

CREDIT OPINION

18 June 2021

 Rate this Research

RATINGS

Transport for London

Domicile	United Kingdom
Long Term Rating	A3
Type	Senior Unsecured - Dom Curr
Short Term Rating	Prime - 2
Type	Commercial Paper - Dom Curr
Outlook	Negative

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)

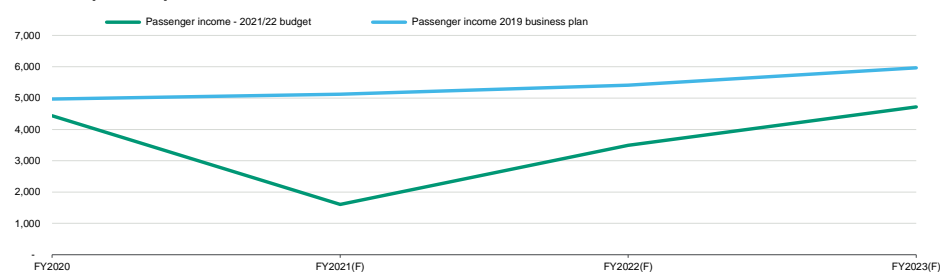
Update following downgrade to A3/Prime-2

Summary

[Transport for London's](#) (TfL, A3/Prime-2 Negative) credit profile reflects the considerable reduction in demand and revenues that it faces due to the coronavirus pandemic, a weakened operating environment reflected in unpredictable and very short-term funding support from the [UK government](#) (UK, Aa3 stable) and a relatively inflexible cost and revenue base. 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 strong likelihood of extraordinary support expected to be provided by UK government in the event that the issuer faced extreme liquidity stress.

Exhibit 1

We expect passenger revenues to decline by £3.5 billion in FY2021, compared with TfL's 2019 business plan expectations



F: Forecast

Source: TfL 2019 Business Plan, TfL 2021/22 Budget, Moody's

Credit Strengths

- » Strategic importance for national transport plans
- » Strong access to liquidity
- » Strong management and governance, particularly in relation to cost control

Credit Challenges

- » Weakened operating environment
- » Material reduction in passenger numbers and farebox revenues, likely to persist
- » Capital programme is large with limited visibility on how it will be funded
- » Debt levels will remain high with some deterioration in metrics due to lower revenues

Rating Outlook

The negative outlook reflects our view that credit risks remain to the downside. There is a considerable lack of certainty over whether TfL will secure a long-term funding agreement before the end of 2021, whether it can successfully adjust its budget to adapt to a permanent loss of ridership demand and how it will fund its large capital programme which remains important in protecting the attractiveness and reliability of services.

Factors that could lead to an upgrade

An upgrade is unlikely given the negative outlook. We would consider changing the outlook to stable if it became increasingly likely that a funding plan was implemented that ensured TfL's long term financial sustainability, through a clear and plausible strategy for raising the additional revenues and/or cutting the expenditure required to balance its operating budget in the medium term, and supporting its capital programme at levels that maintained service quality, without burdening the organisation with significant additional debt.

Factors that could lead to a downgrade

Further material downward pressure on the ratings would result if we concluded that there was unlikely to be a transparent and financially sustainable solution to TfL's long-term financial challenges and/or a clear lack of government willingness to support TfL through further unforeseen shocks. Any further drawdowns on cash reserves or significant increases in debt would be credit negative.

Key Indicators

Exhibit 2

Transport for London Year-ended 31 March

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Own Source Revenues / Total Revenues (%)	60.0	66.9	68.4	65.1	63.7	15.3	32.1
Grants / Total Revenues (%)	39.8	33.0	31.5	34.7	36.1	65.3	41.8
Interest Payables / Total Revenues (%)	4.9	5.3	5.6	5.4	5.6	5.6	4.6
Net direct and indirect debt / Operating Revenues (%)	158.7	157.0	145.1	149.8	178.7	349.1	234.5
Short-term debt / Total Debt (%)	9.5	11.4	8.4	7.1	6.8	6.8	6.8
Current Assets / Current Liabilities (%)	138.6	110.1	73.2	83.6	80.5	80.5	80.5

Total revenues includes grants, including those ring-fenced for Crossrail and the extraordinary revenue support grants from UK government. Operating revenues includes business rates receipts but excludes extraordinary revenue support grants and capital grants.

Source: Moody's

Detailed credit considerations

On 15 June 2021, Moody's downgraded TfL's BCA to baa2 from a3 and its long-term ratings to A3 from A1, its short-term ratings to Prime-2 from Prime-1 and maintained its negative outlook. The rating action reflects our conclusion that TfL's financial strength has been durably and materially weakened by the pandemic and, given the limited level of financial support provided by the UK government and the absence of clarity on future funding arrangements, this is unlikely to be reversed. It also takes into account our view of a lower likelihood of extraordinary support than previously expected, reflecting both the shortfalls in the funding agreements to date, the lack of timeliness with some agreements only put in place on the day of expiry of the previous agreement or extension, and the very short-term focus. The rating action also reflects our view of a weaker and less supportive operating environment which may result in TfL having to make significant cuts to operating and capital expenditures that could undermine the value of its services and its revenue base, and raise costs in the longer term.

The credit profile of Transport for London, as expressed in an A3 rating, combines (1) a baseline credit assessment (BCA) for the entity of baa2 and (2) a strong likelihood of extraordinary support coming from the [UK](#) (Aa3 stable) in the event that the entity faced acute liquidity stress.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Baseline Credit Assessment

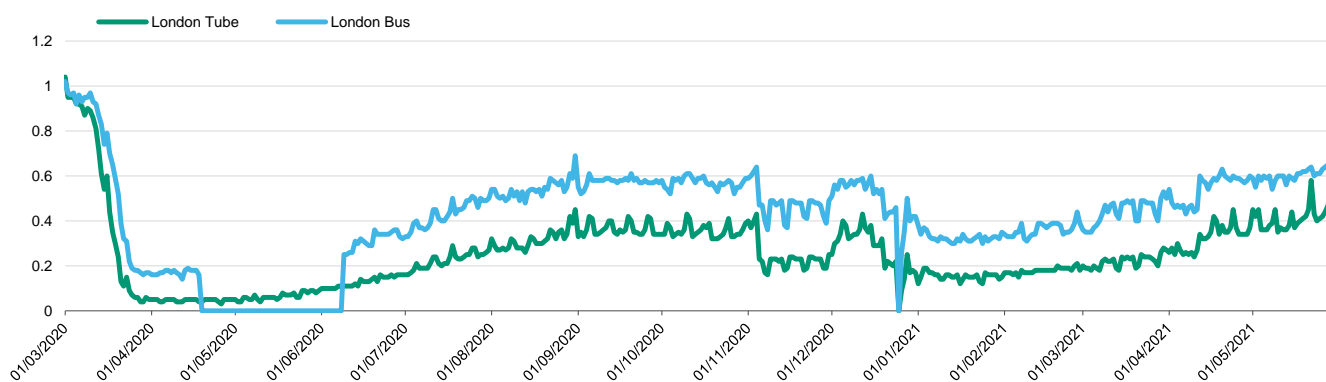
Strategic importance for London's economy

Transport for London is a key functional body of the government of Greater London (Greater London Authority, "GLA"). 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 (8.9 million in London), with little competition, and - before the pandemic - benefitted from very strong ridership. Prior to the pandemic, TfL's underground, bus and rail network provided around 4 billion passenger journeys per year. TfL's very strong utilization ratio of 426 (annual ridership relative to the service area population) in 2020 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. Ridership deteriorated materially in FY2021 due to the impacts of the measures put in place to control the spread of the coronavirus, leading to a gross funding gap of around £3.2 billion in this year (or around 55% of TfL's total operating income in FY2020). 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.

Exhibit 3

In May 2021, London Underground and bus passenger journeys remained 45% and 26% below year-on-year levels respectively
Passenger journeys as % of previous year



Bus data was not available from mid-April to mid-June due to a change in boarding policy.
Source: UK Department of Transport, *Transport use by mode: Great Britain since 1 March 2020*

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 agreements with the Department for Transport include provisions for maintaining this level of liquidity throughout FY2021 and FY2022.

Strong management and governance, particularly in relation to cost control

TfL has implemented a major transformation programme over the past four fiscal years in order to take recurring costs out of the organisation, adapt to its lower grant environment and improve its long-term financial sustainability. It has made around £1 billion of like-for-like recurring cost savings between FY2016 and FY2020 and expects a further £400 million to be delivered by FY2025. The transformation programme follows a comprehensive TfL-wide cost review in order to maximise value for money and improve the 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. TfL needs to identify £900 million of savings or new income in FY2022. This includes a further £300 million of operating savings, use of some of TfL's cash reserves (above the £1.2 billion buffer), higher income from road user charging and business rates, and some cost deferrals. Considering the extensive transformation and cost reductions implemented by TfL to date, we consider that if these cost cuts are to be made permanent it would be very challenging for TfL to identify further efficiencies.

Weakened operating environment

We consider that the stability and predictability of TfL's funding subsidies and policy support from the UK government has weakened fundamentally since the onset of the pandemic. This is evidenced by the challenges involved in agreeing funding support over the past 15 months which has been delivered through six separate funding agreements or extensions, many agreed at or after the date of expiry of the previous agreement, and the shortfalls in the funding packages which have and will need to be met partially through the deterioration of TfL's cash buffer above £1.2 billion and cost cutting. We estimate that approximately 75% of TfL's FY2021 funding gap of £3.2 billion, and around 60% of TfL's estimated FY2022 funding gap of £2.7 billion will be met by grant funding, with the remainder shouldered by TfL and the GLA. In our view this does not reflect the essentiality of TfL's services to London's economy or its limited budget flexibility. There is limited clarity on TfL's funding support after 11th December, although government have acknowledged that TfL will require further support. We consider that there is a mismatch between TfL's obligations and financial commitments which are long-term and need to maximise value for money, and the very short-term funding support from the UK government.

The [latest funding package](#) published on 1st June contains conditions such as revising its capital investment programme to reflect its financially constrained position and identifying new and/or increased income sources of between £0.5 to £1 billion from FY2024 onwards using TfL's existing powers. We consider that both of these will be highly challenging. TfL has identified that any further cuts to its capital programme would be suboptimal from an economic and financial perspective. On the latter, we consider that increasing revenues from existing sources will be challenging due to the medium term impacts of the pandemic on sources such as advertising revenues and commercial rents. Higher road pricing charges may be offset by lower demand and increasing fares substantially may have the same effect.

Governance changes have also been implemented through the funding agreements with UK government. The central government has appointed two representatives to attend TfL board meetings, who can 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. There is an Oversight Group which has been established by DfT and is chaired by DfT, with equal representation from TfL and DfT which will monitor progress on the conditions noted in the funding agreement. DfT will also closely monitor TfL's cash flow and management accounts on a monthly basis.

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 pandemic in the UK. We expect some level of social distancing measures to be in place throughout FY2022, with ridership at around 60% of 2019 or pre-pandemic levels in this year. The pandemic has accelerated pre-pandemic behavioural trends for flexible working and online consumption of retail and leisure, in addition to precipitating large reductions in business travel and a fall in tourism. Some of these trends are likely to remain over the long-term, leading to a permanent reduction in demand for TfL's passenger services. We expect a funding shortfall of around £500-600 million on its operating budget - for which TfL would be required to find additional revenues or expenditure cuts - with an additional gap of £1.6 billion on its capital programme from FY2024, although the UK government has stated that TfL would not be expected to fund major capital enhancements and major renewals from its operating income.

Capital programme is large with limited visibility on how it will be funded

TfL is the joint sponsor of the Crossrail project (operational name: Elizabeth line) - a new 118 kilometre railway line for London and the South East - with DfT. In October 2020 the governance of the project was transferred to TfL as the operator and maintainer of the railway. The transition of the governance will simplify responsibilities as the project moves into final phases of the programme and operational testing is undertaken. A series of delays for the project have been announced over the past two years, which have had impacts on TfL's operating and capital plans. The most recent delay was announced in August 2020, when Crossrail Ltd announced

that the Elizabeth line's central section (which runs from Paddington to Abbey Wood) will be brought into passenger service as soon as practically possible in the first half of 2022 (from an original opening date of December 2018).

To date additional funding of £3.275 billion has been agreed, including a £150 million cash contribution from TfL in July 2018, a £750 million loan from DfT to TfL (fully drawn from April 2021), with the remainder received as grant by TfL.

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. TfL is expecting to start trial operations in summer 2021.

TfL also has a number of other large planned and proposed capital projects including the London Overground extension to Barking Riverside which entered construction in FY2020, the Bakerloo Line Extension, a number of river crossings and Crossrail 2. Crossrail 2 and the Bakerloo line extension have been paused. In TfL's Financial Sustainability Plan published in January 2021, it suggests additional capital funding of an average of £1.6 billion per annum will be required between FY2023 and FY2030. However, there is no clarity on how this will be funded. We expect some reductions to be made to TfL's capital programme in future funding agreements with the UK government, as this is its main source of budget flexibility although large reductions would also affect quality and attractiveness of its services which would have a knock-on impact on demand.

Debt levels will remain high with some deterioration in metrics due to lower revenues

TfL's debt level was £13.9 billion at FYE2020, including an IFRS-16 adjustment of £2.2 billion for finance and operating leases which are now consolidated on TfL's balance sheet. This represents a debt to operating revenues metric of 204% in FY2020. In FY2021, debt increased 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 a £600 million loan from the PWLB. 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 pandemic.

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 have historically been agreed in 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. In TfL's most recent budget published in March 2021, it projects no increase in borrowing from FY2021 to FY2024 with its operational boundary (at the TfL Group level) set at around £15.7 billion over this period. However, this is uncertain - as yet there is no certainty on whether or not TfL will need to debt fund at least some of its capital programme. 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's total retirement benefit obligations, which currently are not included in TfL's debt stock, were at £4.1 billion at FYE2020, or 45% 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 strong support assessment for TfL reflects the importance of the transport system and infrastructure improvement in London for the [UK](#) (Aa3 stable) as reflected in the funding agreements throughout the course of FY2021 and FY2022, despite their short-term focus.

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. 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. TfL is highly exposed to the economic impacts of the coronavirus pandemic. For TfL, passenger demand is affected by the pandemic and the measures implemented to respond to it. Socially-driven policy can also have a material impact on TfL's credit profile. 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 baa2 is the same as the scorecard-indicated BCA of baa2.

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 and our [Government-Related Issuers Methodology](#), published in February 2020.

Exhibit 4

Transport for London, 2020 scorecard

Global Mass Transit Enterprises Methodology	FYE 31 March 2020	
Factor 1: Size (15%)	Measure	Score
a) Issuer Size - Annual Ridership (Million)	3,815,900,000	Aaa
b) Market Size - Service Area Population (Million)	8,961,989	Aaa
Factor 2: Market Position (35%)		
a) Operating Environment	Baa	Baa
b) Service Area Characteristics	Aaa	Aaa
c) Market Share - Utilization (%)	426	Aaa
Factor 3: Financial Flexibility (20%)		
a) Level of Self-Support - Farebox Recovery Ratio (%)	61.2%	Aaa
b) Budget Flexibility (3 Year Avg Fixed Costs as % of Oper. Exp.)	20.3%	Baa
Factor 4: Debt & Financial Metrics (30%)		
a) Leverage - Debt/Revenues	1.8x	Baa
b) Budget Balance -Interest as a % of Operating Revenues (3 Year Avg)	6.3%	A
c) Budget Balance - Net Margin (3 Year Avg)	16.3%	Aaa
d) Liquidity - Days Cash on Hand	104	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 3: Budget Flexibility		
5) Other analyst adjustment to Budget Flexibility	-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	baa2	
b) BCA assigned	baa2	
c) Actual Rating Assigned	A3	

Source: Moody's

Ratings

Exhibit 5

Category	Moody's Rating
TRANSPORT FOR LONDON	
Outlook	Negative
Senior Unsecured -Dom Curr	A3
Commercial Paper -Dom Curr	P-2

Source: Moody's Investors Service

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