Research Update:

Transport for London Upgraded To 'AA-/A-1+' On Post-Pandemic Recovery; Outlook Stable

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PRIMARY CREDIT ANALYST

Noa Fux
London
+ 44 20 7176 0730
noa.fux
@spglobal.com

SECONDARY CONTACTS

Felix Ejgel
London
+ 44 20 7176 6780
felix.ejgel
@spglobal.com

Natalia Legeeva
London
44 20 7176 0618
natalia.legeeva
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Overview

- We forecast that Transport for London (TfL, the authority), a near-monopoly provider of public transportation in London, will gradually improve its financial performance due to strong demand for its service.
- We expect that debt build-up will be contained, with larger surpluses used to invest in existing assets and new projects.
- We therefore raised our long-term issuer credit rating (ICR) to 'AA-' from 'A+' and short-term ICR to 'A-1+' from 'A-1' on TfL. The outlook is stable.

Rating Action

On May 20, 2024, S&P Global Ratings raised its long- and short-term ICRs to 'AA-/A-1+' from 'A+/A-1' on Transport for London. The outlook is stable.

Outlook

The stable outlook reflects our view that increasing ridership and TfL's proactive management will improve the authority's performance. This is despite the end of the COVID-19 pandemic-related extraordinary support from the U.K. (AA/Stable/A-1+) government and uncertainty regarding future long-term capital funding.

Downside scenario

We could lower our ratings if we saw TfL loosening financial controls, or if it engages in large projects that would require material debt intake. We could also lower the rating if we perceived a change in the willingness of the U.K. government to support TfL.

Upside scenario

We could raise our ratings on TfL if additional substantial revenue improves financial forecasts, such that TfL's S&P Global Ratings-adjusted debt-service coverage ratio (DSCR) will improve on a sustained basis.

Rationale

The upgrade reflects our expectation that demand for TfL's services will remain high. This, together with management's continued cost-efficiency measures, would support TfL's ability to cope with external shocks and rebuild flexibility within its operations. We anticipate that TfL's performance will recover to pre-pandemic levels and remain structurally sound, allowing it to gradually increase its investments in assets and improve the level and quality of its services.

Enterprise profile: Near-monopoly status in an economically vibrant service area supports demand for TfL's services

TfL benefits from a near-monopoly business position operating an essential mass transit system in the very large and affluent London metropolitan area. We view its activities as having a low industry risk relative to other industries. The authority's solid economic fundamentals are underpinned by its area of operations. This is characterized by a very high GDP per capita, which we estimate at more than $71,000 (about £57,000) in fiscal year 2024 (ending March 31), about 40% higher than the national average. We expect London's strong and diverse economy, with a population of about nine million, will support demand for TfL's services.

We anticipate that TfL's market position will improve and be resilient to external pressures, despite ridership not yet fully recovered to historical peaks of four billion journeys per annum. In fiscal 2024, we estimate that passenger income reached a new peak, of just over £5 billion, about 6% above the average of the three pre-pandemic years. In our view, the full opening of the Elizabeth line and additional services offerings, the continued economic recovery, and population growth in TfL's service area underpin the solid demand for TfL's services. At the same time, we note that challenges related to behavioral changes regarding the use of public transit, such as increasing working and studying from home and online shopping, remain.

Our assessment of TfL's management and governance is underpinned by a positive track record of achieving cost savings and arranging funding for operations and large unique infrastructure projects. In our view, despite the complex structure and diversified operations, TfL ensures there are built-in buffers in its business plans, and deviations from budgets are small. We note some previous weaknesses related to the management of the large Crossrail project, resulting in material delays and cost overruns. Furthermore, there is still some uncertainty around its long-term financial framework defining future sources of income and quality of services, which needs to be agreed between TfL, Greater London Authority (GLA; AA/Stable/A-1+) and the Department for Transport (DfT).

Financial profile: Sound operating performance, contained debt-build up, and exceptional access to external liquidity

We forecast TfL's financial performance to remain sound, with its DSCR remaining between 1.25x and 2x in the next three years. TfL will bear the risks of inflation, ridership, and strikes as of fiscal

2025. This follows the end of its settlement with the central government, which offered some safeguards to these risks. We expect that TfL will adequately balance external risks, with continued efforts to diversify its revenue sources and seek operating efficiencies, without increasing risks to its operations.

We think these measures would also help TfL to build in flexibility to cope with uncertainty surrounding revenue growth. The mayor of London controls a substantial part of TfL's fares and can limit their increases. We expect that the GLA will largely compensate TfL in case of future fares restrictions, to not weaken TfL's financial position and operations.

Furthermore, we anticipate TfL's debt burden to only moderately grow until fiscal 2027. Our expectation that a large part of the capital program will be financed by operating cash flows and small capital revenues underpins this. Our debt assessment includes debt-like obligations, such as material operating leases and private finance initiative (PFI) liabilities. We understand the latter will see an increase in fiscal 2025, with the opening of the Silvertown tunnel, which is financed via a PFI arrangement. Therefore, we forecast TfL's debt will increase by about 15% in the coming three years through fiscal 2027, to about £17.5 billion, but remain below 10x of its net revenue. We expect additional large projects will be executed if TfL, GLA, and the DfT agree on a capital funding arrangement, which will likely only happen following the U.K.'s general elections later in 2024. We positively note that TfL was previously able to modify its capital program to better match it with availability of funding, implying some flexibility in its plans.

We consider TfL's liquidity position to primarily reflect its solid access to external liquidity sources, while we consider its own cash holdings compared to its size of operations and debt to be relatively weak. TfL adheres to a strict policy of holding sufficient cash to cover 60 days of operating expenditure (opex), which equals roughly £1.3 billion in fiscal 2025. We forecast that through fiscal 2027, TfL's unrestricted cash on hand, including its £200 million of credit facilities, will represent about 70 days of opex--and just below 10% of total debt.

In our view, TfL simultaneously maintains exceptional access to external sources of liquidity, via the Public Works Loan Board (PWLB) and capital markets, mitigating the weaknesses of its intrinsic low cash levels. 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. The GLA also retained the £350 million credit line it provided TfL to balance its budget, in case of need.

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, with significant contribution to the regional and national economy; and
- The very strong link between TfL and the U.K. government. Representatives of the DfT attend TfL's board meetings, allowing for strong oversight of its financials, business plan, and borrowing. The central government also provides ready access to reliable liquidity sources via the PWLB and have provided material extraordinary support during the pandemic. 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 note elevated governance and social risks. We think the regulatory framework under which the authority operates will evolve, especially with regard to the distribution of responsibility for financing between the central government, GLA, and TfL. Furthermore, TfL could be affected by union industrial actions due to disputes around pay and working conditions.

Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Economic fundamentals	1
Industry risk	2
Market position	2
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	AA-

S&P Global Ratings bases its ratings on non-profit transport and infrastructure enterprises on the seven main rating factors listed in the table above. S&P Global Ratings' "Global Not-For-Profit Transportation Infrastructure Enterprises: Methodologies And Assumptions," published on Nov. 2, 2020, summarizes how the seven factors are combined to derive each enterprises' 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

Related Research

- United Kingdom, April 22, 2024
- Transport for London Fare Freeze: Yet Another Twist, Jan. 22, 2024
- Greater London Authority ‘AA/A-1+’ Ratings Affirmed; Outlook Stable, Sept. 29, 2023

Ratings List

Upgraded

	To	From
Transport for London		
Senior Unsecured	AA-	A+
Commercial Paper	A-1+	A-1

Upgraded; Outlook Action

	To	From
Transport for London		
Issuer Credit Rating	AA-/Stable/A-1+	A+/Positive/A-1