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CREDIT OPINION
23 November 2023

Update

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RATINGS

Transport for London

Domicile	United Kingdom
Long Term Rating	A3
Type	Senior Unsecured - Dom Curr
Outlook	Positive

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 upgrade to A3, positive outlook

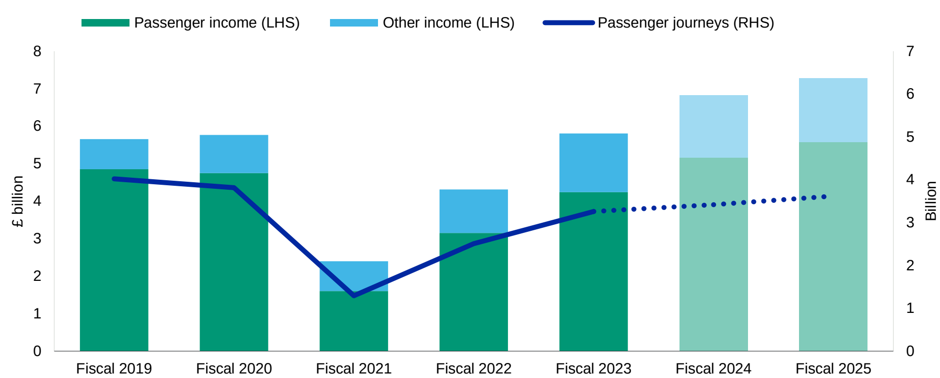
Summary

The credit profile of Transport for London (TfL, A3 positive) reflects its improved operating performance driven by fast recovery in passenger numbers, strong governance and strategic importance in London, offset by a weakened operating environment with funding uncertainty and rising debt levels. It also reflects a strong likelihood of extraordinary support from the government of the United Kingdom (Aa3 stable).

Exhibit 1

TfL's turnover is expected to continue increasing over the next two years

Passenger income, other income and passenger journeys



Fiscal year ends are 31 March. Fiscals 2024 and 2025 are forecasts based on TfL's December 2022 business plan.
Source: TfL and Greater London Authority

Credit Strengths

» Strategic importance for the local and national economy

» Significant improvement in operating performance expected to continue

» Robust management and governance with track record of cost containment

» Strong access to liquidity

Credit Challenges

» Unpredictability in the operating environment

» Significant capital programme amid funding uncertainty

» Debt to increase, but turnover growth will support stable debt metrics

Rating Outlook

The positive outlook reflects our forecast that risks around TfL's financial performance are skewed to the upside, driven by potentially stronger passenger and non-fare income than currently assumed. Passenger traffic is still adjusting to post-pandemic ways of living and working. Meanwhile, TfL is building its non-fare income with potentially stronger results in the next few years. Combined with a consistent focus on cost savings, as well as a moderate capital programme, this would result in larger operating surpluses and stable leverage.

Factors that could lead to an upgrade

Upward pressure on the ratings could result from a sustained improvement in operating performance, leading to growing operating surpluses, without resort to reductions in key capital enhancements that would be detrimental to the quality of service over the longer term. A multi-year funding agreement to finance TfL's capital programme with minimal conditions could also exert upward pressure on the ratings.

Factors that could lead to a downgrade

The positive outlook indicates that a downgrade is unlikely in the near term. Downward pressure on the ratings could result from weaker than anticipated operating performance which looked likely to last and would prevent TfL from achieving the projected financial sustainability. A decrease in government support, including significant underfunding of TfL's capital programme or an agreement which imposes unachievable conditions on TfL, leading to a deterioration in the quality of services, could also negatively impact the ratings.

Key Indicators

Exhibit 2

Transport for London

	Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022	Fiscal 2023
Own Source Revenues / Total Revenues (%)	65.1	63.7	33.6	49.8	62.0
Grants / Total Revenues (%)	34.7	36.1	66.3	50.2	37.7
Farebox Recovery Ratio (%)	64.2	61.4	21.6	40.6	49.9
Net Margin (Operating Surplus / Operating Revenues, %)	15.8	18.6	12.0	19.8	21.6
Interest / Operating Revenues (%)	6.1	8.1	17.2	8.9	8.7
Debt / Revenues (x)	1.5	1.8	2.3	1.9	1.7

Fiscal year ends are 31 March.
Source: TfL and Moody's Investors Service

Detailed credit considerations

On 15 November 2023, we upgraded TfL's baseline credit assessment (BCA) to baa2 from baa3 and long-term ratings to A3 from Baa1, affirmed the short-term ratings at Prime-2 and changed the outlook to positive from stable. The rating action reflects the improvement in TfL's operating performance, reducing the need for financial support to achieve operating surpluses from fiscal 2024 (year ending 31 March 2024), and the more moderate capital programme following the completion of the Elizabeth line, leading to stable leverage.

TfL's ratings combine: (1) a BCA of baa2; and (2) a strong likelihood of extraordinary support coming from the UK government in the event that TfL faced acute liquidity stress.

Baseline Credit Assessment

Strategic importance for the local and national economy

TfL's credit profile benefits from its scale and very strong market position. It is the UK's largest urban transit system and one of the world's largest. Serving a large population of nearly ten million in London with minimal competition, it plays a crucial role in the city, which contributes close to 25% of the national Gross Domestic Product. The future economic growth of London and the capacity of its public transportation system are closely linked, making them significant policy concerns for citizens, businesses and local and national governments.

Before the pandemic, TfL's underground, bus and rail network provided around 4 billion passenger journeys annually. However, the pandemic led to a significant decline in passenger numbers, dropping to 1.3 billion journeys in fiscal 2021. Since then, there has been a strong recovery, with annual ridership rising to 3.3 billion in fiscal 2023. Although we anticipate that passenger journeys will remain below pre-pandemic levels in the medium term, TfL has a very high utilization ratio (annual ridership relative to the service area population) of 338 in fiscal 2023, demonstrating the widespread use of public transportation.

TfL is a key functional body of the Greater London Authority (GLA). Its board is chaired by the Mayor of London, who is also in control of board appointments.

Significant improvement in operating performance expected to continue

TfL's operating performance has significantly improved since the pandemic, underpinned by a robust growth in passenger numbers, which reached 90% of pre-pandemic levels since the beginning of fiscal 2024. This recovery has been supported by growth in London Underground traffic, currently at 85% of pre-pandemic levels, and the launch of the Elizabeth line in May 2022, which recorded 150 million passenger journeys in its first year and surpassed revenue projections. In conjunction with an average fare increase of 5.9% implemented in March 2023, TfL anticipates passenger income of £5.2 billion in fiscal 2024, exceeding pre-pandemic figures. We project a sustained increase in passenger revenue over the next few years, underpinned by robust passenger trends and annual fare rises.

In addition, TfL has effectively generated new income streams, thereby boosting and diversifying its revenue base. Non-fare income, excluding grants, has doubled from fiscal 2019 figures to £1.6 billion in fiscal 2023. We forecast continued growth, especially following the November 2022 announcements regarding the expansion of the Ultra Low Emission Zone (ULEZ), a road user charge, across all of London from August 2023. ULEZ charges contributed £480 million to income in fiscal 2023 and TfL's estimates suggest that the London-wide ULEZ could generate an additional £200 million in net revenues annually for the initial two years.

During the pandemic, TfL was heavily reliant on extraordinary government grants to fund its operations, often in the form of short-term, last-minute funding agreements. However, due to the significant increases in revenue and the organisation's strong focus on cost containment, we expect that TfL will achieve an operating surplus in fiscal 2024, even without the modest government grants received so far. Looking ahead, we expect TfL to maintain its financial sustainability, meaning it will not be dependent on government grants for its operations, mitigating the risks from the unpredictability in government funding.

Robust management and governance with track record of cost containment

TfL's governance and management is strong, as demonstrated by a consistent ability to achieve cost efficiencies. It successfully implemented a major transformation programme since 2016, resulting in approximately £1.2 billion in recurring cost savings through various initiatives, including reducing layers in the organisation, consolidating functions and negotiating contracts. This allowed it to adapt to a lower grant environment and improve its long-term financial sustainability.

Under the current funding agreement with the Department for Transport (DfT), TfL is required to identify an additional £600 million in real term recurring cost savings by fiscal 2026, with £92 million already achieved in fiscal 2023. TfL plans to accomplish those savings through improvements in working practices and supply chain management. Although we anticipate that TfL will deliver the majority of these savings, given its strong track record of cost efficiencies, it may fall short of the target due to the extent of cost savings already realised and the potential risk of employee strike action. Persistent high inflation also poses challenges, impacting operating costs such as staff pay, concessionary contracts and fuel expenses. As a result, we expect that like-for-like costs will rise over the next two years, despite these further efficiency gains. Nevertheless, we project that the increase in costs will be counterbalanced by stronger revenue growth, resulting in growing operating surpluses.

TfL's strong governance and management is also reflected in the accuracy of its budgeting, quality of data analysis and transparency of information. Key documentation, including budgets, business plans and board meeting notes, is publicly available. Detailed information on significant policy changes which impact TfL, such as new road user charges, is also available from the GLA. Furthermore, TfL does comprehensive data analysis, such as its annual Travel in London report, which provides insights into passenger trends and key developments.

Strong access to liquidity

TfL benefits from a diversified investor base and can borrow from the Public Works Loan Board (PWLB), a statutory body within the UK Debt Management Office, which could serve as a potential lender of last resort, thus reducing the risk of liquidity shocks. For short-term liquidity requirements, TfL's £2 billion European Commercial Paper programme allows for rapid and flexible access to liquidity.

TfL has a policy of maintaining a minimum cash level equivalent to 60 days of operating expenses on average. Under the current funding agreement with the DfT, TfL is required to maintain average quarterly cash balances not exceeding £1.2 billion, resulting in lower liquidity levels compared to previous years, but still in compliance with its liquidity policy. We anticipate that TfL will gradually increase its cash balances after the expiration of the current funding agreement in March 2024 in order to continue adhering to its liquidity policy, as operating expenses are expected to rise with the introduction of new services.

Unpredictability in the operating environment

The stability and predictability of TfL's funding subsidies and policy support from the UK government have experienced a fundamental deterioration since the onset of the pandemic. This is demonstrated by the difficulties in agreeing funding support, which during the pandemic has been provided through numerous funding agreements, many of which were agreed upon or after the expiration of the previous agreement. These agreements have generally been short-term, with multiple extensions.

In August 2022, the DfT and TfL reached a more extended funding agreement, offering medium-term certainty. This agreement stipulates that the DfT will cover any deficit in passenger income below £4.5 billion in fiscal 2023 and £5.2 billion in fiscal 2024. This arrangement mitigates the risks associated with passenger numbers and allows TfL to maintain balanced budgets for these two years. Given the strong recovery in passenger income, we do not anticipate that TfL will need additional top-up grant funding in the future.

Nonetheless, the ongoing uncertainty surrounding TfL's long-term capital funding framework continues to affect its credit strength. Although the government has indicated its willingness to support TfL's capital programme through a multi-year funding agreement, no agreement has been finalised yet. We expect that a funding agreement will be agreed by 31 March 2024, when the current agreement expires; however, the terms and duration of a new agreement remain uncertain.

Significant capital programme amid funding uncertainty

TfL requires significant capital expenditures to maintain and improve its services. Over the next three years, TfL has earmarked a total of £6.4 billion for capital expenditures, divided between capital enhancements (£4.0 billion) and capital renewals (£2.4 billion).

The level of capital expenditure during the pandemic has been impacted by uncertainty over funding, coupled with drastic reductions in passenger revenues. However, the DfT's funding agreement in August 2022 has facilitated the execution of key capital projects by providing significantly greater capital and revenue visibility until the end of fiscal 2024. In fiscal 2023, TfL spent £1.4 billion on capital enhancements and £0.6 billion on capital renewals. The funding agreement made provisions for funding major projects such as the Northern line extension, the Jubilee and Northern line rail enhancements, Piccadilly line rolling stock replacement and the completion of the Elizabeth line.

TfL will continue to undertake significant capital enhancement projects, including signalling, modernisation and rolling stock and station upgrades, all aimed at enhancing service and capacity across the existing network. TfL has also earmarked investments for its Healthy Streets project, which includes improvements in the walking and cycling infrastructure. However, the long-term capital funding framework remains uncertain at this stage. If government funding does not align with the expectations outlined in TfL's business plan, TfL will either need to increase its borrowing beyond current expectations or make cuts to critical projects, potentially resulting in a gradual decline in service quality.

Although significant, we note that the level of capital expenditures has significantly reduced from historical levels. Capital expenditures averaged £3.3 billion between fiscals 2017 and 2020, mostly driven by the Elizabeth Line project, which was fully completed in November 2022.

Debt to increase, but turnover growth will support stable debt metrics

TfL's debt is high and expected to gradually increase to finance the capital expenditure programme. In fiscal 2023, TfL's debt (inclusive of finance leases) stood at £15.2 billion and debt to revenues at 1.7x. Based on TfL's latest business plan, total debt will increase to £16.2 billion by fiscal 2026; however, debt metrics are projected to remain stable, driven by robust revenue growth, and we expect that debt to revenues will continue to average 1.7x over the next three years. Nonetheless, the pace of debt growth remains contingent on the amount of capital funding received by the government over the next three years.

TfL's three-year average interest to operating revenues was 11.6% in fiscal 2023, a significant rise from pre-pandemic levels of 5.5% in fiscal 2019. However, this ratio is forecasted to improve to around 8% over the next three years, supported by turnover growth. TfL's exposure to interest rate risk remains limited, with 93% of debt at fixed rates as of October 2023.

Under the Prudential Code, TfL has the ability to borrow for capital purposes up to a limit approved by the mayor, subject to reserve powers retained by the government. We expect TfL to remain significantly below this limit, currently set at £17.9 billion by fiscal 2026. Additional debt will be issued by TfL's commercial property company, Places for London Limited (formerly TTL Properties Limited), but this subsidiary is financially independent and the debt will be non-recourse to TfL.

TfL's total pension deficit, which is currently excluded from TfL's debt, has significantly reduced. The deficit decreased to £88 million in fiscal 2023, down from £3.2 billion in fiscal 2022, driven by the rise in discount rates. The most recent valuation of the TfL Pension Fund technical provisions, carried out in March 2021, showed an improved position from three years prior, with a funding level of 101%. As part of the funding agreement with DfT, TfL was required to present viable options to reduce future pension liabilities by approximately £100 million annually, a proposal that was met with strong opposition from unions. In response to the threat of widespread strikes in the summer of 2023, TfL committed to a three-year moratorium on any changes to pensions.

Extraordinary Support Considerations

The strong level of extraordinary support factored into the ratings reflects the importance that the transport system and infrastructure improvement in London has for the UK, as evidenced by the funding agreements with the government.

ESG considerations

Transport for London's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
ESG Credit Impact Score

CIS-3
Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

TfL's **CIS-3** reflects our view that ESG risks have a materially negative impact on its ratings. TfL has high expenditure requirements related to carbon transition and pollution, as well as exposure to social risks from ridership trends, inflation and a unionised workforce. Governance risks emerge from increased government control and oversight following the pandemic.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	S-3	G-3
Moderately Negative	Moderately Negative	Moderately Negative

Source: Moody's Investors Service

Environmental
TfL has a material exposure to environmental risks (**E-3**), relating to its central role in realising the Mayor of London's vision for a carbon-neutral city by 2030. To meet these environmental objectives, TfL is required to expand the scope of road user charging to reduce pollution, upgrade its bus fleet and transition to fully renewable energy for all rail services.

Social
TfL has a material exposure to social risks (**S-3**), with the shift to hybrid work models predicted to result in a permanent ridership decline compared to pre-pandemic levels, despite its monopoly in London. High inflation, impacting discretionary spending, could further negatively affect ridership. Fare increases, being a politically sensitive issue, are uncertain. Moreover, the unionised nature of TfL's workforce could make changes to staff pay, working conditions and pension schemes challenging, potentially leading to increased instances of strike action.

Governance
TfL has a material exposure to governance risks (**G-3**) due to increased government control and oversight following the pandemic as part of the extraordinary funding arrangements. TfL must comply with numerous stringent conditions outlined in the funding agreements, including identifying cost savings, exploring new revenue streams, looking into potential changes to pensions and assessing the feasibility of driverless trains. These conditions require resource allocation and influence strategic decisions. The occasionally contentious relationship with the government also weakens TfL's credit profile. However, these risks are balanced by

TfL's strong management practices, characterised by a clear strategy, comprehensive budgets and business plans and a high level of transparency.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of baa2 is two notches below the scorecard-indicated BCA of a3. This reflects the decreased policy support from the UK government and the uncertainty over the long-term capital funding programme, which continue to affect TfL's credit strength.

TfL's ratings reflect our assessment of the company's business profile and financial performance in line with our Mass Transit Enterprises Methodology, published in December 2017, and our Government-Related Issuers Methodology, published in February 2020.

Exhibit 5
Fiscal 2023 scorecard

Global Mass Transit Enterprises Methodology	Measure	Score
Factor 1: Size (15%)		
a) Issuer Size - Annual Ridership (Million)	3259	Aaa
b) Market Size - Service Area Population (Million)	10	Aaa
Factor 2: Market Position (35%)		
a) Operating Environment	Baa	Baa
b) Service Area Characteristics	Aaa	Aaa
c) Market Share - Utilization (%)	338	Aaa
Factor 3: Financial Flexibility (20%)		
a) Level of Self-Support - Farebox Recovery Ratio (%)	49.9%	Aa
b) Budget Flexibility (3-Yr Avg Fixed Costs as % of Operating Expenditures)	30.7%	Ba
Factor 4: Debt & Financial Metrics (30%)		
a) Leverage - Debt / Revenues	1.7x	Baa
b) Budget Balance - 3-Yr Avg Interest as a % of Operating Revenues	11.6%	Baa
c) Budget Balance - 3-Yr Avg Net Margin (Operating surplus / revenues)	17.8%	Aaa
d) Liquidity - Days Cash on Hand	60	A
Adjustments / Notching Factors		
Factor 2: Market Position		
1) Challenges adopting adequate fare increases	-0.5	
Factor 3: Budget Flexibility		
3) Collective bargaining or high labor costs that decrease financial or operational flexibility	-1	
5) Other analyst adjustment to Budget Flexibility	-0.5	
Rating		
a) Indicated Rating from Grid after Notching Adjustments	a3	
b) BCA assigned	baa2	
c) Actual Rating Assigned	A3	

Source: TfL and Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
TRANSPORT FOR LONDON	
Outlook	Positive
Baseline Credit Assessment	baa2
Senior Unsecured -Dom Curr	A3
Commercial Paper -Dom Curr	P-2

Source: Moody's Investors Service

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