MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
3 June 2020

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RATINGS

Transport for London

Domicile	United Kingdom
Long Term Rating	Aa3 , Possible Downgrade
Type	Senior Unsecured - Dom Curr
Outlook	Rating(s) Under Review

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Transport for London (United Kingdom)

Update following ratings under review

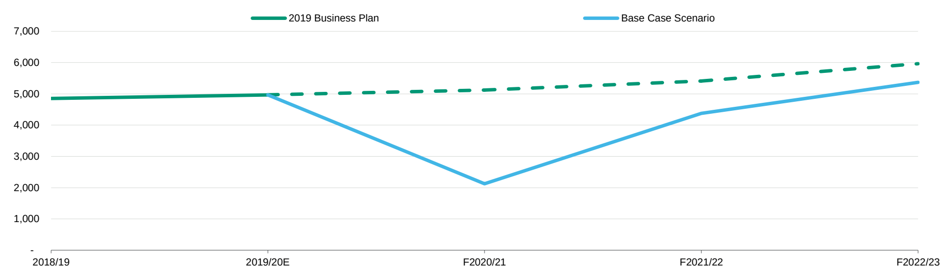
Summary

Transport for London's (TfL, Aa3 RUR down) credit profile reflects the considerable negative pressures that the issuer faces from the coronavirus outbreak, in addition to pre-existing budgetary pressures from the removal of its government operating grant, the key project risk of the Elizabeth line and high debt levels. It also reflects TfL's strategic importance as the main public transport provider in London and its strong management and governance. Its credit profile also reflects the very high likelihood of extraordinary support expected to be provided by the UK government (Aa2 negative) in the event that the issuer faced extreme liquidity stress.

Exhibit 1

We expect passenger revenues to decline by £3.0 billion in FY2021 and remain below 2019 Business Plan expectations over the following two years

Passenger revenues (£ million)



E: Estimate, F: Forecast.
Source: Transport for London 2019 Business Plan, Moody's analysis

Credit Strengths

» Strategic importance for national transport plans

» Strong access to liquidity

» Strong institutional framework providing a high level of transparency

Credit Challenges

» Material reduction in passenger numbers and farebox revenues, likely to persist

» Delayed opening of the Elizabeth Line, crucial to capital and operating plans

» Debt levels will remain high and debt to revenues metric could deteriorate due to lower revenues

Rating Outlook

The review for downgrade reflects the significant negative pressure on TfL's passenger revenues and broader credit metrics resulting from the coronavirus pandemic. This will test the organisation's capacity to adjust to a potentially prolonged period of depressed ridership, and the UK government's willingness and capacity to provide the requisite financial support.

Factors that could lead to an upgrade

Upward pressure on the rating is unlikely due to the review for downgrade.

Factors that could lead to a downgrade

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 weaker debt metrics and eroded cash buffers.

Key Indicators

Exhibit 2

Transport for London

Year-ended 31 March

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Own Source Revenues / Total Revenues (%) [1]	47.3	52.4	60.0	66.9	68.4	65.1
Grants / Total Revenues (%)	52.5	47.4	39.8	33.0	31.5	34.7
Operating Surplus (Deficit) / Operating Revenues (%)[2] [3]	8.6	2.0	-2.6	6.8	5.0	13.4
Interest Payables / Total Revenues (%)	4.2	4.4	4.9	5.3	5.6	5.4
Net direct and indirect debt / Operating Revenues (%)	138.0	150.9	158.7	157.0	161.8	154.2
Short-term debt / Total Debt (%)	9.0	9.4	9.5	11.4	8.4	7.1
Current Assets / Current Liabilities (%)	172.4	179.1	138.6	110.1	73.2	83.6

(1) For all ratios, total revenues include grants, including those ring-fenced for Crossrail. (2) Operating surplus refers to operating revenues minus operating expenses (not including capital grants or capital expenditures). [3] For all ratios, operating revenue excludes capital grants
Source: TfL's financial statements, Moody's Investors Service

Detailed credit considerations

On 2 June 2020, Moody's placed TfL's long-term ratings under review for downgrade and affirmed its short term ratings. The review for downgrade reflects the significant negative pressures on TfL's passenger revenues and broader credit metrics as a result of the coronavirus pandemic.

The credit profile of Transport for London, as expressed in an Aa3 negative rating, combines (1) a baseline credit assessment (BCA) for the entity of a3 and (2) a very high likelihood of extraordinary support coming from the UK government (Aa2 negative) in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

Strategic importance for national transport plans

Transport for London is a key functional body of the government of Greater London (Greater London Authority). Its Board is chaired by the Mayor of London, who is also in control of Board appointments. Future economic growth in London and the capacity of its public transportation system are closely linked and are significant policy concerns to citizens, businesses and the local and national levels of government.

Transport for London is the largest urban transit system in the United Kingdom, and one of the largest in the world. It serves a large population (8.8 million in London) and benefits from very strong ridership. Prior to the coronavirus pandemic, TfL's underground, bus and rail network provided around 4 billion rides annually. TfL's very strong utilization ratio of 451 (annual ridership relative to the service area population) in 2019 was the highest of any system we rate under the Mass Transit Enterprises Methodology, reflecting the pervasiveness of public transport and its importance to London's economy. We expect total ridership to deteriorate materially in FY2021 due to the impacts of the measures put in place to control the spread of the coronavirus. Passenger journeys on the London Underground in April 2020 were down 95% year-on-year and down 85% on buses. As a result, operating income has declined by 90%, including non-passenger revenue. We expect recovery in FY2022 and FY2023 but for ridership to remain lower than projected in the 2019 Business Plan throughout this period due both to the pandemic and its social and economic impacts.

Strong institutional framework provides a high level of transparency

Since FY2003, TfL, the Mayor of London and the Department for Transport (DfT) have agreed long-term funding and planning frameworks. These frameworks take into account a combination of TfL's own resources - mostly fare revenues - and grants from the government, which are balanced against spending in the TfL Business Plan. In March 2017, the Secretary of State for Transport set out a new multi-year funding agreement for TfL for the years FY2018 to FY2021 which sets out DfT grant and TfL's annual borrowing limit. The funding agreement confirms the removal of the general operating grant from FY2019 and the passporting of the investment grant through the GLA's 100% business rates retention pilot from FY2018. The 100% business rates retention pilot has been continued in FY2019, and in FY2020 it was confirmed at the lower rate of 75%. In FY2020, TfL received some £1.9 billion in business rates and another £300 million in grants from the GLA and central government (excluding Crossrail funding).

On 15 May 2020 the Department for Transport and Transport for London agreed a funding package for TfL to compensate for the significant reduction in farebox revenues due to the coronavirus outbreak. The central government's funding package totals £1.6 billion from the period 1 April 2020 to 17 October 2020 and includes a grant of £1.05 billion and a loan of £505 million from the Public Works Loan Board (PWLB). The government has also agreed to increase the funding package – on a proportional basis in terms of grant and debt – to a maximum of £1.9 billion over this period if the initial amount is insufficient. Although we expect that the UK government will provide any additional support required for TfL to have a balanced budget in FY2021, the inclusion of debt in the package - although it remains within TfL's pre-agreed borrowing limits - means that TfL will need to fund some of this year's revenue shortfall over future years. This will be challenging given that demand for TfL's services, and therefore revenues, may be significantly curtailed over the foreseeable future.

The funding package contains conditions that include permission for central government to appoint two representatives to attend TfL board meetings, being able to raise questions and request additional information. One central government appointed representative will also be able to attend meetings of TfL's Finance Committee and Programmes and Investment Committee. Other conditions include reimposing the congestion charge and Ultra Low Emissions Zone, which TfL had suspended since 23 March, as well as a reversal of the fare freeze introduced in January 2017, which will now increase by the retail price index (RPI) plus 1% in 2021.

Strong access to liquidity

TfL benefits from a diverse investor base and may borrow from the Public Works Loan Board (PWLB, statutory body operating within the UK Debt Management Office, an executive agency of the UK Government's Treasury Department), which could also act as a lender of last resort for the entity and hence mitigate the threat of liquidity shocks. For short-term liquidity needs, its European Commercial Paper programme of £2 billion allows for rapid and flexible access to liquidity.

TfL has a policy of maintaining a minimum level of cash of 60 days of operating cost on average (representing approximately £1.2 billion on average for FY2021). Its funding agreement with the Department for Transport includes a provision for maintaining this level of liquidity throughout FY2021.

Material reduction in passenger numbers and farebox revenues, likely to persist

TfL is significantly exposed to the coronavirus pandemic due to its high reliance on farebox revenues and the steep reduction in passenger journeys since the beginning of the outbreak in the UK. Even if the pandemic were to ease later this year, the economy will only recover slowly, and the willingness and capacity to travel may be impaired for some time. As a result, passenger revenues will be lower than budgeted. In our base case – which assumes a 60% reduction in passenger journeys in FY2021 – passenger revenue would be £3.0 billion lower than budgeted (41% of budgeted FY2021 passenger revenue), with additional losses of £450 million in other revenue. If the epidemic weighs on willingness and capacity to travel for longer than we currently assume, losses would be higher.

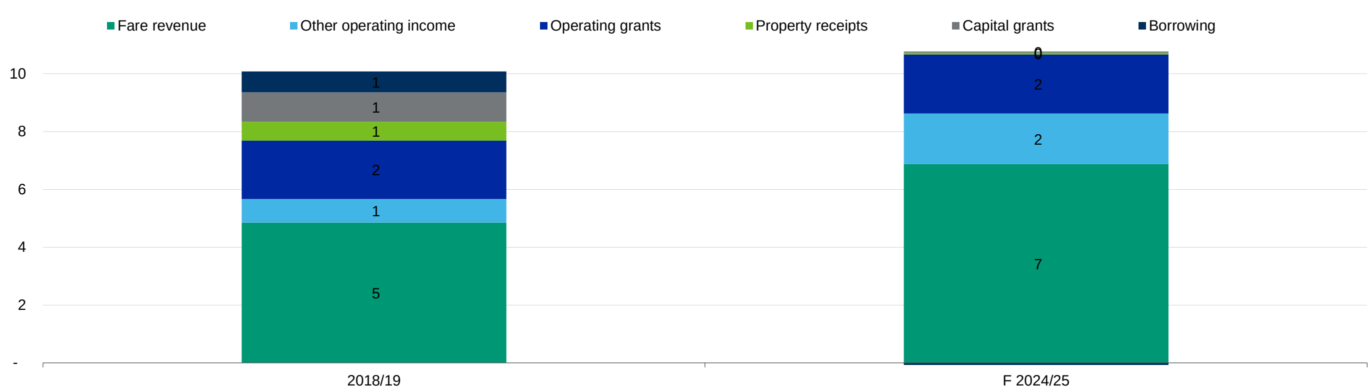
The pandemic poses significant challenges for TfL. We expect a slow economic recovery, which may depress passenger journeys for several years compared to pre-coronavirus projections. In addition, the pandemic may lead to long-term behavioural changes, including an increase in the number of people working from home, a decrease in business travel and a fall in tourism. These would all reduce demand for TfL's passenger services over the longer term.

If demand for TfL's services remains lower for a number of years, TfL will face a challenging restructure to services. In general, TfL has a relatively fixed operating cost base, with large staffing and maintenance requirements across its services – costs are therefore difficult to cut without a considerable overhaul of service provision. While 7,000 of TfL's 28,000 employees were furloughed on 24 April 2020, saving around £16 million per four-week period, the savings represent around 3% of TfL's average £490 million four-week operating costs.

TfL is now more reliant on its operational performance to fund its activities than it was in the past, with operating grant levels falling from 21% of total operating income in FY2016 to a budgeted 15% in FY2020. In the March 2017 funding agreement the Secretary of State for Transport confirmed the removal of the general grant - the general operating grant that TfL has used historically to subsidise its operations. However, its operating grant has to some extent been replaced by non ring-fenced business rates from the GLA. As its operating grant and investment grant are now paid using retained business rates, it gives TfL more financial flexibility as business rates receipts are not ring-fenced and can therefore be used for capital or operating purposes as required. This flexibility has been used to partially offset the operating pressures of the delayed opening of the Elizabeth line on TfL's operating budget. In FY2019, TfL received £3.0 billion of total grants, £1.9 billion of this amount related to non ring-fenced business rates, of which the majority were used to fund TfL's operations, with £219 million used to fund its capital programme.

In order to improve the long-term financial sustainability of the organisation, TfL is implementing a major transformation programme that is aimed at removing £1.2bn of annual operating costs from the organisation by FY2023. The transformation programme follows a comprehensive TfL-wide cost review in order to maximise value for money and improve efficiency of operations and support functions. The different internal workstreams have already led to more than 600 individual initiatives and projects, including reduced layers in the organisation, merged functions and eliminated duplications as well as commercial contracts renegotiations, that should help reach the savings target. The transformation programme is progressing well. TfL's full year results from FY2019 demonstrate operating costs £345 million lower than budget and net cost of operations £479 million lower than initially budgeted, indicating that savings are being generated earlier than anticipated.

Exhibit 3
TfL's changing funding environment
TfL's funding sources, £billion FY2019 to FY2025



Other income includes congestion charge, ULEZ receipts and commercial income. Property and asset receipts in FY2019 includes the now completed sale and leaseback of the Elizabeth line rolling stock.
Source: Moody's Investors Service, Transport for London, 2019 Business Plan

Successful opening of the Elizabeth line, crucial to capital and operating plans

TfL is the joint sponsor of the Crossrail project (operational name: Elizabeth line) with DfT. The Elizabeth line is a new 118 kilometre railway line for London and the South East. A series of delays for the project have been announced over the past year, which have impacts on TfL's operating and capital plans, although the former will have a more material impact on TfL's credit profile. Most recently, on 8th November 2019, Crossrail Limited announced that the central section of the Elizabeth line, which had previously been anticipated to open within a six-month window between October 2020 and March 2021, will now not open in 2020 but at an unspecified point in 2021. In TfL's 2019 Business Plan it estimated that the delay will cost another £600 million in lost passenger revenues to FY2025 in addition to the £750 million announced in the 2018 Business Plan. Since the lockdown in the UK was announced on 23 March 2020, TfL has brought all of its construction projects to a safe stop, including Crossrail. At this point it is uncertain whether this will lead to further delays in the Crossrail project.

In respect of the capital impact of the delay - this had previously been estimated to be between £1.6 to £2.0 billion following an independent review by KPMG (including an amount of £300 million which was agreed to be provided to the project equally by TfL and DfT in July 2018 in respect of pre-delay cost escalation). As part of the funding package agreed between DfT, the GLA and TfL in December 2018, the majority of the cost of the capital overrun will be provided by the GLA to TfL in the form of a grant of £1.4 billion. If the cost overrun exceeds £1.7 billion (£1.4 billion grant plus £300m agreed to be provided in July 2018), DfT will provide a loan facility of up to £750 million to TfL which will be incremental to the previously agreed borrowing limit. With respect to the November 2019 announcement, Crossrail Limited has indicated an additional £400-£650 million of capital cost in excess of the existing funding package. There is no indication yet as to how this will be funded. We expect TfL to use all of the £750 million loan facility in FY2021.

Other major ongoing capital projects include signalling, modernisation and rolling stock upgrades to the 11 London Underground lines aiming to improve service and capacity across the existing London Underground network, and the Northern Line Extension to Nine Elms and Battersea. The latter project is being funded by the GLA, through a hypothecation of future business rate revenues in an Enterprise Zone and developers' contributions, up to £1 billion. However, any cost increases above this level would be the responsibility of TfL. The tunneling work is now complete, however there are still some station fit-out testing and commissioning works which remain to be completed.

TfL also has a number of other large planned and proposed capital projects including the London Overground extension to Barking Riverside which will enter construction in FY2020, the Bakerloo Line Extension, a number of river crossings and Crossrail 2.

In TfL's 2019 Business Plan, total capital expenditure is expected to be £7.1 billion between FY2021 and FY2025, excluding capital renewals. However, we expect changes to be made to TfL's capital programme in its revised FY2021 budget in order to use more of its business rates funding within its operating budget.

Debt levels will remain high and debt to revenues metric may deteriorate due to lower revenues

We expect TfL's debt levels to be £14.4 billion at FYE2020, including an IFRS-16 adjustment of £2.4 billion for finance and operating leases which are now consolidated on TfL's balance sheet. This represents a debt to operating revenues metric of 182% in FY2020. In FY2021, we expect debt to increase by an additional £1.35 billion, including the £750 million loan from the Department of Transport to fund additional costs on the Crossrail project and the £600 million loan from the PWLB as part of the recently agreed funding agreement. This is within TfL's existing borrowing limits as detailed below. Its debt to revenues metric in FY2021 and beyond are expected to be higher than anticipated in its 2019 Business Plan due to lower revenues as a result of the social and economic impacts of the coronavirus outbreak.

Under the Prudential Code, TfL may borrow for capital purposes up to a level approved by the Mayor, subject to reserve powers retained by the government. In practice, increases in debt are agreed in the multi-year funding settlements with DfT. DfT approves and establishes limits for TfL's debt projections, subject to requirements of prudence and affordability required under the Prudential Code. Between FY2018 and FY2021, TfL can increase its debt by up to £2.55 billion. The £750 million loan facility granted to TfL with respect to the Crossrail cost overrun is incremental to this amount. Favourably, the 2016 funding settlement gave TfL flexibility to roll borrowing capacity into future years, meaning debt will grow only when funds are required. Local government finance law imposes statutory obligations upon officers and permits government intervention in cases of mismanagement or financial failure. Accounting standards are high. Audited financials are produced under IFRS accrual formats, but, as with UK local authorities also using this system, can be difficult to reconcile to the more cash-based systems used for budgets and long-term planning.

TfL has guaranteed a number of loans linked to Public-Private Partnership (PPP) contracts. In the last few years most of these PPP contracts were brought back “in-house.” TfL's total retirement benefit obligations, which currently are not included in TfL's debt stock, were at £5.3 billion at FYE2019, or 61% of total revenues. The latest full actuarial valuation of the TfL Pension Fund was carried out as at 31 March 2018, which showed a deficit for funding purposes of £603 million.

Extraordinary Support Considerations

The very high support assessment for TfL reflects the importance of the transport system and infrastructure improvement in London for the UK government (Aa2 negative) as reflected in the multi-year funding settlement and the agreement to proceed with Crossrail and the London Underground upgrades. The very high support also reflects the reputational risk for the central government, should TfL face acute liquidity tensions, given the overall funding of the system and close oversight from the sovereign.

Moody's also assigns a very high default dependence between TfL and the UK government, reflecting the ongoing assurance over funding of its capital programme and its historical co-ordination with national investment policies.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Transport for London

We take into account the impact of environmental, social and governance factors when assessing sub-sovereign issuers' economic and financial strength. In the case of TfL, the materiality of environmental, social and governance considerations to its credit profile are as follows:

Environmental considerations are material to TfL's credit profile. TfL is central to the London Mayor's ambition to achieve a zero carbon London and improve air quality. This involves significant expenditure on the TfL bus fleet such as introducing low-emission buses, increasing energy efficiency on the London Underground and Rail services, introducing the Ultra Low Emission Zone (ULEZ), upgrading London's cycling and walking infrastructure alongside many other capital projects and programmes. The expenditure on these projects and programmes will increase TfL's debt burden over time. TfL's services can also be affected by flooding and other weather-related events but these do not have a material impact on the issuer's finances.

Social considerations are material to TfL's credit profile. Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. TfL is highly exposed to the economic impacts of the coronavirus outbreak. For TfL, passenger demand is affected by the epidemic and the measures implemented to respond to it. Socially-driven policy can also have a material impact on TfL's credit profile. For example, the Mayor of London, Sadiq Khan, introduced a fare freeze in January 2017 in light of affordability concerns for London's residents which was credit negative for TfL. In addition, TfL's ridership is strongly correlated with the health of London's economy and growth in its population; ridership growth on TfL's bus network in particular has weakened in recent years due to a slowdown in London's economy.

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. There is also an external body providing independent assurance and expert advice to the Mayor, the Independent Investment Programme Advisory Group (IIPAG). TfL has high standards of transparency and all material documentation including its annual five-year business plan, budget, financial statements, board meeting notes and material spending decisions are published on its website.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

Rating methodology and scorecard factors

The assigned BCA of a3 is the same as the scorecard-indicated BCA.

TfL's rating reflects our assessment of the company's business profile and financial performance in line with our Mass Transit Enterprises Methodology, published on December 2017.

Exhibit 4

Transport for London, 2019 scorecard

Global Mass Transit Enterprises Methodology	CurrentFYE 31 March 2019	
Factor 1: Size (15%)	**Measure**	**Score**
a) Annual Ridership	4,021,057,000	Aaa
b) Service Area Population	8,908,081	Aaa
Factor 2: Market Position (35%)		
a) Stability and predictability of federal, state and local transportation policy and funding subsidies	Aa	Aa
b) Job and population trends	Aaa	Aaa
c) Utilization	451	Aaa
Factor 3: Financial Flexibility (20%)		
a) Farebox Recovery Ratio	60.0%	Aaa
b) 3-Yr Avg Fixed Costs as % of Operating Expenditures	18.6%	A
Factor 4: Debt & Financial Metrics (30%)		
a) Net Debt / Revenues	1.5x	Baa
b) 3-Yr Avg Interest as a % of Operating Revenues	5.5%	A
c) 3-Yr Avg Net Margin (Operating surplus / revenues	8.4%	Aa
d) Days Cash on Hand	91	A
Adjustments / Notching Factors		
Factor 1: Size		
1) Particularly strong or weak ridership/population trends that are not currently reflected in data set	-1	
Factor 4: Debt and Financial Metrics		
2) Large capital program and/or future borrowing plans	-1	
Other factors:		
3) Credit Event / Trend not yet reflected in existing data set	-1	
Rating:		
a) Indicated Rating from Grid After Notching Adjustment	a3	
b) BCA assigned	a3	
c) Actual Rating Assigned	Aa3	

Note: Financial year-end 31 March 2019
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
TRANSPORT FOR LONDON	
Outlook	Rating(s) Under Review
Senior Unsecured -Dom Curr	Aa3[1]
Commercial Paper -Dom Curr	P-1

[1] Placed under review for possible downgrade on June 2 2020
Source: Moody's Investors Service

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