RATING ACTION COMMENTARY

Fitch Affirms Transport for London at 'AA-'; Outlook Negative

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Fitch Ratings - London - 10 Jan 2024: Fitch Ratings has affirmed Transport for London's (TfL) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'AA-' with Negative Outlooks.

The affirmation of TfL's ratings reflects Fitch unchanged strong assessment of the linkage with its sponsor, the UK (AA-/Negative/F1+) and their incentives to prevent default based on Fitch's Government-Related Entities (GRE) Rating Criteria. The Negative Outlook reflects that of the sovereign as the ratings are equalised, since TfL's Standalone Credit Profile (SCP) is three notches away from the sovereign IDR.

KEY RATING DRIVERS

Status, Ownership and Control: 'Strong'

TfL's legal status is that of a statutory corporation subject to local government finance rules and as such it must produce a balanced budget each year. TfL is a functional body of the Greater London Authority (GLA) and reports to the mayor of London, who is the chair of the board. The mayor appoints its board members and develops and publishes a transport strategy reflecting national and local priorities. Since 2004, a prudential scheme for local authorities has been in place, allowing TfL to borrow up to authorised limits.

Support Track Record: 'Strong'

The UK government has always expressed its support for TfL's long-term commitments.

The majority of the grant TfL receives is from business rates collected and distributed by the GLA. In December 2023 the government agreed to provide an additional GBP250 million in grant funding. During the Covid-19 pandemic, TfL received further extraordinary grants from the UK government to maintain operations and financial stability. Under the funding settlement in August 2022, this will continue until March 2024. The support provided by the government during the pandemic was not immediate, and led to some financial deterioration. It was also initially provided partially as a loan. This is reflected in the 'Strong' assessment.

Socio-Political Implications of Default: 'Strong'

TfL is strategically important for London and for the UK economy. Prior to the pandemic, around four billion journeys were made on TfL's services annually. TfL would be difficult to substitute in the short-to- medium term, with the transition process likely to lead to severe service disruption. Financial default would temporarily endanger the continued provision of essential public services and hamper TfL's investment programme, with significant political or economic repercussions.

Financial Implications of Default: 'Very Strong'

A TfL default would impair the availability and cost of borrowing for other GREs in the UK. The shock waves would result in a fundamental rethink of exposure to the public sector and inevitably lead to a restriction on lending. We believe capital markets (17% of TfL's borrowing following bond repayment and buyback during financial year to March 2023) and the European Investment Bank (25% of borrowing) would restrict funding.

Standalone Credit Profile

Revenue Defensibility 'Stronger'

TfL's revenue defensibility is driven by a strong demand assessment. We expect passenger demand to return to high levels through the cycle, despite the effects of the pandemic, lockdowns, and increased remote working.

Fitch views pricing characteristic as 'Midrange', as TfL does not have the independent ability and full flexibility to collect sufficient revenues to cover all costs through increases in fares. TfL's primary source of gross income is passenger income on London Underground, rail and bus networks, representing around 70% of all revenue (excluding grant income). Nevertheless, its position as the key provider of public transport in the capital has led us to assess revenue defensibility as 'Stronger' overall.

Operating Risk 'Midrange'

We assess operating risk based on a 'Midrange' assessment of operating costs and resource management, with a neutral influence from the capital planning and management factor.

TfL is one of the largest employers in London, with an average 28,006 staff (including agency and fixed-term contracts) in FY23, an increase from 26,994 in FY22. Staff costs accounted for 35% of cash operating costs. It faces no constraints for labour or resources in terms of amount, cost or timing. Operating costs have been hit by inflationary pressures, but these have been effectively managed.

Financial Profile 'Stronger'

TfL's 'Stronger' financial profile reflects more certainty in passenger levels leading to consistent revenues and low net debt/EBITDA. Fitch expects leverage to be maintained at around 10x across its five-year rating case, in line with a 'Stronger' assessment, down from 14x in the pandemic year of FY21.

Prudent management and extraordinary state support have returned TfL to a strong financial position after pandemic-induced deterioration. Fitch expects EBITDA to rise to GBP1.5 billion on average in FY24-FY28 from GBP1.4 billion in FY20, partly driven by increased revenue from the Elizabeth Line. Fitch expects strong performance to continue through the rating case.

Additional Risk Factors Assessment

Fitch assesses all asymmetric factors as 'Neutral' to the rating, as TfL holds high levels of fixed-rate, domestic-currency borrowing across various liquidity sources. It has acceptable governance, with oversight from a democratically elected mayor and board of non-executives. Fitch has a 'Neutral' assessment for both the legal environment in the UK as well as the quality of information, as TfL publishes annual audited accounts and regular business plans. There is no Country Ceiling in place in the UK, and TfL maintains reasonable liquidity.

Derivation Summary

Fitch views TfL as a GRE of the UK. This is underlined by a support score of 40 under our GRE Criteria. As its 'a-' SCP is three notches below the sovereign's rating, the IDR is equalised with that of the sponsor.

Short-Term Ratings

TfL's Short-Term IDR of 'F1+' is in line with that of the sovereign.

Debt Ratings

TfL's 'AA-' debt ratings are aligned with its IDR as the notes of each series constitute direct, unconditional, unsubordinated, unsecured obligations of TfL and rank equally among themselves.

Liquidity and Debt Structure

TfL had cash and liquid deposits of GBP1.4 billion at FYE23. It has a policy of maintaining cash and liquid assets of at least 60 days of operating expenditure.

TfL generally has ample access to external liquidity. Along with other local authorities, it can borrow from the Public Works Loan Board (PWLB, a statutory body operating within the UK Debt Management Office), which provides easy and direct access to funding at short notice. PWLB will lend any amount to TfL within authorised borrowing limits set by the mayor, at a rate of gilts + 80bp. Funds would be credited to TfL within five days.

Issuer Profile

TfL is a statutory body established under the Greater London Authority Act 1999. Its main activity is the provision of integrated transport facilities and services in Greater London, including buses, London Underground, Docklands Light Railway, London Overground, TfL Rail/Elizabeth Line, trams, the management of certain roads in London and the congestion charge scheme, cycling, river services, the licensing of taxi and private hire and the oversight and enforcement of the ultra-low emission zone.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-An unfavourable change in the assessment of the factors under the GRE Criteria, or a sustained weakening in the financial profile, with net debt/EBITDA above 12x for a sustained period. Negative rating action on the sovereign would also directly affect TfL's ratings.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-Improvement in TfL's financial profile through the cycle, specifically a sustained improvement in the net adjusted debt/EBITDA to below 10x under Fitch's rating case, alongside an upgrade to the sovereign ratings

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

TfL's ratings are linked to the UK sovereign ratings.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Transport for London	LT IDR	AA- Rating Outlook Negative	Affirmed	AA- Rating Outlook Negative
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA- Rating Outlook Negative	Affirmed	AA- Rating Outlook Negative
senior unsecured	LT	AA-	Affirmed	AA-
senior unsecured	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Transport for London	UK Issued, EU Endorsed

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