funding settlement, although since April 2017 it no longer subsidises TfL's investment plan. This has included funding for not only the Elizabeth Line but also the extensive modernisation of tube services and stations and the transformation of the road network. Since April 2017, the investment grant has been replaced by an equivalent amount of almost GBP1 billion business rates transferred to TfL by the GLA under a pilot scheme for further business rates devolution.

To date, about a third of TfL's total revenue has come from grants. Some of this is paid directly to TfL from the Department for Transport (DfT), some is transferred from the DfT via the GLA, and some is through business rates collected and distributed by the GLA. The financing package agreed for Crossrail between DfT, GLA and TfL in December 2018 to deliver the final stages of the project and open the Elizabeth line as quickly as possible is evidence of further support from the UK government. A scalable and sustainable arrangement was designed to cover the estimated range of the capital cost overrun.

Socio-Political Implications of Default Assessed as Strong

Disruption would lead to significant political or economic repercussions. TfL is strategically important for London and overall for the UK economy. Over 31 million journeys are undertaken on TfL's network every day. TfL would be difficult to substitute in the short to medium term, with the transition process likely to lead to severe service disruption. Financial default would not necessarily materially affect the provision of service or hamper TfL's investment programme, but the political repercussions would be significant.

Financial Implications of Default Assessed as Very Strong
Fitch has assessed this as Very Strong. If TfL were to default, it would impair the availability and cost of borrowing for other GREs in the UK. The shock waves from such an event would result in a fundamental rethink of exposure to the public sector and would inevitably lead to a restriction on future lending. We believe the capital markets (30% of TfL borrowing), and the European Investment Bank (EIB; 30% of borrowing) would restrict funding.

Standalone Credit Profile
Fitch has assessed TfL's standalone credit profile (SCP) under the Revenue Supported Debt Criteria as 'a-'. It is driven by Fitch's assessment of 'Strong' revenue defensibility, as despite its lack of pricing power, TfL benefits from strong demand with a resilient revenue framework. Operating risks have been assessed as 'Midrange' considering the material capex in the near term. At FYE18 TfL's net debt/EBITDA was under 8x according to Fitch's calculations and this is expected to remain in the range of 10x-12x over the medium term in Fitch's rating case.

TfL's liquidity is supported by ample access to external liquidity. TfL and other local authorities may borrow from the Public Works Loan Board (PWLB, statutory body operating within the UK Debt Management Office), which provides easy and direct access to funding at very short notice. TfL also has GBP200 million of undrawn overdraft facilities with HSBC, a history of issuing under its GBP2 billion commercial paper programme, and GBP200 million in committed facilities with Export Development Canada.

RATING SENSITIVITIES
A change in the rating could result from:
- A downgrade or upgrade of the UK sovereign.
- A change in the assessment of the strength of linkage or incentive to support factors under the Government Related Entity Criteria.
- A sustained weakening in the Financial Profile of TfL's standalone assessment under the Revenue Supported Debt Criteria may also lead to a rating change.

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Summary of Data Adjustments - Fitch has made an adjustment to the statutory accounts in order to reflect the operating nature of TfL:

- A positive adjustment has been made to Fitch calculated EBITDA for all years, representing the difference between the total amount of revenue grants received and the total amount of grants allocated to revenue in the statutory accounts.
- From FYE18 non-ring-fenced business rates received from the GLA and used to fund capital have been reclassified to "Other Revenues considered as Turnover" from Capital Grants, since they could be used to fund operating expenditure if required.

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Additional information is available on www.fitchratings.com
Applicable Criteria
Government-Related Entities Rating Criteria (pub. 29 Mar 2019)
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

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