Research Update:

# Transport for London Outlook Revised To Positive On Post-Pandemic Recovery; 'A+/A-1' Ratings Affirmed

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## Overview

- We expect the financial performance of Transport for London (TfL), a near-monopoly mass transit provider in London, will remain sound in the next two years.
- This is thanks to a gradually increasing passenger base, rising fares, and cost-savings, which will largely offset the negative effects of inflation and winding down of pandemic-related government support.
- We expect TfL's capital program to remain contained, which with continued government capital funding and stable performance would result in an only moderate rise in debt.
- We therefore revised our outlook on TfL to positive from stable and affirmed our 'A+/A-1' long- and short-term issuer credit ratings.

## Rating Action

On May 25, 2023, S&P Global Ratings revised its outlook on Transport for London (TfL; the authority) to positive from stable. We affirmed the 'A+/A-1' long- and short-term issuer credit ratings on the authority.

We also affirmed our 'A+' rating on TfL's senior unsecured debt and 'A-1' short-term rating on its commercial paper program.

## Outlook

The positive outlook reflects our view that recovering ridership and cost controls should allow TfL to gain higher financial flexibility, despite a challenging economic environment. We further expect that borrowings and risks related to TfL's real estate operations will remain contained.

### Upside scenario

We could raise the rating over the next two years if we see better financial capacity and flexibility in TfL's business model. In this scenario, we expect TfL's own revenue sources would allow it to cut a backlog of operating and capital spending and continue funding services without additional government support.

### Downside scenario

We could revise the outlook to stable if ridership and demand for TfL's services don't improve. We expect this would imply TfL continues to underfund operating expenditure (opex).

We could also revise the outlook to stable if we see signs that the U.K. government's willingness to provide extraordinary support to TfL has changed.

## Rationale

The positive outlook reflects our view that TfL's prominent role as a mass transit provider in London will sustain demand for its services, as well as continued support from the U.K. government (unsolicited AA/Stable/A-1+) and Greater London Authority (GLA; AA/Stable/A-1+). We expect TfL's performance will remain sound, even after the current settlement on operating financial support with the U.K. government ends at the current fiscal year (to March 31, 2024; fiscal 2024). We think this would be achieved thanks to management's continued cost-efficiency measures, despite elevated inflation and slowly recovering ridership. However, we note that these measures reduce TfL's capacity to absorb external shocks and increase investment in the level and quality of services.

### Enterprise profile: Near-monopoly status in an economically vibrant service area supports service demand

TfL benefits from strong market position, given its near monopoly business position operating an essential mass transit system in the very large and affluent London metropolitan area, and operations that we consider to carry low industry risk relative to other industries. The authority's solid economic fundamentals are underpinned by its area of operations, which is characterized by a very high GDP per capita, which we estimate at about £56,900 in fiscal 2023, compared with a national average of £38,400 in the same year. We expect London's strong and diverse economy, with a population of about nine million, to continue leading the U.K.'s economy.

That said, TfL faces a risk of decline in demand for its services, which has weakened its market position, in our view. We think ridership will remain below the historical peak of four billion passengers per year over the next two years. This is due to behavioral changes regarding the use of public transit, such as increasing working and studying from home and online shopping, which will shift demand patterns for TfL's services. In fiscal 2023, we estimate that passenger income stood at £4.2 billion, representing a 30% increase on the prior year but still only about 90% of pre-pandemic levels. We expect that ridership will gradually recover, supported by the opening of the final stage of TfL's flagship new Elizabeth Line in May 2023, after operations began in May 2022.

Our assessment of TfL's strong management and governance stems from a positive track record of achieving cost savings and arranging funding for operations and unique infrastructure projects. This is balanced by previous issues related to management of the large Crossrail project and the uncertainty around its long-term financial framework. With declining ridership, TfL still faces uncertainty around the long-term financial framework with GLA and the Department for Transport

(DfT), which will regulate future sources of revenue and quality of services.

## Financial profile: Gradually improving financial performance, contained debt build-up, and solid access to external liquidity sources

We consider TfL's financial performance to be strong, reflecting a projected debt service coverage ratio of about 1.6x in fiscal 2025. We consider that, beyond the current fiscal year, TfL will bear the risks of higher inflation and ridership, since its settlement with the central government offering some safeguards will end. We expect TfL will continue to seek operating efficiencies and strive to diversify its revenue sources to balance those risks.

We also expect TfL to maintain its revenue flexibility, which was restored following negotiations between GLA and the DfT. A freeze on fares in place since 2016 was lifted during the pandemic, enabling TfL to introduce an average increase of 5.9% in March 2023. This is still well below inflation, but we expect future increases will pave the way for sustainable performance, considering the rising cost base.

In our view, TfL's debt burden will remain moderate over the next two years. This is underpinned by our expectation that most of the capital program will be financed by capital grants and operating cash flow. We understand that TfL, GLA, and the DfT continue to work toward a long-term capital funding arrangement. Our expectation is that TfL will not pursue large-scale capital projects at this point, like Crossrail 2 and the extension of the Bakerloo line, and that some uncommitted projects currently planned will be pushed back if matching funding is not agreed. TfL's debt stock including leases will remain above £15 billion, which is just under 10x net revenue, over the next two years.

We view TfL's liquidity and financial flexibility as strong overall, primarily based on exceptional access to external liquidity sources, while we consider its own cash holdings compared to its size of operations and debt to be relatively weak. In line with its strategy, TfL continues to adhere to its strict policy of holding sufficient cash to cover 60 days of opex, which equals roughly £1.3 billion this year. We forecast that TfL's unrestricted cash on hand, including its £200 million of credit facilities, will represent about 70 days of opex, or 10% of total debt, over the next two years.

At the same time, we consider that TfL maintains exceptional access to external sources of liquidity, via the Public Works Loan Board (PWLB) and capital markets, mitigates some of these risks. As a statutory body within the Debt Management Office, the PWLB lends to local authorities--including TfL--at short notice. In addition, TfL has a very strong track record of issuing own-name bonds on the capital markets. More recently, GLA also announced it provided TfL with a £500 million credit line, which further supports our assessment.

## Government-related entity analysis

Due to solid extraordinary support from the U.K. government, the rating on TfL is two notches higher than the stand-alone credit profile. In our opinion, there is a very high likelihood that the U.K. government would provide timely and sufficient extraordinary support to TfL, via the DfT, in the event of financial distress. We base our opinion on:

TfL's very important role as a near monopoly providing essential transportation services in the U.K.'s capital region, especially the services sector; and

The very strong link between TfL and the U.K. government. Representatives of the DfT now attend TfL's board meetings, with oversight of its financials, business plan, and borrowing. The central government also provides ready access to reliable liquidity sources via the PWLB. In our view, a default of TfL would affect the U.K. government's reputation and impair U.K. local authorities' and other public sector entities' access to the market.

## Environmental, Social, And Governance

We analyzed TfL's risks related to environmental, social, and governance factors and acknowledge elevated governance risks. We think the regulatory framework under which the authority operates will continue to evolve, especially with regards to the distribution of responsibility for financing between the central government, GLA, and TfL. We consider some risks associated with TfL's social role directly due to the pandemic have abated.

## Ratings Score Snapshot

Table 1

### Transport for London--Ratings Score Snapshot

| | |
|---|---|
| Enterprise risk profile | 3 |
| Economic fundamentals | 1 |
| Industry risk | 2 |
| Market position | 3 |
| Management and governance | 3 |
| Financial risk profile | 3 |
| Financial performance | 3 |
| Debt and liabilities | 2 |
| Liquidity and financial flexibility | 3 |
| Stand-alone credit profile | a- |
| Issuer credit rating | A+ |

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Governments | General: Global Not-For-Profit Transportation Infrastructure Enterprises: Methodologies And Assumptions , Nov. 2, 2020
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Governments | U.S. Public Finance: Assigning Issue Credit Ratings Of Operating Entities , May 20, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions , March 25, 2015
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating , Oct. 1, 2010

## Related Research

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- Greater London Authority Outlook Revised To Stable After Similar Action On The U.K.; 'AA/A-1+' Ratings Affirmed, April 25, 2023
- Greater London Authority 'AA/A-1+' Ratings Affirmed; Outlook Negative, March 31, 2023

## Ratings List

**Ratings Affirmed; Outlook Action**

| | To | From |
|---|---|---|
| **Transport for London** | | |
| Issuer Credit Rating | A+/Positive/A-1 | A+/Stable/A-1 |
| Senior Unsecured | A+ | A+ |
| Commercial Paper | A-1 | A-1 |