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Transport for London (UK)

Crossrail delay adds to budgetary challenges, but project remains critical to TfL's financial sustainability

RATINGS

Transport for London

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Long Term Rating	Aa3
Type	Senior Unsecured - Dom Curr
Outlook	Stable
Senior Unsecured -Dom Curr	Aa3
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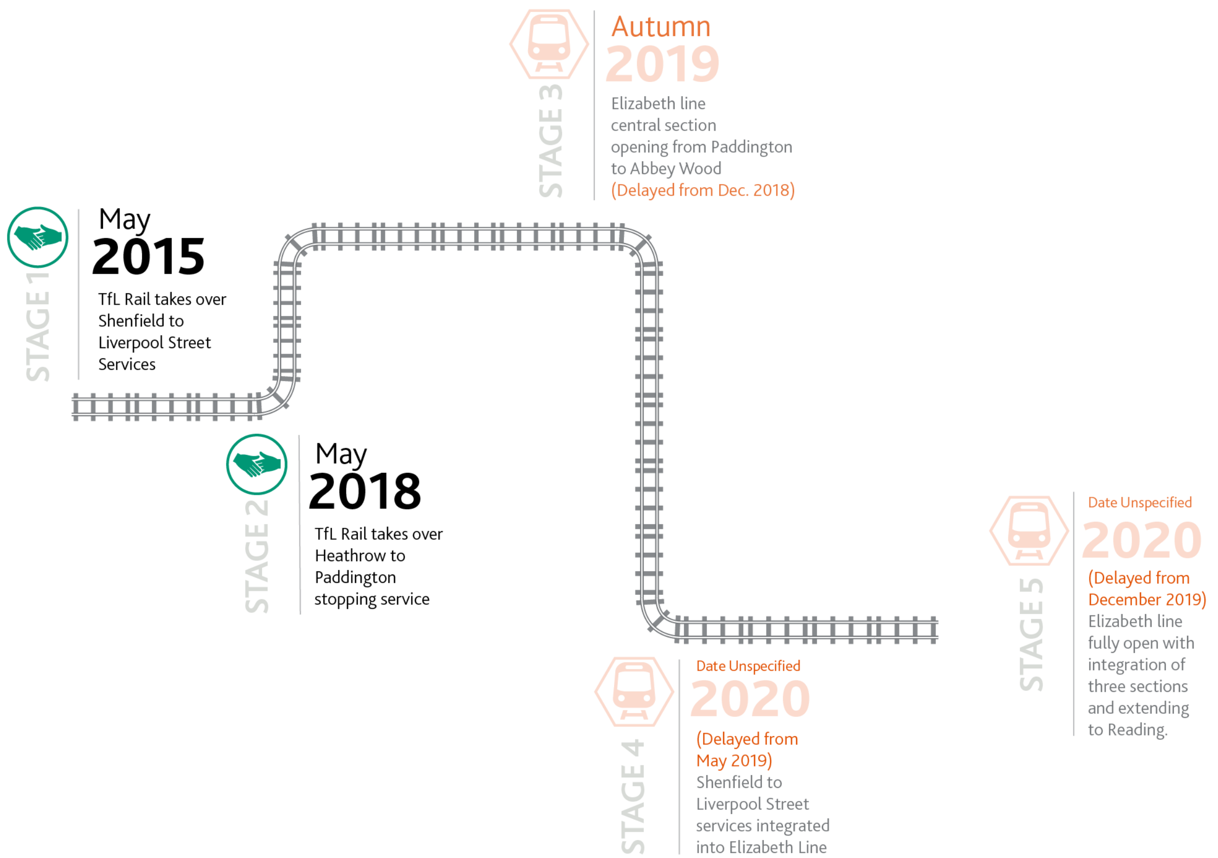
Transport for London (TfL) (Aa3 stable) faces significant budgetary challenges in the medium-term including the loss of its general operating grant, the freeze on fare increases and reduced passenger numbers in London. The recently announced delay to the opening of the central section of the Elizabeth Line (the operational name for the Crossrail project), from December 2018 to autumn 2019, will likely intensify these fiscal pressures through lower than expected passenger income and additional capital costs. However, despite the delayed opening, the Crossrail project remains critical to TfL's long-term financial sustainability.

» **Crossrail delay is one of a number of budgetary challenges for TfL.** TfL is now more reliant on its own operational performance than in the past, with operating grant levels falling from 29% of total operating income in fiscal 2014 to 18% in fiscal 2018. The fare freeze introduced by London Mayor Sadiq Khan in 2016, affects around 50% of TfL's passenger income and will remain in place until 2020. TfL's passenger numbers, a leading indicator of the health of London's economy, fell by 1% in fiscal 2018 on an annual basis.

» **Fiscal impact of the Crossrail delay will be significant over the medium term.** The most significant impact of the Crossrail delay will be in fiscal 2021, with a revenue shortfall of around £400 million and a loss of operating surplus. We expect that the capital cost of the overrun will be shared with the Greater London Authority (GLA). Although TfL will manage the impact of the delay, it will place a significant financial strain on the organisation up to fiscal 2023.

» **Crossrail project remains critical to TfL's financial sustainability.** Despite the delay, Crossrail remains critical for TfL, with the new line boosting the capacity of London's railway network by 10% and bringing an additional 1.5 million people to within 45 minutes of central London. The Elizabeth Line is likely to contribute 14% of TfL's passenger revenue by 2023 and 12% of its total operating revenue.

Exhibit 1
Crossrail's staged opening schedule has been delayed

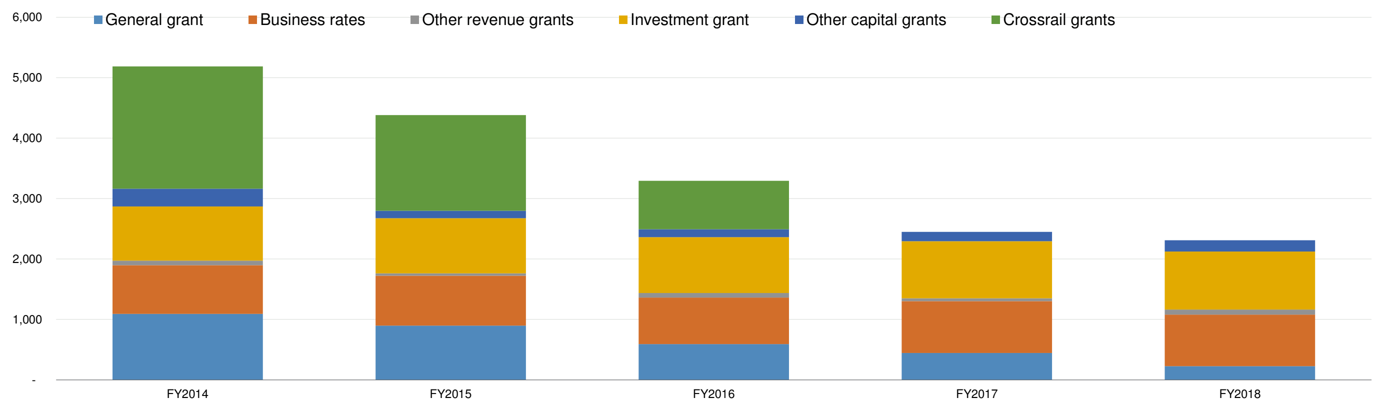


Source: Moody's

Crossrail delay is one of a number of budgetary challenges for TfL

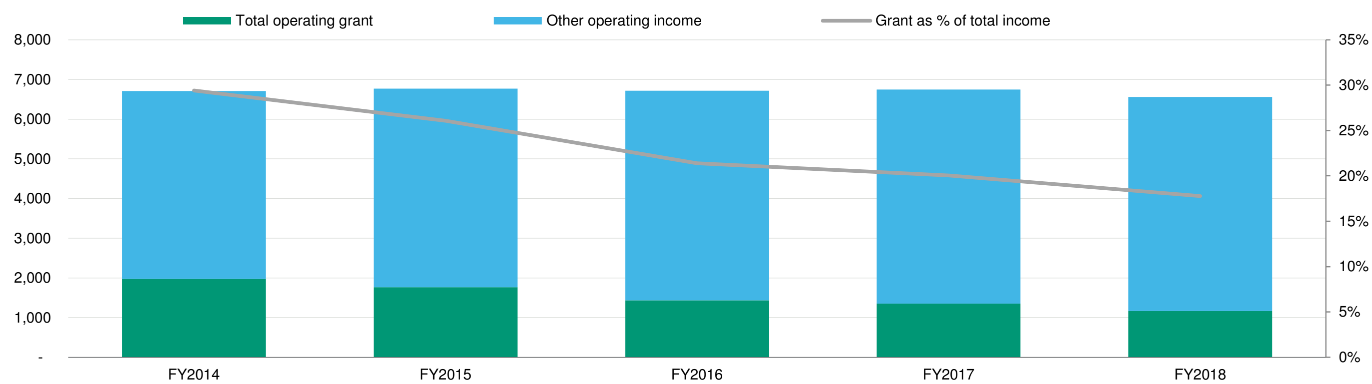
TfL is now more reliant on its operational performance to fund its activities than it was in the past, with operating grant levels falling from 29% of total operating income in fiscal 2014 to 18% in fiscal 2018 (see Exhibit 3). The general grant, which had been its main source of revenue grant (accounting for £1.1 billion of revenue in fiscal 2014), has now been completely phased out. However, it has to some extent been replaced by non ring-fenced business rates from the GLA. Its investment grant, which was previously provided by the Department for Transport (DfT), is now paid by the GLA using retained business rates. This 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. It used a proportion of this business rates revenue to balance its operating budget in fiscal 2018. It plans to do the same in fiscal 2019.

Exhibit 2
TfL's non Crossrail-related grants have decreased from £3.2 billion in fiscal 2014 to £2.3 billion in fiscal 2018
£ million



*TfL's investment grant was replaced by retained business rates from the GLA in fiscal 2018. These can be applied to revenue or capital expenditure.
Source: Transport for London quarterly performance reports, financial year 2013/14 to financial year 2017/18, Moody's analysis

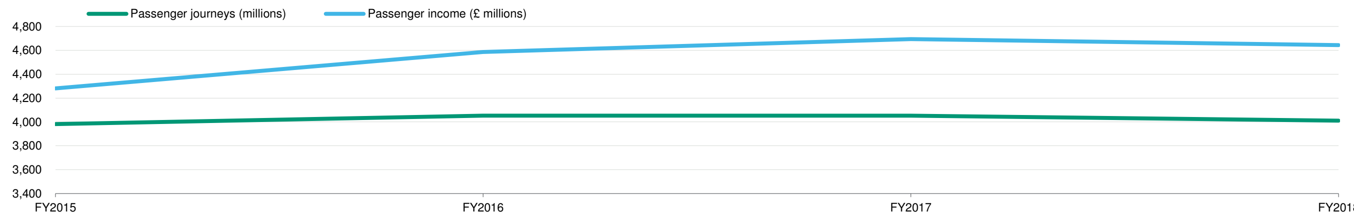
Exhibit 3
TfL's operating grants have decreased from £2.0 billion in fiscal 2014 to £1.2 billion in fiscal 2018
£ million



Source: Transport for London quarterly performance reports, financial year 2013/14 to financial year 2017/18, Moody's analysis

The freeze on passenger fares set by TfL began in January 2017 and is likely to last until December 2020. This affects around half of TfL's passenger income, as the remainder is linked to national rail fares which are controlled by the DfT. The impact of the fare freeze is difficult to quantify as keeping fares constant may have helped to soften the reduction in passenger journeys in fiscal 2018. However, it does weaken TfL's revenue flexibility which is a credit challenge because of the reduced grant revenue it now receives. Passenger numbers and revenue declined by 1% from fiscal 2017 to fiscal 2018. Passenger numbers are strongly correlated with the health of London's economy, through people using TfL's services for business and leisure activities.

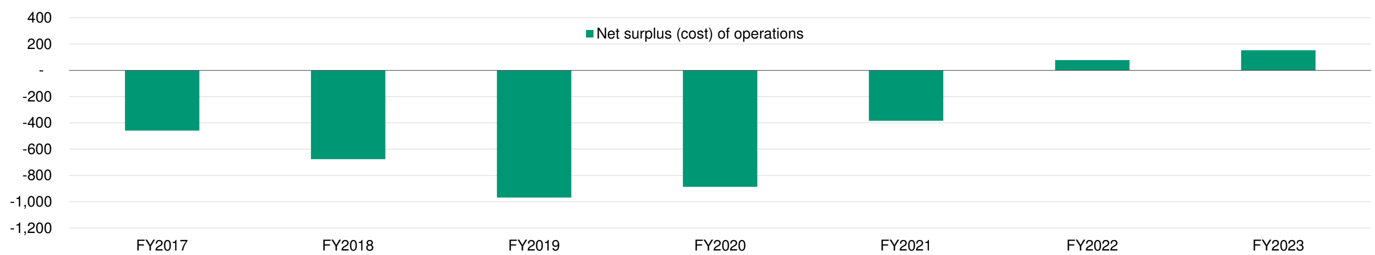
Exhibit 4
TfL's passenger numbers have been stagnant in recent years, with a small decline in passenger income in fiscal 2018
Passenger journeys (million) and passenger income (£ million)



Source: Transport for London quarterly performance reports, financial year 2013/14 to financial year 2017/18, Moody's analysis

TfL is currently generating a net operating deficit (including capital renewals and financing costs), because of the reduction in grant revenue, the ramp up of its cost cutting programme and the staged opening of the Elizabeth line. The deficit was forecast to be around £677 million in fiscal 2018[1], and is projected to increase to £968 million in fiscal 2019. TfL plans to cut annual operating costs by £1.2 billion by fiscal 2023. Although it had initially expected to return to an operating surplus in fiscal 2022 as a result of the cost cutting programme, this date will now likely be pushed forward because of costs associated with the Crossrail delay.

Exhibit 5
TfL was expecting large operating deficits until fiscal 2021 in its 2017 business plan and 2018/19 budget
Net cost of operations, including capital renewals and financing costs



Source: Transport for London, 2017 Business plan and 2018/19 Budget, Moody's analysis

Fiscal impact of the Crossrail delay will be significant over the medium term

On 31 August 2018, it was announced that the opening of the central section of the Elizabeth Line would be delayed from December 2018 to autumn 2019. This is mainly to allow more time for the testing and integration of systems on the new line. Overall, we expect TfL will be able to manage the impact of the delay using its available resources and spending flexibility. However, this will weaken its ability to cope with any other unforeseen costs or revenue shortfalls.

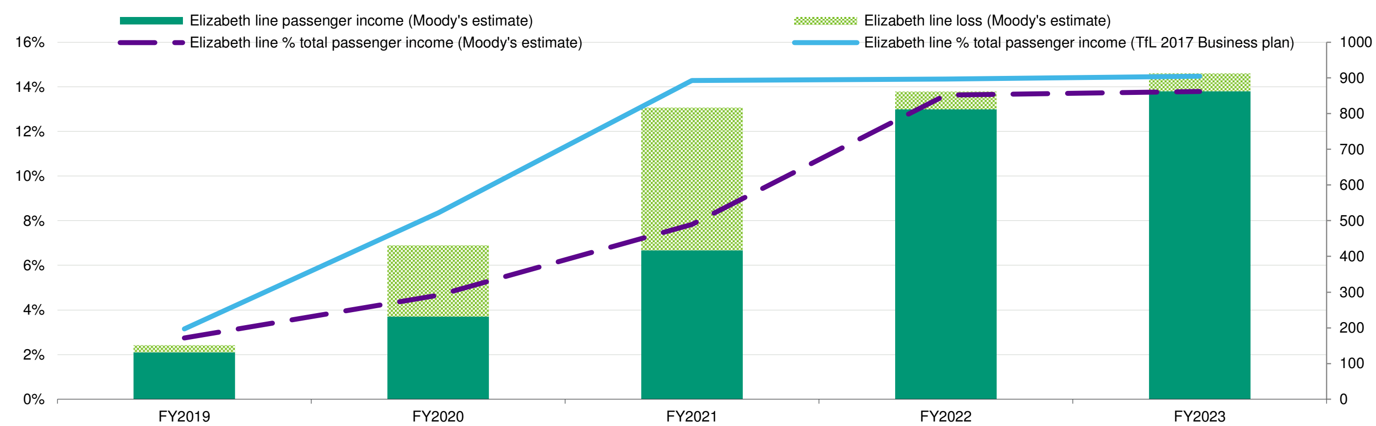
On 26 October 2018, the DfT said it would provide a short-term loan of £350 million in fiscal 2019, to enable the continuation of the Crossrail capital programme. This loan is likely to be provided to the GLA, thereby not increasing TfL's own debt levels. The capital cost of the overrun of the Crossrail project will be at least equivalent to the £350 million short-term loan, but could be significantly higher. It is also additional to the overspend of £590 million announced in July in relation to the capital works undertaken by both Crossrail Limited and Network Rail, of which £150 million will be met by TfL. However, funding of the capital cost overrun will likely be met by London as a whole, with the GLA contributing additional business rates and/or other revenue, alongside any contribution by TfL.

The UK's Office for Budget Responsibility recently estimated that the nine-month delay to the opening of the central section of the Elizabeth line will result in a one-year delay to the opening of the full line, with the latter moving from December 2019 to December 2020.[2] The delay to the opening of the full line would have the largest impact on TfL's revenue as most of the new passenger demand will come from the outer sections of the Elizabeth Line. These will be realised in Stage 5 (see Exhibit 1), when the outer sections are integrated into the central section and the full line is open. This will provide seamless access to central London for people living in outer London and beyond, who have not previously used TfL services.

Based on TfL's 2017 business plan, the most significant jump in passenger income from the Elizabeth Line would have occurred in fiscal 2021 after it had been fully operational for a year. We have estimated the impact of the delay on planned Elizabeth Line passenger revenue (see Exhibit 6). We estimate that there will be a shortfall of around £200 million in fiscal 2020, in line with recent estimates published by the London Assembly,[3] and a shortfall of £400 million in fiscal 2021. In fiscal 2022 and fiscal 2023, the impact is likely to be minor, with the shortfalls representing a slower ramp-up in demand than currently projected. The shortfalls in fiscal 2020 and 2021 represent 4% and 7% of TfL's total projected passenger income in these years, respectively. However, the loss of revenue in fiscal 2020 could be fiscally neutral as the Elizabeth Line was not expected to generate an operating surplus until fiscal 2021.[4]

Exhibit 6

The delay to the opening of the Elizabeth Line will have the most material impact on operating revenue in fiscal 2021
% (left axis), £ million (right axis)



Source: Moody's analysis, Transport for London 2017 business plan

TfL is likely to offset the reduced levels of revenue by accelerating its transformation programme, re-profiling its capital programme and potentially drawing down a limited amount of its usable reserves. TfL is also relying on the sale and leaseback of the Elizabeth Line rolling stock, which is expected to generate around £650 million in fiscal 2019, according to TfL's Budget 2018/19. The impact of this transaction will be critical to TfL balancing its budget this year.

TfL's cost cutting programme is progressing well and its first and second quarter results from fiscal 2019 show that operating costs are around £113 million lower than budgeted, indicating that savings are being generated earlier than anticipated.

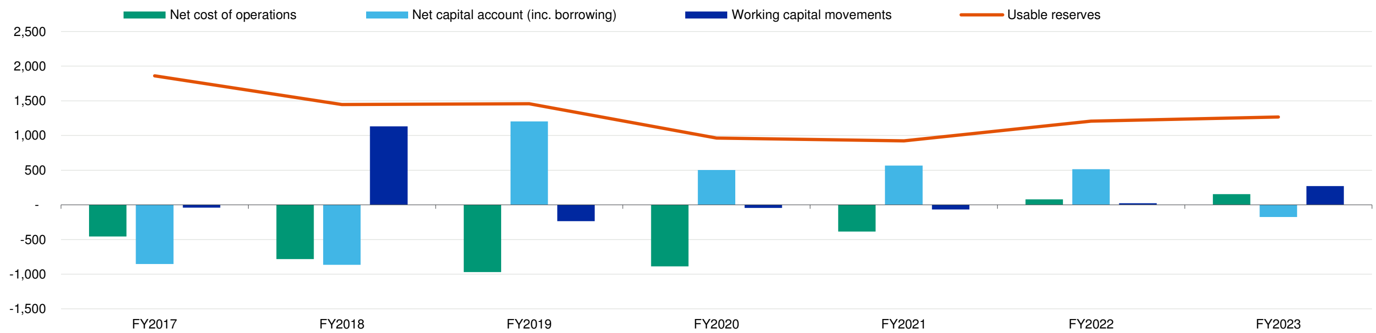
It is unlikely that TfL would draw significantly on its reserves because keeping its liquidity buffer strong is crucial to being able to withstand short-term shocks. Its 2017 business plan estimated that usable reserves will reach their lowest point in fiscal 2021 at £923 million. Its policy is to keep a minimum level of cash, equivalent to 30 days of operating costs, which currently corresponds to around £550 million in cash available on any business day.

We expect that the main budgetary adjustments will be through TfL's capital programme. Although some projects are well underway and may be difficult to change significantly at this point (such as the Northern Line extension), others could be re-profiled or postponed in the medium term. TfL could defer spending on discrete projects, such as station upgrades at Camden Town and Holborn, as this would have a significant impact on its budget without weakening revenue. This would enable TfL to use more of its investment grant business rates (which total around £1 billion per year) to fund its operating deficit.

Any re-profiling of its Underground and rail upgrades would weaken its revenue base in the future as TfL expects a significant proportion of the £1.7 billion projected increase in passenger income from fiscal 2017 to fiscal 2023 to come from increased capacity and services on London Underground lines, London Overground and the DLR (with the remainder because of the introduction of the Elizabeth Line, increases in fares over the period and increases in passengers driven by population growth). Therefore, it is unlikely that TfL would want to re-profile or postpone these projects as they will be important in delivering the surplus uplift it requires to balance its budget in the long term.

Exhibit 7

TfL's usable reserves balance remains relatively healthy, but is likely to weaken following the delayed opening of the Elizabeth Line (£ million)



Source: Transport for London 2017 Business Plan, Moody's analysis

Exhibit 8
TfL's capital programme, fiscal 2019 to fiscal 2023
£ million

Major new capital investment (net of third-party funding)	FY2019 to FY2023 (£m)
London Underground	
Modernisation of the Circle, District, Hammersmith & City and Metropolitan lines	961
Deep Tube upgrade programme	1,549
Northern line extension	595
Major station upgrades - in progress	310
Fleet and signalling renewals	605
Station step-free access	216
Camden Town station upgrade	82
Holborn station upgrade	57
Energy/carbon reduction schemes	56
Elizabeth line	
Crossrail (trains and enabling work)	404
Buses, streets and rail	
Healthy Streets (capital spend only)	1,113
Air quality schemes	289
Silvertown crossing: tunnel	85
DLR enhancements	608
Barking Riverside extension	65
Overground enhancements	75
Tram enhancements - Croydon	50
Professional services	
Customer experience	291
Commercial Development	
Commercial development programmes	705
Total	8,116

Source: Transport for London 2017 Business Plan

Crossrail project remains critical to TfL's financial sustainability

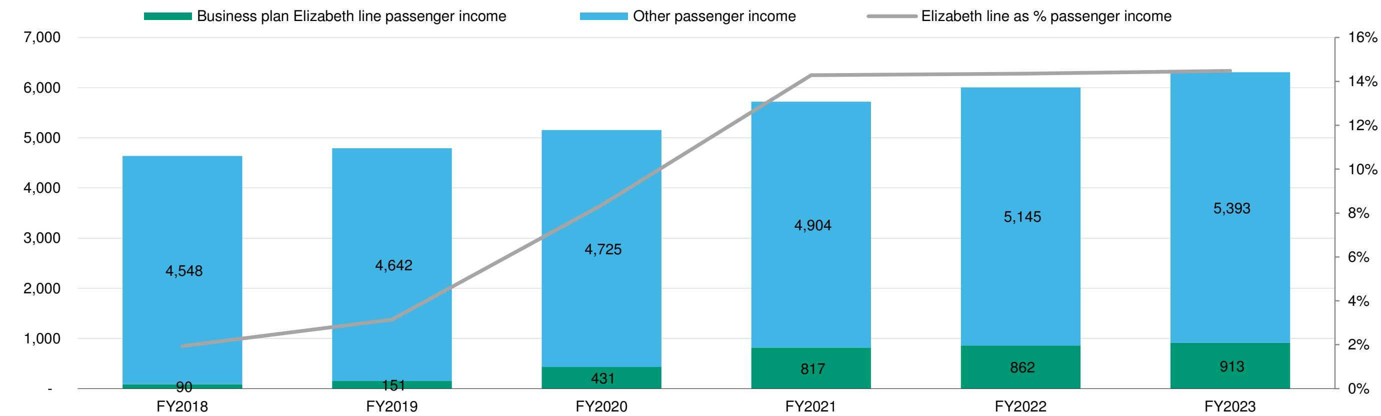
Despite the delay, Crossrail remains critical for TfL's financial sustainability because it will increase the capacity of the railway network in central London by 10%, bringing an extra 1.5 million people to within 45 minutes of central London.

The Elizabeth Line is likely to contribute 14% of TfL's passenger income by fiscal 2023, and 12% of its total operating income. It is crucial to TfL's plan to move to an operating surplus in the latter years of its five-year business plan. Although the timing of this may change in its new business plan, its fiscal importance will not be diminished.

Exhibit 9

TfL's current business plan estimates that the Elizabeth Line will contribute 14% of its passenger income by fiscal 2023

Elizabeth Line passenger income, other passenger income (£ million)



Source: Transport for London 2017 business plan, Moody's analysis

In addition, the Elizabeth Line is likely to stimulate London's economy by spurring the delivery of new homes and businesses and boosting productivity. It is estimated that 180,000 new homes will be built along the route by 2026 and the construction of 4.4 million square feet of new commercial space by 2026 will lead to the creation of 300,000 new jobs.[5]. The new employment space, in particular, will generate new business rates revenue for the GLA, which in turn can be used to fund TfL's operations and capital spending. At present, TfL receives upwards of 80% of the business rates revenue retained by the GLA.

Moody's related publications

- Credit Opinion: Transport for London, March 2018
- Transport for London (UK): Crossrail overspend is credit negative, but manageable; Elizabeth Line opening schedule remains on target, July 2018

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Transport for London (2018) Budget 2018/19
2 Office for Budget Responsibility (October 2018) Economic and fiscal outlook, page 165
3 London Assembly (2018) TfL Finances: The End of the Line?
4 Transport for London (2017) Mayor's Budget 2018/19, TfL Consultation Extracts, p16
5 GVA Grimley (2018) Crossrail Property Impact and Regeneration Study, 2012-2026

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