Research Update:

Transport for London 'AA-/A-1+' Ratings Affirmed Despite Further Elizabeth Line Delay; Outlook Negative

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Overview

- On Nov. 8, 2019, Transport for London (TfL) announced that the large-scale Elizabeth line project will incur further costs, and will not open until at least 2021.
- We understand that TfL is discussing with the Greater London Authority (GLA) and the U.K. government a financial package to cover these additional capital costs.
- We estimate that these increased costs will strain TfL's liquidity. At the same time, the project's further delay will not allow ridership to increase significantly over the next two years.
- We still believe there is a very high likelihood that the GLA would provide timely and sufficient extraordinary government support to TfL.
- We are therefore affirming our 'AA-' long-term and 'A-1+' short-term issuer credit ratings on TfL. The outlook is negative.

Rating Action

On Nov. 13, 2019, S&P Global Ratings affirmed its 'AA-/A-1+' issuer credit ratings on London-based transport operator TfL. The outlook is negative.

At the same time, we affirmed our 'AA-' issue rating on TfL's senior unsecured debt.

Rationale

On Nov. 8, 2019, TfL announced further delays and extra costs associated with the opening of the Elizabeth line. As a result, we believe TfL's ridership and financials will be affected at least until 2021. However, we expect Dft and TfL, along with the GLA, will agree new funding in the next few months. We anticipate this funding to be in the range of £400 million-£650 million, on top of the financial package approved in December 2018. The announcement also means that the central section of the Elizabeth line will not open in 2020. In our previous base case, we assumed that the line would open by the last quarter of 2020.

We continue to consider TfL to be a government-related entity. In our opinion, there is a very high likelihood that the GLA would provide timely and sufficient extraordinary government support to TfL in the event of financial distress. We base our opinion on the following factors:

- TfL's very important role, as a near monopoly providing essential transportation services in the U.K.'s capital region; and
- The very strong link between TfL and the GLA. The Mayor of London plays a critical role in setting TfL's strategy and objectives, and passes on retained business rates from the GLA that represent a significant part of TfL's revenue. The Mayor and central government, via the DfT, set the incremental borrowing limits for TfL. Central government also provides ready access to reliable liquidity sources via the Public Works Loan Board (PWLB).

We factor the very high likelihood of support in our rating with a two-notch uplift to the stand-alone credit profile, which we maintain at 'a'.

We now believe that the Elizabeth line will open in late 2021, leading to higher-than-expected losses in fare revenue, and a weaker liquidity position for a longer period, between now and 2022. We assess liquidity as adequate, compared with our previous assessment of strong. However, we think this is still compatible with our view of an adequate financial risk profile.

We estimate that TfL will be able to maintain its debt service capacity to about 1.3x on average over our forecast horizon through fiscal year (FY) ending March 31, 2021, from 2.0x in FY2019. In 2019, EBITDA (S&P Global Ratings-adjusted for operating lease cost) proved to be more resilient than we expected, at £448 million. While TfL's budget for 2020 anticipates a decline in EBITDA compared with FY2019, we note that second-quarter results for FY2020 point toward a stronger outcome. We factor in the delayed opening of the Elizabeth line, as well as the fare freeze that will remain in place until 2020 (the year of the next London mayoral elections), and a subdued economy, which is affecting passenger numbers. In our base case, we exclude the portion of business rates that replace the investment grant (£976 million in FY2019) to calculate TfL's EBITDA. However, we include capital business rates when calculating the debt service coverage ratio.

TfL's financial risk profile is constrained by its very high debt burden. We expect total debt (including finance leases and operating leases, the latter of which we capitalize) to reach £13.8 billion, or 1.5x total revenues by FY2020; increasing further to 1.8x by FY2021. A significant proportion of capital spending is on large-scale projects that have strategic importance--both to London and the national economy--thereby limiting TfL's ability to delay or cancel these projects once they are committed.

We believe TfL continues to demonstrate strong financial flexibility, resulting from a farebox recovery ratio among the highest of the mass transit systems we rate globally, although this is based more on its ability to cut costs than increase revenue. We note that TfL has over-delivered on its savings program since 2017. On the other hand, we see continued pressure to raise farebox revenue, resulting from the mayor's commitment to keep TfL-controlled fares frozen until December 2020.

We also note that the delay of the opening of the Elizabeth line will hold up the recovery of ridership in TfL's transport system, weakening our view on the entity's market position. Ridership in TfL's transport network peaked in FY2016 and FY2017, with just over 4 billion passengers. We do not have visibility on when TfL will be able to reach a similar level. Having said that, we continue to assess TfL's enterprise risk profile as very strong. This is underpinned by the very low risk associated with the global mass transit industry, and London's still extremely strong and diversified economic fundamentals. The population is growing rapidly, and local per-capita income (gross value added) is significantly higher than the national average. About 5.9 million people now work in the capital, up from 5.2 million in 2013--a five-year historical growth rate of about 12.6%.

We continue to believe that TfL's management and execution plans are constrained by the Crossrail project, following developments observed since 2018 and their impact on TfL's financials.

Table 1

Transport for London--Operating Performance

	--Year ended March 31--				
	2015	2016	2017	2018	2019
Total revenues (mil. £)	9,548.6	9,124.0	8,045.0	7,869.0	9,321.0
Passengers (mil.)	3,970.8	4,031.2	4,028.5	3,988.1	3,999.1
Staff	N.A.	31,213	29,190	28,456	27,280

N.A.--Not available.

Liquidity

We believe TfL will maintain an adequate liquidity position, although it is set to weaken compared with our previous base case. Cash to debt service will continue to decline to just 1x on average over our forecast horizon in 2021, compared with 1.5x in FY2019. We anticipate that free cash to operating expenditure may decline meaningfully in FY2021 from about 110 days in FY2019.

Nevertheless, TfL's exceptional access to external liquidity via the PWLB mitigates some of these risks, in our view. As a statutory body within the Debt Management Office, the PWLB lends to local authorities (and TfL) at short notice. In addition, TfL has a very strong track record of issuing own-name bonds on the capital markets. Hence, we do not view refinancing risk on TfL's commercial paper borrowings to be particularly high, and we have affirmed our short-term rating of 'A-1+'.

Table 2

Transport for London--Financial Summary

	--Fiscal year ended March 31--				
(Mil. £)	2015	2016	2017	2018	2019
Operating revenues	7,675.6	6,697.0	6,763.0	6,559.0	6,682.0
Farebox revenues	4,281.0	4,587.0	4,694.0	4,643.0	4,822.0
Operating expenses before D&A	6,059.3	6,179.3	6,067.9	6,143.7	6,233.7
EBITDA	1,616.3	517.7	695.1	415.3	448.3
Cash and short-term investments	4,696.0	3,203.4	1,961.5	1,931.3	1,781.2
Financial debt*	10,013.6	10,591.5	11,350.3	12,010.8	13,067.1
Adjusted ratios					
EBITDA (DSC) coverage	2.7	0.8	1.0	1.4	2.0
Debt service carrying charge (%)	18%	19%	19%	22%	18%

Table 2

Transport for London--Financial Summary (cont.)

Farebox recovery ratio (%)	71%	74%	77%	76%	77%
Financial debt to revenues	1.0	1.2	1.4	1.5	1.5
Financial debt to net revenues	6.2	20.5	16.3	28.9	29.1

*Including financial leases and capitalized operating leases.

Outlook

The negative outlook reflects our view that TfL's financial profile is stretching, leading to declining cash balances, at a time of heightened risk as a result of economic uncertainty and delivery of large capital projects.

We could lower the rating over the next 12 months if TfL incurred substantially higher costs related to the implementation of the Crossrail project and the project experienced a further delay, which could put structural pressure on future EBITDA generation and jeopardize the recovery of ridership structurally above 4 billion passengers.

We could revise the outlook to stable over the next 12 months if TfL performed in line with our base-case expectations.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Mass Transit Enterprise Ratings: Methodology And Assumptions, Dec. 18, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Summary: United Kingdom, Oct. 25, 2019
- Greater London Authority Ratings Affirmed At ‘AA/A-1+’. Outlook Remains Negative, Sept. 20, 2019
- Transport For London ‘AA-/A-1+’ Ratings Affirmed; Off Watch; Outlook Negative, Dec. 20, 2018
- Bulletin: GLA Has Capacity To Absorb Additional Debt For Crossrail; TfL Still On CreditWatch Negative, Dec. 13, 2018

Ratings List

Ratings Affirmed	
Transport for London	
Issuer Credit Rating	AA-/Negative/A-1+
Senior Unsecured	AA-
Commercial Paper	A-1+