STANDARD & POOR'S

CORPORATE RATINGS

Issuer Credit Rating

AA/Stable/—

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Transport for London

Major Rating Factors

Strengths:

- Continued strong links and good relationship with the U.K. government
- Dominant transport provider in London, which has strategic importance for the U.K. economy
- Investment plan on track, with Olympic Games-related transport projects being delivered on time and to budget
- Flexibility to increase fares or reduce service and adjust investment program, if required
- Stability and oversight provided by the U.K. local authority framework

Weaknesses:

- Direct borrowings to total up to £3.3 billion by 2010, as set out in original business plan
- Challenging investment program, which may stretch project-management capacity
- London Underground service delivery closely linked to performance of PPP contractors

Rationale

The rating on Transport for London (TfL) reflects its significant fare-generating capacity and its strong links with the U.K. government, both through the provision of funding via transport grants and central oversight by the U.K. local authority framework. TfL, an executive body of the Greater London Authority (GLA; AA+/Stable/—), is responsible for most public transport functions in London, including the Underground system and bus services.

TfL's five-year funding agreement, agreed with the U.K. government in 2004, remains unchanged. Although no decision has been made at this stage, it is expected that the agreement will be rolled forward following the Comprehensive Spending Review in July 2007. About one-half of TfL's funding comes from government.

TfL has an extremely strong business position, and a near-monopoly over public transport in the London area, with control over the Underground and bus systems and the associated fares. Furthermore, it is able to capture additional revenues from private transport through its congestion charge.

The business plan underpinning the growth in debt assumes increases in fares and in passenger numbers on both bus and Underground services. Although demand for public transport services in London historically has not been much affected by fare increases, a decline in London's economy could reduce projected passenger numbers.

The growth in TfL's debt has taken place incrementally and is expected to continue in a similar fashion. TfL has a legal obligation to set a balanced budget every year, and any plans to increase debt will be subject to adjustments in order to restore the balance of revenues and operating expenses.

TfL has enjoyed considerable success as the major transport provider in London, which is a growing capital city that contributes a disproportionately high percentage of U.K. GDP. Its schemes related to the Olympic Games, such as construction work associated with the East London Line extension, have so far been delivered on time and to budget. In 2007, TfL will take over responsibility and funding for the Silverlink Metro rail service in North London. Linking the East London Line extension with Silverlink will ultimately allow for a planned orbital rail route around the capital, although details of this plan have yet to be agreed with government.

The most significant infrastructure project proposal potentially affecting TfL is Crossrail, an East-West link across London that will entail a large amount of tunneling work. Crossrail is a 50/50 joint venture company between TfL and the Department for Transport (DoT), and financing for the estimated £10 billion project has yet to be finalized. We do not expect TfL to take on significant additional debt to fund Crossrail, or to take on associated project or operational risk, unless this is supported by additional government funding and other support. For this reason, we do not expect that the ratings on TfL would be fundamentally changed.

Meanwhile, TfL continues to face the ongoing challenges of managing the relationships and cost pressures associated with public-private partnership (PPP) contracts, especially those related to maintenance and refurbishment of the Underground network. Poor performance by the PPP contractors is reflected on TfL, and on London Underground Ltd. (LUL) in particular. At present, there is a risk that there could be an extraordinary review in 2007 of the PPP contracts assigned to Metronet BCV Rail Ltd. and Metronet SSL Rail Ltd., which may result in TfL having to pay out additional amounts to Metronet.

Outlook

The stable outlook reflects TfL's prudent approach to debt accumulation and its strong relationship with the U.K. government. TfL's planned increase in, and use of, debt is expected to be gradual, and consistent with its balance of operating revenues and expenses, and the level of government funding support. TfL's cash position is strong, and it has flexibility to reduce its investment program (with the exception of its Olympic commitments) and associated debt requirements in the event of unforeseen changes to its business-planning assumptions. That said, an adverse outcome from this year's Government Spending Review could put the rating under pressure. Furthermore, any unforeseen liabilities resulting from the extraordinary review of the Metronet PPP contracts, or from planned new infrastructure investments such as Crossrail, could also pressure the rating.

Organizational Background Links To GLA

TfL is an executive body of the GLA, responsible for providing an integrated transport service in London covering the London Underground system, buses, taxis, and strategic trunk roads. Although TfL is an executive arm of the GLA, it is constituted as a separate statutory body. Although TfL has a different credit-risk profile from the GLA, their strategic goals should be closely aligned because the Mayor of London, Ken Livingstone, is also chairman of TfL. The Mayor also appoints the Transport Commissioner for London, who heads the TfL executive management team.

TfL is subject to the support and constraints of the U.K. local government financing system, which translates into a variety of financial and regulatory controls that are significant credit strengths. These include a requirement to provide a balanced budget every year, restrictions on the amount of debt that can be raised, and a requirement for external audits. TfL has a five-year funding agreement with government, and funds are provided to TfL annually.

Legal Structure Outlines TfL's Statutory Powers

TfL is one of the four functional bodies of the GLA established by the Greater London Authority Act 1999 (the GLA Act). TfL's role is to discharge the GLA's transport-related duties, and it can only carry out activities that are within its statutory powers. As a statutory corporation, TfL may be subject to the appointment of a receiver by the High Court, in the event of nonpayment of financial obligations.

TfL has eight wholly owned subsidiaries: Transport Trading Ltd. (TTL), London Bus Services Ltd., London Buses Ltd., London Underground Ltd., Docklands Light Railway Ltd. (DLR), Victoria Coach Station Ltd., London River Services Ltd., and London Regional Transport Pension Fund Trustee Co. Ltd. TfL also holds a majority in London Transport Insurance (Guernsey) Ltd. TTL is the holding company for all the operating transport companies owned by TfL. Under the GLA Act, TfL must ensure that its subsidiary companies do not do anything that TfL itself does not have power to do.

The main operating companies generate their own revenues (principally fares), but these monies do not allow them to break even. The operating companies therefore rely on grant funding provided by the U.K. government to TfL via the GLA. The GLA has some powers to contribute additional transport funds via the council tax precept on Londoners. The level of funding that could be provided by the GLA, however, will amount to only a relatively small amount of additional income.

Government transport grants given to GLA are passed straight through to TfL. In the event that these transport grants are removed in their entirety from TfL, and the ratings on TfL are lowered to below investment grade, bondholders have the right to redeem the bonds. Standard & Poor's is of the opinion that the government, or a successor organization to TfL, would provide support to repay the bonds in the event that they were redeemed. There is, however, no letter of comfort provided by government to this effect. Furthermore, government support may not be timely.

Transport Demand Remains Strong

The business plan and borrowing strategy are set against a background of very strong demand. TfL has a near-monopoly in its specific transport markets in London.

London's population is estimated at 7.4 million, and the catchment area for commuting into the city covers a significantly larger number of people. The city's population is forecast to grow by about 800,000-1 million by 2016, which makes it different from most other major developedworld cities, where city populations are declining. London has a major financial and business services industry and is a major administrative and tourism center. The vast majority of commuters working in central London travel by public transport. Since the potential for increased road use is severely limited, significant increases in transport capacity, both bus and Underground, are therefore required to deal with the forecast growth.

Buses: Lower-than-expected fare increase in 2007 due to above-budget revenues in 2006

London buses carry more than 6 million passengers every weekday, and in the past year bus ridership levels have risen despite significant above-inflation increases in recent years. The rate of ridership increase has been slowing, although this year's lower-than-expected fare increase may help offset a further slowdown in demand. Further significant bus fare increases may be more difficult to achieve without adversely affecting demand, and this will need to be considered in the context of TfL's overall financial flexibility.

Underground: Demand inelasticity offers some flexibility for fare increases

LUL carries about 3 million passengers each weekday and accounts for more than one-third of all journeys to work in central London. Moreover, as many passengers use the Underground each day as use the entire U.K. rail network. As London's population continues to grow and its economy remains strong, demand is expected to continue to increase. Given the inelastic characteristics of demand for the Underground, there remains a degree of financial flexibility to increase fares above planned levels, although politically this could be difficult.

TfL is in a strong position regarding the delivery of public transport services in London within most of its markets. The only possible alternative transport competition is from private motor vehicles. Private-car use has reached saturation levels, with declines in recent years during peak travel periods because of London's serious peak-hour congestion. TfL's congestion charge has proved to be successful in reducing private-vehicle trips within central London, and the charge zone has now been extended to west London. The effect of the extension is expected to further increase demand for public transport.

Key Developments in 2006

Senior Management Changes Kept "In House"

TfL has a strong and experienced management team that has successfully delivered a number of important projects to date. Mr. Peter Hendy was appointed as the new Transport Commissioner by the TfL board in January 2006, and since then he has built on the disciplined management approach at TfL. In particular, Mr Hendy has focused on driving through cost-efficiency gains, tight project and contract management, and risk management. Mr Hendy was previously Managing Director of Surface Transport at TfL.

Mr Jay Walder, Finance Director, announced his decision to resign at the end of 2006. He will leave in April 2007. Mr Walder played a key role in negotiating funding settlements with Government and establishing TfL's investment plan and borrowing program. He is, however, supported by a strong finance team and his resignation is not expected to affect the outcome of negotiations with the DoT ahead of this year's Comprehensive Spending Review. Mr Walder will be replaced on an interim basis by Mr Steve Allen, currently Director of Corporate Finance at TfL. A permanent appointment is expected later this year.

PPP Infrastructure Companies Present Management Challenges

Operationally, LUL is divided into three units, and this division of the network is also reflected in the three PPP infrastructure company (Infraco) contracts. The three private sector Infracos (Metronet Rail SSL Ltd., Metronet Rail BCV Ltd., and Tube Lines (Holdings) Ltd.) are responsible for network renewal and maintenance, which over time will lead to operational and capacity improvements. The PPP contracts are for 30 years and are subject to a review every 7.5 years by an independent statutory arbiter. These periodic reviews allow for changes to service needs and unexpected cost pressures. Under the service contract, the Infracos are protected against higher costs that are deemed economic and efficient. As a consequence, the level of payment by LUL to the PPP contractors could change. In the event of any material change, Standard & Poor's expects the U.K. government to provide additional assistance to ensure that TfL meets any change to its obligations.

TfL remains liable for 95% of the £5 billion debt assigned to the PPP Infracos if a put option is exercised in the event of project default, and this risk is reflected in the rating on TfL. The DoT has strong incentives to step in to pay this obligation, which is treated as a contingent liability of the U.K. government and is supported by a letter of comfort. This support, however, is not legally binding and may not be timely.

Metronet Rail SSL and Metronet Rail BCV continue to lag behind schedule on their track renewal and station upgrade programs, due to problems with the Metronet consortium's supply chain. These operational concerns, coupled with the lack of progress in mitigating work delays, were reflected in the downgrade of the debt issued by the project companies to 'BBB' from 'BBB+' in 2005, and again to 'BBB-' from 'BBB' in 2006.

In 2006, the annual report of the arbiter confirmed that both Metronet Infracos did not perform in line with the required standards. Metronet is seeking clarification from the arbiter regarding certain project-specific areas, where Metronet argues it is performing work outside the original scope of its bid. A more formalized extraordinary review may take place in 2007 where the arbiter will be called on to decide whether the scope of the project or the fees paid to Metronet should be adjusted. Any additional financial burden will in the first place fall back on TfL, although it is likely that the U.K. government would provide additional financial support.

Tube Lines, meanwhile, appears to be performing to expectations on its Piccadilly Line works, and is ahead of its base case on the Jubilee Line works. Progress on the Northern Line has been below expectations, however, as a result of poor rolling stock and signaling performance. The rolling stock is provided by Alstom under a private finance initiative (PFI) contract that was originally agreed with LUL and then transferred to Tube Lines.

LUL also has separate PFI schemes outside the main PPP contracts. These have been in place for a number of years, and relate to radio communications and the power supply. The former (Connect) is behind schedule and over budget, and TfL remains subject to a claim by the PFI contractor for additional works. The delays mean that although drivers on certain lines already have the system, full implementation is now expected by the end of 2007.

TfL is also renegotiating LUL's contracts with Powerlink to upgrade the power-supply projects on the Underground system, and the approval of the renegotiated contracts is expected shortly. The upgrades are needed to support the main PPP projects. Powerlink has been issued with two formal warnings for contract underperformance and system power failure. Although additional costs of upgrading the power supply to the Underground system have been factored into the business plan, significant further amounts may need to be budgeted for beyond 2010. The amounts required will depend on the scope of works involved and how the renegotiated contract impacts LUL. TfL guarantees LUL's obligations under the separate PFI agreements.

TfL is also about to engage in a major new river crossing to the east of London under the U.K. government's PFI initiative, at a cost of about £500 million. Funding approval for the Thames Gateway Bridge has been granted by government and about £350 million of PFI credits have been agreed, with the remaining balance to be generated from toll revenues. The project is subject to planning permission, and ultimately needs authorization by the Secretary of State.

Congestion Charge Zone Expands West

The congestion charging zone was extended to parts of west London in mid-February 2007. Congestion charging produces a relatively small amount of net revenue compared with TfL's overall budget, and its principle objective is environmental improvement rather than revenue generation.

The extension of the congestion charge zone may further increase demand for buses and the Underground, which would further strengthen TfL's financial position.

Adjustments Deliver A Balanced Business Plan

TfL has produced a balanced five-year business plan reflecting its program of investment, the levels of grant funding, increases in fare revenues, and its borrowing plans. TfL outperformed its business plan in 2005-2006, in part due to lower operating costs, improvements in working capital, as well as increased fares, charges, and higher-than-expected patronage levels against increased fares and charges. Capital projects delayed in 2005 (partly due to planning delays) were carried forward into 2006 and progress made in terms of delivering these projects.

The 2006/2007 five-year business plan was adjusted to take account of these investment program delays and reconfigurations, and the transfer of new responsibilities such as the Silverlink Metro rail service. The plan also reflects changes to underlying assumptions regarding demand and fare levels.

In addition to the reprofiling of the investment program, some projects have been added that will be funded from increased revenues and savings. There will be no additional debt over and above that agreed in the original five-year business plan set out in 2004.

Given that revenue trends have been above forecast in recent years, TfL has adjusted its income projections to reflect in particular the lower-than-expected level of disruption arising from planned works by PPP contractors, and the strong London economy. Despite the lower-than-expected bus fare increase in 2007, fare revenues in the latest business plan are greater than the original plan as a result of higher-than-expected passenger volumes.

The business plan incorporates operating savings of about 4% per year. The majority of forecast savings will come from back-office efficiencies arising from the integration of LUL and TfL. This includes savings in procurement, marketing, and internal business services. Additional operating savings have been identified from the introduction of cashless buses, leveraging benefits from the already-established Oyster card (a prepaid ticket card) and communications efficiencies.

Achieving the projected year-on-year savings will be challenging, particularly as savings from technological improvements could be offset by cost pressures elsewhere—trade union demands for high wage settlements, for example. TfL also faces other cost pressures that are largely outside its control, notably regarding energy and insurance. It may also face additional pressure to increase its expenditures related to security, although most of any additional unforeseen costs are expected to fall on the Metropolitan Police.

Although TfL has a pensions deficit, it has an agreement with the government to fund this. The combined deficit in March 2006 was about £769.9 million, down from £960.7 million the previous year. The additional cash needed each year to eventually clear the deficit is built into the funding agreement with the government.

Borrowing Strategy And Projections Provide Flexibility

Total direct borrowing at the end of the business plan period in 2010 is forecast to be about £3.3 billion, which will represent about 60% of total income less money received for PPP payments. The proposed debt to be raised will not be earmarked for specific projects; instead, it will be used to finance a range of projects set out by TfL that reflect the Mayor's transport priorities. The variety and range of projects will give TfL good flexibility to adjust the investment program in response to unforeseen events.

Future borrowing will continue to be a mix of funding types and maturities. The overall objective of the strategy is to match maturities with the asset lives of the investments in the program. Meanwhile, TfL's cash balances provide a buffer against unforeseen variations and should provide further comfort to investors.

In March 2006, TfL issued £200 million of bonds under its MTN program. Together with its borrowing from the Public Works Loan Board (PWLB) and the European Investment Bank (EIB; AAA/Stable/A-1+), TfL's borrowing for the financial year 2005/06 was £550 million as planned. In financial 2006/2007, TfL has an approved borrowing limit of £604 million, consistent with its business plan. In December 2006, TfL issued a further £200 million of bonds under its MTN program.

Potential For Adjustments to Investment Program

TfL's non-PFI/PPP investment program contains a diverse number and type of projects. There is flexibility to delay some of these projects, although those promised in support of the London Olympic Games in 2012 are time-specific. In addition, there are only a few large schemes that, once committed to, could expose TfL to certain project-management risks. The main project in the investment plan is the East London Line extension (ELLX), projected to cost about £900 million. This represents 15% of all non-PFI/PPP capital investment work.

The construction risks associated with the ELLX are relatively low compared with other recent Underground extensions such as that for the Jubilee Line. The ELLX does not involve any new tunneling work, and in part follows existing, or disused, overground rail lines. TfL has undertaken a full risk assessment and has included a significant risk allowance over the expected capital cost. This includes some additional flexibility to allow for interim works to extend the East London Line even further, and an additional contingency allowance for unforeseen risks. The cost estimates are based on best practice and full outturn prices from recent Underground projects, and have been rigorously tested by designers and quantity surveyors.

There are other substantial projects in the program, but they are significantly smaller than the ELLX. The costs of the western extension of the congestion charge, various PPP enabling works, Stratford International DLR, and the Tottenham Court Road station upgrade, for example, total about two-thirds of the cost of ELLX. Appropriate contingency levels have been factored into the program for these and other projects. Progress in terms of running to time and to budget will be key credit considerations, and will be continually monitored by Standard & Poor's.

The majority of the projects in the investment program, however, are much smaller in size and scope. They include cycle paths, bus shelters, and bus-lane enforcement cameras. This means that

TfL has considerable flexibility to cut back its spending on its investment program quickly, if required. Even the larger projects can be revised given appropriate lead times.

Upcoming Government Spending Review Is Crucially Important

TfL's grant funding is set out in a letter it received from the DoT dated July 20, 2004. The agreement provides five years of certainty regarding funding. Although the agreement is not a legal commitment by government, the letter states that: "the Secretary of State will take all possible steps to avoid any deviation from this funding plan." It confirms that the additional income from planned fare increases will not be used to reduce the Secretary of State's commitments under the agreement. This letter has been placed in the public domain on the Web sites of the DoT and TfL.

The Mayor's transport plan for London remains consistent with the U.K. government's transport objectives and strategic direction, and this underpins the funding agreement with the government. Furthermore, improvements in London's transport infrastructure will play a key role in the 2012 Olympic Games, which are strongly supported by the government. Following the successful Olympic bid, the government has made additional funding of about £200 million available for a number of Games-specific projects.

The Comprehensive Spending Review in 2007 is expected establish TfL's funding level for the years beyond the current business period, which runs to 2010, by rolling forward the five-year funding agreement. The funding settlement may have implications for the costs of the second 7.5-year period of the PPP contracts, which occurs after this date. Projections of scheduled PPP payments for the second period (which are currently not binding on the Infracos) are projected to rise substantially above current levels. The government faces significant spending pressures from other departments, and an unfavorable settlement could have adverse credit implications for TfL.

Fare Revenues Are Above Target

The recently implemented London Underground fare increases are slightly higher than inflation, but within past fare-increase levels. The recently implemented changes to bus fares in 2007, on the other hand, are below the increases originally set out in the five-year plan. The lower increases in bus fares are due to the fact that demand was higher then expected in 2006 and ticket revenues were £45 million ahead of budget in 2006/2007. The reduction in bus-fare increases therefore does not have a significant impact on the revised business plan. Over the next few years, bus fares are set to increase by RPI plus 2% per year, while Underground fares are set to increase by RPI plus 1%.

Above-inflation fare increases on both the Underground and buses have not materially affected demand, and revenue growth has been strong. That said, the Underground is vulnerable to changes in London's economic position, and to customers being turned away by service disruption. To date, however, Underground fare revenues have been ahead of forecasts, despite disruption due to line closures. Furthermore, there is no indication the London's economy will slow down in the foreseeable future.

Service Level Flexibility Is High

In addition to having the flexibility to cut back its planned investment program and reduce the need to increase debt, TfL also has a high degree of flexibility to cut back services if required. Buses, for example, have low fixed costs, and service levels can be reduced within TfL's planning horizon in response to changes in business-plan assumptions.

Financial Summary

The following data shows TfL's financial performance, as well as its business plan forecasts for the next four years.

Transport for London Financial Summary and Business Plan 2004-2010f*

	—Year ended March 31—						
(Mil. £)	**2010f**	**2009f**	**2008f**	**2007f**	**2006a**	**2005a**	**2004a**
Income							
Fares	2,986.4	2,825.8	2,660.2	2,482.1	2,290.4	2,155.1	1,968.7
Congestion charging	347.7	358.7	341.2	257.7	254.1	244.2	168.8
Other income	421.9	372.5	330.5	297.4	280.8	180.6	172.7
Investment income	22.8	40.2	65.2	59.3	55.0	52.6	12.8
Total income	3,778.7	3,597.1	3,397.2	3,096.6	2,880.3	2,632.5	2,323.0
Expenditures							
Operating costs¶	(4,521.8)	(4,388.4)	(4,152.4)	(3,862.3)	(3,584.1)	(3,239.0)	(2,878.9)
Capital projects through PFI/PPP schemes	(1,795.5)	(1,617.3)	(1,553.1)	(1,496.7)	(1,410.9)	(1,215.6)	(1,292.6)
Other capital expenditures§	(1,257.6)	(1,579.1)	(1,240.2)	(734.9)	(712.9)	(558.9)	(393.3)
Third-party funding	165.3	220.0	186.4	185.3	174.7	123.9	169.0
Contingency	(28.0)	(28.0)	(27.0)	(26.0)	0.0	0.0	0.0
Debt service	(151.2)	(106.2)	(70.2)	(58.4)	(10.6)	(3.5)	0.0
Net expenditure	(3,810.0)	(3,901.9)	(3,459.2)	(2,896.5)	(2,663.5)	(2,260.5)	(2,072.8)
Working capital and reserve transfers	372.0	358.9	249.2	(108.5)	(102.5)	(193.3)	(522.1)
External funding sources							
Total transport grant	2,826.0	2,781.0	2,598.0	2,389.0	2,196.0	2,232.0	2,537.1
Precept	12.0	12.0	12.0	12.0	20.0	25.8	57.8
Borrowings	600.0	750.0	600.0	604.0	550.0	196.0	0.0
Balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0

*On a cash basis. ¶Net of PFI/PPP and support payments. §Net of overprogramming (that is, a provision which allows TfL to utilize total funds allocated despite delays due to consultation, planning, and authorization). a—Actual. f—Forecast. PFI—Private finance initiative. PPP—Public-private partnership.

Ratings Detail (As Of 01-Mar-2007)*	
Transport for London	
Issuer Credit Rating	AA/Stable/—
Senior Unsecured	
Local Currency	AA
Issuer Credit Ratings History	
12-Mar-2003	AA/Stable/—
18-Oct-2001	AA/Negative/—
05-Jun-2000	AA/Stable/—

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.