

TRANSPORT FOR LONDON

FINANCE AND POLICY COMMITTEE

**SUBJECT: TFL'S CREDIT RATINGS**

**DATE: 13 JULY 2010**

**1 PURPOSE AND DECISION REQUIRED**

- 1.1 TfL is rated by all three of the main credit rating agencies. All three agencies have recently affirmed their credit ratings and, in two cases, recently issued short term ratings. This paper updates the committee on those ratings, together with some commentary provided by the agencies.
- 1.2 The Committee is asked to note this paper.

**2 CURRENT RATINGS**

- 2.1 TfL has a long term credit rating (outlook of more than three years) from all three of the main credit rating agencies: Standard and Poor's (S&P) since 2000, Fitch since 2004 and Moody's since 2006. Fitch has provided TfL with a short term rating (outlook of up to one year) since 2004, and S&P and Moody's published a short term rating in June 2010.
- 2.2 The table below shows TfL's long and short term ratings. The three short term ratings provided by the agencies are the highest ratings provided, and the rating of the Commercial Paper (CP) Programme is linked directly to the main short term rating.

	<b>Short term rating</b>	<b>CP Programme rating</b>	<b>Long term rating</b>
Fitch	F-1+	See footnote <sup>1</sup>	AA (stable)
Moody's	P-1	P-1	Aa1 (stable)
S&P	A-1+	A-1+	AA (stable)

- 2.3 TfL's ratings have been affirmed in light of the Tube Lines acquisition and the imminent launch of TfL's CP programme. The table in Appendix 1 shows a comparison of the rating levels from the agencies as they are viewed in the capital markets. All of the reports issued by the rating agencies are available on TfL's website at [www.tfl.gov.uk/investors](http://www.tfl.gov.uk/investors).

<sup>1</sup> Moody's and S&P provided a short term rating as this was a requirement for TfL at the time the CP documents were signed. While TfL was not obliged to seek a rating from Fitch, Fitch is voluntarily providing a rating of TfL's CP programme and is likely to confirm in the near future.

### **3 RATING RATIONALE**

- 3.1 Each of the agencies has its own rationale for TfL's credit ratings – though there is some similarity in their views. In the main, their views can be summarised as rationale for the current rating and the key issues facing TfL, together with triggers for an upgrade or downgrade in credit rating. Set out below are these key points for each agency.

#### **Fitch (F-1+ / AA (stable))**

- 3.2 The key rating triggers for the rating from Fitch are as follows:
- (a) A weakening of central government support, a substantial decrease in revenue (due to a reduction in patronage) and consistent under-performance against the business plan could trigger a rating downgrade.
  - (b) Closer links with, and stronger commitment from, Central Government and a stabilisation of the debt burden could trigger a rating upgrade.
- 3.3 The main points from Fitch in assessing TfL's ratings include TfL's importance to the economic development of Greater London and its strong links with Central Government. But Fitch also notes TfL's "ambitious" capital spending plan (including Crossrail), "limited and shrinking budgetary flexibility", patronage risk and increasing debt. Specifically, Fitch states that "Due to the considerable increase in leverage, the direct and indirect government support will become increasingly important to the rating." Fitch does not see the transfer of Tube Lines' debt to the TfL group to have any impact on TfL's credit quality as these liabilities had been taken into account in assessing TfL's overall risk profile.

#### **Moody's (P-1 / Aa1 (stable))**

- 3.4 Moody's views the risk for TfL on the downside rather than a rating increase as an upgrade would require a guarantee from the UK Government. A downgrade could be caused by TfL taking on a substantially higher financial burden in its financial projections, were the UK Government to signal a clear dilution of its support for TfL, or were TfL to under-perform persistently in meeting operational or financial goals.
- 3.5 Key credit strengths and weaknesses noted by Moody's are as follows:
- (a) Strengths:
    - (i) the strategic importance of TfL to national transport plans, as the major provider of transport within the capital;
    - (ii) the funding settlement and its inclusion in the Business Plan;
    - (iii) TfL's record of meeting operational and investment goals and keeping to the financial projections laid out in its published Business Plan; and
    - (iv) the comprehensive governance structures of TfL, which provide a high level of transparency in the authority's finances and operations to the GLA, to major stakeholders (primarily DfT) and to passengers.

(b) Weaknesses:

- (i) while fares and congestion charges are fully under the control of the Mayor of London, the need to provide services at politically acceptable prices limits how much can be raised;
- (ii) potential exposures to political stresses in the future on fare and service levels, contributing to a weakening of institutional support for long-term funding agreements;
- (iii) substantial cost and reputational risks related to operating, maintaining and expanding the urban transport infrastructure; and
- (iv) high borrowing levels and substantial contingent liabilities from investment/financing contracts (PPP and PFI).

**S&P (A-1+ / AA (stable))**

3.6 S&P expects TfL will continue to have a positive relationship with the UK Government, which could lead to additional support in the event of financial stress. In the event that such support is not forthcoming, pressure could be put on the rating. S&P believes that any positive rating action is likely to be contingent on greater clarity following the UK general election around TfL's grant settlement, and progress on the construction and revenue collection associated with Crossrail.

3.7 Key credit strengths and weaknesses noted by S&P are as follows:

(a) Strengths:

- (i) continued positive relationship with the UK Government;
- (ii) dominant transport provider in London, which has strategic importance for the UK economy;
- (iii) strong expenditure flexibility, due to sizable capital program; and
- (iv) high levels of liquidity, due to significant cash reserves and access to the Public Works Loan Board.

(b) Weaknesses:

- (i) risks and uncertainties associated with its major capital program, particularly given the complexities of Crossrail (although TfL's Crossrail liabilities are capped); and
- (ii) debt (including finance leases) set to exceed 100 per cent of operating revenues by 2013.

## **4 RECOMMENDATION**

4.1 The Committee is asked to NOTE this paper.

## **5 CONTACT**

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## Comparison of Credit Ratings

### Long term credit ratings

Credit quality	S&P	Moody's	Fitch	
Highest quality	AAA	Aaa	AAA	Investment grade
Substantial payment capacity	AA+	Aa1	AA+	
	AA	Aa2	AA	
	AA-	Aa3	AA-	
High payment capacity	A+	A1	A+	
	A	A2	A	
	A-	A3	A-	
Adequate payment capacity	BBB+	Baa1	BBB+	
	BBB	Baa2	BBB	
	BBB-	Baa3	BBB-	
Payment capacity vulnerable to adverse changes	BB+	Ba1	BB+	Non-investment grade (junk)
	BB	Ba2	BB	
	BB-	Ba3	BB-	
Payment capacity not sufficiently protected against adverse changes	B+	B1	B+	
	B	B2	B	
	B-	B3	B-	
There is a possibility of default – repayment relies on positive conditions	CCC+	Caa1	CCC+	
	CCC	Caa2	CCC	
	CCC-	Caa3	CCC-	
Obligations are close to or in default	CC	Ca	CC	
	C	C	C	
	D		D	

### Short term credit ratings

Credit quality	S&P	Moody's	Fitch	
Highest quality	A-1+	Prime-1	F-1+	Investment Grade
	A-1		F-1	
Good credit quality	A-2		Prime-2	
Adequate credit quality	A-3	Prime-3	F-3	
Payment capacity vulnerable to adverse changes	B-1	Not Prime (NP)	B	Non-investment grade
	B-2			
	B-3			
High default risk	C		C	
Currently defaulting	D		D	