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RATINGS

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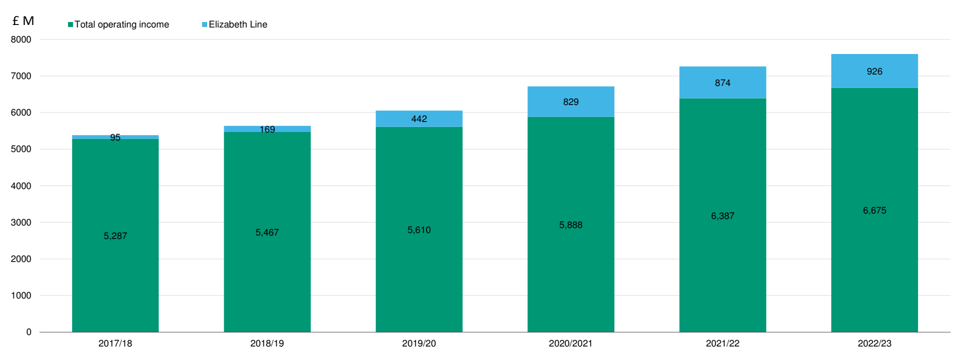
Transport for London (UK)

Crossrail overspend is credit negative, but manageable; Elizabeth Line opening schedule remains on target

On 24 July 2018, the UK government (Aa2 stable) announced a projected overspend of £590 million on the Crossrail project as part of its annual update on the project. This represents 4% of the revised £14.8 billion allocated to the scheme in October 2010 following the Comprehensive Spending Review. Transport for London (Aa3 stable) (TfL) will have to fund £150 million (1.3% of its total operating income for the period) over FY2018/19 and FY2019/20. While this overspend is credit negative for TfL, its share is manageable within its considerable financial resources, which includes a sizeable cash and short-term investments balance of £1.9 billion as of 31 March 2018. We expect TfL to fund the additional spending using options that include asset sales, leasebacks, borrowing and cash drawdowns.

The UK government also reported that the construction of the Elizabeth Line (the operational name for the Crossrail project) is 93% complete. TfL expects that the line will open on schedule on three routes in December 2018, before opening in full in December 2019. Progress on the Crossrail project is more critical to TfL's financial sustainability than the overspend.

Exhibit 1
TfL projects that the Elizabeth Line will account for an increasing share of its operating revenue
By FY2020/21, passenger revenue from the Elizabeth Line will represent 12% of TfL's total operating revenue (excluding grants and Mayoral business rates)



Source: Transport for London

TfL's share of the Crossrail overspend is manageable within its considerable financial resources

The UK government presented its annual update on Crossrail on 24 July 2018. The update reports a projected overspend of £590 million, which represents 4% of the £14.8 billion funding allocated to the project in October 2010. Close to half of the cost (£290 million) relates to the programme of works on the national rail network and these will be met by Network Rail, the government-owned company which owns and manages most of the country's rail network, and the Department for Transport (DfT). The additional £300 million will be split equally between the DfT and TfL, the joint sponsors of the Crossrail project. TfL's total liability will be for £150 million, with the expenditure incurred over FY2018/19 and FY2019/20.

TfL projects that its total operating income over FY2018/19 and FY2019/20 will be £11.7 billion. This figure excludes Mayoral business rates and other revenue grants which represent an additional £1.9 billion over the two-year period. The additional liability related to the overspend represents 1.3% of TfL's total operating income, which we consider to be a relatively immaterial amount.

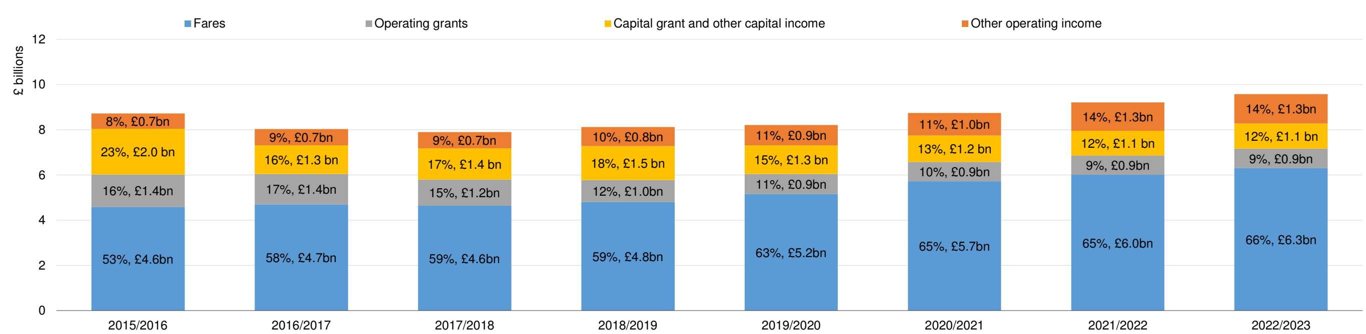
TfL has a number of different options for raising the required funding, including drawdowns on its cash resources, additional borrowing (which would require the central government to temporarily raise its borrowing limit), asset sales or leasebacks. Its total cash resources, including cash and short-term investments, were £1.9 billion at 31 March 2018.

The successful and timely opening of the Elizabeth Line is more critical to TfL's financial sustainability

Aside from the overspend, the more important news in the government's annual update on Crossrail is that the project is now 93% complete, with no significant delays to the opening schedule. The central section of the line will open in December 2018, at which time three separate services will run from Paddington to Abbey Wood; Paddington to Heathrow; and Liverpool Street to Shenfield. The full route will open in December 2019.

Passenger revenue from the Elizabeth Line is critical to TfL's financial sustainability, and will represent 12% of total operating income by FY2020/21. TfL's general grant has been phased out, and from this fiscal year (FY2018/19) TfL will be funded solely through passenger revenue, Mayoral business rates and other revenue grants, the congestion charge and other transport levies and commercial income. As a result, TfL's business model is increasingly reliant on passenger revenue, which should represent 66% of total income by FY2022/23, from 53% in FY2015/16, according to TfL's forecasts. TfL expects some £800 million of the £1.6 billion projected increase in fare revenue between FY2016/17 and FY2022/23 to be delivered by the Elizabeth Line.

Exhibit 2
TfL's changing funding environment
Total income, including capital grants and Mayoral business rates



TfL projected figures, 2017/18 to 2022/23 from 2017 Business Plan. From 2018/19, operating grants will be comprised of Mayoral business rates from the Greater London Authority (GLA) and other revenue grants, with the historical general grant from the DfT having been phased out. Capital grants and other capital income exclude property and asset receipts.
Source: TfL Business Plans (December 2017 and December 2016), Moody's calculations

The Crossrail project and TfL's budget responsibility

Crossrail Limited, the delivery organisation for the Crossrail project, is a 100% subsidiary of TfL. The programme has two joint sponsors — the DfT and TfL. The new railway for London and the South East includes 41 stations (10 new and upgrades to 31) and stretches from Reading and Heathrow in the west to Abbey Wood and Shenfield in the east, using 42 kilometres of new tunnels. The new railway, which will have a total length of 118 kilometres, will bolster central London's rail capacity by 10%.

As a result of the overspend, the funding for the project will now increase to £15.4 billion, from the previous figure of £14.8 billion that was agreed in October 2010. TfL's contribution to the project was originally capped at £7.1 billion, with direct funding of £2.4 billion, through a mix of corporate borrowing and proceeds from the sale of assets. It is also responsible for a further £4.7 billion, which will be funded by a variety of sources including developer contributions and the Business Rate Supplement. For any expenditure in excess of the £7.1 billion, which this overspend represents, TfL has a put option whereby it can transfer responsibility for the project to the DfT. However, the importance of the Elizabeth Line to TfL's financial sustainability means that this option has not been considered at present in light of the relatively minimal overspend.

Moody's related publications

» Credit Opinion: Transport for London, March 2018

» Transport for London is least dependent on government operating subsidies among its international peers, March 2016

» Transport for London's loss of UK government operating grants is credit negative, March 2016

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