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Research Update:

Transport for London Rating Lowered To 'AA' Following Similar Action On The U.K.; Outlook Now Negative

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Overview

- On June 27, 2016, we lowered our unsolicited long-term rating on the U.K. to 'AA' from 'AAA'.
- Consequently, we are lowering our long-term rating on Transport for London to 'AA' from 'AA+' and affirming our 'A-1+' short-term rating. Our outlook is now negative.
- The negative outlook represents risks to the institutional framework for U.K. local and regional governments, and uncertainty arising from the U.K.'s decision to leave the EU in the recent referendum.

Rating Action

On June 29, 2016, S&P Global Ratings lowered its long-term issuer credit rating on U.K. transport provider Transport for London (TfL) to 'AA' from 'AA+'. At the same time, we affirmed our 'A-1+' short-term issuer credit rating on TfL. The outlook is now negative.

We also lowered our long-term rating on TfL's senior unsecured debt to 'AA' from 'AA+' and affirmed our 'A-1+' short-term rating on its £2 billion commercial paper program.

As defined in EU CRA Regulation 1060/2009 "EU CRA Regulation", the ratings on TfL are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2016 EMEA Sovereign, Regional, And Local Government Rating Publication Dates," published Dec. 22, 2015, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation is caused by the lowering of our long-term rating on the United Kingdom to 'AA' from 'AAA' on June 27, 2016. The next scheduled rating publication on TfL will be on Oct. 14, 2016.

Rationale

The downgrade of TfL follows the lowering of our unsolicited long-term sovereign credit rating on the U.K. to 'AA' from 'AAA' (see "Research Update: Ratings On The United Kingdom Lowered To 'AA' On Brexit Vote; Outlook Remains Negative On Continued Uncertainty," published on June 27,2016).

We generally cap the long-term rating on a local and regional government (LRG) at the same level as its respective sovereign. We do not consider that the institutional and financial framework for U.K. LRGs allows any of them to be rated above the sovereign (see "General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," published Nov. 19, 2013). U.K. LRGs do not have formal powers to block changes to the institutional framework. In this respect, we also consider that our rating on TfL could be affected if we were to reassess our view of the institutional framework for U.K. LRGs.

The downgrade also signifies that, in our view, the U.K.'s vote to leave the EU in the recent referendum implies risks to the institutional framework and to projected population growth in London, which may affect demand for TfL's services. We also revised down our view of TfL's budgetary flexibility to satisfactory from strong following the announcement on June 8, 2016, that TfL's controlled fares would be frozen for four years to 2020/21.

The long-term rating on TfL is equivalent to our 'aa' assessment of its stand-alone credit profile. In our view, London will continue to be of strategic importance to the U.K. economy, and TfL continues to benefit from its exceptional liquidity position. At the same time, we anticipate that the decision to leave the EU could lower projected population growth in London and consequently restrict demand for public transport. That said, the effect on London may not be clear until the detailed negotiations on exiting the EU begin. Much depends on the form of the U.K.'s exit from the EU.

The ratings on TfL reflect the institutional framework within which it operates as a U.K. local authority. Although we currently assess this as extremely predictable and supportive, the assessment is subject to review. Although TfL has a major capital program, the U.K. government (via the Department for Transport) effectively underwrites much of the exposure to cost overruns on TfL's largest capital project, Crossrail 1. Therefore, we consider that TfL has very low contingent liabilities. Positively, we view TfL's overall commitment to fiscal discipline and the quality of its financial management as being very strong. The rating is constrained by weakening budgetary performance following the reduction in government grants and substantial capital expenditure (capex). Furthermore, TfL has a high level of tax-supported debt, which we expect to reach about 167% of consolidated operating revenues by 2019.

In theory, TfL has significant flexibility to raise its transport fares, given its near-monopolistic position over public transport in London. However, on June 8, 2016, the Mayor of London, Sadiq Khan, announced that all of TfL's controlled fares would be frozen until May 2020. TfL has forecast that the cost of this fare freeze will be about £640 million in total. We consider that this limits TfL's ability to modify revenues from this source, which affects our assessment of TfL's budgetary flexibility.

Outlook

The negative outlook represents both the risk that the U.K.'s decision to leave the EU might weaken our view of the institutional framework for local authorities in the U.K. and the risk to London's economic growth prospects. The latter risk could restrict demand for TfL's services.

We could also lower the rating over the next two years if TfL substantially increases its capex, either as a result of cost overruns or a shift in financial strategy. This would result in deficits after capex substantially exceeding our base-case expectations on a recurrent basis and TfL's debt burden increasing more rapidly than we currently forecast (this assumes debt rising above existing borrowing limits). In such a scenario, we could revise downward our view of TfL's financial management, and its willingness to use its expenditure flexibilities.

If we were to revise the outlook on the U.K. sovereign rating to stable, we would still maintain the negative outlook on TfL, barring any other changes to its credit profile.

Key Statistics

Table 1

Transport for London Economic Statistics							
	--Fiscal year ending Dec. 31--						
	2012	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Population	8,308,362	8,416,636	8,528,813	8,639,691	8,757,268	8,868,846	8,980,224
Population growth (%)	1.3	1.3	1.3	1.3	1.4	1.3	1.3
GDP per capita (local currency) (single units)	39,191	40,215	41,912	42,690	43,755	45,132	46,622
Real GDP growth (%)	1.5	3.3	4.1	3.1	2.8	2.8	2.8
Unemployment rate (%)	8.4	8.2	6.4	6.3	6.2	6.1	6.0

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices, Eurostat, and Experian Ltd.

Table 2

Transport for London Financial Statistics										
	--Fiscal year beginning April 1--									
(Mil. £)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**	**2016dc**	**2017dc**	**2018dc**
Operating revenues	7,954	7,874	7,704	6,691	6,838	6,992	7,284	6,838	6,992	7,284
Operating expenditures	5,873	6,119	6,407	6,644	6,670	6,990	7,164	6,670	6,990	7,164
Operating balance	2,081	1,755	1,297	47	168	2	120	168	2	120

Table 2

| Transport for London Financial Statistics (cont.) | | | | | | | | | | |

(Mil. £)	2012	2013	2014	2015bc	2016bc	2017bc	2018bc	2016dc	2017dc	2018dc
					--Fiscal year beginning April 1--					
Operating balance (% of operating revenues)	26.2	22.3	16.8	0.7	2.5	0.0	1.6	2.5	0.0	1.6
Capital revenues	2,046	2,141	1,484	1,885	1,599	1,594	1,519	1,599	1,594	1,519
Capital expenditures	3,237	3,146	3,429	4,027	3,504	3,009	2,489	3,609	3,241	2,837
Balance after capital accounts	890	750	(648)	(2,096)	(1,737)	(1,413)	(850)	(1,842)	(1,645)	(1,198)
Balance after capital accounts (% of total revenues)	8.9	7.5	(7.1)	(24.4)	(20.6)	(16.5)	(9.7)	(21.8)	(19.2)	(13.6)
Debt repaid	1,255	1,274	858	879	926	1,159	867	926	1,159	867
Balance after debt repayment and onlending	(365)	(524)	(1,506)	(2,974)	(2,663)	(2,572)	(1,717)	(2,768)	(2,804)	(2,065)
Balance after debt repayment and onlending (% of total revenues)	(3.6)	(5.2)	(16.4)	(34.7)	(31.6)	(30.0)	(19.5)	(32.8)	32.7)	(23.5)
Gross borrowings	1,533	1,538	1,432	1,447	1,563	1,983	1,297	1,669	2,215	1,646
Balance after borrowings	1,168	1,014	(74)	(1,527)	(1,100)	(589)	(420)	(1,100)	(589)	(420)
Operating revenue growth (%)	5.7	(1.0)	(2.2)	(13.1)	2.2	2.3	4.2	2.2	2.3	4.2
Operating expenditure growth (%)	4.8	4.2	4.7	3.7	0.4	4.8	2.5	0.4	4.8	2.5
Modifiable revenues (% of operating revenues)	51.9	56.2	59.6	73.1	74.8	77.0	79.8	74.8	77.0	79.8
Capital expenditures (% of total expenditures)	35.5	34.0	34.9	37.7	34.4	30.1	25.8	35.1	31.7	28.4
Direct debt (outstanding at year-end)	7,564	7,898	8,548	9,148	9,878	10,778	11,278	9,984	11,116	11,964
Direct debt (% of operating revenues)	95.1	100.3	111.0	136.7	144.5	154.2	154.8	146.0	159.0	164.2
Tax-supported debt (% of consolidated operating revenues)	109.4	114.2	124.2	154.9	160.7	168.9	167.9	162.3	173.7	177.3

Table 2

Transport for London Financial Statistics (cont.)										
	--Fiscal year beginning April 1--									
(Mil. £)	2012	2013	2014	2015bc	2016bc	2017bc	2018bc	2016dc	2017dc	2018dc
Interest (% of operating revenues)	4.6	5.0	5.3	6.2	6.3	8.0	8.3	6.4	8.3	8.8
Debt service (% of operating revenues)	20.4	21.1	16.5	19.4	19.9	24.6	20.3	19.9	24.9	20.8

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some, but not all, aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some, but not all, aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

Ratings Score Snapshot

Table 3

Transport for London Ratings Score Snapshot	
Key Rating Factors	
Institutional Framework	Extremely predictable and supportive
Economy	Very strong
Financial Management	Very strong
Budgetary Flexibility	Satisfactory
Budgetary Performance	Very Weak
Liquidity	Exceptional
Debt Burden	High
Contingent Liabilities	Very low

*S&P Global Ratings bases its ratings on local and regional governments on the eight main rating factors listed in the table above. Section A of S&P Global Rating's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

- Research Update: Ratings On The United Kingdom Lowered To 'AA' On Brexit Vote; Outlook Remains Negative On Continued Uncertainty – June 27, 2016

Related Criteria And Research

Related Criteria

- Criteria – Governments – International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign - December 15, 2014
- Criteria – Governments – International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings:

Methodology And Assumptions - November 19, 2013
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research
- Research Update: Ratings On The United Kingdom Lowered To 'AA' On Brexit Vote; Outlook Remains Negative On Continued Uncertainty - June 27, 2016
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - April 21, 2016
- Default, Transition, and Recovery: 2014 Annual International Public Finance Default Study And Rating Transitions - June 08, 2015
- Report Card: U.K. Local Authorities Absorb Major Cuts, But What Flexibility Remains? - March 31, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

	Rating	
	To	From
Transport for London		
Issuer Credit Rating		

Ratings List Continued...

Foreign and Local Currency	AA/Negative/A-1+	AA+/Stable/A-1+
Senior Unsecured		
Local Currency	AA	AA+
Commercial Paper		
Foreign and Local Currency	A-1+	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.