FitchRatings

FITCH AFFIRMS TRANSPORT FOR LONDON AT 'AA-'; OUTLOOK NEGATIVE

Fitch Ratings-Barcelona/London-31 October 2017: Fitch Ratings has affirmed Transport for London's (TfL) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'AA-' with Negative Outlooks and Short-Term Foreign-Currency IDR at 'F1+'.

Fitch has also affirmed TfL's GBP5 billion MTN programme's long-term foreign and local currency rating at 'AA-' and commercial paper (ECP) programme's short-term foreign and local currency ratings at 'F1+. The corresponding debt issues have also been affirmed at 'AA-'/'F1+'.

KEY RATING DRIVERS
TfL's ratings are notched down once from the UK sovereign (AA/Negative/F1+) under Fitch's public-sector entity criteria, reflecting the application of the four key rating factors including legal status, control, strategic importance and integration. Fitch believes that extraordinary support from the UK government would be forthcoming if needed.

Legal Status Attribute Assessed as Stronger
TfL's legal status is that of a statutory corporation subject to local government finance rules. It is regulated under the Local Government Act 2003 and the Local Government Finance Act for capital finance purposes. TfL must produce a balanced budget each year and cannot be liquidated.

Control Attribute Assessed as Midrange
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.

TfL agrees its incremental borrowing limits with the central government as part of the funding settlement. Under the agreement with the Department for Transport (DfT), TfL's borrowing must be contained within annual limits of GBP500 million-GBP900 million until the financial year ending 31 March 2021. Since the 2015 Spending Review TfL has the flexibility to defer part or all of the incremental borrowing from one financial year to the next until it is needed.

Strategic Importance Attribute Assessed as Stronger
TfL is strategically important for London and the UK economy. Over 31 million journeys are undertaken on TfL's network every day, which is half of all bus and rail journeys in England. Passenger journeys across all modes of transport increased in FY17 with the exception of buses. Bus volumes were down primarily due to falling bus speeds owing to challenging conditions on the roads. Nevertheless, under the December 2016 business plan TfL forecasts patronage will increase by a total 11% over the years to FY22 for buses and 9% for the tube. A revised business plan is expected to be published by December 2017.

Integration Attribute Assessed as Midrange
Until now about a third of TfL's total revenue has come from grants. Some of this is paid directly to TfL from the DfT, some is transferred from the DfT via the GLA, and some is through business rates collected and distributed by the GLA. The outcome of the 2015 Spending Review means that TfL's central government grant will decrease, resulting in a loss of about GBP0.7 billion annually to FY21. By FY19 TfL will no longer receive grant from the central government and business rates receipts will be used to cover operating expenditure.

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.

The UK government has expressed its support for TfL's long term commitments in the latest funding settlement, although it will no longer subsidise TfL's investment plan from April 2017. This has included funding for not only the Elizabeth Line but also the extensive work modernising tube services and stations as well as transforming the road network. TfL's total contribution/risk to the Elizabeth Line has been capped at GBP7.1 billion of the total funding budget of GBP14.8 billion and if the costs breach a pre-determined level, there is a put option to the DfT. About two-thirds of the funding for the Elizabeth Line has come from central and local government, either from the DfT or through the GLA.

Ambitious capital expenditure has led to increased debt. Direct debt was GBP9.8 billion at FYE17, and according to TfL's forecast, will increase by GBP3.1 billion to FY22 to reach GBP12.9 billion. Construction of the Elizabeth Line at sites across the city remains on time, with over 85% now complete and with more than half the track and all new station platforms completed. Investment in the Elizabeth Line and the tube is vital to secure future economic growth in the capital and will increase London's rail capacity by 10% and enable new and faster journeys.

As a result of a comprehensive review of TfL, a number of areas have been identified where costs could be reduced without affecting day-to-day transport services, safety or the capital programme. Three key elements involve receiving better value from the supply chain; ensuring the organisation is lean and efficient; and creating a culture and ways of working to support a single, integrated organisation that is commercially-minded and agile. The 2016 Business Plan assumes delivery of GBP4.3 billion of savings by FY22. Savings will be made, for example, by reducing spans and layers in the organisation; on accommodation charges; changing defect and fault repairs and services; and by merging engineering functions.

Fare revenue now accounts for about two-thirds of TfL's operating revenues and will continue rising over the medium term. TfL has flexibility to respond to pressures by de-scoping or reviewing capital projects, delaying or reducing capital expenditure, reducing or revising services, or changing fares, fare structure or concession arrangements. Moreover, liquidity is sound, with cash reserves totalling GBP1.96 billion at FYE17, although GBP510 million of this is ring-fenced for the Elizabeth Line.

RATING SENSITIVITIES
A change in the rating could result from the following:
- A downgrade or upgrade of the UK sovereign
- A weakening of the strategic importance for or support or integration with the central government, which would lead to a wider notching difference. The weakening could be in the form of further reduction in overall funding (including capital funding) without supplementary sources of revenue identified.

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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.

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Additional information is available on www.fitchratings.com

Applicable Criteria
International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/878660
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
https://www.fitchratings.com/site/re/898969
Rating of Public-Sector Entities – Outside the United States (pub. 22 Feb 2016)
https://www.fitchratings.com/site/re/877128