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Rating Action: Moody's places Transport for London's long-term ratings under review for downgrade

02 Jun 2020

London, 02 June 2020 -- Moody's Public Sector Europe ("Moody's") has today placed Transport for London's (TfL) Aa3 long-term debt rating and its (P)Aa3 long-term EMTN programme rating under review for downgrade. Concurrently, Moody's has affirmed TfL's P-1 short-term issuer rating and short-term commercial paper rating.

"The review for downgrade reflects the significant negative pressure on TfL's passenger revenues and broader credit metrics resulting from the coronavirus pandemic that will test the company's capacity to adjust to a potentially prolonged period of depressed ridership, and the UK government's willingness and capacity to provide financial support," says Zoe Jankel, a Moody's Vice President and lead analyst for TfL.

The review period will allow Moody's to assess the scope and effectiveness of the measures that TfL may be able to take to mitigate the impact of a prolonged reduction in demand for its services given a high fixed-cost base; and the size, nature and timeliness of further financial support from the central government.

The coronavirus outbreak is creating a severe and extensive credit shock across many sectors, regions and markets. Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety. TfL is highly exposed to the economic and social impacts of the coronavirus outbreak, as containment measures cut demand for mass transit considerably in the near term and potential long-term behavioural shifts may prevent a return to pre-shock trends.

RATINGS RATIONALE

RATIONALE FOR INITIATING THE REVIEW FOR DOWNGRADE

TfL has the highest farebox recovery ratio in Moody's global mass transit portfolio (fare revenues as a percentage of operating expenditures, at 64% in FY2019) which makes it particularly exposed to reductions in passenger demand. In April, with tight containment measures in place in the UK, passenger numbers on the London Underground were down 95% on a year-on-year basis, and 85% on the bus network. Although passenger numbers are increasing slowly as some parts of the economy re-open, a return to normal capacity utilization is highly unlikely in the next few months. Moody's expects passenger numbers and fare revenues in FY2021 (the year ending in March 2021) to be 60% below budget. Even if the pandemic eases later this year and the economy gradually recovers, willingness and capacity to travel, and with them TfL's revenues, are likely to be impaired for some time.

On 15th May, the Secretary of State for Transport of the United Kingdom announced a GBP1.6 billion support package for TfL[1]. This can be extended up to a maximum of GBP1.9 billion and is for the period from 1st April to 17th October 2020. It will reduce TfL's large funding gap in FY2021, but will not fully compensate the revenue shortfall beyond the next few months. In addition, TfL's debt burden will increase, although it will remain within its pre-agreed borrowing limits. Moody's expects TfL's financial debt levels to increase to GBP13 billion by FYE2021 and total debt (including IFRS 16 adjustments) to GBP15.8 billion. Before the outbreak this would have represented 196% of operating revenue. Significantly lower revenue will exacerbate the increase in TFL's debt burden.

Through the immediate shock, as lower revenues are absorbed by government support and higher debt, Moody's expects that TfL will maintain good cash buffers, a support to the rating. TfL retains its liquidity buffer, which is set at 60 days of operating expenditure and equates to around GBP1.2 billion.

Beyond the near term, the coronavirus outbreak poses significant long-term challenges for TfL's business model. Large staffing and maintenance requirements across its services make significant further cuts to operating expenditure in response to lower revenue difficult to implement. While 7,000 of TfL's 28,000 employees were furloughed on 24 April 2020, the savings, at around GBP16 million per four-week period, represent less than 3% of TfL's average operating costs. Although TfL has demonstrated its capacity to reduce costs in recent years, if demand for its services remains lower for a number of years, it will be challenging to generate further savings through a restructure to services.

These negative pressures on TfL's credit profile are also reflected in the downgrade of the BCA to a3 from a2. The final rating of Aa3 incorporates a three-notch uplift based on Moody's assessment of a very high likelihood of support from the UK government, as per the application of Moody's Joint Default Analysis (JDA).

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS FOR TRANSPORT FOR LONDON

In Moody's assessment, environmental considerations are material to TfL's credit profile. TfL is central to the Mayor of London's carbon reduction and air quality targets. This involves significant expenditure within TfL's capital programme which will add to its debt burden over time.

Social considerations are material to TfL's credit profile. TfL's ridership is strongly correlated with the health of London's economy and demographic trends, including the growth of London's population. Also, as mentioned, Moody's regards the coronavirus outbreak as a social risk under its ESG framework. For TfL, passenger demand is impacted by the epidemic and the measures that have been implemented to respond to it.

Governance considerations are material to TfL's credit profile. TfL has high standards of financial management and governance, and has a number of internal committees that review investment and spending decisions in addition to an external body providing independent assurance and expert advice.

WHAT COULD LEAD TO CONFIRMATION OF THE RATINGS AT THE CURRENT LEVEL

Moody's would consider confirming TfL's ratings if the review concluded that through adjustment measures and/or further sustained financial support from the government, TfL is likely to be able to maintain financial flexibility and debt metrics consistent with a Aa3 rating.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

WHAT COULD MOVE THE RATINGS DOWN

Downward pressure on the rating could result from a high likelihood that funding support from the government and/or TfL's expenditure savings will only partially offset the persistent revenue shortfall in the near and medium term, likely leading to a higher debt burden and eroded cash buffers.

The methodologies used in these ratings were Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207, and Mass Transit Enterprises Methodology published in December 2017 and available at /www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1105431. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

REFERENCES/CITATIONS

[1] Department for Transport - Government grants Transport for London funding package 15-May-2020

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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